Annual Report 2016

COSTCO WHOLESALE

FISCAL YEAR ENDED AUGUST 28, 2016

2016

THE COMPANY

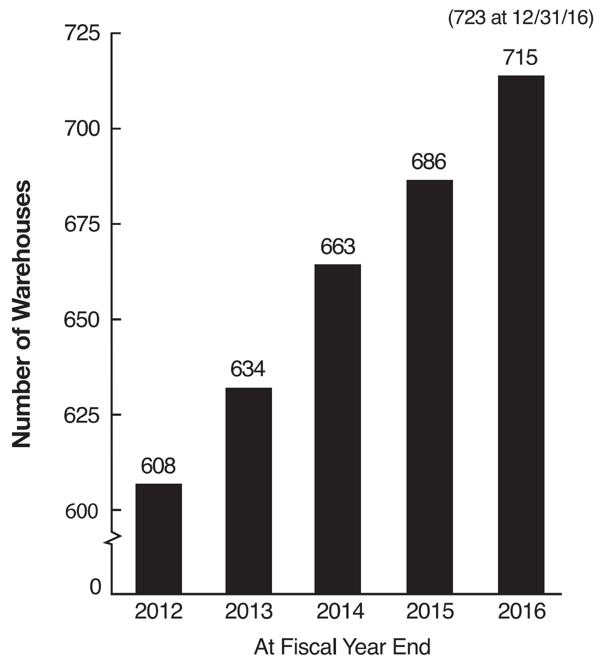
Costco Wholesale Corporation and its subsidiaries (Costco or the Company) began operations in 1983 in Seattle, Washington. In October 1993, Costco merged with The Price Company, which had pioneered the membership warehouse concept in 1976, to form Price/Costco, Inc., a Delaware corporation. In January 1997, after the spin-off of most of its non-warehouse assets to Price Enterprises, Inc., the Company changed its name to Costco Companies, Inc. On August 30, 1999, the Company reincorporated from Delaware to Washington and changes its name to Costco Wholesale Corporation, which trades on the NASDAQ Global Select Market under the symbol "COST."

As of December 2016, the company operated a chain of 723 warehouse in 44 states, Washington, D.C., and Puerto Rico (506 locations), nine Canadian provinces (94 locations), Mexico (36 locations), the United Kingdom (28 locations), Japan (25 Locations), Korea (12 locations), Taiwan (12 locations, through a 55%-owned subsidiary), Australia (eight locations) and Spain (two locations). The Company's online business operates websites in the U.S, Canada, U.K., Mexico, Korea and Taiwan.

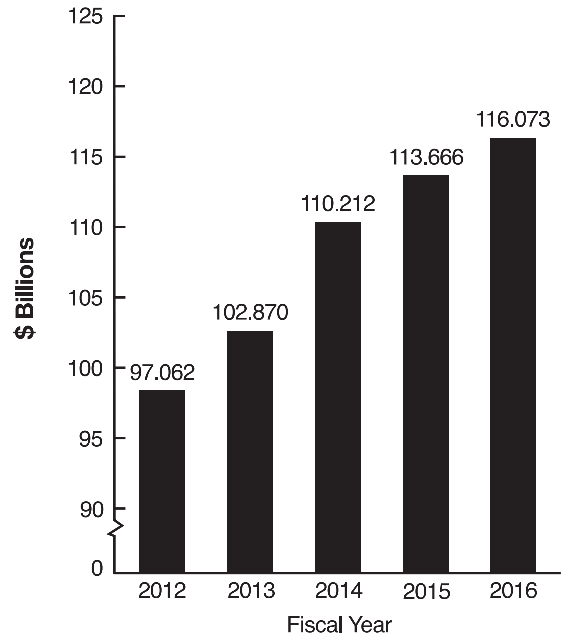
CONTENTS

FINANCIAL HIGHLIGHTS

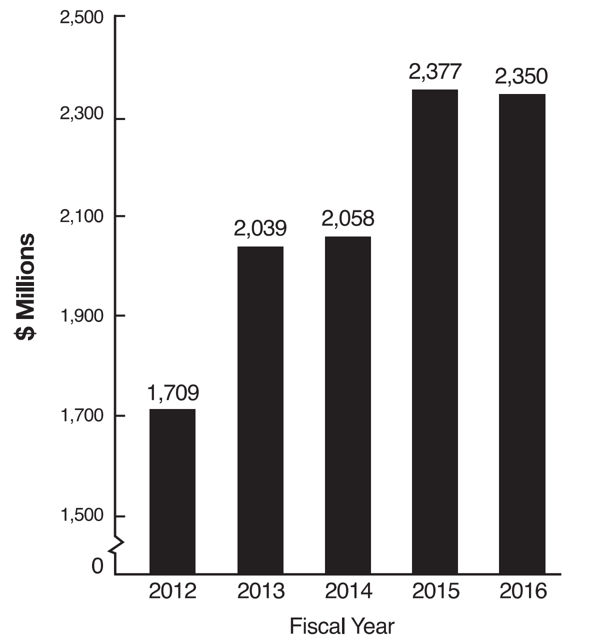
Warehouses in Operation



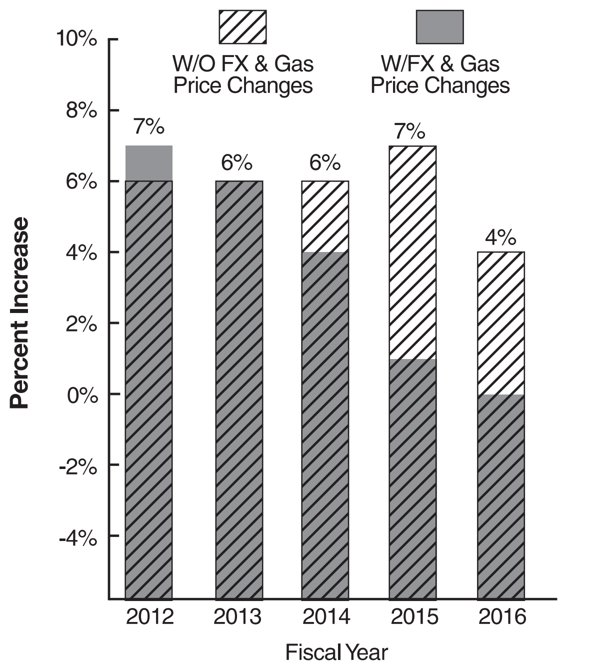
Net Sales



Net Income

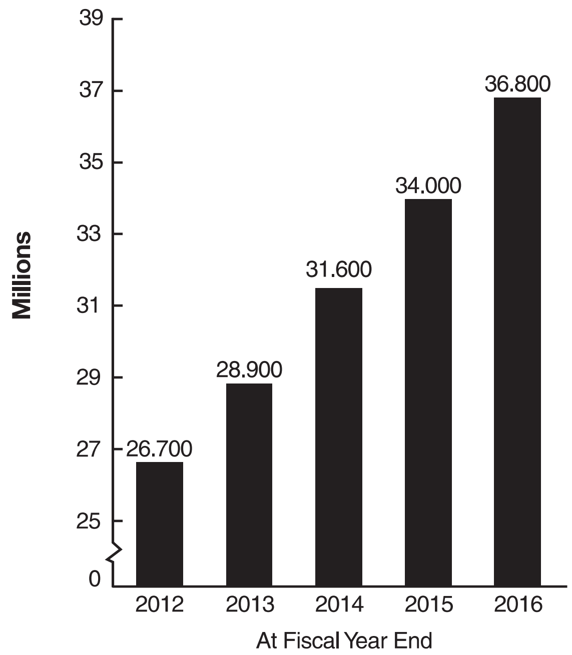


Comparable Sales Growth

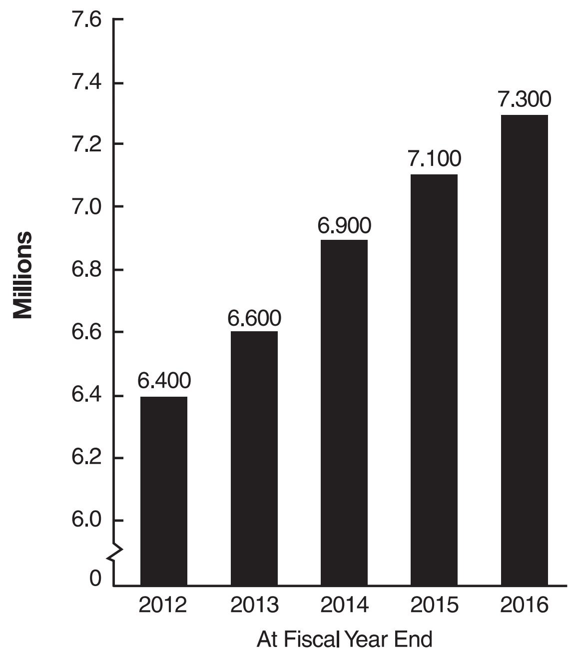


Membership

Gold Star Members



Business Members



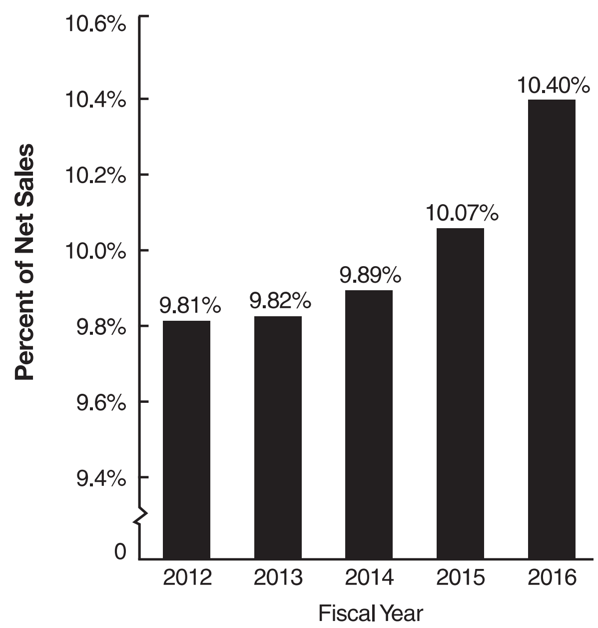
Average Sales Per Warehouse* (Sales In Millions)

Year Opened	# of Whses	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
2016	**29**										$87
2015	**23**									$83	85
2014	**30**								$108	109	115
2013	**26**							$99	109	113	116
2012	**15**						$105	115	124	128	130
2011	**21**					$103	120	130	136	139	139
2010	**13**				$94	106	122	135	144	148	151
2009	**20**			$100	107	130	146	155	157	158	155
2008	**26**		$86	83	99	116	128	136	144	146	147
2007 & **Before**	**512**	$130	140	135	144	151	160	168	175	175	174
Totals	**715**	$130	$137	$131	$139	$146	$155	$160	$164	$162	$159

Fiscal Year

*First year sales annualized.
2011 – 2016 results include Mexico.

Selling, General and Administrative Expenses



December 15, 2016

Dear Costco Shareholders,

Forty years ago the membership warehouse club was born in a converted aircraft building in San Diego, California under the Price Club name. That same building produced annual sales in fiscal 2016 of nearly $250 million – part of Costco's record sales of $116.1 billion – generated by 715 warehouses, each averaging $159 million in annual sales, and operating globally in several countries throughout the world. These results were achieved in a year of retail volatility, along with weaker foreign currencies and falling prices in our gasoline operations – factors that together negatively impacted both sales and net income by over 4%. Total sales in 2016 still increased two percent; and comparable sales, while flat year-over-year on a reported basis, increased four percent excluding the impacts of gasoline prices and foreign currencies. Net income remained strong in 2016, coming in at $2.35 billion or $5.33 per share.

A record $2.65 billion was invested in our business in 2016. Thirty-three warehouses including four relocations were opened; our depot (distribution) and transportation systems were expanded; numerous remodels and facilities upgrades were completed; and the upgrading of our IT infrastructure continued. In addition, over $1.2 billion was returned to shareholders in the form of dividends ($746 million) and stock buy-backs ($486 million).

Costco's growth and evolution to the forefront of retailing has been accomplished with the same mission and set of core values that we have adhered to since the opening of our first warehouse: to continually provide quality goods and services to our members at the lowest possible prices. The execution of this mission has become increasingly demanding as we expand globally, encounter aggressive and new forms of competition – both domestically and abroad – and comply with the varied rules and regulations of each country in which we operate; all while taking care of our members and our employees, and establishing and growing relationships with our many suppliers throughout the world.

Of the twenty-nine new locations opened in 2016, twenty-one of these were in the U.S., including four Costco Business Centers. Two new locations were opened in both Canada and Japan; and one new warehouse was opened in the U.K., Taiwan, Australia, and Spain. Last April, we opened in Tulsa, Oklahoma, which had record new member sign-ups for a U.S. opening. We are now operating in 44 states and Puerto Rico, as well as in Canada, Mexico, the U.K., Spain, Korea, Japan, Taiwan, and Australia. Additionally, we now operate ecommerce websites in the U.S., Canada, the U.K., Mexico, Korea and Taiwan.

Now three months into the new fiscal year, our 2017 plans call for 31 new openings, and extending our global footprint into two more countries: France and Iceland; bringing us to nearly 750 warehouses operating worldwide by fiscal year end. All told, in fiscal 2017 we plan to open 16 new warehouses in the U.S., eight in Canada, and one each in Taiwan, Korea, Japan, Australia, and Mexico; as well as France (near Paris) and Iceland (near Reykjavik) openings.

This past June, we successfully completed the transition to our new co-branded Citi/Visa Anywhere Card, and began accepting all Visa cards in the U.S. and Puerto Rico. We are very excited about this new program; and are pleased with the results to date. It significantly increases the cash rewards earned by Costco members using the new card for purchases at Costco and elsewhere; and it lowers our effective costs of card acceptance.

In 2016, our membership base grew by 7% to nearly 48 million member households, representing more than 87 million Costco cardholders worldwide. Importantly, member loyalty remained strong in 2016. Our U.S. and Canada members, representing over 85% of total Company sales, renewed at a 90% annual rate; and members worldwide at an 88% annual rate. Total membership revenue in 2016 amounted to $2.6 billion; and our Executive Member program continues to grow. It is now offered in the U.S., Canada, Mexico, and the U.K., and represents nearly one-third of our member base and two-thirds of total Company sales.

On the merchandising front, we continue to expand our Kirkland Signature product offerings, as well as offerings of brand-named items. This past year, new Kirkland Signature items included the launch of our

Kirkland Signature golf ball, and several apparel items including girls activewear and expanded womens activewear. A number of new Kirkland Signature food items were also introduced, with a strong emphasis on organics, including: nut bars, protein bars, quinoa, raw honey, Greek yogurt, and hummus, as well as a couple of organic pet supplies. New branded items now offered at Costco include apparel items under the Spyder brand name and kitchen and bath products under the Kohler name.

Costco’s e-commerce business grew 15% in 2016 to nearly $4 billion in sales. We began the fiscal year operating online sites in the U.S., Canada, the U.K. and Mexico; and launched our Korea and Taiwan sites during this fiscal year. During the year and into fiscal 2017 we continue to focus on three primary areas of our e-commerce business. First has been improving merchandising. We have added more exciting, higher-end branded merchandise on an everyday basis; and we have improved our in-stock availability on high velocity items, with more planned into the upcoming calendar year. Second, we are continuing to improve the member experience and functionality of our site, including better search capability, a streamlined checkout process, a simpler and more automated returns process and easier member tracking of orders. Third, we have improved our distribution logistics, increasing the number of distribution points from where we fulfill online orders, for closer and faster delivery times.

Our ancillary businesses, encompassing gas station operations, pharmacies, optical and hearing aid centers, food courts, one-hour photo labs, car washes and travel are all key components of our warehouses. These operations produced strong sales and profits performance in 2016; and helped drive incremental sales throughout the warehouse. We include many of these ancillary offerings in new warehouse openings, whenever possible; as well as add these operations to existing locations, as part of planned remodels and relocations.

We continue to seek to build and operate our business in a responsible and sustainable manner. In this regard, we are committed to enhancing the sustainability of our business, which involves many dimensions, including our workforce, a continuing supply of merchandise, a supply chain that protects the environment as well as the workers and animals in the supply chain, and the efficient use and reuse of resources associated with our operations. Our members, employees, shareholders, and others are increasingly focused on sustainability; as are we. An updated and expanded review of our current efforts and activities, entitled “Sustainability Commitment”, is available on our Costco.com website.

Earlier this year, Jill Ruckelshaus retired from our Board of Directors after twenty years of dedicated service. We want to thank Jill for the significant contributions she made during her two decades on our Board.

Preserving and enhancing our Costco culture and core values developed over the past forty years was a pervasive theme throughout 2016, and remains a primary emphasis as Costco moves into its fifth decade of operations. We seek to exceed the expectations of all our stakeholders. This is our challenge for 2017 and beyond; and we are confident that the entrepreneurial and innovative spirit at every level and in every region of our global company will sustain our growth and allow us to continue to perform at the same high levels achieved historically.

We appreciate the trust you, our shareholders, have placed in our management team; and on behalf of our 225,000 employees around the world, we thank you for your continued support.

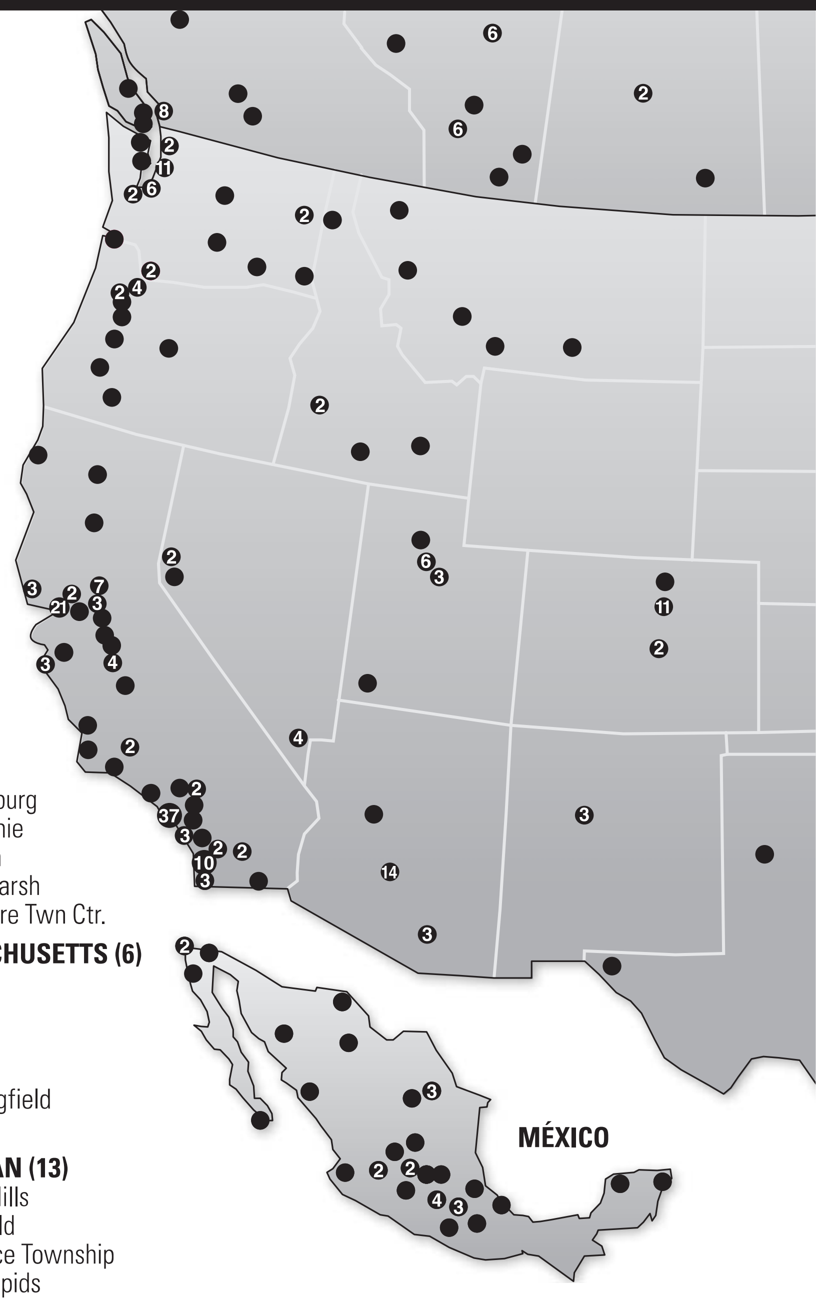
As always, we extend our best wishes to you and your families for a joyous holiday season and a happy, healthy and prosperous New Year!

Best Regards,

Jeff Brotman
Chairman of the Board

Craig Jelinek
President and Chief Executive Officer

723 LOCATIONS A



U.S.A. (506)

ALABAMA (4)
Hoover
Huntsville
Mobile
Montgomery

ALASKA (3)
Anchorage
N. Anchorage
Juneau

ARIZONA (18)
Avondale
Cave Creek Road
Chandler
Gilbert
S.E. Gilbert
Glendale
Mesa
Paradise Valley
Phoenix
Phoenix – Bus. Ctr.
N. Phoenix
Prescott
Scottsdale
Tempe
Thomas Road
Tucson
N.W. Tucson
S.W. Tucson

CALIFORNIA (122)
Alhambra
Almaden
Antioch
Azusa
Bakersfield
S.W. Bakersfield
Burbank
Cal Expo
Carlsbad
Carmel Mountain
Chico
Chino Hills
Chula Vista
Citrus Heights
City of Industry
Clovis
Commerce – Bus. Ctr.
Concord
Corona
Culver City
Cypress
Danville
El Camino
El Centro
Eureka
Fairfield
Folsom
Fontana
Foster City
Fountain Valley
Fremont
Fresno
N. Fresno
Fullerton
Garden Grove
Gilroy
Goleta
Hanford
Hawthorne
Hawthorne – Bus. Ctr.
Hayward
Hayward – Bus. Ctr.
Huntington Beach
Inglewood
Irvine
La Habra
Lakewood
La Mesa
Laguna Marketplace
Laguna Niguel
Lake Elsinore
Lancaster
La Quinta
Livermore
Lodi
Los Feliz
Manteca
Merced
Mission Valley
Modesto
Montclair
Montebello
Morena
Moreno Valley
Mountain View
Northridge
Norwalk
Novato
Oxnard
Pacoima
Palm Desert
Poway
Rancho Cordova
Rancho Cucamonga
Rancho del Rey
Redding
Redwood City
Richmond
Rohnert Park
Roseville
Sacramento
Salinas
San Bernardino
San Diego – Bus. Ctr.
S.E. San Diego
San Dimas
San Francisco
S. San Francisco
San Jose
N.E. San Jose
San Juan Capistrano
San Leandro
San Luis Obispo
San Marcos
Sand City
Santa Clara
Santa Clarita
Santa Cruz
Santa Maria
Santa Rosa
Santee
Signal Hill
Simi Valley
Stockton
Sunnyvale
Temecula
Torrance
Tracy
Turlock
Tustin
Tustin Ranch
Vacaville
Vallejo
Van Nuys
Victorville
Visalia
Vista
Westlake Village
Westminster – Bus. Ctr.
Woodland
Woodland Hills
Yorba Linda

COLORADO (14)
Arvada
Aurora
Colorado Springs
East Colorado Springs
Denver – Bus. Ctr.
S.W. Denver
Douglas County
Gypsum
Parker
Sheridan
Superior
Thornton
Timnath
Westminster

CONNECTICUT (6)
Brookfield
Enfield
Milford
New Britain
Norwalk
Waterbury

DELAWARE (1)
Christiana

FLORIDA (23)
Altamonte Springs
Boca Raton
Brandon
Clearwater
Davie
Estero
Fort Myers
E. Jacksonville
Kendall
Lantana
Miami
N. Miami Beach
Miami Lakes
Naples
E. Orlando
S. Orlando
S. Orlando – Bus. Ctr.
Palm Beach Gardens
Pembroke Pines
Pompano Beach
Royal Palm Beach
Sarasota Square Mall
Tallahassee

GEORGIA (11)
Alpharetta
Augusta
Brookhaven
Cumberland Mall
Cumming
Fort Oglethorpe
Gwinnett
Mall of Georgia
Morrow – Bus. Ctr.
Perimeter
Town Center

HAWAII (7)
Hawaii Kai
Iwilei
Kailua-Kona
Kapolei
Kauai
Maui
Waipio

IDAHO (5)
Boise
Coeur d'Alene
Nampa
Pocatello
Twin Falls

ILLINOIS (19)
Bedford Park – Bus. Ctr.
Bloomingdale
Bolingbrook
Chicago South Loop
Glenview
Lake in the Hills
Lake Zurich
Lincoln Park
Melrose Park
Mettawa
Mount Prospect
Naperville
Niles
Oak Brook
Orland Park
East Peoria
N. Riverside
St. Charles
Schaumburg

INDIANA (6)
Castleton
Fort Wayne
N.W. Indianapolis
S. Indianapolis
Merrillville
Mishawaka

IOWA (2)
Coralville
Des Moines

KANSAS (3)
Lenexa
Overland Park
Wichita

KENTUCKY (4)
Florence
Lexington
Louisville
Louisville II

LOUISIANA (3)
Baton Rouge
Lafayette
New Orleans

MARYLAND (10)
Arundel Mills
Beltsville
Brandywine
Columbia
Frederick
Gaithersburg
Glen Burnie
Wheaton
White Marsh
Woodmore Twn Ctr.

MASSACHUSETTS (6)
Avon
Danvers
Dedham
Everett
W. Springfield
Waltham

MICHIGAN (13)
Auburn Hills
Bloomfield
Commerce Township
Grand Rapids
Green Oak Township
Kalamazoo
Livonia I
Livonia II
Madison Heights
Pittsfield Township
Roseville
Shelby Township
Wyoming

MINNESOTA (8)
Baxter
Burnsville
Coon Rapids
Eden Prairie
Maple Grove
Maplewood
Rochester
St. Louis Park

MISSOURI (5)
Independence
Kansas City
Manchester
S. St. Louis
St. Peters

MONTANA (5)
Billings
Bozeman
Helena
Kalispell
Missoula

NEBRASKA (2)
La Vista
Omaha

NEVADA (7)
Carson City
Centennial
Henderson
Las Vegas – Bus. Ctr.
Reno
Sparks
Summerlin

NEW HAMPSHIRE (1)
Nashua

NEW JERSEY (19)
Brick Township
Bridgewater
N. Brunswick
Clifton
Edison
Flemington
Hackensack – Bus. Ctr.
E. Hanover
Hazlet
Manahawkin
Marlboro
Mount Laurel
Ocean Township
N. Plainfield
Princeton
Teterboro
Union
Wayne
Wharton

NEW MEXICO (3)
Albuquerque
N.W. Albuquerque
S.E. Albuquerque

NEW YORK (18)
Brooklyn
Commack
Holbrook
Lawrence
Manhattan
Melville
Nanuet
Nesconset
New Rochelle
Port Chester
Queens
Rego Park
Riverhead
Rochester
Staten Island
Syracuse
Westbury
Yonkers

NORTH CAROLINA (8)
Apex
Charlotte
Durham
Greensboro
Matthews
Raleigh
Wilmington
Winston-Salem

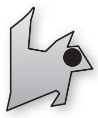
NORTH DAKOTA (1)
West Fargo

OHIO (12)
Avon
Boston Heights
Centerville
Columbus
N.W. Columbus
Deerfield Township
Easton
Mayfield Heights
Perrysburg
Springdale
Strongsville
Toledo

OKLAHOMA (1)
Tulsa

OREGON (13)
Albany
Aloha
Bend
Clackamas
Eugene
Hillsboro
Medford
Portland
Roseburg
Salem
Tigard
Warrenton
Wilsonville

S OF DECEMBER 31, 2016



PENNSYLVANIA (11)
Bucks County
Concordville
Cranberry
Harrisburg
King of Prussia
Lancaster
Lower Macungie
Montgomeryville
Robinson
Sanatoga
West Homestead

SOUTH CAROLINA (5)
Charleston
Columbia
Greenville
Myrtle Beach
Spartanburg

SOUTH DAKOTA (1)
Sioux Falls

TENNESSEE (5)
Brentwood
Farragut
N.E. Memphis
S.E. Memphis
W. Nashville

TEXAS (27)
Arlington
Austin
S. Austin
Bunker Hill
Cedar Park
Duncanville
El Paso
Fort Worth
N. Fort Worth
Frisco
Galleria
Houston
Humble
Lewisville
Lubbock
Pearland
Pharr
East Plano
West Plano
Rockwall
N.W. San Antonio
Selma
Sonterra Park
Southlake
Sugar Land
Willowbrook
The Woodlands

UTAH (11)
W. Bountiful
S. Jordan
Lehi
Murray
S. Ogden
Orem
St. George
Salt Lake City
Sandy
Spanish Fork
West Valley

VERMONT (1)
Colchester

VIRGINIA (17)
Chantilly
Charlottesville
Chesterfield
Fairfax
Fredericksburg
Harrisonburg
W. Henrico
Leesburg
Manassas
Mount Vernon
Newington
Newport News
Norfolk
Pentagon City
Potomac Mills
Sterling
Winchester

WASHINGTON (31)
Aurora Village
Bellingham
Burlington
Clarkston
Covington
Everett
Federal Way
Fife – Bus. Ctr.
Gig Harbor
Issaquah
Kennewick
Kirkland
Lacey
Lynnwood
Lynnwood – Bus. Ctr.
Marysville
Puyallup
Redmond
Seattle
Sequim
Silverdale
Spokane
N. Spokane
Tacoma
Tukwila
Tumwater
Union Gap
Vancouver
E. Vancouver
E. Wenatchee
Woodinville

WISCONSIN (9)
Bellevue
Grafton
Grand Chute
Menemonee Falls
Middleton
New Berlin
Pewaukee
Pleasant Prairie
Sun Prairie

WASHINGTON, D.C. (1)
Washington, D.C.

PUERTO RICO (4)
E. Bayamón
W. Bayamón
Caguas
Carolina

CANADA (94)

ALBERTA (16)
E. Calgary
N. Calgary
N.W. Calgary
S. Calgary
Edmonton
N. Edmonton
S. Edmonton
W. Edmonton
Grande Prairie
Lethbridge
Medicine Hat
Okotoks
Red Deer
Rocky View
Sherwood Park
St. Albert

BRITISH COLUMBIA (14)
Abbotsford
Burnaby
Courtenay
Kamloops
Kelowna
Langford
Langley
Nanaimo
Port Coquitlam
Prince George
Richmond
Surrey
Vancouver
Willingdon

MANITOBA (3)
Winnipeg
E. Winnipeg
S. Winnipeg

NEW BRUNSWICK (3)
Fredericton
Moncton
Saint John

NEWFOUNDLAND AND LABRADOR (1)
St. John's

NOVA SCOTIA (2)
Dartmouth
Halifax

ONTARIO (31)
Ajax
Ancaster
Barrhaven
Barrie
Brampton
Burlington
Downsview
Etobicoke
Gloucester
Guelph
Kanata
Kingston
Kitchener
London
North London
Markham
E. Markham
Mississauga Central
Mississauga North
Mississauga South
Nepean
Newmarket
Oshawa
Peterborough
Richmond Hill
St. Catharines
Scarborough
Sudbury
Vaughan
Waterloo
Windsor

QUÉBEC (21)
Anjou
Boisbriand
Boucherville
Brossard
Candiac
Chicoutimi
Drummondville
Gatineau
Laval
Levis
Marché Central
Montréal
Pointe Claire
Québec
Sainte-Foy
Saint-Hubert
Saint-Jérôme
Sherbrooke
Terrebonne
Trois-Rivières-Ouest
Vaudreuil

SASKATCHEWAN (3)
Regina
Saskatoon
S. Saskatoon

AUSTRALIA (8)

AUS CAP TER (1)
Canberra

NEW SOUTH WALES (2)
Auburn
Sydney

QUEENSLAND (1)
North Lakes

SOUTH AUSTRALIA (1)
Adelaide

VICTORIA (3)
Melbourne
Moorabbin
Ringwood

JAPAN (25)

Amagasaki
Chiba New Town
Chubu
Gifu Hashima
Hiroshima
Hisayama
Hitachinaka
Imizu
Iruma
Izumi
Kaminoyama
Kanazawa Seaside
Kawasaki
Kitakyushu
Kobe Seishin
Maebashi Gunma
Makuhari
Nonoichi
Sapporo
Shin Misato
Tamasakai
Tomiya
Tsukuba
Yawata Kyoto
Zama

SOUTH KOREA (12)

Busan
Cheonan
Daegu
Daejeon
Euijeongbu
Gongse
Gwangmyeong
Ilsan
Sangbong
Ulsan
Yangjae
Yangpyung

TAIWAN (12)

Beitou
Chiayi
Chung Ho
Chungli South
Hsinchu
Kaohsiung
North Kaohsiung
Neihu
Shih Chih
Taichung
Tainan
Taoyuan

UNITED KINGDOM (28)

ENGLAND (24)
Birmingham
Bristol
Chester
Chingford
Coventry
Croydon
Derby
Farnborough
Gateshead
Haydock
Hayes
Leeds
Leicester
Liverpool
Manchester
Milton Keynes
Oldham
Reading
Sheffield
Southampton
Sunbury
Thurrock
Watford
Wembly

SCOTLAND (3)
Aberdeen
Edinburgh
Glasgow

WALES (1)
Cardiff

SPAIN (2)

Getafe
Seville

MÉXICO (36)

AGUASCALIENTES (1)
Aguascalientes

BAJA CALIFORNIA (4)
Ensenada
Mexicali
Tijuana
Tijuana II

BAJA CALIFORNIA SUR (1)
Cabo San Lucas

CHIHUAHUA (2)
Chihuahua
Juarez

COAHUILA (1)
Saltillo

GUANAJUATO (3)
Celaya
León
León II

JALISCO (3)
Guadalajara
Guadalajara II
Puerto Vallarta

MÉXICO (4)
Arboledas
Interlomas
Satélite
Toluca

MÉXICO, D.F. (3)
Coapa
Mixcoac
Polanco

MICHOACÁN (1)
Morelia

MORELOS (1)
Cuernavaca

NUEVO LEÓN (3)
Monterrey
Monterrey II
Monterrey III

PUEBLA (1)
Puebla

QUERÉTARO (1)
Querétaro

QUINTANA ROO (1)
Cancún

SAN LUIS POTOSÍ (1)
San Luis Potosí

SINALOA (1)
Culiacan

SONORA (1)
Hermosillo

VERACRUZ (2)
Veracruz
Xalapa

YUCATÁN (1)
Mérida

BUSINESS OVERVIEW

Forward-Looking Statements

Certain statements contained in this Report constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. They include statements that address activities, events, conditions or developments that we expect or anticipate may occur in the future and may relate to such matters as sales growth, changes in comparable sales, cannibalization of existing locations by new openings, price or fee changes, earnings performance, earnings per share, stock-based compensation expense, warehouse openings and closures, capital spending, the effect of adopting certain accounting standards, future financial reporting, financing, margins, return on invested capital, strategic direction, expense controls, membership renewal rates, shopping frequency, litigation, modernization of information systems, and the demand for our products and services. Forward-looking statements may also be identified by the words “believe,” “project,” “expect,” “anticipate,” “estimate,” “intend,” “strategy,” “future,” “opportunity,” “plan,” “may,” “should,” “will,” “would,” “will be,” “will continue,” “will likely result,” and similar expressions. Such forward-looking statements involve risks and uncertainties that may cause actual events, results, or performance to differ materially from those indicated by such statements, including, without limitation, the factors set forth in the section titled “Risk Factors”, and other factors noted in the section titled “Management's Discussion and Analysis of Financial Condition and Results of Operations” and in the consolidated financial statements and related notes in this Report. Forward-looking statements speak only as of the date they are made, and we do not undertake to update them, except as required by law.

General

Costco Wholesale Corporation and its subsidiaries (Costco or the Company) began operations in 1983 in Seattle, Washington. We are principally engaged in the operation of membership warehouses in the United States (U.S.) and Puerto Rico, Canada, United Kingdom (U.K.), Mexico, Japan, Australia, Spain, and through majority-owned subsidiaries in Taiwan and Korea. Costco operated 715, 686, and 663 warehouses worldwide at August 28, 2016, August 30, 2015, and August 31, 2014, respectively. Our common stock trades on the NASDAQ Global Select Market, under the symbol “COST.”

We report on a 52/53-week fiscal year, consisting of thirteen, four-week periods and ending on the Sunday nearest the end of August. The first three quarters consist of three periods each, and the fourth quarter consists of four periods (five weeks in the thirteenth period in a 53-week year). The material seasonal impact in our operations is an increased level of net sales and earnings during the winter holiday season. References to 2016, 2015, and 2014 relate to the 52-week fiscal years ended August 28, 2016, August 30, 2015, and August 31, 2014, respectively.

We operate membership warehouses based on the concept that offering our members low prices on a limited selection of nationally branded and private-label products in a wide range of merchandise categories will produce high sales volumes and rapid inventory turnover. When combined with the operating efficiencies achieved by volume purchasing, efficient distribution and reduced handling of merchandise in no-frills, self-service warehouse facilities, these volumes and turnover enable us to operate profitably at significantly lower gross margins (net sales less merchandise costs) than most other retailers. We generally sell inventory before we are required to pay for it, even while taking advantage of early payment discounts when available. To the extent that sales increase and inventory turnover becomes more rapid, more inventory is financed through payment terms provided by suppliers rather than by our working capital.

We buy most of our merchandise directly from manufacturers and route it to a cross-docking consolidation point (depot) or directly to our warehouses. Our depots receive large shipments from manufacturers and quickly ship these goods to our individual warehouses. This process maximizes freight volume and handling efficiencies, eliminating many of the costs associated with traditional multiple-step distribution channels.

Our average warehouse space is approximately 144,000 square feet, with newer units slightly larger. Floor plans are designed for economy and efficiency in the use of selling space, the handling of merchandise, and the control of inventory. Because shoppers are attracted principally by the quality of merchandise and the availability of low prices, our warehouses are not elaborate. By strictly controlling the entrances and exits of our warehouses and using a membership format, we have limited inventory losses (shrinkage) to amounts well below those of typical discount retail operations.

Marketing activities for new locations generally include community outreach to local businesses in new and existing markets and direct mail to prospective new members. Ongoing promotional programs primarily relate to coupon mailers, The Costco Connection (a magazine we publish for our members), and promotional e-mails to members.

Our warehouses on average operate on a seven-day, 70-hour week. Gasoline operations generally have extended hours. Because the hours of operation are shorter than other retailers, and due to other efficiencies inherent in a warehouse-type operation, labor costs are lower relative to the volume of sales. Merchandise is generally stored on racks above the sales floor and displayed on pallets containing large quantities, thereby reducing labor required. In general, with variations by country, our warehouses accept certain debit and credit cards, co-branded Costco credit cards, cash, or checks.

Our strategy is to provide our members with a broad range of high-quality merchandise at prices we believe are consistently lower than elsewhere. We seek to limit specific items in each product line to fast-selling models, sizes, and colors. We carry an average of approximately 3,700 active stock keeping units (SKUs) per warehouse in our core warehouse business, significantly less than other broadline retailers. Many consumable products are offered for sale in case, carton, or multiple-pack quantities only.

In keeping with our policy of member satisfaction, we generally accept returns of merchandise. On certain electronic items, we typically have a 90-day return policy and provide, free of charge, technical support services, as well as an extended warranty. Additional third-party warranty coverage is sold on certain electronic items.

We offer merchandise in the following categories:

- **Foods** (including dry foods, packaged foods, and groceries)
- **Sundries** (including snack foods, candy, alcoholic and nonalcoholic beverages, and cleaning supplies)
- **Hardlines** (including major appliances, electronics, health and beauty aids, hardware, and garden and patio)
- **Fresh Foods** (including meat, produce, deli, and bakery)
- **Softlines** (including apparel and small appliances)
- **Other** (including gas stations and pharmacy)

Ancillary businesses within or next to our warehouses provide expanded products and services and encourage members to shop more frequently. We sell gasoline in all countries except Mexico, Korea, and Taiwan and operated 508, 472, and 445 gas stations at the end of 2016, 2015, and 2014, respectively. Ancillary businesses also include optical dispensing centers, food courts, and hearing-aid centers.

Our online businesses, which include e-commerce, business delivery, and travel, operate websites in all countries except Japan, Australia, and Spain. They provide our members additional products and services, typically not found in our warehouses. Net sales for our online business were approximately 4% of our net sales in 2016 and 3% in 2015 and 2014, respectively.

We have direct buying relationships with many producers of national brand-name merchandise. We do not obtain a significant portion of merchandise from any one supplier. We generally have not experienced difficulty in obtaining sufficient quantities of merchandise, and believe that if one or more of our current sources of supply became unavailable, we would be able to obtain alternative sources without substantial disruption of our business. We also purchase private label merchandise, as long as quality and member demand are comparable and the value to our members is greater as compared to brand-name items.

Certain financial information for our segments and geographic areas is included in Note 11 to the consolidated financial statements included in this Report.

Membership

Our members may utilize their memberships at any of our warehouses worldwide. Gold Star memberships are available to individuals; Business memberships are limited to businesses, including individuals with a business license, retail sales license or other evidence of business existence. Business members have the ability to add additional cardholders (add-ons). Add-ons are not available for Gold Star members. Our annual fee for these memberships is $55 in our U.S. and Canadian operations and varies by country in our Other International operations. All paid memberships include a free household card.

Our member renewal rate was 90% in the U.S. and Canada, and 88% on a worldwide basis in 2016. The majority of members renew within six months following their renewal date. Therefore, our renewal rate is a trailing calculation that captures renewals during the period seven to eighteen months prior to the reporting date.

Our membership was made up of the following (in thousands):

	2016	2015	2014
Gold Star	36,800	34,000	31,600
Business, including add-ons	10,800	10,600	10,400
Total paid members	47,600	44,600	42,000
Household cards	39,100	36,700	34,400
Total cardholders	86,700	81,300	76,400

Paid cardholders are eligible to upgrade to an Executive membership in the U.S. and Canada, for an additional annual fee of $55, and in Mexico and the U.K., for which the additional annual fee varies. Executive members earn a 2% reward on qualified purchases (up to a maximum reward of $750 per year in our U.S. and Canadian operations and varies in our Other International operations), which can be redeemed only at Costco warehouses. This program also offers (except in Mexico) additional savings and benefits on various business and consumer services, such as auto and home insurance, the Costco auto purchase program and check printing services. The services are generally provided by third-parties and vary by state and country. Executive members represented 39% of paid cardholders at the end of 2016, 2015, and 2014. Executive members generally spend more than other members, and where executive memberships are offered the percentage of our net sales attributable to these members continues to increase.

Labor

Our employee count was as follows:

	2016	2015	2014
Full-time employees	126,000	117,000	112,000
Part-time employees	92,000	88,000	83,000
Total employees	218,000	205,000	195,000

Approximately 15,000 employees, in a minority of our locations, are represented by the International Brotherhood of Teamsters. We consider our employee relations to be very good.

Competition

Our industry is highly competitive, based on factors such as price, merchandise quality and selection, location, and customer service. We compete on a worldwide basis with global, national, and regional wholesalers and retailers, including supermarkets, supercenters, department and specialty stores, gasoline stations, internet retailers, and operators selling a single category or narrow range of merchandise. Competitors such as Wal-Mart, Target, Kroger, and Amazon.com are among our significant general merchandise retail competitors. We also compete with warehouse club operations (primarily Wal-Mart's Sam's Club and BJ's Wholesale Club), and nearly every major U.S. metropolitan area has multiple club operations.

Intellectual Property

We believe that, to varying degrees, our trademarks, trade names, copyrights, proprietary processes, trade secrets, patents, trade dress, domain names and similar intellectual property add significant value to our business and are important to our success. We have invested significantly in the development and protection of our well-recognized brands, including the Costco Wholesale® series of trademarks and our private label brand, Kirkland Signature®. We believe that Kirkland Signature products are premium products, offered to our members at prices that are generally lower than those for similar national brand products and that they help lower costs, differentiate our merchandise offerings from other retailers, and generally earn higher margins. We expect to continue to increase the sales penetration of our private label items.

We rely on trademark and copyright laws, trade secret protection, and confidentiality, license and other agreements with our suppliers, employees and others to protect our intellectual property rights. The availability and duration of trademark registrations vary by country; however, trademarks are generally valid and may be renewed indefinitely as long as they are in use and their registrations are properly maintained.

RISK FACTORS

The risks described below could materially and adversely affect our business, financial condition and results of operations. These risks are not the only risks that we face. We could also be affected by additional factors that apply to all companies operating in the U.S. and globally, as well as other risks that are not presently known to us or that we currently consider to be immaterial. These Risk Factors should be carefully reviewed in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and related notes in this Report.

Business and Operating Risks

We are highly dependent on the financial performance of our U.S. and Canadian operations.

Our financial and operational performance is highly dependent on our U.S. and Canadian operations, which comprised 87% and 84% of net sales and operating income in 2016, respectively. Within the U.S., we are highly dependent on our California operations, which comprised 31% of U.S. net sales in 2016. Our California market, in general, has a larger percentage of higher volume warehouses as compared to our other domestic markets. Any substantial slowing or sustained decline in these operations could materially adversely affect our business and financial results. Declines in financial performance of our U.S. operations, particularly in California, and our Canadian operations could arise from, among other things: slow growth or declines in comparable warehouse sales (comparable sales); negative trends in operating expenses, including increased labor, healthcare and energy costs; failing to meet targets for warehouse openings; cannibalizing existing locations with new warehouses; shifts in sales mix toward lower gross margin products; changes or uncertainties in economic conditions in our markets, including higher levels of unemployment and depressed home values; and failing to consistently provide high quality products and innovative new products to retain our existing member base and attract new members.

We may be unsuccessful implementing our growth strategy, including expanding our business, both in existing markets and in new markets, which could have an adverse impact on our business, financial condition and results of operations.

Our growth is dependent, in part, on our ability to acquire property and build or lease new warehouses and regional depots. We compete with other retailers and businesses for suitable locations. Local land use and other regulations restricting the construction and operation of our warehouses and depots, as well as local community actions opposed to the location of our warehouses or depots at specific sites and the adoption of local laws restricting our operations and environmental regulations, may impact our ability to find suitable locations, and increase the cost of sites and of constructing, leasing and operating our warehouses and depots. We also may have difficulty negotiating leases or purchase agreements on acceptable terms. In addition, certain jurisdictions have enacted or proposed laws and regulations that would prevent or restrict the operation or expansion plans of certain large retailers and warehouse clubs, including us, within their jurisdictions. Failure to effectively manage these and other similar factors may affect our ability to timely build or lease and operate new warehouses and depots, which could have a material adverse effect on our future growth and profitability.

We seek to expand in existing markets to attain a greater overall market share. A new warehouse may draw members away from our existing warehouses and adversely affect comparable sales performance and member traffic at those existing warehouses.

We also intend to continue to open warehouses in new markets. Associated risks include: difficulties in attracting members due to a lack of familiarity with us, attracting members of other wholesale club operators, our lack of familiarity with local member preferences, and seasonal differences in the market. In addition, entry into new markets may bring us into competition with new competitors or with existing competitors with a large, established market presence. We cannot ensure that our new warehouses and new websites will be profitably deployed and, as a result, our future profitability could be delayed or otherwise materially adversely affected.

Our failure to maintain membership loyalty and brand recognition could adversely affect our results of operations.

Membership loyalty and growth are essential to our business model. The extent to which we achieve growth in our membership base, increase the penetration of our Executive members, and sustain high renewal rates materially influences our profitability. Damage to our brands or reputation may negatively impact comparable sales, diminish member trust, and reduce member renewal rates and, accordingly, net sales and membership fee revenue, negatively impacting our results of operations.

In addition, we sell many products under our private label Kirkland Signature brand. Maintaining consistent product quality, competitive pricing, and availability of our Kirkland Signature products for our members is essential to developing and maintaining member loyalty. These products also generally carry higher margins than national brand products carried in our warehouses and represent a growing portion of our overall sales. If the Kirkland Signature brand experiences a loss of member acceptance or confidence, our sales and gross margin results could be adversely affected.

Disruptions in our depot operations could adversely affect sales and member satisfaction.

We depend on the orderly operation of the merchandise receiving and distribution process, primarily through our depots. Although we believe that our receiving and distribution process is efficient, unforeseen disruptions in operations due to fires, tornadoes and hurricanes, earthquakes or other catastrophic events, labor issues or other shipping problems may result in delays in the delivery of merchandise to our warehouses, which could adversely affect sales and the satisfaction of our members.

We rely extensively on computer systems to process transactions, compile results, and manage our business. Failure or disruption of our primary and back-up systems could adversely affect our business. A failure to adequately update our existing systems and implement new systems could harm our business and adversely affect our results of operations.

Given the very high volume of transactions we process each year it is important that we maintain uninterrupted operation of our business-critical computer systems. Our computer systems, including our back-up systems, are subject to damage or interruption from power outages, computer and telecommunications failures, computer viruses, internal or external security breaches, catastrophic events such as fires, earthquakes, tornadoes and hurricanes, and errors by our employees. If our systems are damaged or cease to function properly, we may have to make significant investments to fix or replace them, and we may suffer interruptions in our operations in the interim. Any material interruption in our computer systems could have a material adverse effect on our business and results of operations.

We are currently making, and will continue to make, significant technology investments to improve or replace critical information systems and processing. Failure to monitor and choose the right investments and implement them at the right pace would be harmful. The risk of system disruption is increased when significant system changes are undertaken, although we believe that our change management process will mitigate this risk. Excessive technological change could impact the effectiveness of adoption, and could make it more difficult for us to realize benefits from the technology. Targeting the wrong opportunities, failing to make the best investments, or making an investment commitment significantly above or below our needs could result in the loss of our competitive position and adversely impact our financial condition and results of operations. Additionally, the potential problems and interruptions associated with implementing technology initiatives could disrupt or reduce the efficiency of our operations in the short term. These initiatives might not provide the anticipated benefits or may provide them on a delayed schedule or at a higher cost.

If we do not maintain the privacy and security of member-related and other business information, we could damage our reputation with members, incur substantial additional costs, and become subject to litigation.

We receive, retain, and transmit personal information about our members and entrust that information to third-party business associates, including cloud service providers that perform activities for us. Our warehouse and online businesses depend upon the secure transmission of encrypted confidential information over public networks, including information permitting cashless payments. A compromise of our security systems or those of our business associates, that results in our members' information being obtained by unauthorized persons, could adversely affect our reputation with our members and others, as well as our operations, results of operations, financial condition and liquidity, and could result in litigation against us or the imposition of penalties. In addition, a breach could require that we expend significant additional resources related to the security of information systems and could disrupt our operations.

The use of data by our business and our business associates is regulated at the national and state or local level in all of our operating countries. Privacy and information security laws and regulations change, and compliance with them may result in cost increases due to necessary systems changes and the development of new processes. If we or those with whom we share information fail to comply with these laws and regulations, our reputation could be damaged, possibly resulting in lost future business, and we could be subjected to additional legal risk as a result of non-compliance.

Our security measures may be undermined due to the actions of outside parties, employee error, internal or external malfeasance, or otherwise, and, as a result an unauthorized party may obtain access to our data systems and misappropriate business and personal information. Because the techniques used to obtain unauthorized access, disable or degrade service, or sabotage systems change frequently and may not immediately produce signs of intrusion, we may be unable to anticipate these techniques, timely discover or counter them, or implement adequate preventative measures. Any such breach or unauthorized access could result in significant legal and financial exposure, damage to our reputation, and potentially have an adverse effect on our business.

We are subject to payment-related risks.

We accept payments using a variety of methods, including cash and checks, a select variety of credit and debit cards, and our proprietary cash card. As we offer new payment options to our members, we may be subject to additional rules, regulations, compliance requirements, and higher fraud losses. For certain payment methods, we pay interchange and other related card acceptance fees, along with additional transaction processing fees. We rely on third parties to provide payment transaction processing services, including the processing of credit and debit cards, and our proprietary cash card, and it could disrupt our business if these companies become unwilling or unable to provide these services to us. We are also subject to payment card association rules and network operating rules, including data security rules, certification requirements and rules governing electronic funds transfers, which could change over time. For example, we are subject to Payment Card Industry Data Security Standards ("PCI DSS"), which contain compliance guidelines and standards with regard to our security surrounding the physical and electronic storage, processing and transmission of individual cardholder data. As of October 1, 2015, the payment card industry shifted the liability of certain credit card transactions to retailers who are not able to process Europay, MasterCard, Visa ("EMV") chip-enabled card transactions. As a result, before our implementation of the EMV technology is complete, we may be liable for costs incurred by payment card issuing banks or other third parties for fraudulent transactions initiated through EMV chip-enabled cards before our implementation of EMV chip technology. Implementation of the EMV chip technology and receipt of final certification is subject to hardware installation, software modification, and certification with our third-party transaction service providers. If we fail to comply with these rules or transaction processing requirements, we may not be able to accept certain payment methods. In addition, if our internal systems are breached or compromised, we may be liable for card re-issuance costs, subject to fines and higher transaction fees and lose our ability to accept credit and/or debit card payments from our members, and our business and operating results could be adversely affected.

We might sell unsafe products, resulting in illness or injury to our members, harm to our reputation, and litigation.

If our merchandise offerings, including food and prepared food products for human consumption, drugs, children's products, pet products, and durable goods, do not meet or are perceived not to meet applicable safety standards or our members' expectations regarding safety, we could experience lost sales, increased costs, and legal and reputational losses. The sale of these items involves the risk of health-related illness or injury to our members. Such illnesses or injuries could result from tampering by unauthorized third parties, product contamination or spoilage, including the presence of foreign objects, substances, chemicals, other agents, or residues introduced during the growing, manufacturing, storage, handling and transportation phases, or faulty design. Our vendors are generally contractually required to comply with product safety laws, and we are dependent on them to ensure that the products we buy comply with all safety standards. While we are subject to governmental inspection and regulations and work to comply in all material respects with applicable laws and regulations, we cannot be sure that consumption or use of our products will not cause a health-related illness or injury in the future or that we will not be subject to claims, lawsuits, or government investigations relating to such matters resulting in costly product recalls and other liabilities that could adversely affect our business and results of operations. Even if a product liability claim is unsuccessful or is not fully pursued, related negative publicity could adversely affect our reputation with existing and potential members and our corporate and brand image, and these effects could be long term.

We may not timely identify or effectively respond to consumer trends, which could negatively affect our relationship with our members, the demand for our products and services, and our market share.

It is difficult to consistently and successfully predict the products and services our members will desire. Our success depends, in part, on our ability to identify and respond to trends in demographics and consumer preferences. Failure to timely identify or effectively respond to changing consumer tastes, preferences (including those relating to sustainability of product sources and animal welfare) and spending patterns could negatively affect our relationship with our members, the demand for our products and services and our market share. If we are not successful at predicting our sales trends and adjusting our purchases accordingly, we may have excess inventory, which could result in additional markdowns and reduce our operating performance. This could have an adverse effect on net sales, gross margin and operating income.

If we do not successfully develop and maintain a relevant multichannel experience for our members, our results of operations could be adversely impacted.

Multichannel retailing is rapidly evolving and we must keep pace with changing member expectations and new developments by our competitors. Our members, especially younger members, are increasingly using computers, tablets, mobile phones, and other devices to shop and to interact with us through social media. As part of our multichannel strategy, we are making technology investments in our websites and mobile applications. If we are unable to make, improve, or develop relevant member-facing technology in a timely manner, our ability to compete and our results of operations could be adversely affected.

Inability to attract, train and retain highly qualified employees could adversely impact our business, financial condition and results of operations.

Our success depends on the continued contributions of members of our senior management and other key operations, merchandising and administrative personnel, and the loss of these contributions could have a material adverse effect on our business. We must attract, train and retain a large and growing number of qualified employees, while controlling related labor costs and maintaining our core values. Our ability to control labor and benefit costs is subject to numerous external factors, including regulatory changes, prevailing wage rates, and healthcare and other insurance costs. We compete with other retail and non-retail businesses for these employees and invest significant resources in training and motivating them. There is no assurance that we will be able to attract or retain highly qualified employees in the future, which could have a material adverse effect on our business, financial condition and results of operations.

Market and Other External Risks

We face strong competition from other retailers and warehouse club operators, which could adversely affect our business, financial condition and results of operations.

The retail business is highly competitive. We compete for members, employees, sites, products and services and in other important respects with a wide range of local, regional and national wholesalers and retailers, both in the United States and in foreign countries, including other warehouse club operators, supermarkets, supercenters, department and specialty stores, gasoline stations, and internet retailers. Such retailers and warehouse club operators compete in a variety of ways, including merchandise pricing, selection and availability, services, location, convenience, store hours, and the attractiveness and ease of use of websites and mobile applications. The evolution of retailing in online and mobile channels has improved the ability of customers to comparison shop with digital devices, which has enhanced competition. Some competitors may have greater financial resources, better access to merchandise and greater market penetration than we do. Our inability to respond effectively to competitive pressures, changes in the retail markets and member expectations could result in lost market share and negatively affect our financial results.

General economic factors, domestically and internationally, may adversely affect our business, financial condition, and results of operations.

Higher energy and gasoline costs, inflation, levels of unemployment, healthcare costs, consumer debt levels, foreign-currency exchange rates, unsettled financial markets, weaknesses in housing and real estate markets, reduced consumer confidence, changes related to government fiscal and tax policies, sovereign debt crises, and other economic factors could adversely affect demand for our products and services or require a change in the mix of products we sell. Prices of certain commodity products, including gasoline and other food products, are historically volatile and are subject to fluctuations arising from changes in domestic and international supply and demand, labor costs, competition, market speculation, government regulations, taxes and periodic delays in delivery. Rapid and significant changes in commodity prices may affect our sales and profit margins. These factors could also increase our merchandise costs and selling, general and administrative expenses, and otherwise adversely affect our operations and financial results. General economic conditions can also be affected by the outbreak of war, acts of terrorism, or other significant national or international events.

Vendors may be unable to supply us with quality merchandise at the right prices in a timely manner or may fail to adhere to our high standards, resulting in adverse effects on our business, merchandise inventories, sales, and profit margins.

We depend heavily on our ability to purchase merchandise in sufficient quantities at competitive prices. As these quantities continue to grow, we have no assurances of continued supply, pricing or access to new products, and any vendor could at any time change the terms upon which it sells to us or discontinue selling to us. Member demands may lead to out-of-stock positions of our merchandise leading to loss of sales and profits.

We purchase our merchandise from numerous domestic and foreign manufacturers and importers and have thousands of vendor relationships. Our inability to acquire suitable merchandise on acceptable terms or the loss of key vendors could negatively affect us. We may not be able to develop relationships with new vendors, and products from alternative sources, if any, may be of a lesser quality or more expensive than those from existing vendors. Because of our efforts to adhere to high quality standards for which available supply may be limited, particularly for certain food items, the large volume we demand may not be consistently available.

Our suppliers (and those they depend upon for materials and services) are subject to risks, including labor disputes, union organizing activities, financial liquidity, inclement weather, natural disasters, supply constraints, and general economic and political conditions that could limit their ability to timely provide us with acceptable merchandise. For these or other reasons, one or more of our suppliers might not adhere to our quality control, legal, regulatory, labor, environmental or animal welfare standards. These deficiencies may delay or preclude delivery of merchandise to us and might not be identified before we sell such merchandise to our members. This failure could lead to recalls and litigation, and otherwise damage our reputation and our brands, increase our costs, and otherwise adversely impact our business.

Fluctuations in foreign exchange rates may adversely affect our results of operations.

During 2016, our international operations, including Canada, generated 27% and 39% of our net sales and operating income, respectively. Our international operations have accounted for an increasingly larger portion of our warehouses and we plan to continue expanding them. Our operations in countries other than the U.S. are conducted primarily in the local currencies of those countries. Our consolidated financial statements are denominated in U.S. dollars, and to prepare those financial statements we must translate the financial statements of our international operations from local currencies into U.S. dollars using exchange rates for the current period. Future fluctuations in currency exchange rates over time that are unfavorable to us may adversely affect the financial performance of our Canadian and Other International operating segments and have a corresponding adverse period-over-period effect on our results of operations. As we continue to expand internationally, our exposure to fluctuations in foreign exchange rates may increase.

We may pay for products we purchase for sale in our warehouses around the world with a currency other than the local currency of the country in which the goods will be sold. Currency fluctuations may increase our cost of goods and may not be passed on to members. Consequently, fluctuations in currency exchange rates may adversely affect our results of operations.

Natural disasters or other catastrophic events could negatively affect our business, financial condition, and results of operations.

Natural disasters, such as hurricanes, typhoons or earthquakes, particularly in California or Washington state, where our centralized operating systems and administrative personnel are located, could negatively affect our operations and financial performance. Such events could result in physical damage to one or more of our properties, the temporary closure of one or more warehouses or depots, the temporary lack of an adequate work force in a market, the temporary or long-term disruption in the supply of products from some local or overseas suppliers, the temporary disruption in the transport of goods to or from overseas, delays in the delivery of goods to our warehouses or depots within the countries in which we operate, and the temporary reduction in the availability of products in our warehouses. Public health issues, whether occurring in the U.S. or abroad, could disrupt our operations, disrupt the operations of suppliers or members, or have an adverse impact on consumer spending and confidence levels. These events could also reduce demand for our products or make it difficult or impossible to receive products from suppliers. We may be required to suspend operations in some or all of our locations, which could have a material adverse effect on our business, financial condition and results of operations.

Factors associated with climate change could adversely affect our business.

We use natural gas, diesel fuel, gasoline, and electricity in our distribution and warehouse operations. Increased U.S. and foreign government and agency regulations to limit carbon dioxide and other greenhouse gas emissions may result in increased compliance costs and legislation or regulation affecting energy inputs that could materially affect our profitability. In addition, climate change could affect our ability to procure needed commodities at costs and in quantities we currently experience. We also sell a substantial amount of gasoline, the demand for which could be impacted by concerns about climate change and which also could face increased regulation. Climate change may be associated with extreme weather conditions, such as more intense hurricanes, thunderstorms, tornadoes, and snow or ice storms, as well as rising sea levels. Extreme weather conditions increase our costs and resulting damage to our properties may not be fully insured.

Failure to meet market expectations for our financial performance could adversely affect the market price and volatility of our stock.

We believe that the price of our stock generally reflects high market expectations for our future operating results. Any failure to meet or delay in meeting these expectations, including our comparable sales growth rates, membership renewal rates, gross margin, earnings, earnings per share, new warehouse openings, or dividend or stock repurchase policies could cause the market price of our stock to decline.

Legal and Regulatory Risks

Our international operations subject us to risks associated with the legislative, judicial, accounting, regulatory, political and economic factors specific to the countries or regions in which we operate which could adversely affect our business, financial condition and results of operations.

During 2016, we operated 214 warehouses in eight countries outside of the U.S. and we plan to continue expanding our international operations. Future operating results internationally could be negatively affected by a variety of factors, many similar to those we face in the U.S., certain of which are beyond our control. These factors include political conditions, economic conditions, regulatory constraints, currency regulations, and other matters in any of the countries or regions in which we operate, now or in the future. Other factors that may impact international operations include foreign trade, monetary and fiscal policies and the laws and regulations of the U.S. and foreign governments, agencies and similar organizations, and risks associated with having major facilities located in countries which have been historically less stable than the U.S. Risks inherent in international operations also include, among others, the costs and difficulties of managing international operations, adverse tax consequences, and greater difficulty in enforcing intellectual property rights.

Changes in accounting standards and subjective assumptions, estimates and judgments by management related to complex accounting matters could significantly affect our financial condition and results of operations.

Accounting principles and related pronouncements, implementation guidelines, and interpretations we apply to a wide range of matters that are relevant to our business, including, but not limited to, revenue recognition, merchandise inventories, vendor rebates and other vendor consideration, impairment of long-lived assets, self-insurance liabilities, and income taxes are highly complex and involve many subjective assumptions, estimates and judgments by our management. Changes in these rules or their interpretation or changes in underlying assumptions, estimates or judgments by our management could significantly change our reported or expected financial performance.

Provisions for losses related to self-insured risks are generally based upon independent actuarially determined estimates. The assumptions underlying the ultimate costs of existing claim losses can be highly unpredictable, which can affect the liability recorded for such claims. For example, variability in health care cost inflation rates inherent in these claims can affect the amounts recognized. Similarly, changes in legal trends and interpretations, as well as changes in the nature and method of how claims are settled can impact ultimate costs. Although our estimates of liabilities incurred do not anticipate significant changes in historical trends for these variables, any changes could have a considerable effect upon future claim costs and currently recorded liabilities and could materially impact our consolidated financial statements.

We could be subject to additional income tax liabilities.

We compute our income tax provision based on enacted tax rates in the countries in which we operate. As the tax rates vary among countries, a change in earnings attributable to the various jurisdictions in which we operate could result in an unfavorable change in our overall tax provision. Additionally, changes in the enacted tax rates, adverse outcomes in tax audits, including transfer pricing disputes, or any change in the pronouncements relating to accounting for income taxes could have a material adverse effect on our financial condition and results of operations.

Significant changes in, or failure to comply with, federal, state, regional, local and international laws and regulations relating to the use, storage, discharge and disposal of hazardous materials, hazardous and non-hazardous wastes and other environmental matters could adversely impact our business, financial condition and results of operations.

We are subject to a wide variety of federal, state, regional, local and international laws and regulations relating to the use, storage, discharge and disposal of hazardous materials, hazardous and non-hazardous wastes and other environmental matters. Failure to comply with these laws could result in significant costs to satisfy environmental compliance, remediation or compensatory requirements, or the imposition of severe penalties or restrictions on operations by governmental agencies or courts that could adversely affect our business, financial condition and results of operations.

We are involved in a number of legal proceedings and audits and some of these outcomes could adversely affect our business, financial condition and results of operations.

Our business requires compliance with many laws and regulations. Failure to achieve compliance could subject us to lawsuits and other proceedings, and lead to damage awards, fines, penalties, and remediation costs. We are, or may become involved, in a number of legal proceedings and audits including grand jury investigations, government and agency investigations, and consumer, employment, tort, unclaimed property laws, and other litigation (see discussion of Legal Proceedings in Note 10 to the consolidated financial statements included in this Report). We cannot predict with certainty the outcomes of these legal proceedings and other contingencies, including environmental remediation and other proceedings commenced by governmental authorities. The outcome of some of these legal proceedings, audits, unclaimed property laws, and other contingencies could require us to take, or refrain from taking, actions which could negatively affect our operations or could require us to pay substantial amounts of money, adversely affecting our financial condition and results of operations. Additionally, defending against these lawsuits and proceedings may involve significant expense and diversion of management's attention and resources.

PROPERTIES

Warehouse Properties

At August 28, 2016 we operated 715 membership warehouses:

NUMBER OF WAREHOUSES

	Own Land and Building	Lease Land and/or Building[1]	Total
United States and Puerto Rico	407	94	501
Canada	80	11	91
Mexico	36	—	36
United Kingdom	22	6	28
Japan	11	14	25
Korea	5	7	12
Taiwan	—	12	12
Australia	5	3	8
Spain	2	—	2
Total	568	147	715

(1) 98 of the 147 leases are land-only leases, where Costco owns the building.

The following schedule shows warehouse openings for the past five fiscal years and expected warehouse openings through December 31, 2016:

Openings by Fiscal Year[1]	United States	Canada	Other International	Total	Total Warehouses in Operation
2012 and prior	439	82	87	608	608
2013	12	3	11	26	634
2014	17	3	9	29	663
2015	12	1	10	23	686
2016	21	2	6	29	715
2017 (expected through 12/31/2016)	5	3	—	8	723
Total	506	94	123	723	

(1) Net of closings and relocations.

At the end of 2016, our warehouses contained approximately 103.2 million square feet of operating floor space: 73.3 million in the U.S.; 12.6 million in Canada; and 17.3 million in Other International locations. Additionally, we operate regional depots for the consolidation and distribution of most merchandise shipments to the warehouses, and various processing, packaging, and other facilities to support ancillary and other businesses, which includes our online business. We operate 24 depots consisting of approximately 10.1 million square feet. Our executive offices are located in Issaquah, Washington, and we operate 18 regional offices in the U.S., Canada and Other International locations.

MARKET FOR COSTCO COMMON STOCK

Market Information and Dividend Policy

Our common stock is traded on the NASDAQ Global Select Market under the symbol "COST." On October 4, 2016, we had 8,572 stockholders of record. The following table shows the quarterly high and low closing prices as reported by NASDAQ for each quarter during the last two fiscal years and the quarterly cash dividend declared per share of our common stock.

	Price Range		Cash Dividends Declared
	High	Low	
2016:			
Fourth Quarter	$ 169.04	$ 141.29	$ 0.450
Third Quarter	158.25	146.44	0.450
Second Quarter	168.87	143.28	0.400
First Quarter	163.10	138.30	0.400
2015:			
Fourth Quarter	146.89	132.71	0.400
Third Quarter	153.14	143.05	0.400
Second Quarter	155.92	137.31	5.355 (1)
First Quarter	140.01	121.35	0.355

(1) Includes a special cash dividend of $5.00 per share.

Payment of future dividends is subject to declaration by the Board of Directors. Factors considered in determining dividends include our profitability and expected capital needs. Subject to these qualifications, we presently expect to continue to pay dividends on a quarterly basis.

Issuer Purchases of Equity Securities

The following table sets forth information on our common stock repurchase program activity for the fourth quarter of fiscal 2016 (dollars in millions, except per share data):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program (1)	Maximum Dollar Value of Shares that May Yet be Purchased under the Program
May 9—June 5, 2016	416,000	$146.08	416,000	$3,292
June 6—July 3, 2016	234,000	154.81	234,000	$3,256
July 4—July 31, 2016	66,000	164.12	66,000	$3,245
August 1—August 28, 2016	140,000	167.34	140,000	$3,222
Total fourth quarter	856,000	$153.34	856,000	

(1) Our repurchase program is conducted under a $4,000 authorization approved by our Board of Directors in April 2015, which expires in April 2019.

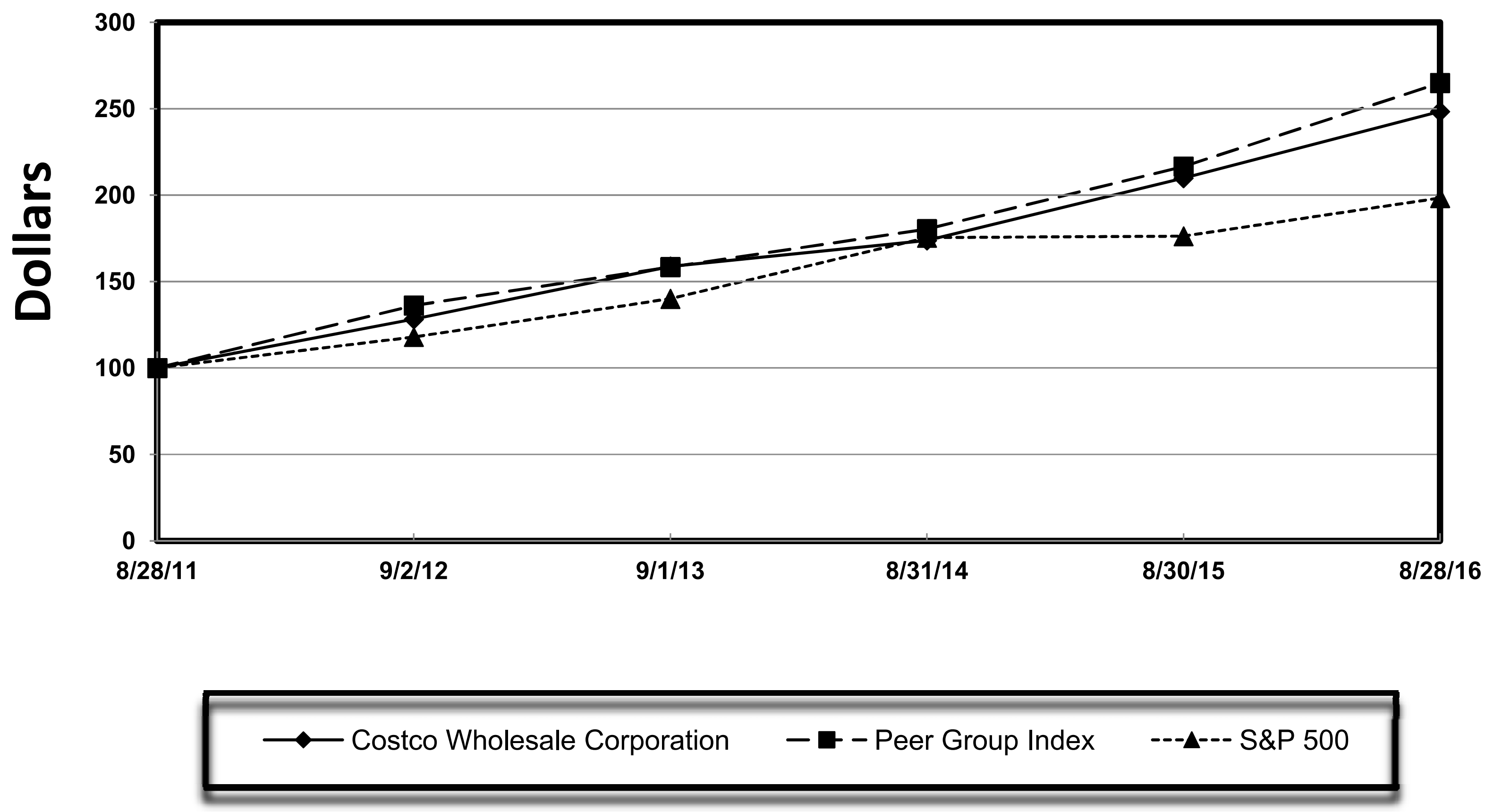
Equity Compensation Plans

Information related to our Equity Compensation Plans is incorporated herein by reference to Costco's Proxy Statement filed with the Securities and Exchange Commission.

Performance Graph

The following graph compares the cumulative total shareholder return (stock price appreciation plus dividends) on our common stock for the last five years with the cumulative total return of the S&P 500 Index and the following group of peer companies (based on weighted market capitalization) selected by the Company: Amazon.com, Inc.; The Home Depot, Inc.; Lowe's Companies; Best Buy Co., Inc.; Staples Inc.; Target Corporation; Kroger Company; and Wal-Mart Stores, Inc. The information provided is from August 28, 2011 through August 28, 2016.

COMPARISON OF 5-YEAR CUMULATIVE TOTAL RETURN
AMONG COSTCO WHOLESALE CORPORATION,
S&P 500 INDEX AND PEER GROUP INDEX



The graph assumes the investment of $100 in Costco common stock, the S&P 500 Index and the Peer Group Index on August 28, 2011 and reinvestment of all dividends.

Available Information

Our U.S. internet website is www.costco.com. We make available through the Investor Relations section of that site, free of charge, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements and Forms 3, 4 and 5, and any amendments to those reports, as soon as reasonably practicable after filing such materials with, or furnishing such documents to, the Securities and Exchange Commission (SEC). The information found on our website is not part of this or any other report filed with or furnished to the SEC. In addition, the public may read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports, proxy and information statements, and other information regarding issuers, such as the Company, that file electronically with the SEC at www.sec.gov.

FIVE YEAR OPERATING AND FINANCIAL HIGHLIGHTS

The following table sets forth information concerning our consolidated financial condition, operating results, and key operating metrics. This information should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, included in this Report, and our consolidated financial statements and notes thereto, included in this Report.

SELECTED FINANCIAL DATA
(dollars in millions, except per share data)

As of and for the year ended	Aug. 28, 2016 (52 weeks)	Aug. 30, 2015 (52 weeks)	Aug. 31, 2014 (52 weeks)	Sept. 1, 2013 (52 weeks)	Sept. 2, 2012 (53 weeks)
RESULTS OF OPERATIONS					
Net sales	$ 116,073	$ 113,666	$ 110,212	$ 102,870	$ 97,062
Membership fees	2,646	2,533	2,428	2,286	2,075
Gross margin[(1)] as a percentage of net sales	11.35 %	11.09 %	10.66%	10.62%	10.55%
Selling, general and administrative expenses as a percentage of net sales	10.40 %	10.07 %	9.89%	9.82%	9.81%
Operating income	$ 3,672	$ 3,624	$ 3,220	$ 3,053	$ 2,759
Net income attributable to Costco[(2)]	2,350	2,377	2,058	2,039	1,709
Net income per diluted common share attributable to Costco	5.33	5.37	4.65	4.63	3.89
Cash dividends declared per common share	1.70	6.51	1.33	8.17	1.03
Changes in comparable sales[(3)]					
United States	1 %	3 %	5%	6%	7%
Canada	(3)%	(5)%	2%	9%	8%
Other International	(3)%	(3)%	3%	1%	3%
Total Company	0 %	1 %	4%	6%	7%
Increase in Total Company comparable sales excluding the impact of changes in foreign currency and gasoline prices	4 %	7 %	6%	6%	6%
BALANCE SHEET DATA					
Net property and equipment	$ 17,043	$ 15,401	$ 14,830	$ 13,881	$ 12,961
Total assets	33,163	33,017	32,662	29,936	26,827
Long-term debt, excluding current portion	4,061	4,852	5,084	4,986	1,380
Costco stockholders' equity	$ 12,079	$ 10,617	$ 12,303	$ 10,833	$ 12,361
WAREHOUSE INFORMATION					
Warehouses in Operation					
Beginning of year	686	663	634	608	592
Opened[(4)]	33	26	30	26	17
Closed[(4)]	(4)	(3)	(1)	0	(1)
End of year	715	686	663	634	608
MEMBERSHIP INFORMATION					
Total paid members (000's)	47,600	44,600	42,000	39,000	36,900

(1) Net sales less merchandise costs.

(2) Includes 50% of the results of Costco Mexico's operations in fiscal 2012 prior to the July acquisition of our former joint venture partner's 50% equity interest. The remainder of fiscal 2012 and thereafter include 100% of Costco Mexico's results of operations.

(3) Includes net sales from warehouses and websites operating for more than one year. For fiscal 2013 and 2012, the prior year includes the comparable 52 and 53 weeks, respectively.

(4) Includes warehouse relocations and closures.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

(amounts in millions, except per share, membership fee, and warehouse count data)

OVERVIEW

We believe that the most important driver of our profitability is sales growth, particularly comparable sales growth. We define comparable sales as sales from warehouses open for more than one year, including remodels, relocations and expansions, as well as online sales related to websites operating for more than one year. Comparable sales growth is achieved through increasing shopping frequency from new and existing members and the amount they spend on each visit (average ticket). Sales comparisons can also be particularly influenced by certain factors that are beyond our control: fluctuations in currency exchange rates (with respect to the consolidation of the results of our international operations); and changes in the cost of gasoline and associated competitive conditions (primarily impacting our U.S. and Canadian operations). The higher our comparable sales exclusive of these items, the more we can leverage certain of our selling, general and administrative expenses, reducing them as a percentage of sales and enhancing profitability. Generating comparable sales growth is foremost a question of making available to our members the right merchandise at the right prices, a skill that we believe we have repeatedly demonstrated over the long term. Another substantial factor in sales growth is the health of the economies in which we do business, especially the United States. Sales growth and gross margins are also impacted by our competition, which is vigorous and widespread, across a wide range of global, national and regional wholesalers and retailers. While we cannot control or reliably predict general economic health or changes in competition, we believe that we have been successful historically in adapting our business to these changes, such as through adjustments to our pricing and to our merchandise mix, including increasing the penetration of our private label items.

Our philosophy is to provide our members with quality goods and services at the most competitive prices. We do not focus in the short term on maximizing prices charged, but instead seek to maintain what we believe is a perception among our members of our "pricing authority" – consistently providing the most competitive values. Our investments in merchandise pricing can, from time to time, include reducing prices on merchandise to drive sales or meet competition and holding prices steady despite cost increases instead of passing the increases on to our members, all negatively impacting near-term gross margin as a percentage of net sales (gross margin percentage). We believe that our gasoline business draws members but it generally has a significantly lower gross margin percentage relative to our non-gasoline business. A higher penetration of gasoline sales will generally lower our gross margin percentage. Rapidly changing gasoline prices may significantly impact our near-term net sales growth. Generally, rising gasoline prices benefit net sales growth which, given the higher sales base, negatively impacts our gross margin percentage but decreases our selling, general and administrative expenses as a percentage of net sales. A decline in gasoline prices has the inverse effect.

We also achieve sales growth by opening new warehouses. As our warehouse base grows, available and desirable potential sites become more difficult to secure, and square footage growth becomes a comparatively less substantial component of growth. The negative aspects of such growth, however, including lower initial operating profitability relative to existing warehouses and cannibalization of sales at existing warehouses when openings occur in existing markets, are increasingly less significant relative to the results of our total operations. Our rate of square footage growth is generally higher in foreign markets, due to the smaller base in those markets, and we expect that to continue. Our online business growth both domestically and internationally has also increased our sales.

Our membership format is an integral part of our business model and has a significant effect on our profitability. This format is designed to reinforce member loyalty and provide continuing fee revenue. The extent to which we achieve growth in our membership base, increase penetration of our Executive members, and sustain high renewal rates, materially influences our profitability.

Our financial performance depends heavily on our ability to control costs. While we believe that we have achieved successes in this area historically, some significant costs are partially outside our control, most particularly health care and utility expenses. With respect to expenses relating to the compensation of our employees, our philosophy is not to seek to minimize their wages and benefits. Rather, we believe that achieving our longer-term objectives of reducing employee turnover and enhancing employee satisfaction requires maintaining compensation levels that are better than the industry average for much of our workforce. This may cause us, for example, to absorb costs that other employers might seek to pass through to their workforces. Because our business is operated on very low margins, modest changes in various items in the income statement, particularly merchandise costs and selling, general and administrative expenses, can have substantial impacts on net income.

Our operating model is generally the same across our U.S., Canada, and Other International operating segments (see Note 11 to the consolidated financial statements included in this Report). Certain countries in the Other International segment have relatively higher rates of square footage growth, lower wages and benefit costs as a percentage of country sales, and/or less or no direct membership warehouse competition. Additionally, we operate our lower-margin gasoline business in all countries except Mexico, Korea, and Taiwan.

In discussions of our consolidated operating results, we refer to the impact of changes in foreign currencies relative to the U.S. dollar, which are references to the differences between the foreign-exchange rates we use to convert the financial results of our international operations from local currencies into U.S. dollars for financial reporting purposes. This impact of foreign-exchange rate changes is calculated based on the difference between the current period's currency exchange rates and that of the comparable prior period. The impact of changes in gasoline prices on net sales is calculated based on the difference between the current period's average price per gallon sold and that of the comparable prior period.

Our fiscal year ends on the Sunday closest to August 31. Fiscal years 2016, 2015 and 2014 were 52-week fiscal years ending on August 28, 2016, August 30, 2015 and August 31, 2014, respectively. Certain percentages presented are calculated using actual results prior to rounding. Unless otherwise noted, references to net income relate to net income attributable to Costco.

Highlights for fiscal year 2016 included:

- We opened 29 net new warehouses in 2016, 21 in the U.S., two in Canada, and six in our Other International segment, compared to 23 net new warehouses in 2015;
- Net sales increased 2% to $116,073, driven by sales at new warehouses opened in 2015 and 2016, while comparable sales were flat. Net and comparable sales results were negatively impacted by changes in most foreign currencies relative to the U.S. dollar and decreases in the price of gasoline;
- Membership fee revenue increased 4% to $2,646, primarily due to membership sign-ups at existing and new warehouses and executive membership upgrades, partially offset by the negative impact of changes in most foreign currencies relative to the U.S. dollar;
- Gross margin percentage increased 26 basis points, primarily from the impact of gasoline price deflation on net sales;
- Selling, general and administrative (SG&A) expenses as a percentage of net sales increased 33 basis points, largely driven by the impact of gasoline price deflation on net sales;
- Net income decreased 1% to $2,350, or $5.33 per diluted share compared to $2,377, or $5.37 per diluted share in 2015. The 2015 results were positively impacted by a $57 tax benefit, or $0.13 per diluted share, in connection with the special cash dividend paid to the Company's 401(k) Plan participants;
- Changes in foreign currencies relative to the U.S. dollar adversely impacted diluted earnings per share by $0.24, largely driven by changes in the Canadian dollar and Mexican peso;
- In December 2015, we paid the outstanding principal balance and associated interest on the 0.65% Senior Notes of approximately $1,204, from our cash and cash equivalents and short-term investments;
- The Board of Directors approved an increase in the quarterly cash dividend from $0.40 to $0.45 per share in April 2016; and
- In June 2016, we transitioned to our new Citibank-Visa exclusive co-branded credit card in the U.S. (described in further detail in this Report).

RESULTS OF OPERATIONS

Net Sales

	2016	2015	2014
Net Sales	$ 116,073	$ 113,666	$ 110,212
Changes in net sales:			
U.S.	3 %	5 %	7%
Canada	(2)%	(3)%	5%
Other International	4 %	2 %	14%
Total Company	2 %	3 %	7%
Changes in comparable sales:			
U.S.	1 %	3 %	5%
Canada	(3)%	(5)%	2%
Other International	(3)%	(3)%	3%
Total Company	0 %	1 %	4%
Increases in comparable sales excluding the impact of changes in foreign currency and gasoline prices:			
U.S.	3 %	6 %	5%
Canada	8 %	8 %	9%
Other International	4 %	6 %	4%
Total Company	4 %	7 %	6%

2016 vs. 2015

Net Sales

Net sales increased $2,407 or 2% during 2016. This was attributable to sales at new warehouses opened in 2015 and 2016. Comparable sales were flat. Changes in foreign currencies relative to the U.S. dollar negatively impacted net sales by approximately $2,690, or 237 basis points, compared to 2015. The negative impact was attributable to most foreign countries in which we operate, predominantly Canada of $1,646, Mexico of $550, and UK of $224. Changes in gasoline prices negatively impacted net sales by approximately $2,194, or 193 basis points, due to a 19% decrease in the average sales price per gallon.

Comparable Sales

Comparable sales were flat during 2016 and were positively impacted by an increase in shopping frequency offset by a decrease in the average ticket. The average ticket and comparable sales results were negatively impacted by changes in foreign currencies relative to the U.S. dollar and a decrease in gasoline prices. Changes in comparable sales also includes the negative impact of cannibalization (established warehouses losing sales to our newly opened locations).

2015 vs. 2014

Net Sales

Net sales increased $3,454 or 3% during 2015. This was attributable to sales at new warehouses opened in 2014 and 2015 and a 1% increase in comparable sales. Changes in foreign currencies relative to the U.S. dollar negatively impacted net sales by approximately $3,344, or 303 basis points, compared to 2014. The negative impact was attributable to all foreign countries in which we operate, predominantly Canada of

$2,027, Mexico of $385, and Japan of $368. Changes in gasoline prices negatively impacted net sales by approximately $2,902, or 263 basis points, due to a 22% decrease in the average sales price per gallon.

Comparable Sales

Comparable sales increased 1% during 2015 and were positively impacted by an increase in shopping frequency partially offset by a decrease in the average ticket. The average ticket and comparable sales results were negatively impacted by changes in foreign currencies relative to the U.S. dollar and a decrease in gasoline prices. Changes in comparable sales also includes the negative impact of cannibalization.

Membership Fees

	2016	2015	2014
Membership fees	$ 2,646	$ 2,533	$ 2,428
Membership fees increase	4%	4%	6%
Membership fees as a percentage of net sales	2.28%	2.23%	2.20%

2016 vs. 2015

The increase in membership fees was primarily due to membership sign-ups at existing and new warehouses and increased number of upgrades to our higher-fee Executive Membership program. These increases were partially offset by changes in foreign currencies relative to the U.S. dollar, which negatively impacted membership fees by approximately $52 in 2016. At the end of 2016, our member renewal rates were 90% in the U.S. and Canada and 88% worldwide.

2015 vs. 2014

Membership fees increased 4% in 2015. This increase was primarily due to membership sign-ups at existing and new warehouses and increased number of upgrades to our higher-fee Executive Membership program. These increases were partially offset by changes in foreign currencies relative to the U.S. dollar, which negatively impacted membership fees by approximately $76 in 2015.

Gross Margin

	2016	2015	2014
Net sales	$ 116,073	$ 113,666	$ 110,212
Less merchandise costs	102,901	101,065	98,458
Gross margin	$ 13,172	$ 12,601	$ 11,754
Gross margin percentage	11.35%	11.09%	10.66%

2016 vs. 2015

The gross margin of our core merchandise categories (food and sundries, hardlines, softlines and fresh foods), when expressed as a percentage of core merchandise sales (rather than total net sales), increased 13 basis points, primarily due to increases in these categories other than fresh foods. This measure eliminates the impact of changes in sales penetration and gross margins from our warehouse ancillary and other businesses.

Total gross margin percentage increased 26 basis points compared to 2015. Excluding the impact of gasoline price deflation on net sales, gross margin as a percentage of adjusted net sales was 11.14%, an increase of five basis points. A larger LIFO benefit in 2016 compared to 2015 positively contributed three basis points. The LIFO benefit resulted largely from lower costs for merchandise inventories, primarily in food and sundries and gasoline. Our core merchandise categories positively contributed one basis point, primarily due to an increase in hardlines, partially offset by food and sundries due to a decrease in sales penetration. Warehouse ancillary and other business gross margin positively contributed one basis point, primarily due to hearing aids and e-commerce businesses, partially offset by our gasoline business. Changes in foreign currencies relative to the U.S. dollar negatively impacted gross margin by approximately $286 in 2016.

Gross margin on a segment basis, when expressed as a percentage of the segment's own sales and excluding the impact of gasoline price deflation on net sales (segment gross margin percentage), increased in our U.S. operations, predominately due to a positive contribution from our core merchandise categories, primarily hardlines and softlines, and the LIFO benefit discussed above. The segment gross margin percentage in our Canadian operations decreased, primarily due to a decrease in all core merchandise categories, except hardlines, partially offset by increases in warehouse ancillary and other businesses, primarily pharmacy and e-commerce businesses. The segment gross margin percentage in Other International operations decreased in all merchandise categories, except fresh foods, which was higher.

2015 vs. 2014

The gross margin of our core merchandise categories (food and sundries, hardlines, softlines and fresh foods), when expressed as a percentage of core merchandise sales, increased five basis points, primarily due to increases in softlines and food and sundries, partially offset by a decrease in fresh foods.

Our gross margin percentage increased 43 basis points compared to 2014 and most of the improvement was derived from the impact of gasoline price deflation on net sales. Excluding this impact, gross margin as a percentage of adjusted net sales was 10.81%, an increase of 15 basis points from the prior year. This increase was predominantly due to: an increase in our warehouse ancillary and other business gross margin of 23 basis points, due primarily to our gasoline business; partially offset by a negative contribution from core merchandise categories of 12 basis points, as a result of a decrease in their sales penetration. A LIFO benefit in 2015 compared to a charge in 2014 positively contributed five basis points. The LIFO benefit resulted largely from lower costs of gasoline. Changes in foreign currencies relative to the U.S. dollar negatively impacted gross margin by approximately $359 in 2015.

Segment gross margin percentage increased in our U.S. operations, primarily due to our gasoline business and the LIFO benefit discussed above. The segment gross margin percentage in our Canadian operations decreased across our core merchandise categories. The segment gross margin percentage in our Other International operations decreased, primarily in food and sundries.

Selling, General and Administrative Expenses

	2016	2015	2014
SG&A expenses	$ 12,068	$ 11,445	$ 10,899
SG&A expenses as a percentage of net sales	10.40%	10.07%	9.89%

2016 vs. 2015

SG&A expenses as a percentage of net sales increased 33 basis points compared to 2015. Excluding the negative impact of gasoline price deflation on net sales, SG&A expenses as a percentage of adjusted net sales were 10.20%, an increase of 13 basis points. This was largely due to: higher central operating costs of six basis points, predominantly due to costs associated with our information systems modernization, including increased depreciation for projects placed in service, incurred by our U.S. operations; and higher stock compensation expense of four basis points, due to appreciation in the trading price of our stock at the time of grant. Our investment in modernizing our information systems is ongoing and expected to continue to negatively impact SG&A expenses. Charges for non-recurring legal and regulatory matters during 2016 negatively impacted SG&A expenses by two basis points. Our warehouse operating costs were higher by one basis point due to higher payroll and employee benefit costs, primarily health care, in our U.S. operations. This increase was partially offset by lower payroll expense as a percentage of net sales in our Canadian operations. Changes in foreign currencies relative to the U.S. dollar decreased our SG&A expenses by approximately $211 in 2016.

2015 vs. 2014

SG&A expenses as a percentage of net sales increased 18 basis points, mostly due to the negative impact of gasoline price deflation on net sales. Excluding this impact, SG&A expenses as a percentage of adjusted net sales were 9.82%, an improvement of seven basis points. This was due to lower warehouse operating costs of 16 basis points, primarily from improvements in payroll expenses in our core business as a result of leveraging increased sales. This improvement was partially offset by higher central operating costs of five basis points, predominantly due to increased depreciation and service contract costs associated with our information systems modernization projects that were placed into service during the year, primarily incurred by our U.S. operations. Higher stock compensation expense also negatively impacted our SG&A expenses by four basis points, due to an appreciation in the trading price of our stock at the time of grant. Changes in foreign currencies relative to the U.S. dollar decreased our SG&A expenses by approximately $282 in 2015.

Preopening Expenses

	2016	2015	2014
Preopening expenses	$ 78	$ 65	$ 63
Warehouse openings, including relocations			
United States	25	14	17
Canada	2	1	3
Other International	6	11	10
Total warehouse openings, including relocations	33	26	30

Preopening expenses include costs for startup operations related to new warehouses, including relocations, development in new international markets, and expansions at existing warehouses. Preopening expenses vary due to the number of warehouse openings, the timing of the opening relative to our year-end, whether the warehouse is owned or leased, and whether the opening is in an existing, new, or international market.

Interest Expense

	2016	2015	2014
Interest expense	$ 133	$ 124	$ 113

Interest expense in 2016 primarily relates to Senior Notes issued by the Company (described in further detail under the heading “Cash Flows from Financing Activities” and in Note 4 to the consolidated financial statements included in this Report). The increase in interest expense is primarily due to the Senior Notes issued in February 2015.

Interest Income and Other, Net

	2016	2015	2014
Interest income	$ 41	$ 50	$ 52
Foreign-currency transaction gains, net	28	47	26
Other, net	11	7	12
Interest income and other, net	$ 80	$ 104	$ 90

2016 vs. 2015

The decrease in interest income in 2016 is attributable to lower average cash and investment balances, due in part to the payment of the outstanding principal balance and interest on the 0.65% Senior Notes in the second quarter of 2016 (see discussion in Note 4 of this Report). Foreign-currency transaction gains, net include mark-to-market adjustments for forward foreign-exchange contracts and the revaluation or settlement of monetary assets and liabilities by our Canadian and Other International operations. See Derivatives and Foreign Currency sections in Note 1 of this Report.

2015 vs. 2014

The increase in net foreign-currency transaction gains was primarily attributable to favorable mark-to-market adjustments for forward foreign exchange contracts compared to the prior year. The increase was also attributable to net gains on the revaluation or settlement of monetary assets and liabilities during the year.

Provision for Income Taxes

	2016	2015	2014
Provision for income taxes	$ 1,243	$ 1,195	$ 1,109
Effective tax rate	34.3%	33.2%	34.7%

In 2015, our provision was favorably impacted by net tax benefits of $68, primarily due to a tax benefit recorded in connection with a special cash dividend paid to employees through our 401(K) Retirement Plan. Dividends paid on these shares are deductible for U.S. income tax purposes.

LIQUIDITY AND CAPITAL RESOURCES

The following table summarizes our significant sources and uses of cash and cash equivalents:

	2016	2015	2014
Net cash provided by operating activities	$ 3,292	$ 4,285	$ 3,984
Net cash used in investing activities	(2,345)	(2,480)	(2,093)
Net cash used in financing activities	(2,419)	(2,324)	(786)

Our primary sources of liquidity are cash flows generated from warehouse operations, cash and cash equivalents and short-term investments. Cash and cash equivalents and short-term investments were $4,729 and $6,419 at the end of 2016 and 2015, respectively. Of these balances, approximately $1,071 and $1,243 at the end of 2016 and 2015, respectively, represented unsettled credit and debit card receivables. These receivables generally settle within one week. Cash and cash equivalents were positively impacted by changes in exchange rates by $50 in 2016 and negatively impacted by $418 and $11 in 2015 and 2014, respectively.

We have not provided for U.S. deferred taxes on cumulative undistributed earnings of certain non-U.S. consolidated subsidiaries, including the remaining undistributed earnings of our Canadian operations, because our subsidiaries have invested or will invest the undistributed earnings indefinitely, or the earnings, if repatriated would not result in an adverse tax consequence. Although we have historically asserted that certain non-U.S. undistributed earnings will be permanently reinvested, we may repatriate such earnings to the extent we can do so without an adverse tax consequence. If we determine that such earnings are no longer indefinitely reinvested, deferred taxes, to the extent required and applicable, are recorded at that time. During 2016, we repatriated the earnings in our Canadian operations that in 2015 were no longer considered indefinitely reinvested. Subsequent to the end of the fiscal year, we determined that a portion of the undistributed earnings in our Canadian operations could be repatriated without adverse tax consequences. Accordingly, we no longer consider that portion to be indefinitely reinvested.

Management believes that our cash position and operating cash flows will be sufficient to meet our liquidity and capital requirements for the foreseeable future. We believe that our U.S. current and projected asset position is sufficient to meet our U.S. liquidity requirements and have no current plans to repatriate for use in the U.S. cash and cash equivalents and short-term investments held by these non-U.S. consolidated subsidiaries whose earnings are considered indefinitely reinvested. Cash and cash equivalents and short-term investments held at these subsidiaries with earnings considered to be indefinitely reinvested totaled $1,535 at August 28, 2016.

Cash Flows from Operating Activities

Net cash provided by operating activities totaled $3,292 in 2016, compared to $4,285 in 2015. Our cash flow provided by operations is primarily derived from net sales and membership fees. Cash flow used in operations generally consists of payments to our merchandise vendors, warehouse operating costs including payroll and employee benefits, credit and debit card processing fees, and utilities. Cash used in operations also includes payments for income taxes. The decrease in net cash provided by operating activities for 2016 when compared to 2015 was primarily due to accelerated vendor payments of approximately $1,700 made in the last week of fiscal 2016, in advance of implementing our modernized accounting system at the beginning of fiscal 2017.

Cash Flows from Investing Activities

Net cash used in investing activities totaled $2,345 in 2016 compared to $2,480 in 2015. Cash flow used in investing activities is primarily related to funding warehouse expansion and remodeling activities. Net cash flows from investing activities also included purchases and maturities of short-term investments.

Capital Expenditure Plans

We opened 29 new warehouses and relocated four warehouses in 2016 and plan to open up to 31 new warehouses and relocate up to three warehouses in 2017. Our primary requirement for capital is acquiring land, buildings, and equipment for new and remodeled warehouses. To a lesser extent, capital is required for initial warehouse operations, the modernization of our information systems, and working capital. In 2016 we spent $2,649 on capital expenditures, and it is our current intention to spend approximately $2,600 to $2,800 during fiscal 2017. These expenditures are expected to be financed with cash from operations, existing cash and cash equivalents, and short-term investments. There can be no assurance that current expectations will be realized and plans are subject to change upon further review of our capital expenditure needs.

Cash Flows from Financing Activities

Net cash used in financing activities totaled $2,419 in 2016 compared to $2,324 in 2015. The primary uses of cash in 2016 were related to the $1,200 repayment of our 0.65% Senior Notes in December 2015, dividend payments of $746, repurchases of common stock, and payment of withholding taxes on stock-based awards. Net cash used in financing activities in 2015 included a $5.00 per share special cash dividend, totaling approximately $2,201, partially offset by the issuance of $1,000 in Senior Notes.

In March 2016, our Japanese subsidiary issued approximately $103 of 0.63% Guaranteed Senior Notes through a private placement. Additionally, in June 2016, our Japanese subsidiary issued approximately $93 of zero percent Guaranteed Senior Notes through a private placement. Interest on both issuances are payable semi-annually, and principal is due in March 2026 and June 2021, respectively.

Stock Repurchase Programs

During 2016 and 2015, we repurchased 3,184,000 and 3,456,000 shares of common stock, at an average price of $149.90 and $142.87, totaling approximately $477 and $494, respectively. The remaining amount available to be purchased under our approved plan was $3,222 at the end of 2016. Purchases are made from time-to-time, as conditions warrant, in the open market or in block purchases and pursuant to plans under SEC Rule 10b5-1. Repurchased shares are retired, in accordance with the Washington Business Corporation Act.

Dividends

Cash dividends paid in 2016 totaled $1.70 per share, as compared to $6.51 per share in 2015, which included a special cash dividend of $5.00 per share. In April 2016, our Board of Directors increased our quarterly cash dividend from $0.40 to $0.45 per share.

Bank Credit Facilities and Commercial Paper Programs

We maintain bank credit facilities for working capital and general corporate purposes. At August 28, 2016, we had borrowing capacity within these facilities of $429, of which $358 was maintained by our international operations. Of the $358, $177 is guaranteed by the Company. There were no outstanding short-term borrowings under the bank credit facilities at the end of 2016 and 2015.

The Company has letter of credit facilities, for commercial and standby letters of credit, totaling $153. The outstanding commitments under these facilities at the end of 2016 totaled $96, including $94 in standby letters of credit with expiration dates within one year. The bank credit facilities have various expiration dates, all within one year, and we generally intend to renew these facilities prior to their expiration. The amount of borrowings available at any time under our bank credit facilities is reduced by the amount of standby and commercial letters of credit then outstanding.

Contractual Obligations

As of August 28, 2016, our commitments to make future payments under contractual obligations were as follows:

	Payments Due by Fiscal Year				
Contractual obligations	2017	2018 to 2019	2020 to 2021	2022 and thereafter	Total
Purchase obligations (merchandise)[1]	$ 6,828	$ 3	$ —	$ —	$ 6,831
Long-term debt[2]	1,221	1,392	1,845	998	5,456
Operating leases [3]	200	379	337	2,204	3,120
Construction and land obligations	700	57	—	—	757
Capital lease obligations[4]	31	61	63	593	748
Purchase obligations (equipment, services and other)[5]	458	98	61	1	618
Other[6]	18	26	11	71	126
Total	$ 9,456	$ 2,016	$ 2,317	$ 3,867	$ 17,656

(1) Includes only open merchandise purchase orders.
(2) Includes contractual interest payments and excludes deferred issuance costs.
(3) Operating lease obligations exclude amounts for common area maintenance, taxes, and insurance and have been reduced by $129 to reflect sub-lease income.
(4) Includes build-to-suit lease obligations and contractual interest payments.
(5) The amounts exclude certain services negotiated at the individual warehouse or regional level that are not significant and generally contain clauses allowing for cancellation without significant penalty.
(6) Includes $64 in asset retirement obligations, and $62 in deferred compensation obligations. The total amount excludes $51 of non-current unrecognized tax contingencies and $29 of other obligations due to uncertainty regarding the timing of future cash payments.

Off-Balance Sheet Arrangements

In the opinion of management, we have no off-balance sheet arrangements, that have had, or are reasonably likely to have, a material current or future effect on our financial condition or financial statements other than the operating leases included in the table above and discussed in Note 1 and Note 5 to the consolidated financial statements included in this Report.

Critical Accounting Estimates

The preparation of our consolidated financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP) requires that we make estimates and judgments, including those related to revenue recognition, merchandise inventory valuation, impairment of long-lived assets, insurance/self-insurance liabilities, and income taxes. We base our estimates on historical experience and on assumptions that we believe to be reasonable, and we continue to review and evaluate these statements. For further information on significant accounting policies, see discussion in Note 1 to the consolidated financial statements included in this Report.

Revenue Recognition

We generally recognize sales, which include shipping fees where applicable, net of returns, at the time the member takes possession of merchandise or receives services. When we collect payment from members prior to the transfer of ownership of merchandise or the performance of services, the amount is generally recorded as deferred sales in the consolidated balance sheets until the sale or service is completed. We provide for estimated sales returns based on historical trends and reduce sales and merchandise costs accordingly. Our sales returns reserve is based on an estimate of the net realizable value of merchandise inventories to be returned. Amounts collected from members for sales and value added taxes are recorded on a net basis.

We evaluate whether it is appropriate to record the gross amount of merchandise sales and related costs or a net amount. Generally, when we are the primary obligor, subject to inventory risk, have latitude in establishing prices and selecting suppliers, influence product or service specifications, or have several but not all of these indicators, revenue is recorded on a gross basis. If we are not the primary obligor and do not possess other indicators of gross reporting as noted above, we record a net amount, which is reflected in net sales. We record related shipping fees on a gross basis.

We account for membership fee revenue, net of refunds, on a deferred basis, whereby revenue is recognized ratably over one year. Our Executive members qualify for a 2% reward on qualified purchases (up to a maximum reward of approximately $750 per year in the U.S. and Canada and varies in our Other International operations), which can be redeemed only at Costco warehouses. We account for this reward as a reduction in sales. The sales reduction and corresponding liability are computed after giving effect to the estimated impact of non-redemptions based on historical data.

Merchandise Inventories

Merchandise inventories are valued at the lower of cost or market, as determined primarily by the retail inventory method, and are stated using the last-in, first-out (LIFO) method for substantially all U.S. merchandise inventories. Merchandise inventories for all foreign operations are primarily valued by the retail inventory method and are stated using the first-in, first-out (FIFO) method. We record an adjustment each quarter, if necessary, for the estimated effect of inflation or deflation, and these estimates are adjusted to actual results determined at year-end. We believe the LIFO method more fairly presents the results of operations by more closely matching current costs with current revenues.

We provide for estimated inventory losses (shrink) between physical inventory counts as a percentage of net sales. The provision is adjusted to reflect results of the actual physical inventory counts, which generally occur in the second and fourth quarters of the year.

Inventory cost, where appropriate, is reduced by estimates of vendor rebates when earned or as we progress toward earning those rebates, provided they are probable and reasonably estimable. Other consideration received from vendors is generally recorded as a reduction of merchandise costs upon completion of contractual milestones, terms of agreement, or other systematic approaches.

Impairment of Long-Lived Assets

We evaluate our long-lived assets for impairment on an annual basis, when relocating or closing a facility, or when events or changes in circumstances occur that may indicate the carrying amount of the asset group, generally an individual warehouse, may not be fully recoverable. Our judgments are based on existing market and operational conditions. Future events could cause us to conclude that impairment factors exist, requiring a downward adjustment of these assets to their then-current fair value.

Insurance/Self-Insurance Liabilities

We use a combination of insurance and self-insurance mechanisms, including for certain risks, a wholly-owned captive insurance subsidiary and participation in a reinsurance program, to provide for potential liabilities for workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, and employee health care benefits. Liabilities associated with the risks that we retain are not discounted and are estimated, in part, by considering historical claims experience, demographic factors, severity factors and other actuarial assumptions. The estimated accruals for these liabilities could be significantly affected if future occurrences and claims differ from these assumptions and historical trends.

Income Taxes

The determination of our provision for income taxes requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. Significant judgment is required in assessing the timing and amounts of deductible and taxable items and the probability of sustaining uncertain tax positions. The benefits associated with uncertain tax positions are recorded in our consolidated financial statements only after determining a more-likely-than-not probability that the positions will withstand challenge from tax authorities. When facts and circumstances change, we reassess these positions and record any changes in the consolidated financial statements as appropriate. Additionally, our cumulative foreign undistributed earnings were considered indefinitely reinvested as of August 28, 2016. These earnings would be subject to U.S. income tax if we changed our position and could result in a U.S. deferred tax liability. Although we have historically asserted that certain non-U.S. undistributed earnings will be permanently reinvested, we may repatriate such earnings to the extent we can do so without an adverse tax consequence.

Recent Accounting Pronouncements

See Note 1 to the consolidated financial statements included in this Report for a detailed description of recent accounting pronouncements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK (amounts in millions)

Our exposure to financial market risk results from fluctuations in interest rates and foreign currency exchange rates. We do not engage in speculative or leveraged transactions or hold or issue financial instruments for trading purposes.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment holdings that are diversified among various instruments considered to be cash equivalents as defined in Note 1 to the consolidated financial statements included in this Report, as well as short-term investments in government and agency securities, and asset and mortgage-backed securities with effective maturities of generally three months to five years at the date of purchase. The primary objective of our investment activities is to preserve principal and secondarily to generate yields. The majority of our short-term investments are in fixed interest rate securities. These securities are subject to changes in fair value due to interest rate fluctuations.

Our policy limits investments in the U.S. to direct U.S. government and government agency obligations, repurchase agreements collateralized by U.S. government and government agency obligations, and U.S. government and government agency money market funds. Our wholly-owned captive insurance subsidiary invests in U.S. government and government agency obligations, corporate notes and bonds, and asset and mortgage-backed securities with a minimum overall portfolio average credit rating of AA+. Our Canadian and Other International subsidiaries' investments are primarily in money market funds, bankers' acceptances, and bank certificates of deposit, generally denominated in local currencies.

A 100 basis-point change in interest rates as of the end of 2016 would have an incremental change in fair market value of $22. For those investments that are classified as available-for-sale, the unrealized gains or losses related to fluctuations in market volatility and interest rates are reflected within stockholders' equity in accumulated other comprehensive income.

The nature and amount of our long-term debt may vary as a result of business requirements, market conditions, and other factors. As of the end of 2016, the majority of our long-term debt is fixed rate Senior Notes, carried at $4,390. Fluctuations in interest rates may affect the fair value of the fixed-rate debt. See Note 4 to the consolidated financial statements included in this Report for more information on our long-term debt.

Foreign Currency-Exchange Risk

Our foreign subsidiaries conduct certain transactions in their non-functional currencies, which exposes us to fluctuations in exchange rates. We manage these fluctuations, in part, through the use of forward foreign-exchange contracts, seeking to economically hedge the impact of these fluctuations on known future expenditures denominated in a non-functional foreign-currency. The contracts are intended primarily to economically hedge exposure to U.S. dollar merchandise inventory expenditures made by our international subsidiaries whose functional currency is other than the U.S. dollar. Currently, these contracts do not qualify for derivative hedge accounting. We seek to mitigate risk with the use of these contracts and do not intend to engage in speculative transactions. These contracts do not contain any credit-risk-related contingent features.

We seek to manage counterparty risk associated with these contracts by limiting transactions to counterparties with which we have established banking relationships. There can be no assurance that this practice is effective. These contracts are limited to less than one year. See Note 1 and Note 3 to the consolidated financial statements included in this Report for additional information on the fair value of unsettled forward foreign-exchange contracts at the end of 2016 and 2015. A hypothetical 10% strengthening of the functional currency compared to the non-functional currency exchange rates at August 28, 2016 would have decreased the fair value of the contracts by $56 and resulted in an unrealized loss in the consolidated statements of income for the same amount.

Commodity Price Risk

We are exposed to fluctuations in prices for energy that we consume, particularly electricity and natural gas, which we seek to partially mitigate through fixed-price contracts for certain of our warehouses and other facilities, predominately in the U.S. and Canada. We also enter into variable-priced contracts for some purchases of electricity and natural gas, in addition to fuel for our gas stations, on an index basis. These contracts meet the characteristics of derivative instruments, but generally qualify for the "normal purchases or normal sales" exception under authoritative guidance and require no mark-to-market adjustment.

Other Information

In February 2015, we entered into a Co-Branded Credit Card Program Agreement (the "Program Agreement") with Citibank, N.A. ("Citi"). Under the terms of the Program Agreement, Citi became the exclusive issuer of our co-branded credit cards to our members. Additionally, Visa U.S.A. Inc. became the credit card network for Costco in the United States and Puerto Rico. Citi purchased the current co-branded credit card portfolio from American Express in June 2016. On June 20, 2016, we began accepting all Visa cards, including the Citi co-branded credit cards, replacing American Express. We receive various forms of consideration under the Program Agreement. The initial term of the Program Agreement is ten years.

Under the Program Agreement, Costco earns a royalty on purchases made with the co-branded card other than from Costco ("external spend"). The royalty varies based on the amount of external spend in relation to total spend. In addition, Costco will fund a portion of the loyalty reward cardholders earn under the program on external spend. Loyalty rewards under the program are as follows: 4% on eligible gasoline purchases, 3% on restaurant and eligible travel purchases, 2% on all purchases from Costco and Costco.com, and 1% on all other purchases. These rewards may be adjusted over the term of the program. The loyalty rewards earned by co-branded cardholders will be in the form of certificates redeemable at Costco, for cash or merchandise. Costco also receives a bounty on approved new credit card accounts acquired through Costco channels. Additionally, the base discount Costco pays related to Visa acceptance is lower than previously paid for American Express acceptance.

EXECUTIVE OFFICERS AND CORPORATE GOVERANCE

The executive officers of Costco, their position, and ages are listed below. All executive officers have 25 or more years of service with the Company.

Name	Position	Executive Officer Since	Age
W. Craig Jelinek	President and Chief Executive Officer. Mr. Jelinek has been President and Chief Executive Officer since January 2012 and a director since February 2010. He was President and Chief Operating Officer from February 2010 to December 2011. Prior to that he was Executive Vice President, Chief Operating Officer, Merchandising since 2004.	1995	64
Jeffrey H. Brotman	Chairman of the Board. Mr. Brotman is a co-founder of Costco and has been a director since its inception.	1983	74
Richard A. Galanti	Executive Vice President and Chief Financial Officer. Mr. Galanti has been a director since January 1995.	1993	60
Franz E. Lazarus	Executive Vice President, Administration. Mr. Lazarus was Senior Vice President, Administration-Global Operations from 2006 to September 2012.	2012	69
John D. McKay	Executive Vice President, Chief Operating Officer, Northern Division. Mr. McKay was Senior Vice President, General Manager, Northwest Region from 2000 to March 2010.	2010	59
Paul G. Moulton	Executive Vice President, Chief Information Officer. Mr. Moulton was Executive Vice President, Real Estate Development from 2001 until March 2010.	2001	65
James P. Murphy	Executive Vice President, Chief Operating Officer, International. Mr. Murphy was Senior Vice President, International, from 2004 to October 2010.	2011	63
Joseph P. Portera	Executive Vice President, Chief Operating Officer, Eastern and Canadian Divisions. Mr. Portera has held these positions since 1994, and has been the Chief Diversity Officer since 2010.	1994	64
Timothy L. Rose	Executive Vice President, Ancillary Businesses, Manufacturing, and Business Centers. Mr. Rose was Senior Vice President, Merchandising, Food and Sundries and Private Label from 1995 to December 2012.	2013	64
Ron M. Vachris	Executive Vice President, Chief Operating Officer, Merchandising. Mr. Vachris was Senior Vice President, Real Estate Development, from August 2015 to June 2016, and Senior Vice President, General Manager, Northwest Region from 2010 to July 2015.	2016	51
Dennis R. Zook	Executive Vice President, Chief Operating Officer, Southwest Division and Mexico.	1993	67

We have adopted a code of ethics for senior financial officers pursuant to Section 406 of the Sarbanes-Oxley Act. Copies of the code are available free of charge, by writing to Secretary, Costco Wholesale Corporation, 999 Lake Drive, Issaquah, WA 98027. If the Company makes any amendments to this code (other than technical, administrative, or non-substantive amendments) or grants any waivers, including implicit waivers, from this code to the CEO, chief financial officer or principal accounting officer and controller, we will disclose (on our website or in a Form 8-K report filed with the SEC) the nature of the amendment or waiver, its effective date, and to whom it applies.

Executive Compensation

Information related to our Executive Compensation and Director Compensation is incorporated herein by reference to Costco's Proxy Statement filed with the Securities and Exchange Commission.

MANAGEMENT'S REPORTS

Management’s Report on the Consolidated Financial Statements

Costco’s management is responsible for the preparation, integrity and objectivity of the accompanying consolidated financial statements and the related financial information. The consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles (U.S. GAAP) and necessarily include certain amounts that are based on estimates and informed judgments. The Company’s management is also responsible for the preparation of the related financial information included in this Annual Report on Form 10-K and its accuracy and consistency with the consolidated financial statements.

The consolidated financial statements have been audited by KPMG LLP, an independent registered public accounting firm, who conducted their audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). The independent registered public accounting firm’s responsibility is to express an opinion as to the fairness with which such consolidated financial statements present our financial position, results of operations and cash flows in accordance with U.S. GAAP.

Disclosure Controls and Procedures

As of the end of the period covered by this Annual Report on Form 10-K, we performed an evaluation under the supervision and with the participation of management, including our Chief Executive Officer and Chief Financial Officer, of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities and Exchange Act of 1934 (the Exchange Act)). Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of the end of the period covered by this Annual Report, our disclosure controls and procedures are effective.

There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) or 15d-15(f) of the Exchange Act) during our fiscal quarter ended August 28, 2016, that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

Management’s Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Exchange Act. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with U.S. GAAP and includes those policies and procedures that: (1) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect our transactions and the dispositions of our assets; (2) provide reasonable assurance that our transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles and that our receipts and expenditures are being made only in accordance with appropriate authorizations; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Under the supervision and with the participation of our management, we assessed the effectiveness of our internal control over financial reporting as of August 28, 2016, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework (2013). Based on its assessment, management has concluded that our internal control over financial reporting was effective as of August 28, 2016. The attestation of KPMG LLP, our independent registered public accounting firm, on the effectiveness of our internal control over financial reporting is included with the consolidated financial statements in this Report.

W. Craig Jelinek
President, Chief Executive Officer and Director

Richard A. Galanti
Executive Vice President, Chief Financial Officer and Director

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Costco Wholesale Corporation:

We have audited the accompanying consolidated balance sheets of Costco Wholesale Corporation and subsidiaries as of August 28, 2016 and August 30, 2015, and the related consolidated statements of income, comprehensive income, equity, and cash flows for the 52-week periods ended August 28, 2016, August 30, 2015 and August 31, 2014. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (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 audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Costco Wholesale Corporation and subsidiaries as of August 28, 2016 and August 30, 2015, and the results of their operations and their cash flows for the 52-week periods ended August 28, 2016, August 30, 2015 and August 31, 2014, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Costco Wholesale Corporation's internal control over financial reporting as of August 28, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated October 11, 2016 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

KPMG LLP

Seattle, Washington
October 11, 2016

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Costco Wholesale Corporation:

We have audited Costco Wholesale Corporation's internal control over financial reporting as of August 28, 2016, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying management's annual report on internal control over financial reporting included in Item 9A. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of August 28, 2016, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of August 28, 2016 and August 30, 2015, and the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the 52-week periods ended August 28, 2016, August 30, 2015 and August 31, 2014, and our report dated October 11, 2016 expressed an unqualified opinion on those consolidated financial statements.

KPMG LLP

Seattle, Washington
October 11, 2016

COSTCO WHOLESALE CORPORATION

CONSOLIDATED BALANCE SHEETS
(amounts in millions, except par value and share data)

	August 28, 2016	August 30, 2015
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$3,379	$4,801
Short-term investments	1,350	1,618
Receivables, net	1,252	1,224
Merchandise inventories	8,969	8,908
Other current assets	268	228
Total current assets	15,218	16,779
PROPERTY AND EQUIPMENT		
Land	5,395	4,961
Buildings and improvements	13,994	12,618
Equipment and fixtures	6,077	5,274
Construction in progress	701	811
	26,167	23,664
Less accumulated depreciation and amortization	(9,124)	(8,263)
Net property and equipment	17,043	15,401
OTHER ASSETS	902	837
TOTAL ASSETS	$33,163	$33,017
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	$7,612	$9,011
Current portion of long-term debt	1,100	1,283
Accrued salaries and benefits	2,629	2,468
Accrued member rewards	869	813
Deferred membership fees	1,362	1,269
Other current liabilities	2,003	1,695
Total current liabilities	15,575	16,539
LONG-TERM DEBT, excluding current portion	4,061	4,852
OTHER LIABILITIES	1,195	783
Total liabilities	20,831	22,174
COMMITMENTS AND CONTINGENCIES		
EQUITY		
Preferred stock $.005 par value; 100,000,000 shares authorized; no shares issued and outstanding	0	0
Common stock $.005 par value; 900,000,000 shares authorized; 437,524,000 and 437,952,000 shares issued and outstanding	2	2
Additional paid-in capital	5,490	5,218
Accumulated other comprehensive loss	(1,099)	(1,121)
Retained earnings	7,686	6,518
Total Costco stockholders' equity	12,079	10,617
Noncontrolling interests	253	226
Total equity	12,332	10,843
TOTAL LIABILITIES AND EQUITY	$33,163	$33,017

The accompanying notes are an integral part of these consolidated financial statements.

COSTCO WHOLESALE CORPORATION

CONSOLIDATED STATEMENTS OF INCOME
(amounts in millions, except per share data)

	52 Weeks Ended August 28, 2016	52 Weeks Ended August 30, 2015	52 Weeks Ended August 31, 2014
REVENUE			
Net sales	$116,073	$113,666	$110,212
Membership fees	2,646	2,533	2,428
Total revenue	118,719	116,199	112,640
OPERATING EXPENSES			
Merchandise costs	102,901	101,065	98,458
Selling, general and administrative	12,068	11,445	10,899
Preopening expenses	78	65	63
Operating income	3,672	3,624	3,220
OTHER INCOME (EXPENSE)			
Interest expense	(133)	(124)	(113)
Interest income and other, net	80	104	90
INCOME BEFORE INCOME TAXES	3,619	3,604	3,197
Provision for income taxes	1,243	1,195	1,109
Net income including noncontrolling interests	2,376	2,409	2,088
Net income attributable to noncontrolling interests	(26)	(32)	(30)
NET INCOME ATTRIBUTABLE TO COSTCO	$2,350	$2,377	$2,058
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO:			
Basic	$5.36	$5.41	$4.69
Diluted	$5.33	$5.37	$4.65
Shares used in calculation (000's)			
Basic	438,585	439,455	438,693
Diluted	441,263	442,716	442,485
CASH DIVIDENDS DECLARED PER COMMON SHARE	$1.70	$6.51	$1.33

The accompanying notes are an integral part of these consolidated financial statements.

COSTCO WHOLESALE CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(amounts in millions)

	52 Weeks Ended August 28, 2016	52 Weeks Ended August 30, 2015	52 Weeks Ended August 31, 2014
NET INCOME INCLUDING NONCONTROLLING INTERESTS	$2,376	$2,409	$2,088
Foreign-currency translation adjustment and other, net	26	(1,063)	49
Comprehensive income	2,402	1,346	2,137
Less: Comprehensive income attributable to noncontrolling interests	30	14	33
COMPREHENSIVE INCOME ATTRIBUTABLE TO COSTCO	$2,372	$1,332	$2,104

The accompanying notes are an integral part of these consolidated financial statements.

COSTCO WHOLESALE CORPORATION

CONSOLIDATED STATEMENTS OF EQUITY
(amounts in millions)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Costco Stockholders' Equity	Noncontrolling Interests	Total Equity
	Shares (000's)	Amount						
BALANCE AT SEPTEMBER 1, 2013	436,839	$2	$4,670	$(122)	$6,283	$10,833	$179	$11,012
Net income	—	—	—	—	2,058	2,058	30	2,088
Foreign-currency translation adjustment and other, net	—	—	—	46	—	46	3	49
Stock-based compensation	—	—	327	—	—	327	—	327
Stock options exercised, including tax effects	971	—	58	—	—	58	—	58
Release of vested restricted stock units (RSUs), including tax effects	2,770	—	(102)	—	—	(102)	—	(102)
Conversion of convertible notes	18	—	1	—	—	1	—	1
Repurchases of common stock	(2,915)	—	(35)	—	(299)	(334)	—	(334)
Cash dividends declared	—	—	—	—	(584)	(584)	—	(584)
BALANCE AT AUGUST 31, 2014	437,683	2	4,919	(76)	7,458	12,303	212	12,515
Net income	—	—	—	—	2,377	2,377	32	2,409
Foreign-currency translation adjustment and other, net	—	—	—	(1,045)	—	(1,045)	(18)	(1,063)
Stock-based compensation	—	—	394	—	—	394	—	394
Stock options exercised, including tax effects	989	—	69	—	—	69	—	69
Release of vested RSUs, including tax effects	2,736	—	(122)	—	—	(122)	—	(122)
Repurchases of common stock	(3,456)	—	(42)	—	(452)	(494)	—	(494)
Cash dividends declared	—	—	—	—	(2,865)	(2,865)	—	(2,865)
BALANCE AT AUGUST 30, 2015	437,952	2	5,218	(1,121)	6,518	10,617	226	10,843
Net income	—	—	—	—	2,350	2,350	26	2,376
Foreign-currency translation adjustment and other, net	—	—	—	22	—	22	4	26
Stock-based compensation	—	—	459	—	—	459	—	459
Stock options exercised, including tax effects	4	—	—	—	—	—	—	—
Release of vested RSUs, including tax effects	2,749	—	(146)	—	—	(146)	—	(146)
Conversion of convertible notes	3	—	—	—	—	—	—	—
Repurchases of common stock	(3,184)	—	(41)	—	(436)	(477)	—	(477)
Cash dividends declared and other	—	—	—	—	(746)	(746)	(3)	(749)
BALANCE AT AUGUST 28, 2016	437,524	$2	$5,490	$(1,099)	$7,686	$12,079	$253	$12,332

The accompanying notes are an integral part of these consolidated financial statements.

COSTCO WHOLESALE CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS
(amounts in millions)

	52 Weeks Ended August 28, 2016	52 Weeks Ended August 30, 2015	52 Weeks Ended August 31, 2014
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income including noncontrolling interests	$2,376	$2,409	$2,088
Adjustments to reconcile net income including noncontrolling interests to net cash provided by operating activities:			
Depreciation and amortization	1,255	1,127	1,029
Stock-based compensation	459	394	327
Excess tax benefits on stock-based awards	(74)	(86)	(84)
Other non-cash operating activities, net	17	(5)	22
Deferred income taxes	269	(101)	(63)
Changes in operating assets and liabilities:			
Merchandise inventories	(25)	(890)	(563)
Accounts payable	(1,532)	880	529
Other operating assets and liabilities, net	547	557	699
Net cash provided by operating activities	3,292	4,285	3,984
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of short-term investments	(1,432)	(1,501)	(2,503)
Maturities and sales of short-term investments	1,709	1,434	2,406
Additions to property and equipment	(2,649)	(2,393)	(1,993)
Other investing activities, net	27	(20)	(3)
Net cash used in investing activities	(2,345)	(2,480)	(2,093)
CASH FLOWS FROM FINANCING ACTIVITIES			
Change in bank checks outstanding	81	(45)	96
Repayments of short-term borrowings	(106)	(51)	(103)
Proceeds from short-term borrowings	106	51	68
Proceeds from issuance of long-term debt	185	1,125	117
Repayments of long-term debt	(1,288)	(1)	0
Minimum tax withholdings on stock-based awards	(220)	(178)	(164)
Excess tax benefits on stock-based awards	74	86	84
Repurchases of common stock	(486)	(481)	(334)
Cash dividend payments	(746)	(2,865)	(584)
Other financing activities, net	(19)	35	34
Net cash used in financing activities	(2,419)	(2,324)	(786)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	50	(418)	(11)
Net change in cash and cash equivalents	(1,422)	(937)	1,094
CASH AND CASH EQUIVALENTS BEGINNING OF YEAR	4,801	5,738	4,644
CASH AND CASH EQUIVALENTS END OF YEAR	$3,379	$4,801	$5,738
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest (reduced by $19 , $14, and $11, interest capitalized in 2016, 2015, and 2014, respectively)	$123	$117	$109
Income taxes, net	$953	$1,186	$869
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:			
Property acquired under build-to-suit and capital leases	$15	$109	$0

The accompanying notes are an integral part of these consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(amounts in millions, except share, per share, and warehouse count data)

Note 1—Summary of Significant Accounting Policies

Description of Business

Costco Wholesale Corporation (Costco or the Company), a Washington corporation, and its subsidiaries operate membership warehouses based on the concept that offering members low prices on a limited selection of nationally branded and private-label products in a wide range of merchandise categories will produce high sales volumes and rapid inventory turnover. At August 28, 2016, Costco operated 715 warehouses worldwide: 501 United States (U.S.) locations (in 44 U.S. states, Washington, D.C., and Puerto Rico), 91 Canada locations, 36 Mexico locations, 28 United Kingdom (U.K.) locations, 25 Japan locations, 12 Korea locations, 12 Taiwan locations, eight Australia locations, and two Spain locations. The Company's online business operates websites in all countries except Japan, Australia, and Spain.

Basis of Presentation

The consolidated financial statements include the accounts of Costco Wholesale Corporation, its wholly-owned subsidiaries, and subsidiaries in which it has a controlling interest. The Company reports noncontrolling interests in consolidated entities as a component of equity separate from the Company's equity. All material inter-company transactions between and among the Company and its consolidated subsidiaries have been eliminated in consolidation. The Company's net income excludes income attributable to noncontrolling interests in its operations in Taiwan and Korea. Unless otherwise noted, references to net income relate to net income attributable to Costco.

Fiscal Year End

The Company operates on a 52/53 week fiscal year basis with the fiscal year ending on the Sunday closest to August 31. References to 2016, 2015, and 2014 relate to the 52-week fiscal years ended August 28, 2016, August 30, 2015, and August 31, 2014, respectively.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions.

Reclassifications

Certain reclassifications have been made to prior fiscal year amounts or balances to conform to the presentation in the current fiscal year. These reclassifications did not have a material impact on the Company's previously reported consolidated financial statements.

Cash and Cash Equivalents

The Company considers as cash and cash equivalents all cash on deposit, highly liquid investments with a maturity of three months or less at the date of purchase, and proceeds due from credit and debit card transactions with settlement terms of up to one week. Credit and debit card receivables were $1,071 and $1,243 at the end of 2016 and 2015, respectively.

Short-Term Investments

In general, short-term investments have a maturity at the date of purchase of three months to five years. Investments with maturities beyond five years may be classified, based on the Company's determination, as short-term based on their highly liquid nature and because they represent the investment of cash that is available for current operations. Short-term investments classified as available-for-sale are recorded at fair value using the specific identification method with the unrealized gains and losses reflected in accumulated other comprehensive income (loss) until realized. Realized gains and losses from the sale of available-for-sale securities, if any, are determined on a specific identification basis and are recorded in interest income and other, net in the consolidated statements of income. Short-term investments classified as held-to-maturity are financial instruments that the Company has the intent and ability to hold to maturity and are reported net of any related amortization and are not remeasured to fair value on a recurring basis.

The Company periodically evaluates unrealized losses in its investment securities for other-than-temporary impairment, using both qualitative and quantitative criteria. In the event a security is deemed to be other-than-temporarily impaired, the Company recognizes the credit loss component in interest income and other, net in the consolidated statements of income.

Fair Value of Financial Instruments

The Company accounts for certain assets and liabilities at fair value. The carrying value of the Company's financial instruments, including cash and cash equivalents, receivables and accounts payable, approximate fair value due to their short-term nature or variable interest rates. See Notes 2, 3, and 4 for the carrying value and fair value of the Company's investments, derivative instruments, and fixed-rate debt, respectively.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is estimated by applying a fair value hierarchy, which requires maximizing the use of observable inputs when measuring fair value. The three levels of inputs are:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Observable market-based inputs or unobservable inputs that are corroborated by market data.

Level 3: Significant unobservable inputs that are not corroborated by market data.

The Company's valuation techniques used to measure the fair value of money market mutual funds are based on quoted market prices, such as quoted net asset values published by the fund as supported in an active market. Valuation methodologies used to measure the fair value of all other non-derivative financial instruments are based on independent external valuation information. The pricing process uses data from a variety of independent external valuation information providers, including trades, bid price or spread, two-sided markets, quotes, benchmark curves including but not limited to treasury benchmarks and Libor and swap curves, discount rates, and market data feeds. All are observable in the market or can be derived principally from or corroborated by observable market data. The Company reports transfers in and out of Levels 1, 2, and 3, as applicable, using the fair value of the individual securities as of the beginning of the reporting period in which the transfer(s) occurred.

Current financial liabilities have fair values that approximate their carrying values. Long-term financial liabilities consist of long-term debt, which is recorded on the balance sheet at issuance price and adjusted for any applicable unamortized discounts or premiums and debt issuance costs.

Receivables, Net

Receivables consist of the following at the end of 2016 and 2015:

	2016	2015
Vendor receivables	$ 755	$ 729
Reinsurance receivables	270	273
Third-party pharmacy receivables	99	103
Other receivables, net	128	119
Receivables, net	$ 1,252	$ 1,224

Vendor receivables include volume rebates or other purchase discounts. Balances are generally presented on a gross basis, separate from any related payable due. In certain circumstances, these receivables may be settled against the related payable to that vendor. Reinsurance receivables are held by the Company's wholly-owned captive insurance subsidiary. The balance primarily represents amounts ceded through reinsurance arrangements gross of the amounts assumed under reinsurance, which are presented within other current liabilities in the consolidated balance sheets. Third-party pharmacy receivables generally relate to amounts due from members' insurance companies. Other receivables primarily consist of amounts due from governmental entities, mostly tax-related items.

Receivables are recorded net of an allowance for doubtful accounts. The allowance is based on historical experience and application of the specific identification method. Write-offs of receivables were immaterial for fiscal years 2016, 2015, and 2014.

Merchandise Inventories

Merchandise inventories consist of the following at the end of 2016 and 2015:

	2016	2015
United States	$ 6,422	$ 6,427
Foreign	2,547	2,481
Merchandise inventories	$ 8,969	$ 8,908

Merchandise inventories are valued at the lower of cost or market, as determined primarily by the retail inventory method, and are stated using the last-in, first-out (LIFO) method for substantially all U.S. merchandise inventories. Merchandise inventories for all foreign operations are primarily valued by the retail inventory method and are stated using the first-in, first-out (FIFO) method. The Company believes the LIFO method more fairly presents the results of operations by more closely matching current costs with current revenues. The Company records an adjustment each quarter, if necessary, for the projected annual effect of inflation or deflation, and these estimates are adjusted to actual results determined at year-end, after actual inflation rates and inventory levels for the year have been determined.

Due to net deflationary trends, a benefit of $64 and $27 was recorded to merchandise costs in 2016 and 2015, respectively. Due to net inflationary trends in 2014, a charge of $28 was recorded to merchandise costs to increase the cumulative LIFO valuation on merchandise inventories. At the end of 2016 and 2015, the cumulative impact of the LIFO valuation on merchandise inventories was immaterial and $82, respectively.

The Company provides for estimated inventory losses between physical inventory counts as a percentage of net sales, using estimates based on the Company's experience. The provision is adjusted periodically to reflect actual physical inventory counts, which generally occur in the second and fourth fiscal quarters. Inventory cost, where appropriate, is reduced by estimates of vendor rebates when earned or as the Company progresses towards earning those rebates, provided that they are probable and reasonably estimable.

Property and Equipment

Property and equipment are stated at cost. In general, new building additions are classified into components, each with its own estimated useful life, generally five to fifty years for buildings and improvements and three to twenty years for equipment and fixtures. Depreciation and amortization expense is computed using the straight-line method over estimated useful lives or the lease term, if shorter. Leasehold improvements made after the beginning of the initial lease term are depreciated over the shorter of the estimated useful life of the asset or the remaining term of the initial lease plus any renewals that are reasonably assured at the date the leasehold improvements are made.

The Company capitalizes certain computer software and software development costs incurred in developing or obtaining computer software for internal use. These costs are included in equipment and fixtures and amortized on a straight-line basis over the estimated useful lives of the software, generally three to seven years.

Repair and maintenance costs are expensed when incurred. Expenditures for remodels, refurbishments and improvements that add to or change the way an asset functions or that extend the useful life are capitalized. Assets that were removed during the remodel, refurbishment or improvement are retired. Assets classified as held-for-sale at the end of 2016 and 2015 were immaterial.

The Company evaluates long-lived assets for impairment on an annual basis, when relocating or closing a facility, or when events or changes in circumstances may indicate the carrying amount of the asset group, generally an individual warehouse, may not be fully recoverable. For asset groups held and used, including warehouses to be relocated, the carrying value of the asset group is considered recoverable when the estimated future undiscounted cash flows generated from the use and eventual disposition of the asset group exceed the respective carrying value. In the event that the carrying value is not considered recoverable, an impairment loss would be recognized for the asset group to be held and used equal to the excess of the carrying value above the estimated fair value of the asset group. For asset groups classified as held-for-sale (disposal group), the carrying value is compared to the disposal group's fair value less costs to sell. The Company estimates fair value by obtaining market appraisals from third party brokers or using other valuation techniques. There were no impairment charges recognized in 2016, and charges were immaterial and included in selling, general and administrative expenses in the consolidated statements of income in 2015 and 2014.

Accounts Payable

The Company's banking system provides for the daily replenishment of major bank accounts as checks are presented. Included in accounts payable at the end of 2016 and 2015 are $619 and $538, respectively, representing the excess of outstanding checks over cash on deposit at the banks on which the checks were drawn. The Company accelerated vendor payments of approximately $1,700 in the last week of fiscal 2016 in advance of implementing its modernized accounting system at the beginning of fiscal 2017.

Insurance/Self-Insurance Liabilities

The Company uses a combination of insurance and self-insurance mechanisms, including for certain risks a wholly-owned captive insurance subsidiary and participation in a reinsurance program, to provide for potential liabilities for workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, and employee health care benefits. Liabilities associated with the risks that are retained by the Company are not discounted and are estimated, in part, by considering historical claims experience, demographic factors, severity factors, and other actuarial assumptions. The estimated accruals for these liabilities could be significantly affected if future occurrences and claims differ from these assumptions and historical trends. At the end of 2016 and 2015, these insurance liabilities were $1,021 and $993 in the aggregate, respectively, and were included in accrued salaries and benefits and other current liabilities in the consolidated balance sheets, classified based on their nature.

The Company's wholly-owned captive insurance subsidiary (the captive) receives direct premiums, which are netted against the Company's premium costs in selling, general and administrative expenses, in the consolidated statements of income. The captive participates in a reinsurance program that includes other third-party participants. The reinsurance agreement is one year in duration, and new agreements are entered into by each participant at their discretion at the commencement of the next calendar year. The participant agreements and practices of the reinsurance program limit any participating members' individual risk. Income statement adjustments related to the reinsurance program and related impacts to the consolidated balance sheets are recognized as information becomes known. In the event the Company leaves the reinsurance program, the Company is not relieved of its primary obligation to the policyholders for activity prior to the termination of the annual agreement.

Other Current Liabilities

Other current liabilities consist of the following at the end of 2016 and 2015:

	2016	2015
Accrued sales, income, and other taxes	$ 532	$ 490
Insurance-related liabilities	401	396
Deferred sales	365	299
Cash card liability	254	201
Returns reserve	137	124
Other	314	185
Other current liabilities	$ 2,003	$ 1,695

Derivatives

The Company is exposed to foreign-currency exchange-rate fluctuations in the normal course of business. It manages these fluctuations, in part, through the use of forward foreign-exchange contracts, seeking to economically hedge the impact of fluctuations of foreign exchange on known future expenditures denominated in a non-functional foreign-currency. The contracts relate primarily to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries, with functional currencies other than the U.S. dollar. Currently, these contracts do not qualify for derivative hedge accounting. The Company seeks to mitigate risk with the use of these contracts and does not intend to engage in speculative transactions. These contracts do not contain any credit-risk-related contingent features. The aggregate notional amounts of open, unsettled forward foreign-exchange contracts were $572 and $889 at the end of 2016 and 2015, respectively. The Company seeks to manage counterparty risk associated with these contracts by limiting transactions to counterparties with which the Company has an established banking relationship. There can be no assurance that this practice is effective. The contracts are limited to less than one year in duration. See Note 3 for information on the fair value of unsettled forward foreign-exchange contracts at the end of 2016 and 2015.

The unrealized gains or losses recognized in interest income and other, net in the accompanying consolidated statements of income relating to the net changes in the fair value of unsettled forward foreign-exchange contracts were immaterial in 2016 and 2014, respectively, and a net gain of $12 in 2015.

The Company is exposed to fluctuations in prices for the energy it consumes, particularly electricity and natural gas, which it seeks to partially mitigate through the use of fixed-price contracts for certain of its warehouses and other facilities, primarily in the U.S. and Canada. The Company also enters into variable-priced contracts for some purchases of natural gas, in addition to fuel for its gas stations, on an index basis. These contracts meet the characteristics of derivative instruments, but generally qualify for the "normal purchases or normal sales" exception under authoritative guidance and require no mark-to-market adjustment.

Foreign Currency

The functional currencies of the Company's international subsidiaries are the local currency of the country in which the subsidiary is located. Assets and liabilities recorded in foreign currencies are translated at the exchange rate on the balance sheet date. Translation adjustments are recorded in accumulated other comprehensive loss. Revenues and expenses of the Company's consolidated foreign operations are translated at average exchange rates prevailing during the year.

The Company recognizes foreign-currency transaction gains and losses related to revaluing or settling monetary assets and liabilities denominated in currencies other than the functional currency in interest income and other, net in the accompanying consolidated statements of income. Generally, these include the U.S. dollar cash and cash equivalents and the U.S. dollar payables of consolidated subsidiaries revalued to their functional currency. Also included are realized foreign-currency gains or losses from settlements of forward foreign-exchange contracts. These items resulted in net gains of $38, $35, and $25 for 2016, 2015, and 2014, respectively.

Revenue Recognition

The Company generally recognizes sales, which include shipping fees where applicable, net of returns, at the time the member takes possession of merchandise or receives services. When the Company collects payments from members prior to the transfer of ownership of merchandise or the performance of services, the amounts received are generally recorded as deferred sales, included in other current liabilities in the consolidated balance sheets, until the sale or service is completed. The Company reserves for estimated sales returns based on historical trends in merchandise returns and reduces sales and merchandise costs accordingly. The sales returns reserve is based on an estimate of the net realizable value of merchandise inventories to be returned. Amounts collected from members for sales or value added taxes are recorded on a net basis.

The Company evaluates whether it is appropriate to record the gross amount of merchandise sales and related costs or the net amount earned. Generally, when Costco is the primary obligor, is subject to inventory risk, has latitude in establishing prices and selecting suppliers, can influence product or service specifications, or has several but not all of these indicators, revenue is recorded on a gross basis. If the Company is not the primary obligor and does not possess other indicators of gross reporting as noted above, it records the net amounts earned, which is reflected in net sales. The Company records related shipping fees on a gross basis.

The Company accounts for membership fee revenue, net of refunds, on a deferred basis, ratably over the one-year membership period. The Company's Executive members qualify for a 2% reward on qualified purchases (up to a maximum reward of approximately $750 per year), which can be redeemed only at Costco warehouses. The Company accounts for this reward as a reduction in sales. The sales reduction and corresponding liability (classified as accrued member rewards in the consolidated balance sheets) are computed after giving effect to the estimated impact of non-redemptions based on historical data. The net reduction in sales was $1,172, $1,128, and $1,051 in 2016, 2015, and 2014, respectively.

Merchandise Costs

Merchandise costs consist of the purchase price of inventory sold, inbound and outbound shipping charges and all costs related to the Company's depot operations, including freight from depots to selling warehouses, and are reduced by vendor consideration. Merchandise costs also include salaries, benefits, depreciation, and utilities in fresh foods and certain ancillary departments.

Vendor Consideration

The Company has agreements with vendors to receive funds for volume rebates and a variety of other programs. Volume rebates or other purchase discounts are evidenced by signed agreements that are reflected in the carrying value of the inventory when earned or as the Company progresses towards earning the rebate or discount, and as a component of merchandise costs as the merchandise is sold. Other vendor consideration is generally recorded as a reduction of merchandise costs upon completion of contractual milestones, terms of the related agreement, or by another systematic approach.

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of salaries, benefits and workers' compensation costs for warehouse employees, other than fresh foods departments and certain ancillary businesses, as well as all regional and home office employees, including buying personnel. Selling, general and administrative expenses also include substantially all building and equipment depreciation, credit and debit card processing fees, utilities, and stock-based compensation expense as well as other operating costs incurred to support warehouse operations.

Retirement Plans

The Company's 401(k) Retirement Plan is available to all U.S. employees who have completed 90 days of employment. The plan allows pre-tax deferrals, a portion of which the Company matches. In addition, the Company provides each eligible participant an annual discretionary contribution. The Company also has a defined contribution plan for Canadian employees and contributes a percentage of each employee's salary. Certain subsidiaries in the Company's Other International operations have defined benefit and defined contribution plans that are not material. Amounts expensed under all plans were $489, $454, and $436 for 2016, 2015, and 2014, respectively, and are included in selling, general and administrative expenses and merchandise costs in the accompanying consolidated statements of income.

Stock-Based Compensation

Restricted stock units (RSUs) granted to employees generally vest over five years and allow for quarterly vesting of the pro-rata number of stock-based awards that would vest on the next anniversary of the grant date in the event of retirement or voluntary termination. The Company does not reduce stock-based compensation for an estimate of forfeitures, which are inconsequential in light of historical experience and considering the awards vest on a quarterly basis. Actual forfeitures are recognized as they occur.

Compensation expense for all stock-based awards granted is predominantly recognized using the straight-line method over the requisite service period for the entire award. The terms of the Company's stock-based awards for employees and non-employee directors provide for accelerated vesting of a portion of outstanding shares based on reaching certain cumulative years of service with the Company. Compensation expense for the accelerated shares is recognized upon achievement of the long service term. The cumulative amount of compensation cost recognized at any point in time equals at least the portion of the grant-date fair value of the award that is vested at that date. The fair value of RSUs is calculated as the market value of the common stock on the measurement date less the present value of the expected dividends forgone during the vesting period.

Stock-based compensation expense is predominantly included in selling, general and administrative expenses in the consolidated statements of income. See Note 7 for additional information on the Company's stock-based compensation plans.

Leases

The Company leases land and/or buildings at warehouses and certain other office and distribution facilities, primarily under operating leases. Operating leases expire at various dates through 2064, with the exception of one lease in the Company's U.K. subsidiary, which expires in 2151. These leases generally contain one or more of the following options, which the Company can exercise at the end of the initial lease term: (a) renewal of the lease for a defined number of years at the then-fair market rental rate or rate stipulated in the lease agreement; (b) purchase of the property at the then-fair market value; or (c) right of first refusal in the event of a third-party purchase offer.

The Company accounts for its lease expense with free rent periods and step-rent provisions on a straight-line basis over the original term of the lease and any extension options that the Company more likely than not expects to exercise, from the date the Company has control of the property. Certain leases provide for periodic rental increases based on price indices, or the greater of minimum guaranteed amounts or sales volume.

The Company has capital leases for certain warehouse locations, expiring at various dates through 2054. Capital lease assets are included in land and buildings and improvements in the accompanying consolidated balance sheets. Amortization expense on capital lease assets is recorded as depreciation expense and is predominately included in selling, general and administrative expenses. Capital lease liabilities are recorded at the lesser of the estimated fair market value of the leased property or the net present value of the aggregate future minimum lease payments and are included in other current liabilities and other liabilities in the accompanying consolidated balance sheets. Interest on these obligations is included in interest expense in the consolidated statements of income.

The Company records an asset and related financing obligation for the estimated construction costs under build-to-suit lease arrangements where it is considered the owner for accounting purposes, to the extent the Company is involved in the construction of the building or structural improvements or has construction risk prior to commencement of a lease. Upon occupancy, the Company assesses whether these arrangements qualify for sales recognition under the sale-leaseback accounting guidance. If the Company continues to be the deemed owner, it accounts for the arrangement as a financing lease.

The Company’s asset retirement obligations (ARO) are primarily related to leasehold improvements that at the end of a lease must be removed in order to comply with the lease agreement. These obligations are recorded as a liability with an offsetting asset at the inception of the lease term based upon the estimated fair value of the costs to remove the leasehold improvements. These liabilities are accreted over time to the projected future value of the obligation using the Company’s incremental borrowing rate. The ARO assets are depreciated using the same depreciation method as the respective leasehold improvement assets and are included with buildings and improvements. Estimated ARO liabilities associated with these leases amounted to $64 and $54 at the end of 2016 and 2015, respectively, and are included in other liabilities in the accompanying consolidated balance sheets.

Preopening Expenses

Preopening expenses related to new warehouses, new regional offices and other startup operations are expensed as incurred.

Income Taxes

The Company accounts for income taxes using the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributed to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and tax credits and loss carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences and carry-forwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance is established when necessary to reduce deferred tax assets to amounts that are more likely than not expected to be realized.

The determination of the Company’s provision for income taxes requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. Significant judgment is required in assessing the timing and amounts of deductible and taxable items and the probability of sustaining uncertain tax positions. The benefits of uncertain tax positions are recorded in the Company’s consolidated financial statements only after determining a more-likely-than-not probability that the uncertain tax positions will withstand challenge, if any, from tax authorities. When facts and circumstances change, the Company reassesses these probabilities and records any changes in the consolidated financial statements as appropriate. Additionally, certain of the Company's cumulative foreign undistributed earnings were considered indefinitely reinvested as of August 28, 2016. These earnings would be subject to U.S. income tax if we changed our position and could result in a U.S. tax liability. Although the Company has historically asserted that certain non-U.S. undistributed earnings will be permanently reinvested, it may repatriate such earnings to the extent it can do so without an adverse tax consequence. See Note 8 for additional information.

Net Income per Common Share Attributable to Costco

The computation of basic net income per share uses the weighted average number of shares that were outstanding during the period. The computation of diluted net income per share uses the weighted average number of shares in the basic net income per share calculation plus the number of common shares that would be issued assuming vesting of all potentially dilutive common shares outstanding using the treasury stock method for shares subject to RSUs and the “if converted” method for the convertible note securities.

Stock Repurchase Programs

Repurchased shares of common stock are retired, in accordance with the Washington Business Corporation Act. The par value of repurchased shares is deducted from common stock and the excess repurchase price over par value is deducted by allocation to additional paid-in capital and retained earnings. The amount allocated to additional paid-in capital is the current value of additional paid-in capital per share outstanding and is applied to the number of shares repurchased. Any remaining amount is allocated to retained earnings. See Note 6 for additional information.

Recently Adopted Accounting Pronouncements

In November 2015, the Financial Accounting Standards Board (FASB) issued guidance on the presentation of deferred tax assets and liabilities by jurisdiction, along with any related valuation allowance. The guidance requires companies to classify all deferred tax assets and liabilities as non-current on the balance sheet on either a prospective or retrospective basis. The guidance is effective for fiscal years and interim periods within those years beginning after December 15, 2016, with early adoption permitted. The Company elected to early adopt the guidance at the beginning of the second quarter of fiscal year 2016 on a retrospective basis and reclassified deferred tax assets and liabilities from current to non-current. The reclassifications reduced other current assets and other liabilities by $520 and $410, respectively, increased other assets by $109, and had an immaterial impact on other current liabilities in the accompanying consolidated balance sheet for the fiscal year ended August 30, 2015. Adoption of this guidance also had an immaterial impact on the total assets by segment as disclosed in Note 11.

In April 2015, the FASB issued guidance to simplify the presentation of debt issuance costs by recording deferred debt issuance costs as a direct deduction from the carrying amount of the related debt liability. The guidance is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years, with early adoption permitted. The Company elected to early adopt the guidance at the beginning of its first quarter of fiscal year 2016 on a retrospective basis. The Company reclassified deferred issuance costs from other assets to the respective debt liability. Adoption of this guidance and prior fiscal year reclassifications had an immaterial impact on previously reported consolidated financial statements and an immaterial impact on the total assets by segment as disclosed in Note 11.

In April 2014, the FASB issued guidance that changed the criteria for reporting discontinued operations, as well as requiring new disclosures regarding discontinued operations and disposals that do not qualify for discontinued operations reporting. This guidance became effective for fiscal years beginning after December 15, 2014. The Company adopted this guidance at the beginning of fiscal year 2016. Adoption did not have an impact on the Company’s consolidated financial statements or disclosures.

Recent Accounting Pronouncements Not Yet Adopted

In May 2014, the FASB issued new guidance on the recognition of revenue from contracts with customers. The guidance converges the requirements for reporting revenue and requires disclosures sufficient to describe the nature, amount, timing, and uncertainty of revenue and cash flows arising from these contracts.

Companies can transition to the standard either retrospectively or as a cumulative effect adjustment as of the date of adoption. The new standard is effective for fiscal years and interim periods within those years beginning after December 15, 2017. The Company plans to adopt this guidance at the beginning of its first quarter of fiscal year 2019.

In February 2016, the FASB issued new guidance on leases, which will require lessees to recognize assets and liabilities on the balance sheet for the rights and obligations created by all leases with terms greater than twelve months. The standard is effective for fiscal years and interim periods within those years beginning after December 15, 2018, with early adoption permitted. The Company plans to adopt this guidance at the beginning of its first quarter of fiscal year 2020.

In March 2016, the FASB issued new guidance on stock compensation, which is intended to simplify accounting for share-based payment transactions. The guidance will change several aspects of the accounting for share-based payment award transactions, including accounting for income taxes, forfeitures, and minimum statutory tax withholding requirements. The new standard is effective for fiscal years and interim periods within those years beginning after December 15, 2016, with early adoption permitted. The Company plans to adopt this guidance at the beginning of its first quarter of fiscal year 2018.

The Company is evaluating the impact of these standards on its consolidated financial statements and disclosures.

Note 2—Investments

The Company's investments at the end of 2016 and 2015 were as follows:

2016:	Cost Basis	Unrealized Gains, Net	Recorded Basis
Available-for-sale:			
Government and agency securities	$ 1,028	$ 6	$ 1,034
Asset and mortgage-backed securities	1	0	1
Total available-for-sale	1,029	6	1,035
Held-to-maturity:			
Certificates of deposit	306		306
Bankers' acceptances	9		9
Total held-to-maturity	315		315
Total short-term investments	$ 1,344	$ 6	$ 1,350

2015:	Cost Basis	Unrealized Gains, Net	Recorded Basis
Available-for-sale:			
Government and agency securities	$ 1,394	$ 4	$ 1,398
Asset and mortgage-backed securities	5	0	5
Total available-for-sale	1,399	4	1,403
Held-to-maturity:			
Certificates of deposit	215		215
Total short-term investments	$ 1,614	$ 4	$ 1,618

Gross unrealized gains and losses on available-for-sale securities were not material in 2016, 2015, and 2014. At the end of 2016, the Company had no available-for-sale securities in a continuous unrealized-loss position, and in 2015 and 2014, they were not material. There were no gross unrealized gains and losses on cash equivalents at the end of 2016, 2015, or 2014.

The proceeds from sales of available-for-sale securities were $291, $246, and $116 during 2016, 2015, and 2014, respectively. Gross realized gains or losses from sales of available-for-sale securities were not material in 2016, 2015, and 2014.

The maturities of available-for-sale and held-to-maturity securities at the end of 2016, were as follows:

	Available-For-Sale		
	Cost Basis	Fair Value	Held-To-Maturity
Due in one year or less	$ 231	$ 231	$ 315
Due after one year through five years	746	751	0
Due after five years	52	53	0
Total	$ 1,029	$ 1,035	$ 315

Note 3—Fair Value Measurement

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The tables below present information at the end of 2016 and 2015, respectively, regarding the Company's financial assets and financial liabilities that are measured at fair value on a recurring basis and indicate the level within the fair value hierarchy reflecting the valuation techniques utilized to determine such fair value.

2016:	Level 1	Level 2
Money market mutual funds[1]	$ 222	$ 0
Investment in government and agency securities	0	1,034
Investment in asset and mortgage-backed securities	0	1
Forward foreign-exchange contracts, in asset position[2]	0	11
Forward foreign-exchange contracts, in (liability) position[2]	0	(13)
Total	$ 222	$ 1,033

2015:	Level 1	Level 2
Money market mutual funds[1]	$ 306	$ 0
Investment in government and agency securities	0	1,398
Investment in asset and mortgage-backed securities	0	5
Forward foreign-exchange contracts, in asset position[2]	0	16
Forward foreign-exchange contracts, in (liability) position[2]	0	(4)
Total	$ 306	$ 1,415

(1) Included in cash and cash equivalents in the accompanying consolidated balance sheets.
(2) The asset and the liability values are included in other current assets and other current liabilities, respectively, in the accompanying consolidated balance sheets. See Note 1 for additional information on derivative instruments.

During and at the end of both 2016 and 2015, the Company did not hold any Level 3 financial assets and liabilities that were measured at fair value on a recurring basis. There were no transfers in or out of Level 1 or 2 during 2016 and 2015.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Financial assets measured at fair value on a nonrecurring basis include held-to-maturity investments that are carried at amortized cost and are not remeasured to fair value on a recurring basis. There were no fair value adjustments to these financial assets during 2016 and 2015. See Note 4 for discussion on the fair value of long-term debt.

Nonfinancial assets measured at fair value on a nonrecurring basis include items such as long-lived assets that are measured at fair value resulting from an impairment, if deemed necessary. There were no fair value adjustments to nonfinancial assets during 2016 and these adjustments were immaterial during 2015.

Note 4—Debt

Short-Term Borrowings

The Company enters into various short-term bank credit facilities, totaling $429 and $407 in 2016 and 2015, respectively. At the end of 2016 and 2015, there were no outstanding borrowings under these credit facilities.

In 2016, the average and maximum short term borrowings in Japan were $99 and $110, respectively, and had a weighted average interest rate of 0.52% during the year. All other short term borrowings during the year were immaterial. In 2015, the average and maximum short term borrowings were immaterial.

Long-Term Debt

On February 17, 2015, the Company issued $1,000 in aggregate principal amount of Senior Notes (February 2015 Notes), as follows: $500 of 1.75% Senior Notes due February 15, 2020; and $500 of 2.25% Senior Notes due February 15, 2022. Interest is due semi-annually on February 15 and August 15; the first payment was made on August 15, 2015. The Company, at its option, may redeem the February 2015 Notes at any time, in whole or in part, at the redemption price plus accrued and unpaid interest to the date of redemption. The redemption price is equal to the greater of 100% of the principal amount of the notes to be redeemed or the sum of the present value of the remaining scheduled payments of principal and interest to maturity. The Company will be required to offer to purchase the February 2015 Notes, at a price of 101% of the principal amount plus accrued and unpaid interest to the date of repurchase, upon certain events as defined by the terms of the February 2015 Notes. The discount and issuance costs associated with the February 2015 Notes are being amortized to interest expense over the term of the notes, which are valued using Level 2 inputs.

In December 2012, the Company issued $3,500 in aggregate principal amount of Senior Notes (December 2012 Notes) as follows: $1,200 of 0.65% Senior Notes due December 7, 2015; $1,100 of 1.125% Senior Notes due December 15, 2017; and $1,200 of 1.7% Senior Notes due December 15, 2019. Interest is payable semi-annually. The Company, at its option, may redeem the December 2012 Notes at any time, in whole or in part, at a redemption price plus accrued interest. The redemption price is equal to the greater of 100% of the principal amount of the December 2012 Notes to be redeemed or the sum of the present value of the remaining scheduled payments of principal and interest to maturity. Additionally, the Company will be required to make an offer to purchase the December 2012 Notes at a price of 101% of the principal amount plus accrued and unpaid interest to the date of repurchase, upon certain events as defined by the terms of the December 2012 Notes. The discount and issuance costs associated with the December 2012 Notes are being amortized to interest expense over the terms of the notes. In December 2015, the Company paid the outstanding principal balance and interest on the 0.65% Senior Notes with existing sources of cash and cash equivalents and short term investments. The remaining December 2012 Notes are valued using Level 2 inputs.

In February 2007, the Company issued $1,100 of 5.5% Senior Notes due March 15, 2017 (2007 Senior Note). Interest is payable semi-annually. The Company, at its option, may redeem the 2007 Senior Note at any time, in whole or in part, at a redemption price plus accrued interest. The redemption price is equal to the greater of 100% of the principal amount of the 2007 Senior Note to be redeemed or the sum of the present value of the remaining scheduled payments of principal and interest to maturity. Additionally, the Company will be required to make an offer to purchase the 2007 Senior Note at a price of 101% of the principal amount plus accrued and unpaid interest to the date of repurchase, upon certain events as defined by the terms of the 2007 Senior Note. The discount and issuance costs associated with the 2007 Senior Note are being amortized to interest expense over the term of the note. This note is valued using Level 2 inputs.

Other long-term debt consisted primarily of promissory notes and term loans issued by the Company's Japanese subsidiary. These notes and term loans are valued primarily using Level 3 inputs. In March 2016, the Company's Japanese subsidiary issued approximately $103 of 0.63% Guaranteed Senior Notes through a private placement. Interest is payable semi-annually, and principal is due in March 2026. Additionally in June 2016, the Company's Japanese subsidiary issued approximately $93 of zero percent Guaranteed Senior Notes through a private placement. Interest is payable semi-annually, and principal is due in June 2021. Both notes are included in other long-term debt in the table below.

The estimated fair value of the Company's debt was based primarily on reported market values, recently completed market transactions, and estimates based upon interest rates, maturities, and credit. The carrying value and estimated fair value at the end of 2016 and 2015 consisted of the following:

	2016		2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
0.65% Senior Notes due December 2015	$ 0	$ 0	$ 1,200	$ 1,201
5.5% Senior Notes due March 2017	1,100	1,129	1,099	1,171
1.125% Senior Notes due December 2017	1,099	1,103	1,098	1,097
1.7% Senior Notes due December 2019	1,196	1,219	1,195	1,186
1.75% Senior Notes due February 2020	498	508	497	494
2.25% Senior Notes due February 2022	497	512	496	484
Other long-term debt	771	803	550	555
Total long-term debt	5,161	5,274	6,135	6,188
Less current portion	1,100	1,130	1,283	1,284
Long-term debt, excluding current portion	$ 4,061	$ 4,144	$ 4,852	$ 4,904

Maturities of long-term debt during the next five fiscal years and thereafter, excluding deferred issuance costs, are as follows:

2017	$ 1,100
2018	1,195
2019	100
2020	1,698
2021	100
Thereafter	978
Total	$ 5,171

Note 5—Leases

Operating Leases

The aggregate rental expense for 2016, 2015, and 2014 was $250, $252, and $230, respectively. Sub-lease income and contingent rent was not material in 2016, 2015, and 2014, respectively.

Capital and Build-to-Suit Leases

Gross assets recorded under capital and build-to-suit leases were $392 and $300 at the end of 2016 and 2015, respectively. These assets are recorded net of accumulated amortization of $63 and $42 at the end of 2016 and 2015, respectively.

At the end of 2016, future minimum payments, net of sub-lease income of $129 for all years combined, under non-cancelable operating leases with terms of at least one year and capital leases were as follows:

	Operating Leases	Capital Leases[1]
2017	$ 200	$ 31
2018	195	31
2019	184	30
2020	171	31
2021	166	32
Thereafter	2,204	593
Total	$ 3,120	748
Less amount representing interest		(374)
Net present value of minimum lease payments		374
Less current installments[2]		(10)
Long-term capital lease obligations less current installments[3]		$ 364

(1) Includes build-to-suit lease obligations.
(2) Included in other current liabilities in the accompanying consolidated balance sheets.
(3) Included in other liabilities in the accompanying consolidated balance sheets.

Note 6—Stockholders' Equity

Dividends

The Company's current quarterly dividend rate is $0.45 per share. In February 2015, the Company paid a special cash dividend of $5.00 per share, totaling approximately $2,201.

Stock Repurchase Programs

The Company's stock repurchase program is conducted under a $4,000 authorization by the Board of Directors approved on April 17, 2015, which expires April 17, 2019. This authorization revoked previously authorized but unused amounts, totaling $2,528. As of the end of 2016, the remaining amount available for stock repurchases under the approved plan was $3,222. The following table summarizes the Company's stock repurchase activity:

	Shares Repurchased (000's)	Average Price per Share	Total Cost
2016	3,184	$ 149.90	$ 477
2015	3,456	142.87	494
2014	2,915	114.45	334

These amounts may differ from the stock repurchase balances in the accompanying consolidated statements of cash flows due to changes in unsettled stock repurchases at the end of each fiscal year.

Note 7—Stock-Based Compensation Plans

The Company grants stock-based compensation to employees and non-employee directors. Beginning in 2009, RSU grants to all executive officers have been performance-based. Through a series of shareholder approvals, there have been amended and restated plans and new provisions implemented by the Company. RSUs held by employees and non-employee directors are subject to quarterly vesting upon certain terminations of employment or service. Employees who attain certain years of service with the Company receive shares under accelerated vesting provisions on the annual vesting date rather than upon retirement. The Seventh Restated 2002 Stock Incentive Plan (Seventh Plan), amended in the second quarter of fiscal 2015, is the Company's only stock-based compensation plan with shares available for grant at the end of 2016. Each share issued in respect of stock awards is counted as 1.75 shares toward the limit of shares made available under the Seventh Plan. The Seventh Plan authorized the issuance of 23,500,000 shares (13,429,000 RSUs) of common stock for future grants in addition to the shares authorized under the previous plan. The Company issues new shares of common stock upon vesting of RSUs. Shares for vested RSUs are generally delivered to participants annually, net of shares equal to the minimum statutory withholding taxes.

As required by the Company's Seventh Plan, in conjunction with the special cash dividend discussed in Note 6, adjustments were made to awards outstanding on the dividend record date to preserve their value following the dividend, as follows: (i) the number of shares subject to outstanding RSUs was increased; and (ii) the exercise prices of outstanding stock options were reduced and the number of shares subject to such options was increased. Approximately 410,000 stock options were adjusted, and approximately 8,956,000 RSUs were adjusted. These adjustments did not result in additional stock-based compensation expense, as the fair value of the outstanding awards did not change. As further required by the Seventh Plan, the maximum number of shares issuable under the Seventh Plan was proportionally adjusted, which resulted in an additional 750,000 RSU shares available to be granted.

Summary of Restricted Stock Unit Activity

RSUs granted to employees and to non-employee directors generally vest over five years and three years, respectively. Additionally, the terms of the RSUs, including performance-based awards, provide for accelerated vesting for employees and non-employee directors who have attained 25 or more years and five or more years of service with the Company, respectively, and provide for vesting upon certain terminations of employment or service. Recipients are not entitled to vote or receive dividends on non-vested and undelivered shares. At the end of 2016, 15,068,000 shares were available to be granted as RSUs under the Seventh Plan.

The following awards were outstanding at the end of 2016:

- 7,878,000 time-based RSUs that vest upon continued employment over specified periods of time;
- 448,000 performance-based RSUs, of which 236,000 were granted to executive officers subject to the certification of the attainment of specified performance targets for 2016. This certification occurred in September 2016, at which time a portion vested as a result of the long service of all executive officers. The remaining awards vest upon continued employment over specified periods of time.

The following table summarizes RSU transactions during 2016:

	Number of Units (in 000's)	Weighted-Average Grant Date Fair Value
Outstanding at the end of 2015	9,233	$ 99.72
Granted	3,521	153.46
Vested and delivered	(4,147)	102.43
Forfeited	(281)	115.69
Outstanding at the end of 2016	8,326	$ 120.56

The weighted-average grant date fair value of RSUs granted was $153.46, $125.68, and $113.64 in 2016, 2015, and 2014, respectively. The remaining unrecognized compensation cost related to non-vested RSUs at the end of 2016 was $690 and the weighted-average period of time over which this cost will be recognized is 1.6 years. Included in the outstanding balance at the end of 2016 were approximately 2,602,000 RSUs vested but not yet delivered.

Summary of Stock-Based Compensation

The following table summarizes stock-based compensation expense and the related tax benefits under the Company's plans:

	2016	2015	2014
Stock-based compensation expense before income taxes	$ 459	$ 394	$ 327
Less recognized income tax benefit	(150)	(131)	(109)
Stock-based compensation expense, net of income taxes	$ 309	$ 263	$ 218

Note 8—Income Taxes

Income before income taxes is comprised of the following:

	2016	2015	2014
Domestic (including Puerto Rico)	$ 2,622	$ 2,574	$ 2,145
Foreign	997	1,030	1,052
Total	$ 3,619	$ 3,604	$ 3,197

The provisions for income taxes for 2016, 2015, and 2014 are as follows:

	2016	2015	2014
Federal:			
Current	$ 468	$ 766	$ 696
Deferred	233	(12)	(105)
Total federal	701	754	591
State:			
Current	108	131	107
Deferred	21	1	(3)
Total state	129	132	104
Foreign:			
Current	398	399	369
Deferred	15	(90)	45
Total foreign	413	309	414
Total provision for income taxes	$ 1,243	$ 1,195	$ 1,109

Tax benefits associated with the exercise of employee stock programs were allocated to equity attributable to Costco in the amount of $74, $86, and $84, in 2016, 2015, and 2014, respectively.

The reconciliation between the statutory tax rate and the effective rate for 2016, 2015, and 2014 is as follows:

	2016		2015		2014	
Federal taxes at statutory rate	$ 1,267	35.0%	$ 1,262	35.0%	$ 1,119	35.0%
State taxes, net	91	2.5	85	2.3	66	2.1
Foreign taxes, net	(21)	(0.6)	(125)	(3.5)	(85)	(2.7)
Employee stock ownership plan (ESOP)	(17)	(0.5)	(66)	(1.8)	(11)	(0.3)
Other	(77)	(2.1)	39	1.2	20	0.6
Total	$ 1,243	34.3%	$ 1,195	33.2%	$ 1,109	34.7%

The Company's provision for income taxes for 2015 was favorably impacted by a $57 tax benefit in connection with the special cash dividend of $5.00 per share paid by the Company to employees, through shares owned in the Company's 401(k) Retirement Plan. Dividends paid on these shares are deductible for U.S. income tax purposes. There was no similar special cash dividend in 2016 and 2014.

The components of the deferred tax assets (liabilities) are as follows:

	2016	2015
Equity compensation	$ 99	$ 90
Deferred income/membership fees	177	90
Accrued liabilities and reserves	601	641
Other[1]	63	107
Property and equipment	(779)	(560)
Merchandise inventories	(256)	(200)
Net deferred tax (liabilities)/assets	$ (95)	$ 168

(1) Includes foreign tax credits of $78 and $33 for 2016 and 2015, respectively, which will expire beginning in 2025.

The deferred tax accounts at the end of 2016 and 2015 include non-current deferred income tax assets of $202 and $219, respectively, included in other assets; and non-current deferred income tax liabilities of $297 and $51, respectively, included in other liabilities.

The Company has not provided for U.S. deferred taxes on cumulative undistributed earnings of certain non-U.S. consolidated subsidiaries as such earnings are deemed by the Company to be indefinitely reinvested because its subsidiaries have invested or will invest the undistributed earnings indefinitely, or the earnings if repatriated would not result in an adverse tax consequence. Deferred taxes are recorded for earnings of foreign operations when it is determined that such earnings are no longer indefinitely reinvested.

During 2015, the Company repatriated a portion of the earnings in the Canadian operations that, in 2014, the Company determined were no longer considered indefinitely reinvested. In the fourth quarter of 2015, the Company changed its position regarding an additional portion of the undistributed earnings of the Canadian operations, which are no longer considered indefinitely reinvested. These earnings were distributed in 2016. Current exchange rates compared to historical rates when these earnings were generated resulted in an immaterial U.S. benefit, which was recorded at the end of 2015. Subsequent to the end of fiscal 2016, the Company determined that a portion of the undistributed earnings of its Canadian operations could be repatriated without adverse tax consequences. Accordingly, the Company no longer considers that portion to be indefinitely reinvested.

The Company has not provided for U.S. deferred taxes on cumulative undistributed earnings of $3,280 and $2,845 at the end of 2016 and 2015, respectively, of certain non-U.S. consolidated subsidiaries because the subsidiaries have invested or will invest the undistributed earnings indefinitely, or the earnings, if repatriated would not result in an adverse tax consequence. Because of the availability of U.S. foreign tax credits and complexity of the computation, it is not practicable to determine the U.S. federal income tax liability that would be associated with such earnings if such earnings were not deemed to be indefinitely reinvested.

The Company believes that its U.S. current and projected asset position is sufficient to meet its U.S. liquidity requirements and has no current plans to repatriate for use in the U.S. the cash and cash equivalents and short-term investments held by these non-U.S. subsidiaries whose earnings are considered indefinitely reinvested.

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits for 2016 and 2015 is as follows:

	2016	2015
Gross unrecognized tax benefit at beginning of year	$ 158	$ 75
Gross increases—current year tax positions	2	26
Gross increases—tax positions in prior years	1	63
Gross decreases—tax positions in prior years	(47)	(1)
Settlements	(25)	(3)
Lapse of statute of limitations	(37)	(2)
Gross unrecognized tax benefit at end of year	$ 52	$ 158

The gross unrecognized tax benefit includes tax positions for which the ultimate deductibility is highly certain but there is uncertainty about the timing of such deductibility. At the end of 2016 and 2015, these amounts were immaterial and $50, respectively. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of these tax positions would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority to an earlier period. At the end of 2015, the Company recorded an offsetting long-term asset of $48. There was no offsetting long-term asset at the end of 2016.

The total amount of such unrecognized tax benefits that, if recognized, would favorably affect the effective income tax rate in future periods is $46 and $98 at the end of 2016 and 2015, respectively.

Accrued interest and penalties related to income tax matters are classified as a component of income tax expense. Interest and penalties recognized by the Company were not material in 2016 and 2015. Accrued interest and penalties were not material at the end of 2016 and 2015.

The Company is currently under audit by several taxing jurisdictions in the United States and in several foreign countries. Some audits may conclude in the next 12 months and the unrecognized tax benefits we have recorded in relation to the audits may differ from actual settlement amounts. It is not practical to estimate the effect, if any, of any amount of such change during the next 12 months to previously recorded uncertain tax positions in connection with the audits. The Company does not anticipate that there will be a material increase or decrease in the total amount of unrecognized tax benefits in the next 12 months.

The Company files income tax returns in the United States, various state and local jurisdictions, in Canada and in several other foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state or local examination for years before fiscal 2013. The Company is currently subject to examination in Canada for fiscal years 2012 to present and in California for fiscal years 2007 to present. No other examinations are believed to be material.

Note 9—Net Income per Common and Common Equivalent Share

The following table shows the amounts used in computing net income per share and the effect on net income and the weighted average number of shares of potentially dilutive common shares outstanding (shares in 000's):

	2016	2015	2014
Net income available to common stockholders after assumed conversions of dilutive securities	$ 2,350	$ 2,377	$ 2,058
Weighted average number of common shares used in basic net income per common share	438,585	439,455	438,693
RSUs	2,668	3,249	3,771
Conversion of convertible notes	10	12	21
Weighted average number of common shares and dilutive potential of common stock used in diluted net income per share	441,263	442,716	442,485

Note 10—Commitments and Contingencies

Legal Proceedings

The Company is involved in a number of claims, proceedings and litigation arising from its business and property ownership. In accordance with applicable accounting guidance, the Company establishes an accrual for legal proceedings if and when those matters reach a stage where they present loss contingencies that are both probable and reasonably estimable. There may be exposure to loss in excess of any amounts accrued. The Company monitors those matters for developments that would affect the likelihood of a loss (taking into account where applicable indemnification arrangements concerning suppliers and insurers) and the accrued amount, if any, thereof, and adjusts the amount as appropriate. As of the date of this Report, the Company has recorded an immaterial accrual with respect to two matters described below. If the loss contingency at issue is not both probable and reasonably estimable, the Company does not establish an accrual, but will continue to monitor the matter for developments that will make the loss contingency both probable and reasonably estimable. In each case, there is a reasonable possibility that a loss may be incurred, including a loss in excess of the applicable accrual. For matters where no accrual has been recorded, the possible loss or range of loss (including any loss in excess of the accrual) cannot in our view be reasonably estimated because, among other things: (i) the remedies or penalties sought are indeterminate or unspecified; (ii) the legal and/or factual theories are not well developed; and/or (iii) the matters involve complex or novel legal theories or a large number of parties.

The Company is a defendant in the following matters, among others:

Numerous putative class actions have been brought around the United States against motor fuel retailers, including the Company, alleging that they have been overcharging consumers by selling gasoline or diesel that is warmer than 60 degrees without adjusting the volume sold to compensate for heat-related expansion or disclosing the effect of such expansion on the energy equivalent received by the consumer. The Company is named in the following actions: Raphael Sagalyn, et al., v. Chevron USA, Inc., et al., Case No. 07-430 (D. Md.); Phyllis Lerner, et al., v. Costco Wholesale Corporation, et al., Case No. 07-1216 (C.D. Cal.); Linda A. Williams, et al., v. BP Corporation North America, Inc., et al., Case No. 07-179 (M.D. Ala.); James Graham, et al. v. Chevron USA, Inc., et al., Civil Action No. 07-193 (E.D. Va.); Betty A. Delgado, et al., v. Allsups, Convenience Stores, Inc., et al., Case No. 07-202 (D.N.M.); Gary Kohut, et al. v. Chevron USA, Inc., et al., Case No. 07-285 (D. Nev.); Mark Rushing, et al., v. Alon USA, Inc., et al., Case No. 06-7621 (N.D. Cal.); James Vanderbilt, et al., v. BP Corporation North America, Inc., et al., Case No. 06-1052 (W.D. Mo.); Zachary Wilson, et al., v. Ampride, Inc., et al., Case No. 06-2582 (D.Kan.); Diane Foster, et al., v. BP North America Petroleum, Inc., et al., Case No. 07-02059 (W.D. Tenn.); Mara Redstone, et al., v. Chevron USA, Inc., et al., Case No. 07-20751 (S.D. Fla.); Fred Aguirre, et al. v. BP West Coast Products LLC, et al., Case No. 07-1534

(N.D. Cal.); J.C. Wash, et al., v. Chevron USA, Inc., et al.; Case No. 4:07cv37 (E.D. Mo.); Jonathan Charles Conlin, et al., v. Chevron USA, Inc., et al.; Case No. 07 0317 (M.D. Tenn.); William Barker, et al. v. Chevron USA, Inc., et al.; Case No. 07-cv-00293 (D.N.M.); Melissa J. Couch, et al. v. BP Products North America, Inc., et al., Case No. 07cv291 (E.D. Tex.); S. Garrett Cook, Jr., et al., v. Hess Corporation, et al., Case No. 07cv750 (M.D. Ala.); Jeff Jenkins, et al. v. Amoco Oil Company, et al., Case No. 07-cv-00661 (D. Utah); and Mark Wyatt, et al., v. B. P. America Corp., et al., Case No. 07-1754 (S.D. Cal.). On June 18, 2007, the Judicial Panel on Multidistrict Litigation assigned the action, entitled In re Motor Fuel Temperature Sales Practices Litigation, MDL Docket No 1840, to Judge Kathryn Vratil in the United States District Court for the District of Kansas. On April 12, 2009, the Company agreed to settle the actions in which it is named as a defendant. Under the settlement, which was subject to final approval by the court, the Company agreed, to the extent allowed by law and subject to other terms and conditions in the agreement, to install over five years from the effective date of the settlement temperature-correcting dispensers in the States of Alabama, Arizona, California, Florida, Georgia, Kentucky, Nevada, New Mexico, North Carolina, South Carolina, Tennessee, Texas, Utah, and Virginia. Other than payments to class representatives, the settlement does not provide for cash payments to class members. On September 22, 2011, the court preliminarily approved a revised settlement, which did not materially alter the terms. On April 24, 2012, the court granted final approval of the revised settlement. A class member who objected has filed a notice of appeal from the order approving the settlement. Plaintiffs have moved for an award of $10 in attorneys’ fees, as well as an award of costs and payments to class representatives. A report and recommendation has been issued in favor of a fee award of $3.8, to which the Company is objecting. On August 24, 2016, the district court affirmed the report and recommendation. On March 20, 2014, the Company filed a notice invoking a “most favored nation” provision under the settlement, under which it seeks to adopt provisions in later settlements with certain other defendants. The motion was denied on January 23, 2015. Final judgment was entered on September 22, 2015, and the Company has filed a notice of appeal.

The Company received notices from most states stating that they have appointed an agent to conduct an examination of the books and records of the Company to determine whether it has complied with state unclaimed property laws. In addition to seeking the turnover of unclaimed property subject to escheat laws, the states may seek interest, penalties, costs of examinations, and other relief. Certain states have separately also made requests for payment by the Company concerning a specific type of property, some of which have been paid in immaterial amounts.

The Company has received from the Drug Enforcement Administration subpoenas and administrative inspection warrants concerning the Company's fulfillment of prescriptions related to controlled substances and related practices. Offices of the United States Attorney in various districts have communicated to the Company their belief that the Company has committed civil regulatory violations concerning these subjects. The Company is seeking to cooperate with these processes and is holding discussions concerning a potential resolution.

The Company does not believe that any pending claim, proceeding or litigation, either alone or in the aggregate, will have a material adverse effect on the Company’s financial position; however, it is possible that an unfavorable outcome of some or all of the matters, however unlikely, could result in a charge that might be material to the results of an individual fiscal quarter.

Note 11—Segment Reporting

The Company and its subsidiaries are principally engaged in the operation of membership warehouses in the U.S., Canada, Mexico, U.K., Japan, Australia, and Spain and through majority-owned subsidiaries in Taiwan and Korea. The Company's reportable segments are largely based on management's organization of the operating segments for operational decisions and assessments of financial performance, which considers geographic locations. The material accounting policies of the segments are the same as described in Note 1. All material inter-segment net sales and expenses have been eliminated in computing total revenue and operating income. Certain operating expenses, predominantly stock-based compensation, are incurred on behalf of the Company's Canadian and Other International operations, but are included in the U.S. operations because those costs are not allocated internally and generally come under the responsibility of the Company's U.S. management team.

	United States Operations	Canadian Operations	Other International Operations	Total
2016				
Total revenue	$ 86,579	$ 17,028	$ 15,112	$ 118,719
Operating income	2,326	778	568	3,672
Depreciation and amortization	946	109	200	1,255
Additions to property and equipment	1,823	299	527	2,649
Net property and equipment	11,745	1,628	3,670	17,043
Total assets	22,511	3,480	7,172	33,163
2015				
Total revenue	$ 84,351	$ 17,341	$ 14,507	$ 116,199
Operating income	2,308	771	545	3,624
Depreciation and amortization	848	119	160	1,127
Additions to property and equipment	1,574	148	671	2,393
Net property and equipment	10,815	1,381	3,205	15,401
Total assets	22,988	3,608	6,421	33,017
2014				
Total revenue	$ 80,477	$ 17,943	$ 14,220	$ 112,640
Operating income	1,880	796	544	3,220
Depreciation and amortization	755	124	150	1,029
Additions to property and equipment	1,245	204	544	1,993
Net property and equipment	10,132	1,662	3,036	14,830
Total assets	21,586	4,889	6,187	32,662

The following table summarizes the percentage of net sales by merchandise category:

	2016	2015	2014
Foods	22%	22%	22%
Sundries	21%	21%	21%
Hardlines	16%	16%	16%
Fresh Foods	14%	14%	13%
Softlines	12%	11%	11%
Other	15%	16%	17%

Note 12—Quarterly Financial Data (Unaudited)

The two tables that follow reflect the unaudited quarterly results of operations for 2016 and 2015.

	52 Weeks Ended August 28, 2016				
	First Quarter (12 Weeks)	Second Quarter (12 Weeks)	Third Quarter (12 Weeks)	Fourth Quarter (16 Weeks)	Total (52 Weeks)
REVENUE					
Net sales	$ 26,627	$ 27,567	$ 26,151	$ 35,728	$ 116,073
Membership fees	593	603	618	832	2,646
Total revenue	27,220	28,170	26,769	36,560	118,719
OPERATING EXPENSES					
Merchandise costs	23,621	24,469	23,162	31,649	102,901
Selling, general and administrative	2,806	2,835	2,731	3,696	12,068
Preopening expenses	26	10	18	24	78
Operating income	767	856	858	1,191	3,672
OTHER INCOME (EXPENSE)					
Interest expense	(33)	(31)	(30)	(39)	(133)
Interest income and other, net	28	16	7	29	80
INCOME BEFORE INCOME TAXES	762	841	835	1,181	3,619
Provision for income taxes	275	286	286	396	1,243
Net income including noncontrolling interests	487	555	549	785	2,376
Net income attributable to noncontrolling interests	(7)	(9)	(4)	(6)	(26)
NET INCOME ATTRIBUTABLE TO COSTCO	$ 480	$ 546	$ 545	$ 779	$ 2,350
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO:					
Basic	$ 1.10	$ 1.24	$ 1.24	$ 1.78	$ 5.36
Diluted	$ 1.09	$ 1.24	$ 1.24	$ 1.77	$ 5.33
Shares used in calculation (000's)					
Basic	438,342	439,648	438,815	437,809	438,585
Diluted	441,386	441,559	441,066	440,868	441,263
CASH DIVIDENDS DECLARED PER COMMON SHARE	$ 0.40	$ 0.40	$ 0.45	$ 0.45	$ 1.70

Note 12—Quarterly Financial Data (Unaudited) (Continued)

	52 Weeks Ended August 30, 2015				
	First Quarter (12 Weeks)	Second Quarter (12 Weeks)	Third Quarter (12 Weeks)	Fourth Quarter (16 Weeks)	Total (52 Weeks)
REVENUE					
Net sales	$ 26,284	$ 26,872	$ 25,517	$ 34,993	$ 113,666
Membership fees	582	582	584	785	2,533
Total revenue	26,866	27,454	26,101	35,778	116,199
OPERATING EXPENSES					
Merchandise costs	23,385	23,897	22,687	31,096	101,065
Selling, general and administrative	2,696	2,671	2,579	3,499	11,445
Preopening expenses	15	9	14	27	65
Operating income	770	877	821	1,156	3,624
OTHER INCOME (EXPENSE)					
Interest expense	(26)	(27)	(31)	(40)	(124)
Interest income and other, net	35	20	9	40	104
INCOME BEFORE INCOME TAXES	779	870	799	1,156	3,604
Provision for income taxes	274	263 (1)	280	378	1,195
Net income including noncontrolling interests	505	607	519	778	2,409
Net income attributable to noncontrolling interests	(9)	(9)	(3)	(11)	(32)
NET INCOME ATTRIBUTABLE TO COSTCO	$ 496	$ 598	$ 516	$ 767	$ 2,377
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO:					
Basic	$ 1.13	$ 1.36	$ 1.17	$ 1.75	$ 5.41
Diluted	$ 1.12	$ 1.35	$ 1.17	$ 1.73	$ 5.37
Shares used in calculation (000's)					
Basic	438,760	440,384	440,070	438,835	439,455
Diluted	442,210	442,896	443,132	442,404	442,716
CASH DIVIDENDS DECLARED PER COMMON SHARE	$ 0.355	$ 5.355 (2)	$ 0.40	$ 0.40	$ 6.51

(1) Includes a $57 tax benefit recorded in the second quarter in connection with the special cash dividend paid to employees through the Company's 401(k) Retirement Plan.

(2) Includes the special cash dividend of $5.00 per share paid in February 2015.

DIRECTORS AND OFFICERS

BOARD OF DIRECTORS

Jeffrey H. Brotman
Co-Founder, Chairman of the Board, Costco
Susan L. Decker[(a)]
Principal of Deck3 Ventures LLC;
Former President of Yahoo! Inc.
Daniel J. Evans[(a)(c)]
Chairman, Daniel J. Evans Associates; Former U.S. Senator and Governor of the State of Washington
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Executive Vice President and Chief Financial Officer, Costco
Hamilton E. James
President and Chief Operating Officer, The Blackstone Group
W. Craig Jelinek
President and Chief Executive Officer, Costco
Richard M. Libenson
A Founder, former Director and Executive Officer of The Price Company
John W. Meisenbach
President of MCM, A Meisenbach Company
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Vice Chairman of the Board of Berkshire Hathaway Inc.;
Chairman of the Board of Daily Journal Corporation
Jeffrey S. Raikes[(c)*]
Founder and CEO of the Raikes Foundation; Former CEO of the Bill and Melinda Gates Foundation
James D. Sinegal
Co-Founder, former President and CEO, Costco
John W. Stanton[(b)*]
Chairman of Trilogy International Partners, Inc.;
Chairman of Trilogy Equity Partners
Maggie A. Wilderotter[(c)]
Former Executive Chairman of Frontier Communications

Board Committees
(a) Audit Committee
(b) Compensation Committee
(c) Nominating and Governance Committee
* 2016 Committee Chair

EXECUTIVE AND SENIOR OFFICERS

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Executive Vice President, Chief Financial Officer
Jaime Gonzalez
Senior Vice President, General Manager – Mexico
William Hanson
Senior Vice President, Merchandising – Foods & Sundries
Daniel M. Hines
Senior Vice President, Corporate Controller
W. Craig Jelinek
President and Chief Executive Officer
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Senior Vice President, Merchandising – Non-Foods & Ecommerce
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Senior Vice President, Membership, Marketing, Services & Publishing
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Executive Vice President, Administration
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Senior Vice President, General Manager – Northeast Region
Jeffrey B. Lyons
Senior Vice President, Merchandising – Fresh Foods
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Senior Vice President, Real Estate Development
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Senior Vice President, General Manager – Western Canada Region
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Senior Vice President, Construction
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Executive Vice President, Chief Information Officer
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Executive Vice President, COO – International Division
Mario Omoss
Senior Vice President, General Manager – Northwest Region
Stephen M. Pappas
Senior Vice President, General Manager – Europe
David S. Petterson
Senior Vice President, Accounting
Joseph P. Portera
Executive Vice President, COO – Eastern & Canadian Divisions and Chief Diversity Officer
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Senior Vice President, General Manager – Eastern Canada Region
Timothy L. Rose
Executive Vice President, Ancillary Businesses, Manufacturing & Business Centers
Yoram B. Rubanenko
Senior Vice President, General Manager – Southeast Region
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Senior Vice President, Information Systems
John Sullivan
Senior Vice President, General Counsel & Chief Compliance Officer
John D. Thelan
Senior Vice President, Depots & Traffic
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Executive Vice President, COO – Merchandising
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Senior Vice President, General Manager – Texas Region
Richard Wilcox
Senior Vice President, General Manager – San Diego Region
Dennis R. Zook
Executive Vice President, COO – Southwest Division & Mexico

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GMM – Foods & Sundries – Western Canada Region
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GMM – Business Centers – Canadian Division
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Financial Accounting Controller
Bryan Blank
Operations – San Diego Region
Christopher Bolves
Operations – Northwest Region
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Information Systems
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Operations – Texas Region
Deborah Calhoun
GMM – Foods – San Diego Region
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Country Manager – Korea
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Wendy Davis
Operations – Midwest Region
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Operations – Western Canada Region
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Murray T. Fleming
GMM – Hardlines – Canadian Division
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GMM – Bakery & Food Court
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Merchandise Accounting Controller
Darby Greek
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GMM – Non-Foods – Canadian Division
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Costco Travel

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Mitzi Hu
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Administration & Community Giving
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Robert Leuck
Operations – Northeast Region
Steve Mantanona
GMM – Merchandising – Mexico
Mark Maushund
Operations – Los Angeles Region
Susan McConnaha
Operations – Bakery & Food Court
Daniel McMurray
Operations – Midwest Region
Tim Murphy
GMM – Foods – Bay Area Region
Robert Murvin
GMM – Foods – Texas Region
Robert E. Nelson
Treasury, Financial Planning & Investor Relations
Pietro Nenci
GMM – Foods & Sundries, Quality Assurance, Food Safety & Business Delivery – Canadian Division
Patrick J. Noone
Country Manager – Australia
Frank Padilla
GMM – Corporate Produce & Fresh Meat
Daniel Parent
Operations – Eastern Canada Region
Shawn Parks
Operations – Los Angeles Region
Michael Parrott
GMM – Corporate Non-Foods
Steven D. Powers
Operations – Southeast Region
Paul Pulver
Operations – Northeast Region

Giro Rizzuti
GMM – Non-Foods – Canadian Division
Aldyn J. Royes
Operations – Southeast Region
Chris Rylance
Information Systems
Drew Sakuma
Operations – Bay Area Region
Debbie Sarter
Operations – Los Angeles Region
Adam Self
Operations – Northeast Region
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Geoff Shavey
GMM – Corporate Non-Foods
Louie Silveira
Manager – Taiwan
David L. Skinner
Operations – Eastern Canada Region
Monica Smith
Corporate Tax and Customs Compliance
James Stafford
GMM – Foods – Northeast Region
Richard Stephens
Operations – Pharmacy
Kimberley L. Suchomel
GMM – International
Steve Supkoff
Operations – Ecommerce
Gary Swindells
Country Manager – France
Mauricio Talayero
Chief Financial Officer – Mexico
Ken J. Theriault
Country Manager – Japan
Brian Thomas
Operations – Midwest Region
Yves Thomas
GMM – Optical, Optical Labs, Mini-labs & Gasoline – Canadian Division
Keith H. Thompson
Construction
Todd Thull
Construction
Adrian Thummler
Operations – Mexico
Diane Tucci
Country Manager – Spain
Azmina K. Virani
Sr. GMM – Non-Foods – Canadian Division
Sarah Wehling
GMM – Food & Sundries – Los Angeles Region
Jack Weisbly
GMM – Corporate Non-Foods
Shannon West
GMM – Corporate Non-Foods
Craig Wilson
Food Safety & Quality Assurance
Charlie A. Winters
Operations – Fresh Meat, Produce & Service Deli
Earl Wiramanaden
GMM – Fresh Foods – Asia/Australia

ADDITIONAL INFORMATION

A copy of Costco's annual report to the Securities and Exchange Commission on Form10-K and quarterly reports on Form 10-Q will be provided to any shareholder upon written request directed to Investor Relations, Costco Wholesale Corporation, 999 Lake Drive, Issaquah, Washington 98027. Internet users can access recent sales and earnings releases, the annual report and SEC filings, as well as our Costco Online web site, at http://www.costco.com. E-mail users may direct their investor relations questions to investor@costco.com. All of the Company's filings with the SEC may be obtained at the SEC's Public Reference Room at Room 1580, 100 F Street NE, Washington, DC 20549. For information regarding the operation of the SEC's Public Reference Room, please contact the SEC at 1-800-SEC-0330. Additionally, the SEC maintains an internet site that contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC at www.sec.gov.

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Annual Meeting
Thursday, January 26, 2017 at 4:00 PM
Meydenbauer Center
11100 NE 6th Street
Bellevue, Washington 98004

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