



Report of Independent Auditors and
Consolidated Financial Statements with
Supplementary Information for

Kaua'i Island Utility Cooperative

December 31, 2012 and 2011

MOSS ADAMS LLP

Certified Public Accountants | Business Consultants

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REPORT OF INDEPENDENT AUDITORS

To the Board of Directors
Kaua'i Island Utility Cooperative

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Kaua'i Island Utility Cooperative (the Cooperative), which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operation, equities and margins, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

REPORT OF INDEPENDENT AUDITORS (continued)

Opinions

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kaua'i Island Utility Cooperative as of December 31, 2012 and 2011, and the consolidated results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated April 24, 2013 on our consideration of the Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Cooperative's internal control over financial reporting and compliance.

A handwritten signature in blue ink that reads "Miss Adams U.P.".

Portland, Oregon

April 24, 2013

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**KAUA'I ISLAND UTILITY COOPERATIVE
CONSOLIDATED BALANCE SHEETS**

ASSETS

	December 31,	
	<u>2012</u>	<u>2011</u>
UTILITY PLANT		
Electric plant in service	\$ 420,311,882	\$ 410,001,917
Electric plant acquisition cost	54,852,453	54,852,453
Accumulated depreciation and amortization	<u>(238,615,696)</u>	<u>(230,027,434)</u>
Net electric plant in service	236,548,639	234,826,936
Construction work in progress	<u>26,707,641</u>	<u>18,406,091</u>
Net utility plant	<u>263,256,280</u>	<u>253,233,027</u>
OTHER PROPERTY AND INVESTMENTS		
Investments in associated organizations	673,885	637,759
Rural economic development loans	<u>827,485</u>	<u>555,446</u>
Total other property and investments	<u>1,501,370</u>	<u>1,193,205</u>
CURRENT ASSETS		
Cash and cash equivalents	3,375,496	3,520,986
Restricted cash and cash equivalents	635,715	546,548
Accounts and notes receivable, less allowance for doubtful accounts of \$468,161 and \$454,699 in 2012 and 2011, respectively	13,867,571	12,164,224
Accrued unbilled revenue	8,927,119	8,058,573
Energy rate adjustment clause	467,044	-
Inventories	14,788,423	14,032,643
Other current and accrued assets	<u>1,220,917</u>	<u>996,266</u>
Total current assets	<u>43,282,285</u>	<u>39,319,240</u>
DEFERRED DEBITS	<u>7,087,067</u>	<u>5,445,557</u>
Total assets	<u><u>\$ 315,127,002</u></u>	<u><u>\$ 299,191,029</u></u>

**KAUA'I ISLAND UTILITY COOPERATIVE
CONSOLIDATED BALANCE SHEETS**

LIABILITIES, EQUITIES, AND MARGINS

	December 31,	
	2012	2011
EQUITIES AND MARGINS	\$ 78,546,204	\$ 69,347,485
LONG-TERM DEBT, less current maturities	177,645,916	178,291,187
POST-RETIREMENT BENEFIT OBLIGATION	2,382,400	1,880,500
COMMITMENTS AND CONTINGENCIES (NOTE 11)		
CURRENT LIABILITIES		
Current maturities of long-term debt	10,395,000	9,661,000
Line of credit	14,178,000	8,700,000
Accounts payable	6,253,705	7,980,716
Energy rate adjustment clause	-	540,985
Consumer deposits	1,272,909	1,248,210
Accrued employee compensation	2,257,497	2,047,226
Accrued taxes	10,231,266	9,684,268
Other current and accrued liabilities	182,863	165,995
Total current liabilities	44,771,240	40,028,400
DEFERRED CREDITS	11,781,242	9,643,457
Total liabilities, equities, and margins	\$ 315,127,002	\$ 299,191,029

KAUA'I ISLAND UTILITY COOPERATIVE

CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31,				Increase (Decrease)
	2012		2011		
	Amount	%	Amount	%	
OPERATING REVENUES					
Residential	\$ 70,785,142	37.5	\$ 69,031,915	37.8	\$ 1,753,227
Irrigation	58,037	0.0	33,626	0.0	24,411
Commercial and industrial	115,808,374	61.5	111,772,088	61.2	4,036,286
Public street and highway lighting	1,647,004	0.9	1,573,722	0.9	73,282
Other operating revenues	153,179	0.1	168,047	0.1	(14,868)
Total operating revenues	188,451,736	100.0	182,579,398	100.0	5,872,338
OPERATING EXPENSES					
Power cost	118,103,206	62.7	113,125,392	62.0	4,977,814
Transmission – operation	337,746	0.2	320,984	0.2	16,762
Transmission – maintenance	561,774	0.3	724,633	0.4	(162,859)
Distribution – operation	1,097,882	0.6	1,202,106	0.7	(104,224)
Distribution – maintenance	2,574,091	1.4	2,852,571	1.6	(278,480)
Customer accounts	2,694,477	1.4	2,549,349	1.4	145,128
Customer service and information	653,260	0.3	612,107	0.3	41,153
Administrative and general	13,958,675	7.4	14,766,674	8.1	(807,999)
Depreciation and amortization	13,434,517	7.1	13,372,215	7.3	62,302
Taxes	15,782,639	8.4	15,288,561	8.4	494,078
Other interest expense	547,978	0.3	130,754	0.1	417,224
Total operating expenses	169,746,245	90.1	164,945,346	90.5	4,800,899
OPERATING MARGINS, before interest	18,705,491	9.9	17,634,052	9.5	1,071,439
INTEREST ON LONG-TERM DEBT	8,335,362	4.4	8,668,886	4.7	(333,524)
OPERATING MARGINS	10,370,129	5.5	8,965,166	4.8	1,404,963
NONOPERATING MARGINS					
Interest income	584,930	0.3	552,980	0.3	31,950
Capital credits	34,256	0.0	29,665	0.0	4,591
Other nonoperating income	101,528	0.1	109,061	0.1	(7,533)
Total nonoperating margins	720,714	0.4	691,706	0.4	29,008
NET MARGINS	11,090,843	5.9	9,656,872	5.2	\$ 1,433,971
COMPREHENSIVE LOSS					
Post-retirement benefit obligation loss	(850,700)		(272,100)		
COMPREHENSIVE INCOME	\$ 10,240,143		\$ 9,384,772		

KAUA'I ISLAND UTILITY COOPERATIVE
CONSOLIDATED STATEMENTS OF EQUITIES AND MARGINS

	Years Ended December 31,	
	2012	2011
Memberships		
Balance at January 1,	\$ 428	\$ 409
Additions	6	19
	<u>434</u>	<u>428</u>
Balance at December 31,		
Patronage capital		
Balance at January 1,	68,383,816	59,755,656
Transfer of net margins	11,090,843	9,656,872
Retirement of capital credits, net	(1,103,216)	(1,028,712)
	<u>78,371,443</u>	<u>68,383,816</u>
Balance at December 31,		
Other equity		
Balance at January 1,	193,841	120,990
Additions	61,786	72,851
	<u>255,627</u>	<u>193,841</u>
Balance at December 31,		
Post-retirement benefit obligation gain (loss)		
Balance at January 1,	769,400	1,041,500
Loss	(850,700)	(272,100)
	<u>(81,300)</u>	<u>769,400</u>
Balance at December 31,		
Total equities and margins	<u>\$ 78,546,204</u>	<u>\$ 69,347,485</u>

KAUA'I ISLAND UTILITY COOPERATIVE
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net margins	\$ 11,090,843	\$ 9,656,872
Adjustments to reconcile net margins to net cash from operating activities		
Depreciation and amortization	13,807,592	13,727,445
Capital credits allocated	(34,256)	(29,665)
Change in assets and liabilities		
Accounts and notes receivable and unbilled revenue	(2,571,893)	(2,785,487)
Energy rate adjustment clause	(1,008,029)	965,936
Inventories and other current and accrued assets	(980,431)	152,928
Deferred debits	(1,641,510)	889,733
Post-retirement benefit obligation	(348,800)	(372,200)
Accounts payable, consumer deposits and accrued expenses	(928,175)	3,291,473
Deferred credits	2,137,785	15,183
Net cash from operating activities	<u>19,523,126</u>	<u>25,512,218</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to utility plant, net	(23,830,845)	(25,529,137)
Rural economic development loans	(272,039)	81,515
Other property and investments	(1,870)	1,687
Net cash from investing activities	<u>(24,104,754)</u>	<u>(25,445,935)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Payments on long-term debt	(10,233,271)	(9,829,402)
Borrowings from long-term debt	10,322,000	-
Net activity on line of credit	5,478,000	8,700,000
Memberships	6	19
Other equity	61,786	72,851
Retirement of patronage capital	(1,103,216)	(1,028,712)
Net cash from financing activities	<u>4,525,305</u>	<u>(2,085,244)</u>
CHANGE IN CASH AND CASH EQUIVALENTS	(56,323)	(2,018,961)
CASH AND CASH EQUIVALENTS, beginning of year	<u>4,067,534</u>	<u>6,086,495</u>
CASH AND CASH EQUIVALENTS, end of year	<u>\$ 4,011,211</u>	<u>\$ 4,067,534</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION		
Cash paid during the year for		
Interest on long-term debt	\$ 8,335,362	\$ 8,668,886
Income taxes	\$ 354	\$ 5,012

KAUA'I ISLAND UTILITY COOPERATIVE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 – Nature of Organization and Operations

Kaua'i Island Utility Cooperative (KIUC or the Cooperative), a not-for-profit cooperative association pursuant to the provisions of Chapter 421C of the Hawaii Revised Statutes, was formed to purchase and operate the electric utility on the island of Kaua'i, Hawaii. KIUC is the exclusive retail electric service provider for the island of Kaua'i and provides electric generation, transmission and distribution services to approximately 36,000 customers. The Cooperative's headquarters facility is located in Lihue, Hawaii.

On November 1, 2002, the Cooperative acquired substantially all of the assets of Kaua'i Electric (KE), a division of Citizens Communications Company (Citizens). The aggregate purchase price was approximately \$218 million, which included transaction costs incurred in the acquisition, and was financed by lines of credit from the National Rural Utilities Cooperative Finance Corporation (CFC) and loans from the U.S. government.

On October 10, 2011, the Cooperative created a wholly owned subsidiary, KIUC Renewable Solutions One LLC (KRS One). KRS One is a Delaware limited liability company that has elected to be treated as a corporation for federal tax purposes. KRS One was created to construct, own, and operate a photovoltaic (PV) facility for the purpose of selling the renewable energy produced by the PV facility to the Cooperative for use in the Cooperative's operations.

The accompanying consolidated financial statements reflect the financial position and results of operations for the Cooperative and its wholly owned subsidiary KRS One. See Note 2, principles of consolidation, for further discussion on consolidation.

Note 2 – Summary of Significant Accounting Policies

Principles of consolidation – The consolidated financial statements include the accounts of the Cooperative and its wholly owned subsidiary, KRS One. The consolidation of the Cooperative and KRS One eliminated all inter-company transactions and balances. See supplemental information for details on the elimination of inter-company transactions and balances.

Basis of accounting and presentation – The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as applied to regulated enterprises, which conform to policies prescribed or permitted by the Hawaii Public Utilities Commission (HPUC) and the United States Department of Agriculture, Rural Utilities Service (RUS).

The accounting records of the Cooperative are maintained in accordance with the Uniform System of Accounts as prescribed by the Federal Energy Regulatory Commission (FERC) for Class A and B electric utilities.

KAUA'I ISLAND UTILITY COOPERATIVE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 – Summary of Significant Accounting Policies (continued)

Regulatory accounting – Due to regulation of its rates by the HPUC, the Cooperative follows regulatory accounting requirements. Regulatory accounting requirements recognize that the ratemaking process can result in differences in the application of generally accepted accounting principles between regulated and non-regulated businesses. Such differences generally involve the accounting period in which various transactions enter into the determination of net margins. Accordingly, certain costs and income may be capitalized as a regulatory asset or liability that would otherwise be charged to expense or revenues. Regulatory assets and liabilities are recorded when it is probable that future rates will permit recovery and are approved by the HPUC (see Notes 6 and 10). Such balances are amortized over the period specified by the HPUC.

In accordance with an HPUC Decision & Order, KIUC is allowed recovery of depreciation expense not realized due to the early retirement of an electric plant destroyed in hurricane Iniki. In 1996, the HPUC approved \$7,598,760 as the total amount of Iniki deferred depreciation with an amortization period of 26 years. The annual amortization amount is \$292,260 ending in 2022. The Iniki regulatory asset is amortized to depreciation expense and the offsetting Iniki regulatory liability is amortized to accumulated depreciation.

Memberships – In accordance with KIUC's bylaws, all electricity users can elect whether or not to become a member. Each member is entitled to one vote regardless of billing amounts.

Patronage capital – Net margins are assigned to individual Cooperative members' capital credit accounts based upon their pro rata use of total Cooperative electricity provided for the year (see Note 7). Capital credits are returned to members in accordance with the Cooperative's policies. Under the provisions of the mortgage agreements, until the equities and margins equal or exceed 30% of the total assets of the Cooperative, the return to patrons of capital contributed by them is limited generally to 25% of the patronage capital or margins received by the Cooperative in the prior calendar year. The equities and margins of the Cooperative represent 24.93% and 23.18% of the total assets at December 31, 2012 and 2011, respectively. Under the provisions of the 2010 HPUC approved rate case, subject to the loan agreements, KIUC is required to return patronage capital for amounts exceeding a 2.00 TIER in a given year.

Electric plant, acquisition cost, depreciation, and maintenance – Electric plant is stated at the original cost of construction, which includes the cost of contracted services, direct labor and materials, and overhead items (see Note 3). Contributions from others toward the construction of electric plant are credited to the applicable plant accounts.

In accordance with RUS accounting regulations, electric plant acquisition cost represents the difference between the purchase price for the acquisition of KE's assets and the carrying value of those assets. This amount is being amortized over the remaining useful life of the assets acquired which was originally estimated to be 25 years.

KAUA'I ISLAND UTILITY COOPERATIVE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 – Summary of Significant Accounting Policies (continued)

Provision has been made for depreciation of electric plant at a straight-line composite rate of approximately 2.9% per annum. A depreciation study was conducted in March 2009 and was approved by the HPUC in 2010. The effective date of the new depreciation rates was June 1, 2010. Depreciation for the years ended December 31, 2012 and 2011 was \$13,807,592 and \$13,727,445, respectively, of which \$13,434,517 and \$13,372,215 was charged to depreciation and amortization expense and \$373,075 and \$355,230 was allocated to other accounts, respectively.

When property which represents a retirement unit is replaced or removed, the average cost of such property as determined from the continuing property records is credited to electric plant and such cost, together with cost of removal less salvage, is charged to the accumulated provision for depreciation.

Maintenance and repairs, including the renewal of minor items of plant not comprising a retirement unit, are charged to the appropriate maintenance accounts, except that repairs of transportation and service equipment are charged to clearing accounts and redistributed to operating expense and capital accounts.

Management assesses impairment and the existence of asset retirement obligations annually and as circumstances warrant.

Investments in associated organizations – Investments in associated organizations are carried at cost (see Note 4), which approximates fair value, plus capital credits allocated and not retired.

Rural economic development loans – The Cooperative has received Rural Economic Development Grants (RED Grant) from the USDA Rural Development (USDA RD) Office in order to provide loans to promote sustainable rural economic development and job creation projects. KIUC is required to match 20% of the RED Grant award. The RED Grant is awarded to KIUC, who in turn loans the funds to the eligible project applicant at 0% interest for a term of up to ten years. When the loan recipient repays the loan, the loan funds are retained and placed into the Revolving Loan Fund (RLF) and then reused to fund new loans to additional projects (RLF Loans). The RLF Loans are made in accordance with the USDA RD approved Revolving Loan Fund Plan Loan Policies and Procedures Manual. Both the RED Grant loans and the RLF loans are stated at cost (see Note 4).

Cash equivalents – The Cooperative considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

Restricted cash – Cash restricted for rural economic development loans.

Accounts and notes receivable – Accounts and notes receivable are recorded when invoices are issued and are written off when they are determined to be uncollectible. The allowance for doubtful accounts is estimated considering the Cooperative's historical losses, review of specific problem accounts, existing economic conditions and the financial stability of its customers, currently 0.1% of monthly operating revenues. Generally, the Cooperative considers accounts receivable past due after 44 days.

KAUA'I ISLAND UTILITY COOPERATIVE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 – Summary of Significant Accounting Policies (continued)

Inventories – Materials and supplies inventories consist primarily of items for construction and maintenance of electric plant and are valued at average unit cost. Fuel inventories consist of naphtha and diesel fuel for the generation units and are valued at lower of cost or current market (see Note 5).

Preliminary survey and investigation charges – Preliminary Survey and Investigation (PSI) Charges, included under Deferred Debits, include costs for preliminary surveys, plans, and investigations made for the purpose of determining the feasibility of proposed construction projects. The portion pertaining to plant which is actually constructed is charged to Construction Work in Progress. Any portion pertaining to projects that are abandoned is charged to Other Deductions or to the appropriate operating expense account.

Accrued vacation – The Cooperative accrues accumulated unpaid vacation as the obligation is incurred. Compensated absences are included in “accrued employee compensation.”

Customer advances for construction – Customer advances for construction represent advances for construction jobs that the customer requested, such as line extensions. The customer advance is held in a deferred credit account until the requirements have been met, at which time the advance, or applicable proportion of the advance, is refunded. If the requirements are not met within a five-year time period, the advance is forfeited by the customer and credited to electric plant.

Overhaul accounting – In accordance with an HPUC Decision & Order, KIUC accrues for overhaul costs on the generation equipment by charging a proportion of the estimated cost of the overhaul, over the period covered by the overhaul cycle, to maintenance expense. The overhaul cycle for the individual generation units vary based on the type of unit and hours of use. For most generation units, the typical overhaul cycle is every two to five years. When the overhaul occurs, the actual costs are charged against the overhaul deferred credit (regulatory liability – scheduled plant maintenance), with any leftover being charged to maintenance expense (see Note 10).

Post-retirement benefits – KIUC sponsors a Retiree Welfare Benefit Plan (the Plan). The Cooperative accounts for the Plan by reporting the current economic status (the overfunded or underfunded status) of the Plan in the balance sheets and measuring the Plan assets and Plan obligations as of the balance sheets date (see Note 13).

Taxes – The Cooperative is exempt from federal income taxes under the provisions of Section 501(c)(12) of the Internal Revenue Code, except to the extent of unrelated business income, if any. The Cooperative adopted Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 740-10, relating to accounting for uncertain tax positions. As of December 31, 2012 and 2011, the Cooperative does not have any uncertain tax positions. The Cooperative files an exempt organization tax return in the U.S. federal jurisdiction and is no longer subject to examination by taxing authorities before 2009.

KAUA'I ISLAND UTILITY COOPERATIVE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 – Summary of Significant Accounting Policies (continued)

KIUC is not exempt under Hawaii Revised Statutes from state income taxes; however, margins that are allocated within a specific time period are considered a deduction for state income tax purposes. For the State of Hawaii, KIUC is assessed a 5.885% of gross revenues PSC Tax in lieu of general excise taxes and county real property taxes. Also, KIUC is assessed a 0.5% of gross revenues PUC Fee. For the County of Kaua'i, Hawaii, KIUC is assessed a 2.5% franchise fee on gross revenues.

Electric revenues and unbilled revenue – KIUC recognizes revenues based on rates (tariffs) authorized by the HPUC including unbilled revenue, revenue from electric power delivered but not yet billed to the customers.

The Cooperative's tariffs for electric service include energy rate adjustment clauses under which billings to customers are adjusted to reflect changes in the cost of fuel. In order to match power costs and related revenues, under-collected or over-collected power costs to be billed or credited to consumers in subsequent periods is recognized as a current asset or current liability and as an increase or decrease of classified operating revenues on the statement of operations.

Cushion of credit – RUS established a Cushion of Credit Payment Program, whereby borrowers may make advance payments on their RUS and Federal Financing Bank (FFB) notes. These advance payments earn interest at the rate of 5.0% per annum. The advance payments, plus any accrued interest, can only be used for the payment of principal and interest on the notes. The Cooperative's participation in the Cushion of Credit Payment Program totaled approximately \$11.3 million and \$10.7 million at December 31, 2012 and 2011, respectively, and is recorded as a reduction of RUS long-term debt on the consolidated balance sheets.

Environmental matters – KIUC is subject to federal, state and local environmental laws. These laws regulate the discharge of materials into the environment and may require KIUC to mitigate the effects of a release of a hazardous substance. Environmental matters are recorded when it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated. In general, costs related to environmental matters are charged to expense. Environmental costs are capitalized if the costs increase the value of the property and/or prevent or mitigate contamination from future operations. Although the level of future expenditures for environmental matters is difficult to determine, it is management's opinion that such costs when determined will not have a material adverse effect on KIUC's financial condition. Accordingly, no provision has been included in the accompanying consolidated financial statements.

Concentration of credit risk – Financial instruments that are exposed to concentrations of credit risk consist primarily of cash, including other investments, and receivables.

The Cooperative maintains its cash in deposit accounts in various financial institutions and its other investments in highly rated securities. At times these balances exceed federally insured limits.

KAUA'I ISLAND UTILITY COOPERATIVE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 2 – Summary of Significant Accounting Policies (continued)

Credit is extended to customers generally without collateral requirements; however, the Cooperative requires a deposit from some members upon connection, which is applied to unpaid bills and fees in the event of default. The deposit accrues interest annually and is returned along with accrued interest periodically. In addition, formal shut-off procedures are in place.

Use of estimates – The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates include the allowance for doubtful accounts, unbilled revenue, overhaul deferrals, the post-retirement benefit obligation and depreciation of electric plant. Actual results could differ from those estimates.

Subsequent events – The Cooperative has evaluated subsequent events through April 24, 2013, the date the consolidated financial statements were available to be issued.

Note 3 – Electric Plant in Service

The major classes of electric plant in service are as follows at December 31:

	<u>2012</u>	<u>2011</u>
Production plant	\$ 148,703,470	\$ 146,919,566
Transmission plant	73,822,168	73,635,610
Distribution plant	169,134,365	162,518,492
General plant	<u>28,651,879</u>	<u>26,928,249</u>
Total electric plant in service	<u><u>\$ 420,311,882</u></u>	<u><u>\$ 410,001,917</u></u>

KAUA'I ISLAND UTILITY COOPERATIVE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 4 – Other Property and Investments

Other property and investments consisted of the following at December 31:

	<u>2012</u>	<u>2011</u>
Investments in associated organizations (CFC)		
Capital term certificates, interest from 0% to 7.5% maturing through 2044 or consistent with the related debt (see Note 8)	\$ 520,926	\$ 502,716
Patronage capital	146,357	130,819
Membership/other	<u>6,602</u>	<u>4,224</u>
	<u>\$ 673,885</u>	<u>\$ 637,759</u>
Rural economic development loans		
YWCA	\$ 360,000	\$ -
National Tropical Botanical Gardens	196,875	237,500
Island School	215,625	253,125
Hale Opio	<u>54,985</u>	<u>64,821</u>
	<u>827,485</u>	<u>555,446</u>
Total other property and investments	<u>\$ 1,501,370</u>	<u>\$ 1,193,205</u>

Note 5 - Inventories

Inventories consisted of the following at December 31:

	<u>2012</u>	<u>2011</u>
Materials and supplies	\$ 12,744,875	\$ 12,370,029
Fuel	<u>2,043,548</u>	<u>1,662,614</u>
Total inventories	<u>\$ 14,788,423</u>	<u>\$ 14,032,643</u>

KAUA'I ISLAND UTILITY COOPERATIVE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6 – Deferred Debits

Deferred debits consisted of the following at December 31:

	<u>2012</u>	<u>2011</u>
Regulatory asset – Iniki damage	\$ 2,849,472	\$ 3,141,732
Regulatory asset – post-retirement transition	-	68,961
Regulatory asset – demand-side management (DSM) and integrated resource plan (IRP)	(19,274)	(20,226)
Preliminary survey and investigation	3,269,366	1,924,008
Other deferred debits	<u>987,503</u>	<u>331,082</u>
Total deferred debits	<u>\$ 7,087,067</u>	<u>\$ 5,445,557</u>

Note 7 – Patronage Capital

Patronage capital consisted of the following at December 31:

	<u>2012</u>	<u>2011</u>
Assigned	\$ 86,409,599	\$ 76,752,727
Assignable	<u>11,090,843</u>	<u>9,656,872</u>
	97,500,442	86,409,599
Less: Retired	<u>(19,128,999)</u>	<u>(18,025,783)</u>
Total patronage capital	<u>\$ 78,371,443</u>	<u>\$ 68,383,816</u>

KAUA'I ISLAND UTILITY COOPERATIVE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8 – Long-Term Debt

The Cooperative has long-term debt due to RUS, CFC, and FFB. Substantially all assets of the Cooperative are pledged as security for the long-term debt and the notes are subject to certain covenants.

Following is a summary of long-term debt at December 31:

	<u>2012</u>	<u>2011</u>
Fixed and variable notes payable due to RUS in monthly installments of principal and interest with rates ranging from 1.625% to 4.875%, maturing October 31, 2027.	\$ 160,982,574	\$ 168,614,673
Fixed and variable notes payable due to FFB in quarterly installments of principal and interest with rates ranging from 2.837% to 4.430%, maturing December 31, 2023.	22,969,971	24,629,796
Fixed and variable notes payable due to FFB in quarterly installments of principal and interest with rates ranging from 2.424% to 2.604%, maturing December 31, 2042.	10,322,000	-
Fixed note payable due to CFC in quarterly installments of principal and interest at a rate of 2.725%, maturing September 30, 2023.	5,036,706	5,431,715
RUS/FFB advance payments (cushion of credit)	<u>(11,270,335)</u>	<u>(10,723,997)</u>
Total long-term debt	188,040,916	187,952,187
Less current maturities	<u>(10,395,000)</u>	<u>(9,661,000)</u>
Long-term debt, less current maturities	<u>\$ 177,645,916</u>	<u>\$ 178,291,187</u>

Maturities of long-term debt for the next five years and thereafter are as follows:

2013	\$ 10,395,000
2014	15,803,327
2015	10,892,831
2016	11,313,916
2017	11,767,828
Thereafter	<u>127,868,014</u>
	<u>\$ 188,040,916</u>

KAUA'I ISLAND UTILITY COOPERATIVE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 8 – Long-Term Debt (continued)

The carrying value for variable rate debt is considered fair value due to the frequency of repricing. The fair market value of the Cooperative's fixed rate long-term debt is determined using currently quoted or offered rates for similar issues.

	Carrying Value	Fair Value
	<u> </u>	<u> </u>
December 31, 2012	\$ 199,311,250	\$ 134,119,407
December 31, 2011	\$ 198,676,184	\$ 129,187,782

Note 9 – Line of Credit

The Cooperative has a perpetual \$60,000,000 disaster line of credit, a perpetual \$5,000,000 line of credit for short-term financing, and a 3-year \$20,000,000 line of credit for construction financing with CFC all at a variable interest rate. Subsequent to year-end, KIUC executed a 3-year non-revolving line of credit with CFC on January 10, 2013 in the amount of \$70,000,000 to finance construction of KRS One. The lines are secured by substantially all Cooperative assets and subject to termination provisions and certain covenants. The total balance outstanding was \$14,178,000 and \$8,700,000 at December 31, 2012 and 2011.

Note 10 – Deferred Credits

Deferred credits consisted of the following:

	2012	2011
	<u> </u>	<u> </u>
Rural economic development grant	\$ 1,223,134	\$ 921,927
Customer advances for construction	3,428,700	3,466,422
Regulatory liability – Iniki	2,849,472	3,141,732
Regulatory liability – scheduled plant maintenance	4,279,936	2,113,376
	<u> </u>	<u> </u>
	\$ 11,781,242	\$ 9,643,457
	<u> </u>	<u> </u>

KAUA'I ISLAND UTILITY COOPERATIVE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 – Litigation, Commitments, and Contingencies

Litigation – In the normal course of business, the Cooperative is a party to claims and matters of litigation. The ultimate outcome of these matters cannot presently be determined; however, in the opinion of management of the Cooperative, the resolution of these matters will not have a material adverse effect on the Cooperative's financial position, results of operations or liquidity.

Fuel contract – As a result of the purchase of KE assets, Citizens assigned to KIUC a fuel supply contract with an international oil refining company that is renewable for 12-month periods unless terminated by KIUC or the supplier; 100.0% of KIUC's fuel is obtained through this supply contract. The price is adjusted monthly to equal a published price, as defined, plus other defined costs such as terminal and freight costs. Fuel costs under this contract for the years ended December 31, 2012 and 2011 were \$94,032,833 and \$89,769,233, respectively. The contract was renegotiated and signed December 2011, with an effective date of April 1, 2012.

Power supply – Most of KIUC's power is generated using diesel and naphtha generating units. In addition, KIUC maintains various power supply agreements to purchase power from hydroelectric and photovoltaic projects. The terms of the agreements vary and include termination provisions.

In 2011, the Cooperative installed a 41kW roof solar photovoltaic system on its Port Allen maintenance shop roof. In addition, the Cooperative installed 16 utility pole mount solar photovoltaic panels which generate a total of 3 kW. In 2012, the Cooperative installed an additional 28 utility pole mount solar photovoltaic panels which generate a total of 6 kW.

In 2011, the Cooperative created a wholly owned subsidiary, KIUC Renewable Solutions One LLC (KRS One). KRS One is developing a 12 MW solar photovoltaic facility with an integrated Battery Energy Storage System and associated interconnection facilities on a 55-acre parcel of land leased from the State of Hawaii, Department of Hawaiian Home Lands located in Anahola, Kauai, Hawaii. The output of the project is expected to provide 12 MW of peak power for the electric system on Kauai, an amount that represents about 5% of total energy consumption and would power approximately 4,000 homes. The solar project is being built for KRS One under an Engineering Procurement and Construction contract with REC Solar, Inc. and is expected to be placed in service in the first quarter of 2014. This project is estimated to have a 25-year life.

In 2011, the Cooperative signed an agreement with McBryde Sugar Company, Limited, to purchase power from its proposed 6 MW solar photovoltaic facility, which was placed in service December 2012. This contract has a term of 20 years.

In 2011, the Cooperative signed an agreement with MP2 Hawaii Solar I, LLC, to purchase power from its proposed 300kW photovoltaic facility, which was completed in December 2012 and placed in service in January 2013. This contract has a term of 20 years.

KAUA'I ISLAND UTILITY COOPERATIVE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11 – Litigation, Commitments, and Contingencies (continued)

In 2012, the Cooperative created a wholly owned subsidiary, KIUC Renewable Solutions Two LLC (KRS Two). KRS Two is developing a 12 MW solar photovoltaic facility with an integrated Battery Energy Storage System and associated interconnection facilities on a 67-acre parcel of land leased from Grove Farm Co., Inc. near Koloa, Kauai, Hawaii. The output of the project is expected to provide 12 MW of peak power for the electric system on Kauai, an amount that represents about 5% of total energy consumption and would power approximately 4,000 homes. The solar project is being built for KRS Two under an Engineering Procurement and Construction contract with SolarCity and is expected to be placed in service in the second quarter of 2014. The project is expected to have a 25-year life.

Union contract – KIUC has an agreement with one union. As of December 31, 2012, 60% of the positions and 60% of the employees were covered by the union contract. The agreement expires in December 2015.

Operating lease – KIUC leases their headquarters under a non-cancelable operating lease which expires in 2020 and contains options to extend the term up to an additional 25 years. The lease also includes an option to purchase the landlord's interest, as defined, in the year 2025. As of December 31, 2012, the future minimum rental commitment under this lease is as follows:

2013	\$ 1,077,000
2014	1,077,000
2015	1,077,000
2016	1,020,000
2017	1,020,000
Thereafter	<u>3,060,000</u>
	<u>\$ 8,331,000</u>

In addition to the amounts above, the Cooperative is responsible for common area maintenance costs, real property taxes and other reimbursable operating expenses. Rent expense for the years ended December 31, 2012 and 2011 was \$1,313,679 and \$1,310,312, respectively.

Note 12 – Pension Benefits

Effective November 1, 2002, the Cooperative adopted a retirement program available for all employees meeting length of service requirements. The program is a multi-employer plan administered by the National Rural Electric Cooperative Association (NRECA) and includes a non-contributory defined benefit pension and a contributory defined contribution 401(k) plan. Approximately 1,000 rural electric systems participate in each of these plans. Withdrawal from the plan may result in the Cooperative having a significant obligation to the program. The Cooperative does not currently intend to withdraw from the plan and, accordingly, no provision has been included in the accompanying financial statements.

KAUA'I ISLAND UTILITY COOPERATIVE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 12 – Pension Benefits (continued)

RS Plan Disclosure Information for the Retirement Security Plan

The National Rural Electric Cooperative Association (NRECA) Retirement Security Plan (RS Plan) is a defined benefit pension plan qualified under Section 401 and tax-exempt under Section 501(a) of the Internal Revenue Code. It is a multiemployer plan under the accounting standards. The plan sponsor's Employer Identification Number is 53-0116145 and the Plan Number is 333.

A unique characteristic of a multiemployer plan compared to a single employer plan is that all plan assets are available to pay benefits of any plan participant. Separate asset accounts are not maintained for participating employers. This means that assets contributed by one employer may be used to provide benefits to employees of other participating employers.

Plan Information

The Cooperative's contributions to the RS Plan in 2012 and in 2011 represented less than 5 percent of the total contributions made to the plan by all participating employers. The Cooperative made contributions to the plan of \$3,132,838 in 2012 and \$2,761,775 in 2011. There have been no significant changes that affect the comparability of 2012 and 2011 contributions.

In the RS Plan, a "zone status" determination is not required, and therefore not determined, under the Pension Protection Act (PPA) of 2006. In addition, the accumulated benefit obligations and plan assets are not determined or allocated separately by individual employer. In total, the Retirement Security Plan was between 65% and 80% funded at January 1, 2012 and over 80% funded at January 1, 2011, based on the PPA funding target and PPA actuarial value of assets on those dates.

Because the provisions of the PPA do not apply to the RS Plan, funding improvement plans and surcharges are not applicable. Future contribution requirements are determined each year as part of the actuarial valuation of the plan and may change as a result of plan experience.

Disclosure Information for the NRECA 401(K) Plan

The NRECA 401(k) permits elective contributions up to 100% of the participant's salary to a maximum of \$17,000. These limits do not include certain catch-up provisions and provides the Cooperative will match 50% of the first 8% of employee base pay contributions. The Cooperative employer portion of the 401(k) plan contributions for 2012 and 2011 totaled \$486,914 and \$471,586, respectively.

KAUA'I ISLAND UTILITY COOPERATIVE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13 – Post-Retirement Benefits

The KIUC Retiree Welfare Benefit Plan (the Plan) and its associated trust, the KIUC Retiree Welfare Benefit Trust (the Trust), were adopted effective January 1, 2003. The Plan provides certain non-contributory medical (which includes a dollar cap, for which retirees pay back KIUC for amounts exceeding the cap), dental, vision and life insurance benefits for retired employees, their beneficiaries, and covered dependents. Benefits are paid on behalf of retirees and are a function of medical insurance costs and number of retirees. Benefits paid for the years ended December 31, 2012 and 2011 were \$297,316 and \$332,403, respectively. The measurement date for the current valuation is December 31, 2012.

KAUA'I ISLAND UTILITY COOPERATIVE
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13 – Post-Retirement Benefits (continued)

Assumptions:

The actuarial cost method used for the valuation is the projected unit credit cost method.

Weighted-average assumptions used to determine the net periodic benefit cost for the year ended December 31, 2012:

- Discount rate: 4.5%
- Expected long-term return on plan assets: 3.15% (based on the five-year performance of the funds, weighted by market value as of December 31, 2012)
- Health care cost trend rate assumed for next year: 7.0%
- Rate to which the cost trend rate is assumed to decline (the ultimate trend rate): 5.0% in 2017

	2012	2011
I) Net post-retirement benefit cost		
Service cost	\$ -	\$ -
Interest cost	284,400	291,200
Expected return on plan assets	(102,800)	(86,800)
Amortization of actuarial gain	(127,600)	(171,900)
Net post-retirement benefit cost	\$ 54,000	\$ 32,500
II) Accumulated post-retirement benefit obligation (APBO)		
APBO balance at the beginning of year	\$ (5,143,300)	\$ (5,256,800)
Net actuarial loss and other	(1,185,076)	(258,601)
Net post-retirement benefit cost	(54,000)	(32,500)
Benefits paid	380,376	404,601
Net post-retirement benefit obligation at year-end	\$ (6,002,000)	\$ (5,143,300)
III) Reconciliation of funded status		
APBO	\$ (6,002,000)	\$ (5,143,300)
Assets funded	3,619,600	3,262,800
Accrued post-retirement funded status	\$ (2,382,400)	\$ (1,880,500)
IV) Accumulated other comprehensive (gain) loss		
Unrecognized prior service cost	\$ (769,400)	\$ (1,041,500)
Other comprehensive loss	850,700	272,100
Accumulated other comprehensive (gain) loss	\$ 81,300	\$ (769,400)

KAUA'I ISLAND UTILITY COOPERATIVE

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13 – Post-Retirement Benefits (continued)

The following benefit payments, which reflect expected future service as appropriate, are expected to be paid:

2013	\$	417,600
2014		423,300
2015		397,700
2016		381,800
2017		368,600
2018 – 2022		1,813,300

The Plan has been partially funded as of December 31, 2012. The Plan assets are held in the Trust and are invested in the Central Pacific Bank's Trust Division at December 31, 2012.

The Plan assets are managed by a trustee and are authorized to be held in various equity and fixed income investments and cash equivalents. The trustee is not allowed to invest in real estate or any other investment other than those noted in the investment policy. The investing strategy is long-term with a focus on moderate volatility and moderate growth investments. All investments at December 31, 2012 and 2011 were level one investments as outlined in the fair value hierarchy as they have quoted prices in active markets for identical assets. The following table shows the investment allocation for Plan assets:

	2012		2011			
Cash and other accrued income	\$	6,169	0%	\$	3,677	0%
Mutual funds		3,298,623	91%		1,405,881	43%
Bonds		314,808	9%		194,760	6%
Fixed income		-	0%		958,844	29%
Equities		-	0%		699,658	22%
Due to brokers		-	0%		(20)	0%
		\$			\$	3,262,800

SUPPLEMENTARY INFORMATION

REPORT OF INDEPENDENT AUDITORS ON SUPPLEMENTARY INFORMATION

To the Board of Directors
Kaua'i Island Utility Cooperative

We have audited the consolidated financial statements of Kaua'i Island Utility Cooperative (the Cooperative) as of and for the years ended December 31, 2012 and 2011 and have issued our report thereon dated April 24, 2013. The audits were conducted for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The supplementary information as of and for the years ended December 31, 2012 and 2011 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements as a whole.



Portland, Oregon
April 24, 2013

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KAUA'I ISLAND UTILITY COOPERATIVE
CONSOLIDATING BALANCE SHEETS
DECEMBER 31, 2012

	As of December 31, 2012			KIUC Consolidated
	KIUC	KRS One	Eliminations	
UTILITY PLANT				
Electric plant in service	\$ 420,311,882	\$ -	\$ -	\$ 420,311,882
Electric plant acquisition cost	54,852,453	-	-	54,852,453
Accumulated depreciation and amortization	(238,615,696)	-	-	(238,615,696)
Net electric plant in service	236,548,639	-	-	236,548,639
Construction work in progress	18,901,804	7,805,837	-	26,707,641
Net utility plant	255,450,443	7,805,837	-	263,256,280
OTHER PROPERTY AND INVESTMENTS				
Investments in subsidiary companies	8,052,200	-	(8,052,200)	-
Investments in associated organizations	673,885	-	-	673,885
Rural economic development loans	827,485	-	-	827,485
Total other property and investments	9,553,570	-	(8,052,200)	1,501,370
CURRENT ASSETS				
Cash and cash equivalents	3,126,138	249,358	-	3,375,496
Restricted cash and cash equivalents	635,715	-	-	635,715
Accounts and notes receivable, less allowance for doubtful accounts of \$468,161 and \$454,699 in 2012 and 2011, respectively	13,867,571	-	-	13,867,571
Accrued unbilled revenue	8,927,119	-	-	8,927,119
Energy rate adjustment clause	467,044	-	-	467,044
Inventories	14,788,423	-	-	14,788,423
Other current and accrued assets	1,220,917	-	-	1,220,917
Total current assets	43,032,927	249,358	-	43,282,285
DEFERRED DEBITS	7,087,067	-	-	7,087,067
Total assets	\$ 315,124,007	\$ 8,055,195	\$ (8,052,200)	\$ 315,127,002

KAUA'I ISLAND UTILITY COOPERATIVE
CONSOLIDATING BALANCE SHEETS
DECEMBER 31, 2012

	As of December 31, 2012			KIUC Consolidated
	KIUC	KRS One	Eliminations	
EQUITIES AND MARGINS	\$ 78,546,204	\$ (229,750)	229,750	\$ 78,546,204
LONG-TERM DEBT, less current maturities	177,645,916	8,081,712	(8,081,712)	177,645,916
POST-RETIREMENT BENEFIT OBLIGATION	2,382,400	-	-	2,382,400
COMMITMENTS AND CONTINGENCIES (NOTE 11)				
CURRENT LIABILITIES				
Current maturities of long-term debt	10,395,000	-	-	10,395,000
Line of credit	14,178,000	-	-	14,178,000
Accounts payable	6,250,710	2,995	-	6,253,705
Energy rate adjustment clause	-	-	-	-
Consumer deposits	1,272,909	-	-	1,272,909
Accrued employee compensation	2,257,497	-	-	2,257,497
Accrued taxes	10,231,266	-	-	10,231,266
Other current and accrued liabilities	182,863	200,238	(200,238)	182,863
Total current liabilities	44,768,245	203,233	(200,238)	44,771,240
DEFERRED CREDITS	11,781,242	-	-	11,781,242
Total liabilities and equities	\$ 315,124,007	\$ 8,055,195	\$ (8,052,200)	\$ 315,127,002

**KAUA'I ISLAND UTILITY COOPERATIVE
CONSOLIDATING STATEMENT OF OPERATIONS
YEAR ENDED DECEMBER 31, 2012**

	As of December 31, 2012			
	KIUC	KRS One	Eliminations	KIUC Consolidated
OPERATING REVENUES				
Residential	\$ 70,785,142	\$ -	\$ -	\$ 70,785,142
Irrigation	58,037	-	-	58,037
Commercial and industrial	115,808,374	-	-	115,808,374
Public street and highway lighting	1,647,004	-	-	1,647,004
Other operating revenues	153,179	-	-	153,179
Total operating revenues	188,451,736	-	-	188,451,736
OPERATING EXPENSES				
Power cost	118,103,206	-	-	118,103,206
Transmission – operation	337,746	-	-	337,746
Transmission – maintenance	561,774	-	-	561,774
Distribution – operation	1,097,882	-	-	1,097,882
Distribution – maintenance	2,574,091	-	-	2,574,091
Customer accounts	2,694,477	-	-	2,694,477
Customer service and information	653,260	-	-	653,260
Administrative and general	13,954,163	4,512	-	13,958,675
Depreciation and amortization	13,434,517	-	-	13,434,517
Taxes	15,782,639	-	-	15,782,639
Other interest expense	547,978	193,678	(193,678)	547,978
Total operating expenses	169,741,733	198,190	(193,678)	169,746,245
OPERATING MARGINS, before interest	18,710,003	(198,190)	193,678	18,705,491
INTEREST ON LONG-TERM DEBT	8,335,362	-	-	8,335,362
OPERATING MARGINS	10,374,641	(198,190)	193,678	10,370,129
NONOPERATING MARGINS				
Interest income	778,608	-	(193,678)	584,930
Capital credits	34,256	-	-	34,256
Other nonoperating income	(96,662)	-	198,190	101,528
Total nonoperating margins	716,202	-	4,512	720,714
NET MARGINS	11,090,843	(198,190)	198,190	11,090,843
COMPREHENSIVE INCOME				
Post-retirement benefit obligation gain	(850,700)	-	-	(850,700)
COMPREHENSIVE INCOME	\$ 10,240,143	\$ (198,190)	\$ 198,190	\$ 10,240,143

KAUA'I ISLAND UTILITY COOPERATIVE
CONSOLIDATING BALANCE SHEETS
DECEMBER 31, 2011

	As of December 31, 2011			KIUC Consolidated
	KIUC	KRS One	Eliminations	
UTILITY PLANT				
Electric plant in service	\$ 410,001,917	\$ -	\$ -	\$ 410,001,917
Electric plant acquisition cost	54,852,453	-	-	54,852,453
Accumulated depreciation and amortization	(230,027,434)	-	-	(230,027,434)
Net electric plant in service	234,826,936	-	-	234,826,936
Construction work in progress	13,452,399	4,953,692	-	18,406,091
Net utility plant	248,279,335	4,953,692	-	253,233,027
OTHER PROPERTY AND INVESTMENTS				
Investments in subsidiary companies	5,593,493	-	(5,593,493)	-
Investments in associated organizations	637,759	-	-	637,759
Rural economic development loans	555,446	-	-	555,446
Total other property and investments	6,786,698	-	(5,593,493)	1,193,205
CURRENT ASSETS				
Cash and cash equivalents	2,881,185	639,801	-	3,520,986
Restricted cash and cash equivalents	546,548	-	-	546,548
Accounts and notes receivable, less allowance for doubtful accounts of \$454,699 and \$711,029 in 2011 and 2010, respectively	12,164,224	-	-	12,164,224
Accrued unbilled revenue	8,058,573	-	-	8,058,573
Energy rate adjustment clause	-	-	-	-
Inventories	14,032,643	-	-	14,032,643
Other current and accrued assets	996,266	-	-	996,266
Total current assets	38,679,439	639,801	-	39,319,240
DEFERRED DEBITS	5,445,557	-	-	5,445,557
Total assets	\$ 299,191,029	\$ 5,593,493	\$ (5,593,493)	\$ 299,191,029

KAUA'I ISLAND UTILITY COOPERATIVE
CONSOLIDATING BALANCE SHEETS
DECEMBER 31, 2011

	As of December 31, 2011			KIUC Consolidated
	KIUC	KRS One	Eliminations	
EQUITIES AND MARGINS	\$ 69,347,485	\$ (31,560)	\$ 31,560	\$ 69,347,485
LONG-TERM DEBT, less current maturities	178,291,187	5,618,493	(5,618,493)	178,291,187
POST-RETIREMENT BENEFIT OBLIGATION	1,880,500	-	-	1,880,500
COMMITMENTS AND CONTINGENCIES (NOTE 11)				
CURRENT LIABILITIES				
Current maturities of long-term debt	9,661,000	-	-	9,661,000
Line of credit	8,700,000	-	-	8,700,000
Accounts payable	7,980,716	-	-	7,980,716
Energy rate adjustment clause	540,985	-	-	540,985
Consumer deposits	1,248,210	-	-	1,248,210
Accrued employee compensation	2,047,226	-	-	2,047,226
Accrued taxes	9,684,268	-	-	9,684,268
Other current and accrued liabilities	165,995	6,560	(6,560)	165,995
Total current liabilities	40,028,400	6,560	(6,560)	40,028,400
DEFERRED CREDITS	9,643,457	-	-	9,643,457
Total liabilities and equities	\$ 299,191,029	\$ 5,593,493	\$ (5,593,493)	\$ 299,191,029

**KAUA'I ISLAND UTILITY COOPERATIVE
CONSOLIDATING STATEMENT OF OPERATIONS
YEAR ENDED DECEMBER 31, 2011**

	As of December 31, 2011			
	KIUC	KRS One	Eliminations	KIUC Consolidated
OPERATING REVENUES				
Residential	\$ 69,031,915	\$ -	\$ -	\$ 69,031,915
Irrigation	33,626	-	-	33,626
Commercial and industrial	111,772,088	-	-	111,772,088
Public street and highway lighting	1,573,722	-	-	1,573,722
Other operating revenues	168,047	-	-	168,047
Total operating revenues	<u>182,579,398</u>	<u>-</u>	<u>-</u>	<u>182,579,398</u>
OPERATING EXPENSES				
Power cost	113,100,392	25,000	-	113,125,392
Transmission – operation	320,984	-	-	320,984
Transmission – maintenance	724,633	-	-	724,633
Distribution – operation	1,202,106	-	-	1,202,106
Distribution – maintenance	2,852,571	-	-	2,852,571
Customer accounts	2,549,349	-	-	2,549,349
Customer service and information	612,107	-	-	612,107
Administrative and general	14,766,674	-	-	14,766,674
Depreciation and amortization	13,372,215	-	-	13,372,215
Taxes	15,288,561	-	-	15,288,561
Other interest expense	130,754	6,560	(6,560)	130,754
Total operating expenses	<u>164,920,346</u>	<u>31,560</u>	<u>(6,560)</u>	<u>164,945,346</u>
OPERATING MARGINS, before interest	17,659,052	(31,560)	6,560	17,634,052
INTEREST ON LONG-TERM DEBT	8,668,886	-	-	8,668,886
OPERATING MARGINS	<u>8,990,166</u>	<u>(31,560)</u>	<u>6,560</u>	<u>8,965,166</u>
NONOPERATING MARGINS				
Interest income	559,540	-	(6,560)	552,980
Capital credits	29,665	-	-	29,665
Other nonoperating income	77,501	-	31,560	109,061
Total nonoperating margins	<u>666,706</u>	<u>-</u>	<u>25,000</u>	<u>691,706</u>
NET MARGINS	9,656,872	(31,560)	31,560	9,656,872
COMPREHENSIVE INCOME				
Post-retirement benefit obligation gain	(272,100)	-	-	(272,100)
COMPREHENSIVE INCOME	<u>\$ 9,384,772</u>	<u>\$ (31,560)</u>	<u>\$ 31,560</u>	<u>\$ 9,384,772</u>

REPORT REQUIRED BY GOVERNMENT AUDITING STANDARDS

REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors
Kaua'i Island Utility Cooperative

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Kaua'i Island Utility Cooperative (the Cooperative) as of and for the year ended December 31, 2012, and the related notes to the financial statements, and have issued our report thereon dated April 24, 2013.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Cooperative's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**REPORT OF INDEPENDENT AUDITORS ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT
AUDITING STANDARDS*
(continued)**

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Cooperative's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to the Cooperative's Board of Directors and management in a presentation.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Portland, Oregon
April 24, 2013