Consolidated Financial Statements
December 31, 2016 and 2015

Kaua'i Island Utility Cooperative

EideBailly
CPAs & BUSINESS ADVISORS

Independent Auditor's Report

The Board of Directors
Kaua'i Island Utility Cooperative
Lihue, Kaua'i, Hawaii

Report on the Financial Statements
We have audited the accompanying consolidated financial statements of Kaua'i Island Utility Cooperative which comprise the consolidated balance sheet as of December 31, 2016 and 2015, and the related consolidated statements of operations, equities, and cash flows for the years then ended, and the related notes to the consolidated 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 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 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.

Opinion
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Kaua'i Island Utility Cooperative as of December 31, 2016 and 2015, and the consolidated results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

200 E. 10th St., Ste. 500 | P.O. Box 5125 | Sioux Falls, SD 57117-5125 | T 605.339.1999 | F 605.339.1306 | EOE

Report Issued in Accordance with Government Auditing Standards
In accordance with *Government Auditing Standards*, we have also issued a report dated April 10, 2017 on our consideration of Kaua'i Island Utility Cooperative's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, 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 the internal control over financial reporting or on compliance. Those reports are an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Kaua'i Island Utility Cooperative's internal control over financial reporting and compliance.

Eide Bailly LLP

Sioux Falls, South Dakota
April 10, 2017

(This page left blank intentionally.)

	2016	2015
Assets		
Utility Plant		
Electric plant in service	$ 531,571,236	$ 546,374,192
Electric plant acquisition cost	54,852,453	54,852,453
Accumulated depreciation and amortization	(277,043,994)	(265,316,187)
Net electric plant in service	309,379,695	335,910,458
Construction work in progress	10,497,169	8,311,847
Net utility plant	319,876,864	344,222,305
Other Property and Investments		
Investments in associated organizations	1,035,816	889,780
Rural economic development loans	1,162,866	873,750
Total other investments	2,198,682	1,763,530
Current Assets		
Cash and cash equivalents	11,059,315	19,447,410
Restricted cash and cash equivalents	2,267,151	2,126,117
Accounts and notes receivable, less allowance ($225,000 and $688,103 as of December 31, 2016 and 2015, respectively)	10,066,400	9,423,591
Accrued unbilled revenue	7,560,590	6,599,036
Inventories	13,796,978	14,538,474
Other current assets	1,340,101	1,431,463
Total current assets	46,090,535	53,566,091
Post-retirement Benefit Asset	864,300	1,252,400
Deferred Debits	11,436,894	10,509,802
	$ 380,467,275	$ 411,314,128

See Notes to Financial Statements

	2016	2015
Equities and Liabilities		
Equities		
Controlling equity interest	$ 102,980,938	$ 96,528,528
Non-controlling equity interest	21,517,825	22,702,967
Total equities	124,498,763	119,231,495
Long-Term Debt, Less Current Maturities	208,649,723	187,819,625
Asset Retirement Obligations	2,362,254	2,278,249
Current Liabilities		
Current maturities of long-term debt	14,802,318	13,952,739
Line-of-credit	5,308,600	59,500,000
Accounts payable	5,276,775	5,617,070
Energy rate adjustment clause	355,924	1,259,609
Consumer deposits	1,674,548	1,593,707
Accrued employee compensation	1,839,328	2,047,106
Accrued taxes	6,185,140	6,218,963
Other current and accrued liabilities	611,585	729,181
Total current liabilities	36,054,218	90,918,375
Deferred Credits	8,902,317	11,066,384
	$ 380,467,275	$ 411,314,128

	2016	2015
Operating Revenues		
Residential	$ 55,787,616	$ 55,512,573
Irrigation	16,264	59,629
Commercial and industrial	85,934,227	86,013,501
Public street and highway lighting	1,268,893	1,362,924
Other operating revenues	491,563	508,142
Total operating revenues	143,498,563	143,456,769
Operating Expenses		
Cost of power	74,024,340	75,873,417
Transmission - operation	383,830	408,792
Transmission - maintenance	776,727	576,009
Distribution - operation	1,380,267	1,264,327
Distribution - maintenance	3,389,191	3,058,602
Customer accounts	1,555,263	2,278,950
Customer service and information	442,917	597,264
Administrative and general	16,927,136	16,717,504
Depreciation and amortization	18,472,511	17,018,391
Taxes	12,060,249	12,100,554
Accretion expense	84,005	41,053
Other interest expense	533,276	1,371,908
Total operating expenses	130,029,712	131,306,771
Operating Margin Before Interest	13,468,851	12,149,998
Interest on Long-Term Debt	7,657,491	7,529,211
Operating Margins	5,811,360	4,620,787
Nonoperating Margins		
Interest income	683,733	613,607
Allowance for funds used during construction	-	1,098,704
Capital credits	143,430	97,309
Other nonoperating income (loss)	36,996	(534,698)
Total nonoperating margins	864,159	1,274,922
Net Margins	6,675,519	5,895,709
Net (Margins) Loss Attributable to Non-controlling Interest	(78,602)	55,172
Net Margins - Cooperative	6,596,917	5,950,881
Comprehensive Income		
Postretirement benefit obligation	65,000	(353,700)
Comprehensive Income - Cooperative	$ 6,661,917	$ 5,597,181

See Notes to Financial Statements

	2016	2015
Controlling Equity Interest		
Memberships		
Balance at January 1,	$ 483	$ 467
Additions	16	16
Balance at December 31	499	483
Patronage capital		
Balance at January 1,	96,389,604	92,527,762
Transfer of net margins	6,596,917	5,950,881
Retirement of capital credits, net	(389,607)	(2,089,039)
Balance at December 31,	102,596,914	96,389,604
Other equity		
Balance at January 1,	397,441	396,333
Additions	180,084	1,108
Balance at December 31,	577,525	397,441
Accumulated other comprehensive income (loss)		
Balance at January 1,	(259,000)	94,700
Amortization of gains and losses	259,000	(94,700)
Actuarial loss	(194,000)	(259,000)
Balance at December 31,	(194,000)	(259,000)
Total controlling equity interest	102,980,938	96,528,528
Non-Controlling Equity Interest		
Capital Account - A&B KRS II		
Balance at January 1,	22,702,967	23,928,991
Distributions	(1,263,744)	(1,170,852)
Non-controlling interest in current earnings (loss)	78,602	(55,172)
Total non-controlling equity interest	21,517,825	22,702,967
Total equities	$ 124,498,763	$ 119,231,495

	2016	2015
Operating Activities		
Net margins	$ 6,596,917	$ 5,950,881
Adjustments to reconcile net margins to net cash from operating activities		
Depreciation and amortization	19,004,772	17,510,336
Accretion of asset retirement obligation	84,005	41,053
Interest earned on cushion of credit	(666,463)	(634,155)
Capital credit allocations	(143,430)	(97,309)
Net margins attributable to non-controlling interest	78,602	(55,172)
Change in assets and liabilities		
Accounts receivable and unbilled revenue	(1,604,363)	2,197,639
Energy rate adjustment clause	(903,685)	149,839
Inventories and other current assets	832,858	(354,980)
Deferred debits	(927,092)	(2,979,055)
Postretirement benefit obligation	453,100	(492,700)
Payables and accrued expenses	(1,114,250)	(3,457,170)
Deferred credits	(2,164,067)	(544,895)
Net Cash from Operating Activities	19,526,904	17,234,312
Investing Activities		
Additions to utility plant, net	(12,855,132)	(33,371,749)
Grant funds and tax credit applied to utility plant	18,691,400	-
Rural economic development loans	(289,116)	199,563
Other investments	(2,606)	(676)
Net Cash from (used for) Investing Activities	5,544,546	(33,172,862)
Financing Activities		
Borrowings from long-term debt	166,082,640	10,961,000
Principal payments on long-term debt	(143,736,500)	(12,626,467)
Net activity on line-of-credit	(54,191,400)	20,500,000
Distributions to non-controlling equity interest	(1,263,744)	(1,170,852)
Memberships	16	16
Other equities	180,084	1,108
Retirement of patronage capital	(389,607)	(2,089,039)
Net Cash (used for) from Financing Activities	(33,318,511)	15,575,766
Net Change in Cash and Cash Equivalents	(8,247,061)	(362,784)
Cash and Cash Equivalents, Beginning of Year	21,573,527	21,936,311
Cash and Cash Equivalents, End of Year	$ 13,326,466	$ 21,573,527

	2016	2015
Supplemental Disclosures of Cash Flow Information		
Cash paid during the year for		
Interest	$ 8,190,767	$ 8,902,286
Income taxes	$ 25,500	$ 31,508
Noncash investing activities		
Liabilities incurred for asset retirement obligations	$ -	$ 1,097,446
Liabilities incurred for additions to utility plant	$ 495,599	$ -

Note 1 - Organization

General

Kaua'i Island Utility Cooperative (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. The Cooperative is the exclusive retail electric service provider for the island of Kaua'i and provides electric generation, transmission and distribution services to approximately 37,000 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 facility went into commercial operation on October 30, 2015.

On October 11, 2012, the Cooperative created a wholly owned subsidiary, KIUC Renewable Solutions Two LLC (KRS Two). KRS Two is a Delaware limited liability company that has elected to be treated as a disregarded entity for federal tax purposes. KRS Two was created to construct, own, and operate a 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 facility went into commercial operation on September 5, 2014.

On August 1, 2013, the Cooperative created a wholly owned subsidiary, KIUC Renewable Solutions Two Holdings LLC (KRS Two Holdings). KRS Two Holdings is a Delaware limited liability company that initially elected to be treated as a disregarded entity for federal tax purposes. Effective January 1, 2014, KRS Two Holdings has elected to be treated as a corporation for federal tax purposes. KRS Two Holdings was created as a holding company to own KRS Two. On August 28, 2013, the Cooperative transferred 100% of its membership interests in KRS Two to KRS Two Holdings.

On July 3, 2014, KRS Two Holdings and A&B KRS II LLC (Investor) entered into an Amended and Restated Limited Liability Company Agreement (the LLC Agreement) of KRS Two. On that date, KRS Two Holdings made a capital contribution to KRS Two in exchange for all of the Class A membership interests in KRS Two and the Investor made a capital contribution to KRS Two in exchange for all of the Class B Membership Interests in KRS Two. KRS Two Holdings is the Managing Member of KRS Two. Allocations of profits, losses, contributions, and distributions are made in accordance with the LLC Agreement. In accordance with the LLC Agreement, the "Flip Date" means the date on which Investor achieves an Internal Rate of Return (IRR) equal to the Target IRR, as defined in the LLC Agreement. As of December 31, 2016, the Flip Date had not occurred.

The accompanying consolidated financial statements reflect the financial position and results of operations for the Cooperative and its wholly owned subsidiaries KRS One and KRS Two Holdings. 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 subsidiaries, KRS One and KRS Two Holdings. KRS Two Holdings' consolidated financial statements include the accounts of KRS Two Holdings partially owned subsidiary KRS Two. The consolidation of the Cooperative, KRS One, and KRS Two Holdings eliminated all inter-company transactions and balances. The consolidation of KRS Two Holdings and KRS Two eliminated all inter-company transactions and balances. See supplementary 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.

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, the Cooperative 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 the Cooperative'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 margins received by the Cooperative in the prior calendar year. The equities and margins of the Cooperative represent 30.22% and 26.08% of the total assets at December 31, 2016 and 2015, respectively. The equity percentage is based on unconsolidated assets and equity of the Cooperative. Under the provisions of the 2010 HPUC approved rate case, subject to the loan agreements, the Cooperative 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 costs represent 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.

Provision has been made for depreciation of electric plant at a straight-line composite rate by asset category averaging approximately 3.1% 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, 2016 and 2015 was $19,004,772 and $17,510,336, respectively, of which $18,472,511 and $17,018,391 was charged to depreciation and amortization expense and $532,261 and $491,945 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. The Cooperative is required to match 20% of the RED Grant award. The RED Grant is awarded to the Cooperative, 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. Cash and cash equivalents, beginning of year, reported on the Statement of Cash Flows includes both cash and cash equivalents and restricted cash.

Restricted Cash

Restricted 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 46 days.

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 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, the Cooperative 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

The Cooperative 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 14).

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, 2016 and 2015, the Cooperative does not have any uncertain tax positions. The Cooperative files an exempt organization and unrelated business income tax return in the U.S. federal jurisdiction and the corporate subsidiaries file a corporate return with the U.S. federal and state of Hawaii jurisdictions.

The Cooperative 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, the Cooperative is also assessed a 5.885% of gross revenues Public Service Company Tax in lieu of general excise taxes and county real property taxes. Also, the Cooperative is assessed a 0.5% of gross revenues Public Utility Commission Fee. For the County of Kaua'i, Hawaii, the Cooperative is assessed a 2.5% franchise fee on gross revenues.

KRS One is a Delaware limited liability company that has elected to be treated as a corporation for federal tax purposes. KRS One has a tax net operating losses of approximately $15.7 million as of December 31, 2016. A valuation allowance has been recorded to offset the deferred tax asset related to the tax net operating losses due to the uncertainty of the ability for the Company to generate future taxable profits to utilize the tax benefit.

KRS Two Holdings is a Delaware limited liability company that has elected to be treated as a corporation for federal tax purposes. KRS Two Holdings has tax net operating losses of approximately $585,000 as of December 31, 2016. A valuation allowance has been recorded to offset the deferred tax asset related to the tax net operating losses due to the uncertainty of the ability for the Company to generate future taxable profits to utilize the tax benefit.

Electric Revenues and Unbilled Revenue

The Cooperative 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 $13.7 million and $13.1 million at December 31, 2016 and 2015, respectively, and is recorded as a reduction of RUS long-term debt on the consolidated balance sheets.

Environmental Matters

The Cooperative is subject to federal, state and local environmental laws. These laws regulate the discharge of materials into the environment and may require the Cooperative 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 the Cooperative'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.

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 only accrues interest if held longer than the establishment of 12 months of good payment history and is returned along with any 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, asset retirement obligation and depreciation of electric plant. Actual results could differ from those estimates.

Fair Value Measurements

The Cooperative has determined the fair value of certain assets and liabilities in accordance with the provisions of Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, which provides a framework for measuring fair value under generally accepted accounting principles

ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 requires that valuation techniques maximize the use of observable inputs and minimize the use of unobservable inputs. ASC 820 also establishes a fair value hierarchy, which prioritizes the valuation inputs into three broad levels.

Level 1 inputs consist of quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the related asset or liability. Level 3 inputs are unobservable inputs related to the asset or liability. The Cooperative's policy is to recognize significant transfers between levels on the date of the transfer.

Note 3 - Electric Plant in Service

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

	2016	2015
Production plant	$ 217,735,007	$ 233,069,450
Transmission plant	79,364,612	79,290,042
Distribution plant	195,610,360	196,223,744
General plant	36,624,060	35,553,759
Asset retirement costs	2,237,197	2,237,197
Total electric plant in service	$ 531,571,236	$ 546,374,192

Note 4 - Other Investments

Other investments consisted of the following at December 31:

	2016	2015
Investments in associated organizations		
National Rural Utilities Cooperative Finance Corporation		
Capital term certificates		
Subscription capital term certificates (3% interest)	$ 273,013	$ 212,352
Zero term capital certificates (0% interest, mature 2024)	164,800	164,800
Member capital securities (5% interest, first call date 2024, mature 2044)	250,000	250,000
Patronage capital	299,588	242,495
Membership	1,000	1,000
Other	47,415	19,133
	1,035,816	889,780
Rural economic development loans		
National Tropical Botanical Gardens 2	360,000	-
YWCA	243,750	288,750
Island School	65,535	103,125
National Tropical Botanical Gardens	46,875	84,375
IHP TV	140,905	-
Tiki Iniki	91,253	113,164
Kauai Brewers LLC	77,144	98,269
JC Linen	68,738	84,774
Kipuni Way	68,666	77,020
Hale Opio	-	24,273
	1,162,866	873,750
Total other investments	$ 2,198,682	$ 1,763,530

As these investments are not actively traded and there is no market value available, the fair value is considered materially comparable to cost.

Note 5 - Inventories

Inventories consisted of the following at December 31:

	2016	2015
Materials and supplies	$ 12,736,412	$ 13,067,549
Fuel	1,060,566	1,470,925
Total inventories	$ 13,796,978	$ 14,538,474

Note 6 - Deferred Debits

Deferred debits consisted of the following at December 31:

	2016	2015
Regulatory asset - Iniki damage	$ 1,680,432	$ 1,972,692
Regulatory asset - demand-side management (DSM) and integrated resource plan (IRP)	141,582	(451,942)
Regulatory asset - pension costs	3,067,146	2,364,088
DHHL Lease Road Fund	953,333	993,333
HCDC Joint Development fee	143,000	149,000
Preliminary survey and investigation	5,107,139	5,088,894
Other deferred debits	344,262	393,737
Total deferred debits	$ 11,436,894	$ 10,509,802

Regulatory asset – Iniki damage relates to costs of utility plant destroyed in 1992 that were approved by the HPUC in 1996 to be deferred over twenty-six years. The regulatory asset is being amortized to depreciation expense and the regulatory liability (Note 10) is being amortized to accumulated depreciation. Amortization was $292,260 during 2015 and 2016 and is expected to be $292,260 each year of the next five years and $219,132 in 2022.

As part of the 2009 rate case, the HPUC approved a maximum amount of annual pension plan costs to be included in rates. The rate case also required the Cooperative to establish a tracking mechanism to record changes in costs beginning in January 2010 as a regulatory asset. The treatment of the accumulated balance in the regulatory asset will be addressed in the next rate case.

Preliminary survey and investigation deferred debits includes $4,125,507 in costs related to a hydro facility that is currently in the site-control study and engineering phase in addition to engineering and related costs for other planned projects. Construction of the hydro facility is expected to begin in 2018 or 2019. Deferred preliminary survey and investigation costs are capitalized to construction in progress when the construction phase begins or expensed if the project is abandoned.

Note 7 - Patronage Capital

Patronage capital consisted of the following at December 31:

	2016	2015
Assigned to date	$ 122,054,260	$ 116,103,378
Assignable	6,596,917	5,950,881
Total	128,651,177	122,054,259
Retired to date	(26,054,263)	(25,664,655)
Balance	$ 102,596,914	$ 96,389,604

Note 8 - Long-Term Debt

The Cooperative has long-term debt due to RUS, FFB, CFC and NCSC. 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:

	2016	2015
Fixed and variable notes payable due to RUS in monthly installments of principal and interest with rates ranging from 0.875% to 4.875%, maturing October 31, 2027	$ -	$ 135,150,216
Fixed and variable notes payable due to FFB in quarterly installments of principal and interest with rates ranging from 1.341% to 4.430%, maturing December 31, 2023	15,572,923	17,527,651
Fixed and variable notes payable due to FFB in quarterly installments of principal and interest with rates ranging from 1.574% to 3.334%, maturing December 31, 2042	76,130,690	42,323,272
Fixed note payable due to CFC in quarterly installments of principal and interest at a rate of 2.725%, maturing September 30, 2023	3,330,420	3,771,737
Fixed note payable due to CFC in monthly installments of principal and interest at a rate of 2.55%, maturing March 31, 2028	126,472,472	-
RUS/FFB advance payments (cushion of credit)	(13,748,381)	(13,081,919)
Fixed noted payable due to NCSC in quarterly installments of principal and interest at a rate of 4.650%, maturing June 30, 2039	15,693,917	16,081,407
Total long-term debt	223,452,041	201,772,364
Less current maturities	(14,802,318)	(13,952,739)
Long-term debt, less current maturities	$ 208,649,723	$ 187,819,625

KRS Two has a loan with the National Cooperative Services Corporation (NCSC), an affiliate of the National Rural Utilities Cooperative Finance Corporation (CFC), to provide permanent financing for the solar project. Substantially all assets of KRS Two are pledged as security for the loan and the loan is subject to financial covenants. The Cooperative has provided NCSC with a guaranty of the indebtedness of KRS Two to NCSC.

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

2017	$ 14,802,318
2018	15,202,535
2019	15,588,266
2020	16,021,685
2021	16,451,935
Thereafter	145,385,302
	$ 223,452,041

The carrying value for variable rate debt is considered fair value due to the frequency of repricing. Generally, the carrying value of the Cooperative's fixed rate long-term debt approximates fair value, but certain fixed-rate long-term debt financial instruments of the Cooperative have carrying values that may differ from their estimated fair values. It is not practicable for the Cooperative to estimate the fair value of these financial instruments given the nature of the debt agreements that are in place which include debt from federal agencies of the United States with interest rates that are not considered to have comparable prevailing rates as of December 31, 2016 and 2015.

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, a 5-year $20,000,000 line-of-credit for construction financing with CFC, a 3-year non-revolving line-of-credit with CFC in the amount of $70,000,000 to finance construction of KRS One which terminated on January 18, 2016, and a 1-year unsecured $25,000,000 line-of-credit for working capital with CoBank all at a variable interest rate. The CFC lines are secured by substantially all Cooperative assets and subject to termination provisions and certain covenants. The total balance outstanding was $5,308,600 and $59,500,000 at December 31, 2016 and 2015, respectively.

Note 10 - Deferred Credits

Deferred credits consisted of the following:

	2016	2015
Rural economic development grant	$ 1,570,048	$ 1,258,022
Hydro security deposit	1,500,000	1,500,000
Customer advances for construction	1,813,372	1,746,945
Regulatory liability - Iniki	1,680,432	1,972,692
Regulatory liability - scheduled plant maintenance	2,338,465	4,588,725
Total deferred credits	$ 8,902,317	$ 11,066,384

Note 11 - Asset Retirement Obligation

For the year ended December 31, 2014, KRS Two completed an asset retirement obligation (ARO) calculation with the assumption that the assets will be in service through the year 2044. The useful life expectations used in the calculations of the ARO are based on the assumption that operations will continue without deviation from historical trends. As of December 31, 2014, the ARO capitalized asset and the offsetting ARO liability were established at present value. The ARO asset will be depreciated through 2044 on a straight line basis and the ARO liability will be accreted through 2044 using a discount rate and effective interest method.

In 2015 KRS Two was able to obtain a more accurate estimate of the decommissioning costs by surveying the contractors who built KRS Two's Koloa Solar Farm and KRS One's Anahola Solar Farm. Based on the estimates from the two independent nationwide contractors, KRS Two revised its estimate of the decommissioning costs, resulting in a $698,556 decrease to the present value of the ARO capitalized asset and offsetting ARO liability.

For the year ended December 31, 2015, KRS One completed an asset retirement obligation (ARO) calculation with the assumption that the assets will be in service through the year 2040. The useful life expectations used in the calculations of the ARO are based on the assumption that operations will continue without deviation from historical trends. As of December 31, 2015, the ARO capitalized asset and the offsetting ARO liability were established at present value. The ARO asset will be depreciated through 2040 on a straight line basis and the ARO liability will be accreted through 2040 using a discount rate and effective interest method.

The following table provides a reconciliation of the beginning and ending ARO liability for 2015 and 2014:

	2016	2015
Balance at January 1	$ 2,278,249	$ 1,139,750
Liabilities incurred in the current period		
KRS One Solar Farm	-	1,796,002
Accretion of ARO liability	84,005	41,053
Revisions in estimated cash flows		
KRS Two Solar Farm	-	(698,556)
Balance at December 31	$ 2,362,254	$ 2,278,249

Note 12 - 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 the Cooperative a fuel supply contract with an international oil refining company that is renewable for 12-month periods unless terminated by the Cooperative or the supplier; 100% of the Cooperative'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, 2016 and 2015, were $34,559,063 and $50,885,581, respectively.

Power Supply

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

In 2011, the Cooperative created a wholly owned subsidiary, KIUC Renewable Solutions One LLC (KRS One). KRS One developed a 14.5 MWdc 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 provides 12 MWac 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 was built for KRS One under an Engineering Procurement and Construction contract with REC Solar, Inc. was placed in service in October 2015. This project is estimated to have a 25-year life.

In 2011, the Cooperative signed an agreement with Green Energy Team LLC, to purchase power from its proposed 6.7 MW biomass-to-energy facility located near Koloa. The biomass-to-energy plant contributes firm capacity to the Cooperative's system and provides more than 11% of Kauai's energy needs. The biomass plant supplies enough electricity to power 8,500 homes, annually replacing about 3.7 million gallons of imported fossil fuel. This project is the first closed-loop biomass-to-energy plant in the United States and is considered to be carbon neutral. The project maximizes the use of natural fertilization processes, including intercropping with alternate rows of nitrogen-fixing trees and the use of fertilizers created as a byproduct of the plant combustion cycle. The biomass fuel is supplied primarily by more than 2,500 acres of short-rotation crops grown on Kaua'i. In 2013, construction began on the facility. During 2015, the facility began exporting test energy to the Cooperative's grid. The facility was placed in service in January 2016. The contract includes a fixed-price per MWh power purchase agreement with a term of 20 years in addition to a monthly capacity charge. The annual capacity charge is $5.7 million per year over the life of the initial term of the agreement. This capacity charge is subject to adjustment based on the terms of the agreement. Total power payments to Green Energy Team LLC were $12,763,157 and $702,576 during the years ended December 31, 2016 and 2015, respectively.

In 2012, the Cooperative created a wholly owned subsidiary, KIUC Renewable Solutions Two LLC (KRS Two). KRS Two developed a 14.3 MWdc solar photovoltaic facility associated interconnection facilities on a 67-acre parcel of land leased from Grove Farm Co., Inc. near Koloa, Kaua'i, Hawaii. The output of the project provides 12 MWac of peak power for the electric system on Kaua'i, an amount that represents about 5% of total energy consumption and would power approximately 4,000 homes. The solar project was built for KRS Two under an Engineering Procurement and Construction contract with SolarCity and was placed in service in September 2014. The project is expected to have a 25-year life.

In addition to power purchased from wholly owned subsidiaries and Green Energy Team, LLC, the Cooperative has agreements with other entities for the purchase of hydroelectric and solar photovoltaic power. Total payments under these fixed-price per MWh power purchase agreements were $9,987,374 and $10,115,331 during the years ended December 31, 2016 and 2015, respectively.

In 2014, the Cooperative signed an agreement with Gay & Robinson Inc., to continue to purchase power from its existing 1.25 MW hydroelectric generating facility and to purchase power from its proposed 6 MW expansion hydroelectric generating facility, which is anticipated to be constructed in 2018 / 2019. This contract includes a fixed-price per MWh power purchase agreement with an initial term of 25 years once it is in commercial operation.

In 2015, the Cooperative signed an agreement with SolarCity Corporation, to purchase power from its proposed 13 MW dispatchable solar storage facility located adjacent to the Cooperative's Kapaia power station. The utility-scale solar array and battery storage system will allow the Cooperative to use stored solar energy to displace fossil fuel generation in the evening hours and is believed to be the first utility-scale dispatchable solar system in the United States. The facility is anticipated to be placed in service in April 2017. The contract includes a fixed-price per MWh power purchase agreement with a term of 20 years once it is in commercial operation..

During 2016, the Cooperative signed an agreement with AES Lawai Solar, LLC to purchase power from its dispatched solar storage facility. The project will combine 28 MWdc of solar capacity with a 20 MWdc five hour duration energy storage system to help the Cooperative shift solar energy into the evening peak hours. Subject to securing state and local regulatory approvals, the project is expected to start operations by late 2018. This contract includes a fixed-price per MWh power purchase agreement with an initial term of 25 years once it is in commercial operations.

Union Contract

The Cooperative has an agreement with one union. As of December 31, 2016, 61% of the positions and 62% of the employees were covered by the union contract. The agreement expires in December 2018.

Operating Lease

The Cooperative 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.

KRS One leases the land upon which their solar facility is located under non-cancelable operating lease which expires in 2040.

KRS Two leases the land upon which their solar facility is located under a non-cancelable operating lease which expires in 2039 and contains an option to extend the term an additional 5 years.

As of December 31, 2016, the future minimum rental commitments under these leases are as follows:

2017	$ 1,233,747
2018	1,235,629
2019	1,237,568
2020	1,239,565
2021	214,731
Thereafter	5,399,825
	$ 10,561,065

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, 2016 and 2015, was $1,475,998 and $1,416,442, respectively.

Note 13 - 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 consolidated financial statements.

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 2016 and in 2015 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 $3,343,658 in 2016 and $3,293,004 in 2015. There have been no significant changes that affect the comparability of 2016 and 2015 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 over 80% funded at January 1, 2016 and 2015, 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 $18,000. 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 2016 and 2015 totaled $531,533 and $551,661, respectively.

Note 14 - Post-Retirement Benefits

The Cooperative's 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 the Cooperative 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, 2016 and 2015, were $242,584 and $266,838, respectively. The measurement date for the current valuation is December 31, 2016.

Weighted-average assumptions used to determine the net periodic benefit cost for the year ended December 31, 2016:

- Discount rate: 4.0% and 4.5% as of December 31, 2016 and 2015, respectively
- Expected long-term return on plan assets: 5.0% (based on the ten-year performance of the funds, weighted by market value as of December 31, 2015)
- Health care cost trend rate assumed for next year: 6.5%
- Rate to which the cost trend rate is assumed to decline (the ultimate trend rate): 5.0% in 2020

	2016	2015
Net post-retirement benefit cost		
Interest cost	$ 130,900	$ 137,600
Expected return on plan assets	(215,700)	(236,700)
Recognized net actuarial expense (gains)	259,000	(126,762)
Net post-retirement expense (gain)	$ 174,200	$ (225,862)
Accumulated post-retirement benefit obligation (APBO)		
APBO balance at the beginning of year	$ (3,191,700)	$ (3,353,000)
Interest costs	(130,900)	(137,600)
Actuarial (loss) gain	(92,384)	32,062
Benefits paid	242,584	266,838
APBO balance at the end of year	$ (3,172,400)	$ (3,191,700)

	2016	2015
Reconciliation of funded status		
APBO	$ (3,172,400)	$ (3,191,700)
Assets funded	4,036,700	4,444,100
Accrued post-retirement funded status	$ 864,300	$ 1,252,400
Accumulated other comprehensive loss (gain)		
Unrecognized prior loss (gain)	$ 259,000	$ (94,700)
Amortization of gains and losses	(259,000)	94,700
Actuarial loss	194,000	259,000
Accumulated other comprehensive loss	$ 194,000	$ 259,000

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

2017	$ 263,800
2018	281,700
2019	268,500
2020	258,700
2021	232,000
2022-2026	925,600

The Plan has been fully funded as of December 31, 2016. The Plan assets are held in the Trust and are invested in the Central Pacific Bank's Trust Division at December 31, 2016.

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, 2016 and 2015, were Level 1 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:

	2016		2015	
Cash and other accrued income	$ 2,629	0%	$ 3,505	0%
Mutual funds	3,413,536	85%	3,949,125	89%
Bonds	620,535	15%	491,470	11%
	$ 4,036,700		$ 4,444,100	

Note 15 - Subsequent Events

On March 27, 2017, KIUC submitted a loan application to the Rural Utilities Service (RUS) for a RUS guaranteed loan to the Cooperative from the Federal Financing Bank (FFB), for $58,037,000 to finance system extensions and additions. If the loan application is approved by RUS, KIUC anticipates the loan closing during 2017.

The Cooperative has evaluated subsequent events through April 10, 2017, the date the consolidated financial statements were available to be issued.

Supplementary Information
December 31, 2016 and 2015

Kaua'i Island Utility Cooperative

CPAs & BUSINESS ADVISORS

Independent Auditor's Report on Supplementary Information

The Board of Directors
Kaua'i Island Utility Cooperative
Lihue, Kaua'i, Hawaii

We have audited the consolidated financial statements of Kaua'i Island Utility Cooperative as of and for the years ended December 31, 2016 and 2015 and our report thereon dated April 10, 2017, which contained an unmodified opinion on those financial statements, appears on page 1. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The supplementary information as of and for the years ended December 31, 2016 and 2015 is presented for the purposes of additional analysis of the consolidated financial statements and is not a required part of the consolidated financial statements. Such information is the responsibility of management and is 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 audits of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the 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 financial statements as a whole.

Eide Bailly LLP

Sioux Falls, South Dakota
April 10, 2017

	KIUC	KRS One	KRS Two Holdings	Eliminations	Consolidated
Assets					
Utility Plant					
In service	$ 450,531,046	$ 41,955,214	$ 39,084,976	$ -	$ 531,571,236
Plant acquisition cost	54,852,453	-	-	-	54,852,453
Less accumulated depreciation	(271,184,622)	(2,512,893)	(3,346,479)	-	(277,043,994)
Total utility plant	234,198,877	39,442,321	35,738,497	-	309,379,695
Construction work in progress	10,497,169	-	-	-	10,497,169
Net utility plant	244,696,046	39,442,321	35,738,497	-	319,876,864
Other Property and Investments					
Investments in subsidiary companies	37,706,150	-	-	(37,706,150)	-
Investments in associated organizations	1,035,816	-	-	-	1,035,816
Rural economic development loans	1,162,866	-	-	-	1,162,866
Total other property and investments	39,904,832	-	-	(37,706,150)	2,198,682
Current Assets					
Cash and cash equivalents	10,460,460	33,272	565,583	-	11,059,315
Restricted cash and cash equivalents	2,267,151	-	-	-	2,267,151
Accounts receivable	9,722,339	168,224	175,837	-	10,066,400
Accrued unbilled revenue	7,560,590	-	-	-	7,560,590
Inventories	13,796,978	-	-	-	13,796,978
Other current assets	1,143,006	126,673	70,422	-	1,340,101
Total current assets	44,950,524	328,169	811,842	-	46,090,535
Post-retirement Benefit Asset	864,300	-	-	-	864,300
Deferred Debits	10,340,561	1,096,333	-	-	11,436,894
	$ 340,756,263	$ 40,866,823	$ 36,550,339	$ (37,706,150)	$ 380,467,275

	KIUC	KRS One	KRS Two Holdings	Eliminations	KIUC Consolidated
Equities and Liabilities					
Equities					
Controlling equity interest	$ 102,980,938	$ (1,855,783)	$ (1,462,793)	$ 3,318,576	$ 102,980,938
Non-controlling equity interest	-	-	21,517,825	-	21,517,825
Total equities	102,980,938	(1,855,783)	20,055,032	3,318,576	124,498,763
Long-Term Debt, Less Current Maturities	193,361,631	40,686,101	15,541,052	(40,939,061)	208,649,723
Asset Retirement Obligations	-	1,852,782	509,472	-	2,362,254
Current Liabilities					
Current maturities of long-term debt	14,396,493	-	405,825	-	14,802,318
Line-of-credit	5,308,600	-	-	-	5,308,600
Accounts payable	5,139,759	98,058	38,958	-	5,276,775
Energy rate adjustment clause	355,924	-	-	-	355,924
Consumer deposits	1,674,548	-	-	-	1,674,548
Accrued employee compensation	1,839,328	-	-	-	1,839,328
Accrued taxes	6,185,140	-	-	-	6,185,140
Other current and accrued liabilities	611,585	85,665	-	(85,665)	611,585
Total current liabilities	35,511,377	183,723	444,783	(85,665)	36,054,218
Deferred Credits	8,902,317	-	-	-	8,902,317
	$ 340,756,263	$ 40,866,823	$ 36,550,339	$ (37,706,150)	$ 380,467,275

	KIUC	KRS One	KRS Two Holdings	Eliminations	KIUC Consolidated
Assets					
Utility Plant					
In service	$ 447,239,844	$ 60,089,406	$ 39,044,942	$ -	$ 546,374,192
Plant acquisition cost	54,852,453	-	-	-	54,852,453
Less accumulated depreciation	(263,059,851)	(458,905)	(1,797,431)	-	(265,316,187)
Total utility plant	239,032,446	59,630,501	37,247,511	-	335,910,458
Construction work in progress	8,287,147	2,489	22,211	-	8,311,847
Net utility plant	247,319,593	59,632,990	37,269,722	-	344,222,305
Other Property and Investments					
Investments in subsidiary companies	58,373,194	-	-	(58,373,194)	-
Investments in associated organizations	889,780	-	-	-	889,780
Rural economic development loans	873,750	-	-	-	873,750
Total other property and investments	60,136,724	-	-	(58,373,194)	1,763,530
Current Assets					
Cash and cash equivalents	18,581,988	373,891	491,531	-	19,447,410
Restricted cash and cash equivalents	2,126,117	-	-	-	2,126,117
Accounts receivable	9,028,072	187,489	208,030	-	9,423,591
Accrued unbilled revenue	6,599,036	-	-	-	6,599,036
Inventories	14,538,474	-	-	-	14,538,474
Other current assets	1,219,011	135,129	77,323	-	1,431,463
Total current assets	52,092,698	696,509	776,884	-	53,566,091
Post-retirement Benefit Asset	1,252,400	-	-	-	1,252,400
Deferred Debits	9,367,469	1,142,333	-	-	10,509,802
	$ 370,168,884	$ 61,471,832	$ 38,046,606	$ (58,373,194)	$ 411,314,128

	KIUC	KRS One	KRS Two Holdings	Eliminations	KIUC Consolidated
Equities and Liabilities					
Equities					
Controlling equity interest	$ 96,528,528	$ (28,555)	$ (1,510,593)	$ 1,539,148	$ 96,528,528
Non-controlling equity interest	-	-	22,702,967	-	22,702,967
Total equities	96,528,528	(28,555)	21,192,374	1,539,148	119,231,495
Long-Term Debt, Less Current Maturities	172,125,709	59,527,146	15,944,376	(59,777,606)	187,819,625
Asset Retirement Obligations	-	1,804,144	474,105	-	2,278,249
Current Liabilities					
Current maturities of long-term debt	13,565,249	-	387,490	-	13,952,739
Line-of-credit	59,500,000	-	-	-	59,500,000
Accounts payable	5,534,448	34,361	48,261	-	5,617,070
Energy rate adjustment clause	1,259,609	-	-	-	1,259,609
Consumer deposits	1,593,707	-	-	-	1,593,707
Accrued employee compensation	2,047,106	-	-	-	2,047,106
Accrued taxes	6,218,963	-	-	-	6,218,963
Other current and accrued liabilities	729,181	134,736	-	(134,736)	729,181
Total current liabilities	90,448,263	169,097	435,751	(134,736)	90,918,375
Deferred Credits	11,066,384	-	-	-	11,066,384
	$ 370,168,884	$ 61,471,832	$ 38,046,606	$ (58,373,194)	$ 411,314,128

	KIUC	KRS One	KRS Two Holdings	Eliminations	KIUC Consolidated
Operating Revenues					
Residential	$ 55,787,616	$ -	$ -	$ -	$ 55,787,616
Irrigation	16,264	-	-	-	16,264
Commercial and industrial	85,934,227	-	-	-	85,934,227
Public street and highway lighting	1,268,893	-	-	-	1,268,893
Sale for resale	-	2,706,050	2,748,265	(5,454,315)	-
Other operating revenues	491,563	-	-	-	491,563
Total operating revenues	143,498,563	2,706,050	2,748,265	(5,454,315)	143,498,563
Operating Expenses					
Cost of power	78,468,028	704,559	306,068	(5,454,315)	74,024,340
Transmission - operation	372,156	11,674	-	-	383,830
Transmission - maintenance	771,916	4,811	-	-	776,727
Distribution - operation	1,280,399	99,868	-	-	1,380,267
Distribution - maintenance	3,375,113	14,078	-	-	3,389,191
Customer accounts	1,555,263	-	-	-	1,555,263
Customer service and information	442,917	-	-	-	442,917
Administrative and general	16,761,306	138,618	27,212	-	16,927,136
Depreciation and amortization	14,869,475	2,053,988	1,549,048	-	18,472,511
Taxes	12,083,645	13,530	(36,926)	-	12,060,249
Accretion expense	-	48,638	35,367	-	84,005
Other interest expense	533,276	1,443,514	-	(1,443,514)	533,276
Total operating expenses	130,513,494	4,533,278	1,880,769	(6,897,829)	130,029,712
Operating Margin (Loss) Before Interest	12,985,069	(1,827,228)	867,496	1,443,514	13,468,851
Interest on Long-Term Debt	6,916,397	-	741,094	-	7,657,491
Operating Margins (Losses)	6,068,672	(1,827,228)	126,402	1,443,514	5,811,360
Nonoperating Margins (Losses)					
Interest income	2,127,247	-	-	(1,443,514)	683,733
Capital credits	143,430	-	-	-	143,430
Loss from subsidiaries	(1,779,428)	-	-	1,779,428	-
Other nonoperating loss	36,996	-	-	-	36,996
Total nonoperating margins	528,245	-	-	335,914	864,159
Net Margins (Losses)	6,596,917	(1,827,228)	126,402	1,779,428	6,675,519
Net Margins Attributable to Non-controlling Interest	-	-	(78,602)	-	(78,602)
Net Margins (Losses) - Cooperative	6,596,917	(1,827,228)	47,800	1,779,428	6,596,917
Comprehensive Income					
Postretirement benefit obligation gain	65,000	-	-	-	65,000
Comprehensive Income (Loss) - Cooperative	$ 6,661,917	$ (1,827,228)	$ 47,800	$ 1,779,428	$ 6,661,917

	KIUC	KRS One	KRS Two Holdings	Eliminations	KIUC Consolidated
Operating Revenues					
Residential	$ 55,512,573	$ -	$ -	$ -	$ 55,512,573
Irrigation	59,629	-	-	-	59,629
Commercial and industrial	86,013,500	-	-	-	86,013,500
Public street and highway lighting	1,362,924	-	-	-	1,362,924
Sale for resale	-	863,667	2,633,443	(3,497,110)	-
Other operating revenues	508,143	-	-	-	508,143
Total operating revenues	143,456,769	863,667	2,633,443	(3,497,110)	143,456,769
Operating Expenses					
Cost of power	79,048,848	107,329	214,350	(3,497,110)	75,873,417
Transmission - operation	405,710	3,082	-	-	408,792
Transmission - maintenance	576,009	-	-	-	576,009
Distribution - operation	1,259,689	4,638	-	-	1,264,327
Distribution - maintenance	3,058,602	-	-	-	3,058,602
Customer accounts	2,278,950	-	-	-	2,278,950
Customer service and information	597,264	-	-	-	597,264
Administrative and general	16,652,095	13,198	52,211	-	16,717,504
Depreciation and amortization	14,936,649	458,905	1,622,837	-	17,018,391
Taxes	12,083,069	4,318	13,167	-	12,100,554
Accretion expense	-	8,141	32,912		41,053
Other interest expense	1,371,908	1,371,849	-	(1,371,849)	1,371,908
			-		
Total operating expenses	132,268,793	1,971,460	1,935,477	(4,868,959)	131,306,771
Operating Margin (Loss) Before Interest	11,187,976	(1,107,793)	697,966	1,371,849	12,149,998
Interest on Long-Term Debt	6,770,498	-	758,713	-	7,529,211
Operating Margins (Losses)	4,417,478	(1,107,793)	(60,747)	1,371,849	4,620,787
Nonoperating Margins (Losses)					
Interest income	1,985,456		-	(1,371,849)	613,607
Allowance for funds used during construction	-	1,098,704	-	-	1,098,704
Capital credits	97,309	-	-	-	97,309
Loss from subsidiaries	(14,664)	-	-	14,664	-
Other nonoperating income	(534,698)	-	-	-	(534,698)
Total nonoperating (losses) margins	1,533,403	1,098,704	-	(1,357,185)	1,274,922
Net Margins (Losses)	5,950,881	(9,089)	(60,747)	14,664	5,895,709
Net Margins Attributable to Non-controlling Interest	-	-	55,172	-	55,172
Net Margins (Losses) - Cooperative	5,950,881	(9,089)	(5,575)	14,664	5,950,881
Comprehensive Income					
Postretirement benefit obligation (loss)	(353,700)	-	-	-	(353,700)
Comprehensive Income (Loss) - Cooperative	$ 5,597,181	$ (9,089)	$ (5,575)	$ 14,664	$ 5,597,181

Independent Auditor's Report 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*

The Board of Directors
Kaua'i Island Utility Cooperative
Lihue, Kaua'i, Hawaii

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 consolidated financial statements of Kaua'i Island Utility Cooperative, which comprise the consolidated balance sheets as of December 31, 2016 and 2015, and the related consolidated statements of operations, equities, and cash flows for the years then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated April 10, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered Kaua'i Island Utility 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 opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of Kaua'i Island Utility 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 a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's consolidated 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 the 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 and therefore, material weaknesses or significant deficiencies may exist that were not identified. 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.

200 E. 10th St., Ste. 500 | P.O. Box 5125 | Sioux Falls, SD 57117-5125 | T 605.339.1999 | F 605.339.1306 | EOE

Compliance and Other Matters
As part of obtaining reasonable assurance about whether Kaua'i Island Utility Cooperative's consolidated financial statements are free from 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 audits, 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*.

Purpose of this Report
The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the Cooperative'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 Cooperative's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Eide Bailly LLP

Sioux Falls, South Dakota
April 10, 2017