UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended August 28, 2022

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 0-20355

Costco Wholesale Corporation

(Exact name of registrant as specified in its charter)

Washington	**91-1223280**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

999 Lake Drive, Issaquah, WA 98027

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(425) 313-8100**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock, $.005 Par Value	COST	The NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☒	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

The aggregate market value of the voting stock held by non-affiliates of the registrant as of February 13, 2022 was $225,434,477,639.

The number of shares outstanding of the registrant's common stock as of September 27, 2022, was 442,604,145.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on January 19, 2023, are incorporated by reference into Part III of this Form 10-K.

COSTCO WHOLESALE CORPORATION
ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED AUGUST 28, 2022

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INFORMATION RELATING TO FORWARD LOOKING STATEMENTS

Certain statements contained in this document constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. For these purposes, forward-looking statements are statements that address activities, events, conditions or developments that the Company expects or anticipates may occur in the future and may relate to such matters as net sales growth, changes in comparable sales, cannibalization of existing locations by new openings, price or fee changes, earnings performance, earnings per share, stock-based compensation expense, warehouse openings and closures, capital spending, the effect of adopting certain accounting standards, future financial reporting, financing, margins, return on invested capital, strategic direction, expense controls, membership renewal rates, shopping frequency, litigation, and the demand for our products and services. In some cases, forward-looking statements can be identified because they contain words such as “anticipate,” “believe,” “continue,” “could,” “estimate,” “expect,” “intend,” “likely,” “may,” “might,” “plan,” “potential,” “predict,” “project,” “seek,” “should,” “target,” “will,” “would,” or similar expressions and the negatives of those terms. Such forward-looking statements involve risks and uncertainties that may cause actual events, results, or performance to differ materially from those indicated by such statements, including, without limitation, the factors set forth in the section titled “Item 1A-Risk Factors”, and other factors noted in the section titled “Item 7-Management's Discussion and Analysis of Financial Condition and Results of Operations” and in the consolidated financial statements and related notes in Item 8 of this Report. Forward-looking statements speak only as of the date they are made, and we do not undertake to update these statements, except as required by law.

PART I

Item 1—Business

Costco Wholesale Corporation and its subsidiaries (Costco or the Company) began operations in 1983, in Seattle, Washington. We are principally engaged in the operation of membership warehouses in the United States (U.S.) and Puerto Rico, Canada, Mexico, Japan, United Kingdom (U.K.), Korea, Taiwan, Australia, Spain, France, China, and Iceland. Costco operated 838, 815, and 795 warehouses worldwide at August 28, 2022, August 29, 2021, and August 30, 2020, respectively. The Company operates e-commerce websites in the U.S., Canada, Mexico, U.K., Korea, Taiwan, Japan, and Australia. Our common stock trades on the NASDAQ Global Select Market, under the symbol “COST.”

We report on a 52/53-week fiscal year, consisting of thirteen four-week periods and ending on the Sunday nearest the end of August. The first three quarters consist of three periods each, and the fourth quarter consists of four periods (five weeks in the thirteenth period in a 53-week year). The material seasonal impact in our operations is increased net sales and earnings during the winter holiday season. References to 2022, 2021, and 2020 relate to the 52-week fiscal years ended August 28, 2022, August 29, 2021, and August 30, 2020, respectively.

General

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

We buy most of our merchandise directly from manufacturers and route it to cross-docking consolidation points (depots) or directly to our warehouses. Our depots receive large shipments from manufacturers and quickly ship these goods to warehouses. This process creates freight volume and handling efficiencies, lowering costs associated with traditional multiple-step distribution channels. For our e-commerce operations we ship merchandise through our depots, our logistics operations for big and bulky items, as well as through drop-ship and other delivery arrangements with our suppliers.

Our average warehouse space is approximately 146,000 square feet, with newer units being slightly larger. Floor plans are designed for economy and efficiency in the use of selling space, the handling of merchandise, and the control of inventory. Because shoppers are attracted principally by the quality of merchandise and low prices, our warehouses are not elaborate. By strictly controlling the entrances and exits and using a membership format, we believe our inventory losses (shrinkage) are well below those of typical retail operations.

Our warehouses on average operate on a seven-day, 70-hour week. Gasoline operations generally have extended hours. Because the hours of operation are shorter than many other retailers, and due to other efficiencies inherent in a warehouse-type operation, labor costs are lower relative to the volume of sales. Merchandise is generally stored on racks above the sales floor and displayed on pallets containing large quantities, reducing labor required. In general, with variations by country, our warehouses accept certain credit cards, including Costco co-branded cards, debit cards, cash and checks, Executive member 2% reward certificates, co-brand cardholder rebates, and our proprietary stored-value card (shop card).

Our strategy is to provide our members with a broad range of high-quality merchandise at prices we believe are consistently lower than elsewhere. We seek to limit most items to fast-selling models, sizes, and colors. We carry less than 4,000 active stock keeping units (SKUs) per warehouse in our core warehouse business, significantly less than other broadline retailers. We average anywhere from 10,000 to 11,000 SKUs online, some of which are also available in our warehouses. Many consumable products are offered for sale in case, carton, or multiple-pack quantities only.

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

We offer merchandise and services in the following categories:

Core Merchandise Categories (or core business):

- **Foods and Sundries** (including sundries, dry grocery, candy, cooler, freezer, deli, liquor, and tobacco)
- **Non-Foods** (including major appliances, electronics, health and beauty aids, hardware, garden and patio, sporting goods, tires, toys and seasonal, office supplies, automotive care, postage, tickets, apparel, small appliances, furniture, domestics, housewares, special order kiosk, and jewelry)
- **Fresh Foods** (including meat, produce, service deli, and bakery)

Warehouse Ancillary (includes gasoline, pharmacy, optical, food court, hearing aids, and tire installation) and **Other Businesses** (includes e-commerce, business centers, travel, and other)

Warehouse ancillary businesses operate primarily within or next to our warehouses, encouraging members to shop more frequently. The number of warehouses with gas stations varies significantly by country, and we have no gasoline business in Korea or China. We operated 668 gas stations at the end of 2022. Net sales for our gasoline business increased to approximately 14% of total net sales in 2022.

Our other businesses sell products and services that complement our warehouse operations (core and warehouse ancillary businesses). Our e-commerce operations give members convenience and a broader selection of goods and services. Net sales for e-commerce represented approximately 7% of total net sales in 2022. This figure does not include other services we offer online in certain countries such as business delivery, travel, same-day grocery, and various other services. Our business centers carry items tailored specifically for food services, convenience stores and offices, and offer walk-in shopping and deliveries. Business centers are included in our total warehouse count. Costco Travel offers vacation packages, hotels, cruises, and other travel products exclusively for Costco members (offered in the U.S., Canada, and the U.K.).

We have direct buying relationships with many producers of brand-name merchandise. We do not obtain a significant portion of merchandise from any one supplier. The COVID-19 pandemic created unprecedented supply constraints, including disruptions and delays that have impacted and could continue to impact the flow and availability of certain products. When sources of supply become unavailable, we seek alternatives. We also purchase and manufacture private-label merchandise, as long as quality and member demand are high and the value to our members is significant.

Certain financial information for our segments and geographic areas is included in Note 11 to the consolidated financial statements included in Item 8 of this Report.

Membership

Our members may utilize their memberships at all of our warehouses and websites. Gold Star memberships are available to individuals; Business memberships are limited to businesses, including individuals with a business license, retail sales license, or comparable document. Business members may add additional cardholders (affiliates), to which the same annual fee applies. Affiliates are not available for Gold Star members. Our annual fee for these memberships is $60 in the U.S. and varies in other countries. All paid memberships include a free household card.

Our member renewal rate was 93% in the U.S. and Canada and 90% worldwide at the end of 2022. The majority of members renew within six months following their renewal date. Our renewal rate, which excludes affiliates of Business members, is a trailing calculation that captures renewals during the period seven to eighteen months prior to the reporting date. Our membership counts include active memberships as well as memberships that have not renewed within the 12 months prior to the reporting date. At the end of 2020, we standardized our membership count methodology globally to be consistent with the U.S. and Canada, which resulted in the addition to the count of approximately 2.0 million total cardholders for 2020, of which 1.3 million were paid members. Membership fee income and the renewal rate calculations were not affected. Our membership was made up of the following (in thousands):

	2022	2021	2020
Gold Star	54,000	50,200	46,800
Business, including affiliates	11,800	11,500	11,300
Total paid members	65,800	61,700	58,100
Household cards	53,100	49,900	47,400
Total cardholders	118,900	111,600	105,500

Paid cardholders (except affiliates) are eligible to upgrade to an Executive membership in the U.S., for an additional annual fee of $60. Executive memberships are also available in Canada, Mexico, the U.K., Japan, Korea, and Taiwan, for which the additional fee varies. Executive members earn a 2% reward on qualified purchases (generally up to a maximum reward of $1,000 per year), redeemable at Costco warehouses. This program also offers (except in Mexico and Korea) access to additional savings and benefits on various business and consumer services, such as auto and home insurance, the Costco auto purchase program, and check printing. These services are generally provided by third parties and vary by state and country. Executive members totaled 29.1 million and represented 57% of paid members (excluding affiliates) in the U.S. and Canada, and 22% of paid members (excluding affiliates) in our Other International operations. The sales penetration of Executive members represented approximately 71% of worldwide net sales in 2022.

Human Capital

Our Code of Ethics requires that we "Take Care of Our Employees," which is fundamental to the obligation to "Take Care of Our Members." We must also carefully control our selling, general and administrative (SG&A) expenses, so that we can sell high quality goods and services at low prices. Compensation and benefits for employees is our largest expense after the cost of merchandise and is carefully monitored.

Employee Base

At the end of 2022, we employed 304,000 employees worldwide. The large majority (approximately 95%) is employed in our membership warehouses and distribution channels, and less than 10% are represented by unions. We also utilize seasonal employees during peak periods. The total number of employees by segment is:

	Number of Employees	
	2022	2021
United States	202,000	192,000
Canada	50,000	47,000
Other International	52,000	49,000
Total employees	304,000	288,000

Growth and Engagement

We believe that our warehouses are among the most productive in the retail industry, owing in substantial part to the commitment and efficiency of our employees. We seek to provide them not merely with employment but careers. Many attributes of our business contribute to the objective; the more significant include: competitive compensation and benefits for those working in our membership warehouses and distributions channels; a commitment to promoting from within; and maintaining a ratio of at least 50% of our employee base being full-time employees. These attributes contribute to what we consider, especially for the industry, a high retention rate. In 2022, in the U.S. that rate was approximately 90% for employees who have been with us for at least one year.

Diversity, Equity and Inclusion

The commitment to "Take Care of Our Employees" is also the foundation of our approach to diversity, equity and inclusion and creating an inclusive and respectful workplace. In 2022, we appointed a new Chief Diversity and Inclusion Officer. Embracing differences is important to the growth of our Company. It leads to more opportunities, innovation, and employee satisfaction and connects us to the communities where we do business.

Well Being

In October 2021, we provided an increase of a minimum of $0.50 per hour for U.S. and Canada wage scales. In March 2022, we provided certain compensation increases, including a $0.75 per hour increase to the top of the U.S. wage scales, increased the starting wage to $17.50, and granted our employees one additional day of paid time off. In July 2022, we provided an additional increase to the top of the U.S. wage scales of $0.50 per hour. Costco is firmly committed to helping protect the health and safety of our members and employees and to serving our communities. As the global effect of COVID-19 continues to evolve, we are closely monitoring the changing situation and complying with public health guidance.

For more detailed information regarding our programs and initiatives, see “Employees” within our Sustainability Commitment (located on our website). This report and other information on our website are not incorporated by reference into and do not form any part of this Annual Report.

Competition

Our industry is highly competitive, based on factors such as price, merchandise quality and selection, location, convenience, distribution strategy, and customer service. We compete on a worldwide basis with global, national, and regional wholesalers and retailers, including supermarkets, supercenters, internet retailers, gasoline stations, hard discounters, department and specialty stores, and operators selling a single category or narrow range of merchandise. Walmart, Target, Kroger, and Amazon are among our significant general merchandise retail competitors in the U.S. We also compete with other warehouse clubs, including Walmart's Sam's Club and BJ's Wholesale Club. Many of the major metropolitan areas in the U.S. and certain of our Other International locations have multiple competing clubs.

Intellectual Property

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

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

Available Information

Our U.S. website is www.costco.com. We make available through the Investor Relations section of that site, free of charge, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements and Forms 3, 4 and 5, and any amendments to those reports, as soon as reasonably practicable after filing such materials with or furnishing such documents to the Securities and Exchange Commission (SEC). The information found on our website is not part of this or any other report filed with or furnished to the SEC. The SEC maintains a site that contains reports, proxy and information statements, and other information regarding issuers, such as the Company, that file electronically with the SEC at www.sec.gov.

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

Information about our Executive Officers

The executive officers of Costco, their position, and ages are listed below. All have over 25 years of service with the Company, with the exception of Mr. Sullivan who has 21 years of service.

Name	Position	Executive Officer Since	Age
W. Craig Jelinek	Chief Executive Officer. Mr. Jelinek has been a director since February 2010. Mr. Jelinek previously was President and CEO from January 2012 to February 2022. He was President and Chief Operating Officer from February 2010 to December 2011. Prior to that he was Executive Vice President, Chief Operating Officer, Merchandising since 2004.	1995	70
Ron M. Vachris	President and Chief Operating Officer. Mr. Vachris has been a director since February 2022. Mr. Vachris previously served as Executive Vice President of Merchandising from June 2016 to January 2022, as Senior Vice President, Real Estate Development, from August 2015 to June 2016, and Senior Vice President, General Manager, Northwest Region, from 2010 to July 2015.	2016	57
Richard A. Galanti	Executive Vice President and Chief Financial Officer. Mr. Galanti has been a director since January 1995.	1993	66
Jim C. Klauer	Executive Vice President, Chief Operating Officer, Northern Division. Mr. Klauer was Senior Vice President, Non-Foods and E-commerce Merchandise, from 2013 to January 2018.	2018	60
Patrick J. Callans	Executive Vice President, Administration. Mr. Callans was Senior Vice President, Human Resources and Risk Management, from 2013 to December 2018.	2019	60
Russ D. Miller	Senior Executive Vice President, U.S. Operations. Mr. Miller was Executive Vice President, Chief Operating Officer, Southern Division and Mexico, from January 2018 to May 2022. Mr. Miller was Senior Vice President, Western Canada Region, from 2001 to January 2018.	2018	65
James P. Murphy	Executive Vice President, Chief Operating Officer, International Division. Mr. Murphy was Senior Vice	2011	69

Item 1A—Risk Factors

The risks described below could materially and adversely affect our business, financial condition and results of operations. We could also be affected by additional risks that apply to all companies operating in the U.S. and globally, as well as other risks that are not presently known to us or that we currently consider to be immaterial. These Risk Factors should be carefully reviewed in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 and our consolidated financial statements and related notes in Item 8 of this Report.

Business and Operating Risks

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

Our financial and operational performance is highly dependent on our U.S. and Canadian operations, which comprised 87% and 85% of net sales and operating income in 2022, respectively. Within the U.S., we are highly dependent on our California operations, which comprised 28% of U.S. net sales in 2022. Our California market, in general, has a larger percentage of higher volume warehouses as compared to our other domestic markets. Any substantial slowing or sustained decline in these operations could materially adversely affect our business and financial results. Declines in financial performance of our U.S. operations, particularly in California, and our Canadian operations could arise from, among other things: slow growth or declines in comparable warehouse sales (comparable sales); negative trends in operating expenses, including increased labor, healthcare and energy costs; failing to meet targets for warehouse openings; cannibalizing existing locations with new warehouses; shifts in sales mix toward lower gross margin products; changes or uncertainties in economic conditions in our markets, including higher levels of unemployment and depressed home values; and failing to consistently provide high quality and innovative new products.

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

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

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

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

We have made and may continue to make investments and acquisitions to improve the speed, accuracy and efficiency of our supply chains and delivery channels. The effectiveness of these investments can be less predictable than opening new locations and might not provide the anticipated benefits or desired rates of return.

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

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

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

Disruptions in merchandise distribution or processing, packaging, manufacturing, and other facilities could adversely affect sales and member satisfaction.

We depend on the orderly operation of the merchandise receiving and distribution process, primarily through our depots. We also rely upon processing, packaging, manufacturing and other facilities to support our business, which includes the production of certain private-label items. Although we believe that our operations are efficient, disruptions due to fires, tornadoes, hurricanes, earthquakes, pandemics or other extreme weather conditions or catastrophic events, labor issues or other shipping problems may result in delays in the production and delivery of merchandise to our warehouses, which could adversely affect sales and the satisfaction of our members. Our e-commerce operations depend heavily on third-party and in-house logistics providers and is negatively affected when these providers are unable to provide services in a timely fashion.

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

It is difficult to consistently and successfully predict the products and services that our members will desire. Our success depends, in part, on our ability to identify and respond to trends in demographics and consumer preferences. Failure to identify timely or effectively respond to changing consumer tastes, preferences (including those relating to environmental, social and governance practices) and spending patterns could negatively affect our relationship with our members, the demand for our products and services, and our market share. If we are not successful at predicting our sales trends and adjusting our purchases accordingly, we may have excess inventory, which could result in additional markdowns, or we may experience out-of-stock positions and delivery delays, which could result in higher costs, both of which would reduce our operating performance. This could have an adverse effect on net sales, gross margin and operating income.

Availability and performance of our information technology (IT) systems are vital to our business. Failure to successfully execute IT projects and have IT systems available to our business would adversely impact our operations.

IT systems play a crucial role in conducting our business. These systems are utilized to process a very high volume of transactions, conduct payment transactions, track and value our inventory and produce reports critical for making business decisions. Failure or disruption of these systems could have an adverse impact on our ability to buy products and services from our suppliers, produce goods in our manufacturing plants, move the products in an efficient manner to our warehouses and sell products to our members. We are undertaking large technology and IT transformation projects. The failure of these projects could adversely impact our business plans and potentially impair our day to day business operations. Given the high volume of transactions we process, it is important that we build strong digital resiliency to prevent disruption from events such as power outages, computer and telecommunications failures, viruses, internal or external security breaches, errors by employees, and catastrophic events such as fires, earthquakes, tornadoes and hurricanes. Any debilitating failure of our critical IT systems, data centers and backup systems would require significant investments in resources to restore IT services and may cause serious impairment in our business operations including loss of business services, increased cost of moving merchandise and failure to provide service to our members. We are currently making substantial investments in maintaining and enhancing our digital resiliency and failure or delay in these projects could be costly and harmful to our business. Failure to deliver IT transformation efforts efficiently and effectively could result in the loss of our competitive position and adversely impact our financial condition and results of operations.

We are required to maintain the privacy and security of personal and business information amidst multiplying threat landscapes and in compliance with privacy and data protection regulations globally. Failure to do so could damage our business, including our reputation with members, suppliers and employees, cause us to incur substantial additional costs, and become subject to litigation and regulatory action.

Increased security threats and more sophisticated cyber misconduct pose a risk to our systems, networks, products and services. We rely upon IT systems and networks, some of which are managed by third parties, in connection with virtually all of our business activities. Additionally, we collect, store and process sensitive information relating to our business, members, suppliers and employees. Operating these IT systems and networks, and processing and maintaining this data, in a secure manner, is critical to our business operations and strategy. Increased remote work has also increased the possible attack surfaces. Threats designed to gain unauthorized access to systems, networks and data, both ours and third parties with whom we work, are increasing in frequency and sophistication. Cybersecurity attacks may range from random attempts to coordinated and targeted attacks, including sophisticated computer crimes and advanced persistent threats. Phishing attacks have emerged as particularly prominent, including as vectors for ransomware attacks, which have increased in breadth and frequency. While we train our employees as part of our security efforts, that training cannot be completely effective. These threats pose a risk to the security of our systems and networks and the confidentiality, integrity, and availability of our data. It is possible that our IT systems and networks, or those managed by third parties such as cloud providers or suppliers that otherwise host confidential information, could have vulnerabilities, which could go unnoticed for a period of time. While our cybersecurity and compliance efforts seek to mitigate such risks, there can be no guarantee that the actions and controls we and our third-party service providers have implemented and are implementing, will be sufficient to protect our systems, information or other property.

The potential impacts of a material cybersecurity attack include reputational damage, litigation, government enforcement actions, penalties, disruption to systems, unauthorized release of confidential or otherwise protected information, corruption of data, diminution in the value of our investment in IT systems and increased cybersecurity protection and remediation costs. This could adversely affect our competitiveness, results of operations and financial condition and, critically in light of our business model, loss of member confidence. Further, the insurance coverage we maintain and indemnification arrangements with third-parties may be inadequate to cover claims, costs, and liabilities relating to cybersecurity incidents. In addition, data we collect, store and process is subject to a variety of U.S. and international laws and regulations, such as the European Union's General Data Protection Regulation, California Consumer Privacy Act, Health Insurance Portability and Accountability Act, and other privacy and cybersecurity laws across the various states and around the globe, which may carry significant potential penalties for noncompliance.

We are subject to payment-related risks.

We accept payments using a variety of methods, including select credit and debit cards, cash and checks, co-brand cardholder rebates, Executive member 2% reward certificates, and our shop card. As we offer new payment options to our members, we may be subject to additional rules, regulations, compliance requirements, and higher fraud losses. For certain payment methods, we pay interchange and other related acceptance fees, along with additional transaction processing fees. We rely on third parties to provide payment transaction processing services for credit and debit cards and our shop card. It could disrupt our business if these parties become unwilling or unable to provide these services to us. We are also subject to fee increases by these service providers.

We must comply with evolving payment card association and network operating rules, including data security rules, certification requirements and rules governing electronic funds transfers. For example, we are subject to Payment Card Industry Data Security Standards, which contain compliance guidelines and standards with regard to our security surrounding the physical and electronic storage, processing and transmission of individual cardholder data. If our internal systems are breached or compromised, we may be liable for card re-issuance costs, subject to fines and higher transaction fees and lose our ability to accept card payments from our members, and our business and operating results could be adversely affected.

We might sell products that cause illness or injury to our members, harm to our reputation, and expose us to litigation.

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

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

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

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

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

We may incur property, casualty or other losses not covered by our insurance.

Claims for employee health care benefits, workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, inventory loss, and other exposures are funded predominantly through self-insurance. Insurance coverage is maintained for certain risks to limit exposures arising from very large losses. The types and amounts of insurance may vary from time to time based on our decisions with respect to risk retention and regulatory requirements. Significant claims or events, regulatory changes, a substantial rise in costs of health care or costs to maintain our insurance or the failure to maintain adequate insurance coverage could have an adverse impact on our financial condition and results of operations.

Although we maintain specific coverages for catastrophic property losses, we still bear a significant portion of the risk of losses incurred as a result of any physical damage to, or the destruction of, any warehouses, depots, manufacturing or home office facilities, loss or spoilage of inventory, and business interruption. Such losses could materially impact our cash flows and results of operations.

Market and Other External Risks

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

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

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

Higher energy and gasoline costs, inflation, levels of unemployment, healthcare costs, consumer debt levels, foreign-currency exchange rates, unsettled financial markets, weaknesses in housing and real estate markets, reduced consumer confidence, changes and uncertainties related to government fiscal

and tax policies including changes in tax rates, duties, tariffs, or other restrictions, sovereign debt crises, pandemics and other health crises, and other economic factors could adversely affect demand for our products and services, require a change in product mix, or impact the cost of or ability to purchase inventory. Additionally, actions in various countries, particularly China and the United States, have affected the costs of some of our merchandise. The degree of our exposure is dependent on (among other things) the type of goods, rates imposed, and timing of the tariffs. The impact to our net sales and gross margin is influenced in part by our merchandising and pricing strategies in response to potential cost increases. Higher tariffs could adversely impact our results.

Prices of certain commodities, including gasoline and consumable goods used in manufacturing and our warehouse retail operations, are historically volatile and are subject to fluctuations arising from changes in domestic and international supply and demand, inflationary pressures, labor costs, competition, market speculation, government regulations, taxes and periodic delays in delivery. Rapid and significant changes in commodity prices and our ability and desire to pass them through to our members may affect our sales and profit margins. These factors could also increase our merchandise costs and selling, general and administrative expenses, and otherwise adversely affect our operations and financial results. General economic conditions can also be affected by events like the outbreak of hostilities, including but not limited to the Ukraine conflict, or acts of terrorism.

Inflationary factors such as increases in merchandise costs may adversely affect our business, financial condition and results of operations. If inflation on merchandise increases beyond our ability to control we may not be able to adjust prices to sufficiently offset the effect of the various cost increases without negatively impacting consumer demand. Certain merchandise categories were impacted by inflation higher than what we have experienced in recent years due to, among other things, the continuing impacts of the pandemic and uncertain economic environment.

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

We depend heavily on our ability to purchase quality merchandise in sufficient quantities at competitive prices. As the quantities we require continue to grow, we have no assurances of continued supply, appropriate pricing or access to new products, and any supplier has the ability to change the terms upon which they sell to us or discontinue selling to us. Member demands may lead to out-of-stock positions causing a loss of sales and profits.

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

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

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

During 2022, our international operations, including Canada, generated 27% and 32% of our net sales and operating income, respectively. Our international operations have accounted for an increasing portion of our warehouses, and we plan to continue international growth. To prepare our consolidated financial statements, we translate the financial statements of our international operations from local currencies into U.S. dollars using current exchange rates. Future fluctuations in exchange rates that are unfavorable to us may adversely affect the financial performance of our Canadian and Other International operations and have a corresponding adverse period-over-period effect on our results of operations. As we continue to expand internationally, our exposure to fluctuations in foreign exchange rates may increase.

A portion of the products we purchase is paid for in a currency other than the local currency of the country in which the goods are sold. Currency fluctuations may increase our merchandise costs and may not be passed on to members. Consequently, fluctuations in currency exchange rates may adversely affect our results of operations.

Natural disasters, extreme weather conditions, public health emergencies or other catastrophic events could negatively affect our business, financial condition, and results of operations.

Natural disasters and extreme weather conditions, including those impacted by climate change, such as hurricanes, typhoons, floods, earthquakes, wildfires, droughts; acts of terrorism or violence, including active shooter situations; energy shortages; public health issues, including pandemics and quarantines, particularly in California or Washington state, where our centralized operating systems and administrative personnel are located, could negatively affect our operations and financial performance. Such events could result in physical damage to our properties, limitations on store operating hours, less frequent visits by members to physical locations, the temporary closure of warehouses, depots, manufacturing or home office facilities, the temporary lack of an adequate work force, disruptions to our IT systems, the temporary or long-term disruption in the supply of products from some local or overseas suppliers, the temporary disruption in the transport of goods to or from overseas, delays in the delivery of goods to our warehouses or depots, and the temporary reduction in the availability of products in our warehouses. Public health issues, whether occurring in the U.S. or abroad, could disrupt our operations, disrupt the operations of suppliers or members, or have an adverse impact on consumer spending and confidence levels. These events could also reduce demand for our products or make it difficult or impossible to procure products. We may be required to suspend operations in some or all of our locations, which could have a material adverse effect on our business, financial condition and results of operations.

The COVID-19 pandemic continues to affect our business, financial condition and results of operations in many respects.

The continuing impacts of the COVID-19 pandemic are highly unpredictable and volatile and are affecting certain business operations, demand for our products and services, in-stock positions, costs of doing business, availability of labor, access to inventory, supply chain operations, our ability to predict future performance, exposure to litigation, and our financial performance, among other things.

Other factors and uncertainties include, but are not limited to:

- The severity and duration of the pandemic, including future mutations or related variants of the virus in areas in which we operate;
- Evolving macroeconomic factors, including general economic uncertainty, unemployment rates, and recessionary pressures;
- Changes in labor markets affecting us and our suppliers;
- Unknown consequences on our business performance and initiatives stemming from the substantial investment of time and other resources to the pandemic response;
- The pace of recovery when the pandemic subsides;
- The long-term impact of the pandemic on our business, including consumer behaviors; and
- Disruption and volatility within the financial and credit markets.

To the extent that COVID-19 continues to adversely affect the U.S. and global economy, our business, results of operations, cash flows, or financial condition, it may also heighten other risks described in this section, including but not limited to those related to consumer behavior and expectations, competition, brand reputation, implementation of strategic initiatives, cybersecurity threats, payment-related risks, technology systems disruption, supply chain disruptions, labor availability and cost, litigation, operational risk as a result of remote work arrangements and regulatory requirements.

Factors associated with climate change could adversely affect our business.

We use natural gas, diesel fuel, gasoline, and electricity in our distribution and warehouse operations. Government regulations limiting carbon dioxide and other greenhouse gas emissions may increase compliance and merchandise costs, and other regulation affecting energy inputs could materially affect our profitability. As the economy transitions to lower carbon intensity we cannot guarantee that we will make adequate investments or successfully implement strategies that will effectively achieve our climate-related goals, which could lead to negative perceptions among members and other stakeholders and result in reputational harm. Climate change, extreme weather conditions, wildfires, droughts and rising sea levels could affect our ability to procure commodities at costs and in quantities we currently experience.

We also sell a substantial amount of gasoline, the demand for which could be impacted by concerns about climate change and increased regulations. More stringent fuel economy standards and public policies aimed at increasing the adoption of zero-emission and alternative fuel vehicles and other regulations related to climate change will affect our future operations and may adversely impact our profitability, and require significant capital expenditures.

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

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

Legal and Regulatory Risks

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

At the end of 2022, we operated 260 warehouses outside of the U.S., and we plan to continue expanding our international operations. Future operating results internationally could be negatively affected by a variety of factors, many similar to those we face in the U.S., certain of which are beyond our control. These factors include political and economic conditions, regulatory constraints, currency regulations,

policy changes such as the withdrawal of the U.K. from the European Union, and other matters in any of the countries or regions in which we operate, now or in the future. Other factors that may impact international operations include foreign trade (including tariffs and trade sanctions), monetary and fiscal policies and the laws and regulations of the U.S. and foreign governments, agencies and similar organizations, and risks associated with having major facilities in locations which have been historically less stable than the U.S. Risks inherent in international operations also include, among others, the costs and difficulties of managing international operations, adverse tax consequences, and difficulty in enforcing intellectual property rights.

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

Accounting principles and related pronouncements, implementation guidelines, and interpretations we apply to a wide range of matters that are relevant to our business, including self-insurance liabilities, are highly complex and involve subjective assumptions, estimates and judgments by our management. Changes in rules or interpretation or changes in underlying assumptions, estimates or judgments by our management could significantly change our reported or expected financial performance and have a material impact on our consolidated financial statements.

We are exposed to risks relating to evaluations of controls required by Section 404 of the Sarbanes-Oxley Act.

Section 404 of the Sarbanes-Oxley Act of 2002 requires management assessments of the effectiveness of internal control over financial reporting and disclosure controls and procedures. If we are unable to maintain effective internal control over financial reporting or disclosure controls and procedures, our ability to record, process and report financial information accurately and to prepare financial statements within required time periods could be adversely affected, which could subject us to litigation or investigations requiring management resources and payment of legal and other expenses, negatively affect investor confidence in our financial statements and adversely impact our stock price.

Changes in tax rates, new U.S. or foreign tax legislation, and exposure to additional tax liabilities could adversely affect our financial condition and results of operations.

We are subject to a variety of taxes and tax collection and remittance obligations in the U.S. and numerous foreign jurisdictions. Additionally, at any point in time, we may be under examination for value added, sales-based, payroll, product, import or other non-income taxes. We may recognize additional tax expense, be subject to additional tax liabilities, or incur losses and penalties, due to changes in laws, regulations, administrative practices, principles, assessments by authorities and interpretations related to tax, including tax rules in various jurisdictions. We compute our income tax provision based on enacted tax rates in the countries in which we operate. As tax rates vary among countries, a change in earnings attributable to the various jurisdictions in which we operate could result in an unfavorable change in our overall tax provision. Additionally, changes in the enacted tax rates or adverse outcomes in tax audits, including transfer pricing disputes, could have a material adverse effect on our financial condition and results of operations.

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

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

Operations at our facilities require the treatment and disposal of wastewater, stormwater and agricultural and food processing wastes, the use and maintenance of refrigeration systems, including ammonia-based chillers, noise, odor and dust management, the operation of mechanized processing equipment, and other operations that potentially could affect the environment and public health and safety. Failure to comply with current and future environmental, health and safety standards could result in the imposition of fines and penalties, illness or injury of our employees, and claims or lawsuits related to such illnesses or injuries, and temporary closures or limits on the operations of facilities.

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

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

Item 1B—Unresolved Staff Comments

None.

Item 2—Properties

Warehouse Properties

At August 28, 2022, we operated 838 membership warehouses:

	Own Land and Building	Lease Land and/or Building(1)	Total
United States and Puerto Rico	466	112	578
Canada	90	17	107
Other International	105	48	153
Total	661	177	838

(1) 126 of the 177 leases are land-only leases, where Costco owns the building.

At the end of 2022, our warehouses contained approximately 122.5 million square feet of operating floor space: 85.4 million in the U.S.; 15.2 million in Canada; and 21.9 million in Other International. Total square feet associated with distribution and logistics facilities were approximately 31.0 million. Additionally, we operate various processing, packaging, manufacturing and other facilities to support our business, which includes the production of certain private-label items.

Item 3—Legal Proceedings

See discussion of Legal Proceedings in Note 10 to the consolidated financial statements included in Item 8 of this Report.

Item 4—Mine Safety Disclosures

Not applicable.

PART II

Item 5—Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information and Dividend Policy

Our common stock is traded on the NASDAQ Global Select Market under the symbol "COST." On September 27, 2022, we had 10,279 stockholders of record.

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

Issuer Purchases of Equity Securities

The following table sets forth information on our common stock repurchase activity for the fourth quarter of 2022 (dollars in millions, except per share data):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program[(1)]	Maximum Dollar Value of Shares that May Yet be Purchased under the Program
May 9—June 5, 2022	98,000	$ 463.77	98,000	$ 2,947
June 6—July 3, 2022	98,000	467.53	98,000	2,901
July 4—July 31, 2022	89,000	512.08	89,000	2,856
August 1—August 28, 2022	88,000	545.08	88,000	2,808
Total fourth quarter	373,000	$ 495.49	373,000	

(1) The repurchase program is conducted under a $4,000 authorization approved by our Board of Directors in April 2019, which expires in April 2023.

Performance Graph

The following graph compares the cumulative total shareholder return assuming reinvestment of dividends on an investment of $100 in Costco common stock, S&P 500 Index, and the S&P 500 Retail Index over the five years from September 3, 2017, through August 28, 2022.
cost-20220828_g1.jpg
The following graph provides information concerning average sales per warehouse over a 10-year period.

Average Sales Per Warehouse*

(Sales In Millions)

Year Opened	# of Whses	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
2022	**23**										$ 150
2021	**20**									$ 140	158
2020	**13**								$ 132	152	184
2019	**20**							$ 129	138	172	208
2018	**21**						$ 116	119	141	172	202
2017	**26**					$ 121	142	158	176	206	237
2016	**29**				$ 87	97	118	131	145	173	204
2015	**23**			$ 83	85	94	112	122	136	163	189
2014	**30**		$ 108	109	115	125	140	144	155	182	208
2013 & Before	**633**	$ 160	167	168	167	173	186	193	203	230	261
Totals	**838**	160	164	162	159	163	176	182	192	217	245

Fiscal Year

*First year sales annualized.

2017 was a 53-week fiscal year but it has been normalized for purposes of comparability

Item 6—Reserved

Item 7—Management's Discussion and Analysis of Financial Conditions and Results of Operations
(amounts in millions, except per share, share, membership fee, and warehouse count data)

The following Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to promote understanding of the results of operations and financial condition. MD&A is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and the accompanying Notes to Financial Statements (Part II, Item 8 of this Form 10-K). This section generally discusses the results of operations for 2022 compared to 2021. For discussion related to the results of operations and changes in financial condition for 2021 compared to 2020 refer to Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in our fiscal year 2021 Form 10-K, which was filed with the United States Securities and Exchange Commission (SEC) on October 6, 2021.

Overview

We believe that the most important driver of our profitability is increasing net sales, particularly comparable sales. Net sales includes our core merchandise categories (foods and sundries, non-foods, and fresh foods), warehouse ancillary (gasoline, pharmacy, optical, food court, hearing aids, and tire installation) and other businesses (e-commerce, business centers, travel and other). We define comparable sales as net sales from warehouses open for more than one year, including remodels, relocations and expansions, and sales related to e-commerce websites operating for more than one year. Comparable sales growth is achieved through increasing shopping frequency from new and existing members and the amount they spend on each visit (average ticket). Sales comparisons can also be particularly influenced by certain factors that are beyond our control: fluctuations in currency exchange rates (with respect to our international operations); inflation and changes in the cost of gasoline and associated competitive conditions. The higher our comparable sales exclusive of these items, the more we can leverage our SG&A expenses, reducing them as a percentage of sales and enhancing profitability. Generating comparable sales growth is foremost a question of making available to our members the right merchandise at the right prices, a skill that we believe we have repeatedly demonstrated over the long-term. Another substantial factor in net sales growth is the health of the economies in which we do business, including the effects of inflation or deflation, especially the United States. Net sales growth and gross margins are also impacted by our competition, which is vigorous and widespread, across a wide range of global, national and regional wholesalers and retailers, including those with e-commerce operations. While we cannot control or reliably predict general economic health or changes in competition, we believe that we have been successful historically in adapting our business to these changes, such as through adjustments to our pricing and merchandise mix, including increasing the penetration of our private-label items, and through online offerings.

Our philosophy is to provide our members with quality goods and services at competitive prices. We do not focus in the short-term on maximizing prices charged, but instead seek to maintain what we believe is a perception among our members of our "pricing authority" – consistently providing the most competitive values. Merchandise costs in 2022 were impacted by inflation higher than what we have experienced in recent years. The impact to our net sales and gross margin is influenced in part by our merchandising and pricing strategies in response to cost increases. Those strategies can include, but are not limited to, working with our suppliers to share in absorbing cost increases, earlier-than-usual purchasing and in greater volumes, offering seasonal merchandise outside its season, as well as passing cost increases on to our members. Our investments in merchandise pricing may include reducing prices on merchandise to drive sales or meet competition and holding prices steady despite cost increases instead of passing the increases on to our members, all negatively impacting gross margin and gross margin as a percentage of net sales (gross margin percentage).

We believe our gasoline business enhances traffic in our warehouses, but it generally has a lower gross margin percentage relative to our non-gasoline business. It also has lower SG&A expenses as a percent of net sales compared to our non-gasoline business. A higher penetration of gasoline sales will generally lower our gross margin percentage. Rapidly changing gasoline prices may significantly impact our near-

term net sales growth. Generally, rising gasoline prices benefit net sales growth which, given the higher sales base, negatively impacts our gross margin percentage but decreases our SG&A expenses as a percentage of net sales. A decline in gasoline prices has the inverse effect. Additionally, actions in various countries, particularly China and the United States, have affected the costs of some of our merchandise. The degree of our exposure is dependent on (among other things) the type of goods, rates imposed, and timing of the tariffs. Higher tariffs could adversely impact our results.

We also achieve net sales growth by opening new warehouses. As our warehouse base grows, available and desirable sites become more difficult to secure, and square footage growth becomes a comparatively less substantial component of growth. The negative aspects of such growth, however, including lower initial operating profitability relative to existing warehouses and cannibalization of sales at existing warehouses when openings occur in existing markets, are continuing to decline in significance as they relate to the results of our total operations. Our rate of square footage growth is generally higher in foreign markets, due to the smaller base in those markets, and we expect that to continue. Our e-commerce business growth, domestically and internationally, has also increased our sales but it generally has a lower gross margin percentage relative to our warehouse operations. E-commerce sales growth slowed in 2022 compared to 2021 and 2020.

The membership format is an integral part of our business and has a significant effect on our profitability. This format is designed to reinforce member loyalty and provide continuing fee revenue. The extent to which we achieve growth in our membership base, increase the penetration of our Executive members, and sustain high renewal rates materially influences our profitability. Our paid membership growth rate may be adversely impacted when warehouse openings occur in existing markets as compared to new markets.

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

Our operating model is generally the same across our U.S., Canadian, and Other International operating segments (see Note 11 to the consolidated financial statements included in Item 8 of this Report). Certain operations in the Other International segment have relatively higher rates of square footage growth, lower wage and benefit costs as a percentage of sales, less or no direct membership warehouse competition, or lack e-commerce or business delivery.

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

Our fiscal year ends on the Sunday closest to August 31. References to 2022, 2021, and 2020 relate to the 52-week fiscal years ended August 28, 2022, August 29, 2021, and August 30, 2020, respectively. Certain percentages presented are calculated using actual results prior to rounding. Unless otherwise noted, references to net income relate to net income attributable to Costco.

Highlights for 2022 versus 2021 include:

- We opened 26 new warehouses, including 3 relocations: 14 net new in the U.S., 2 net new in our Canadian segment, and 7 new in our Other International segment, compared to 22 new warehouses, including 2 relocations in 2021;
- Net sales increased 16% to $222,730 driven by a 14% increase in comparable sales and sales at new warehouses opened in 2021 and 2022;
- Membership fee revenue increased 9% to $4,224, driven by new member sign-ups, upgrades to Executive membership, and an increase in our renewal rate;
- Gross margin percentage decreased 65 basis points, driven primarily by our core merchandise categories and a LIFO charge for higher merchandise costs;
- SG&A expenses as a percentage of net sales decreased 77 basis points, primarily due to leveraging increased sales and ceasing of incremental wages related to COVID-19, despite additional wage and benefits increases;
- We incurred a one-time $77 pretax charge, primarily related to granting our employees one additional day of paid time off in March 2022;
- The effective tax rate in 2022 was 24.6% compared to 24.0% in 2021;
- Net income increased 17% to $5,844, or $13.14 per diluted share compared to $5,007, or $11.27 per diluted share in 2021;
- In June 2022, the Company paid a cash dividend of $208 and purchased the remaining equity interest of its Taiwan operations from its former joint-venture partner for $842, totaling $1,050 in the aggregate; and
- In April 2022, the Board of Directors approved an increase in the quarterly cash dividend from $0.79 to $0.90 per share.

COVID-19

The COVID-19 pandemic continued to impact our business during 2022, albeit to a lesser extent. COVID-related and other supply and logistics constraints have continued to adversely affect some merchandise categories and are expected to do so for the foreseeable future. During 2021, we paid $515 in incremental wages related to COVID-19, which ceased in February 2021.

RESULTS OF OPERATIONS

Net Sales

	2022	2021	2020
Net Sales	$ 222,730	$ 192,052	$ 163,220
Increases in net sales:			
U.S.	17 %	16 %	9 %
Canada	16 %	22 %	5 %
Other International	10 %	23 %	13 %
Total Company	16 %	18 %	9 %
Increases in comparable sales:			
U.S.	16 %	15 %	8 %
Canada	15 %	20 %	5 %
Other International	7 %	19 %	9 %
Total Company	14 %	16 %	8 %
Increases in comparable sales excluding the impact of changes in foreign currency and gasoline prices:			
U.S.	10 %	14 %	9 %
Canada	12 %	12 %	7 %
Other International	10 %	13 %	11 %
Total Company	11 %	13 %	9 %

Net Sales

Net sales increased $30,678 or 16% during 2022. The improvement was attributable to an increase in comparable sales of 14%, and sales at new warehouses opened in 2021 and 2022. Sales increased $15,830 in core merchandise categories and $14,848 in warehouse ancillary and other businesses. The rate of increase was strongest in our gasoline, business centers, and travel businesses. Sales continued to be impacted by inflation, higher than what we experienced in previous fiscal years.

During 2022, higher gasoline prices positively impacted net sales by $9,230, 481 basis points, compared to 2021, with a 42% increase in the average price per gallon. The volume of gasoline sold increased approximately 22%, positively impacting net sales by $3,847, 200 basis points. Changes in foreign currencies relative to the U.S. dollar negatively impacted net sales by approximately $1,762, 92 basis points, compared to 2021, attributable primarily to our Other International operations.

Comparable Sales

Comparable sales increased 14% during 2022 and were positively impacted by increases in shopping frequency and average ticket, which includes the effects of inflation and changes in foreign currency. E-commerce comparable sales increased 10% during 2022, including inflation.

Membership Fees

	2022	2021	2020
Membership fees	$ 4,224	$ 3,877	$ 3,541
Membership fees increase	9 %	9 %	6 %

Membership fee revenue increased 9% in 2022, driven by new member sign-ups and upgrades to Executive membership. Changes in foreign currencies relative to the U.S. dollar negatively impacted membership fees by $42, compared to 2021. At the end of 2022, our member renewal rates were 93% in the U.S. and Canada and 90% worldwide. Renewal rates continue to benefit from more members auto renewing and increased penetration of Executive members, who on average renew at a higher rate. Our renewal rate, which excludes affiliates of Business members, is a trailing calculation that captures renewals during the period seven to eighteen months prior to the reporting date. We account for membership fee revenue on a deferred basis, recognized ratably over the one-year membership period.

Gross Margin

	2022	2021	2020
Net sales	$ 222,730	$ 192,052	$ 163,220
Less merchandise costs	199,382	170,684	144,939
Gross margin	$ 23,348	$ 21,368	$ 18,281
Gross margin percentage	10.48 %	11.13 %	11.20 %

Total gross margin percentage decreased 65 basis points compared to 2021. Excluding the impact of gasoline price inflation on net sales, gross margin was 10.94%, a decrease of 19 basis points. This was primarily due to a 33 basis-point decrease in core merchandise categories, predominantly driven by decreases in fresh foods and foods and sundries, and 19 basis points due to a LIFO charge for higher merchandise costs. Gross margin was also negatively impacted by one basis point due to increased 2% rewards. Warehouse ancillary and other businesses positively impacted gross margin by 29 basis points, predominantly gasoline, partially offset by e-commerce. Gross margin was positively impacted by five basis points due to the net impact of ceasing incremental wages related to COVID-19 and the negative impact of a one-time charge related to granting our employees one additional day of paid time off. Changes in foreign currencies relative to the U.S. dollar negatively impacted gross margin by approximately $176, compared to 2021, primarily attributable to our Other International Operations.

The gross margin in core merchandise categories, when expressed as a percentage of core merchandise sales (rather than total net sales), decreased 27 basis points. The decrease was across all categories, most significantly in fresh foods. This measure eliminates the impact of changes in sales penetration and gross margins from our warehouse ancillary and other businesses.

Gross margin on a segment basis, when expressed as a percentage of the segment's own sales and excluding the impact of changes in gasoline prices on net sales (segment gross margin percentage), decreased across all segments. All segments were negatively impacted due to decreases in core merchandise categories, partially offset by increases in warehouse ancillary and other businesses. Gross margin in our U.S. segment was also negatively impacted by the LIFO charge. Our Other International segment was negatively impacted by increased 2% rewards. All segments benefited from the ceasing of incremental wages related to COVID-19.

Selling, General and Administrative Expenses

	2022	2021	2020
SG&A expenses	$ 19,779	$ 18,537	$ 16,387
SG&A expenses as a percentage of net sales	8.88 %	9.65 %	10.04 %

SG&A expenses as a percentage of net sales decreased 77 basis points compared to 2021. SG&A expenses as a percentage of net sales excluding the impact of gasoline price inflation was 9.26%, a decrease of 39 basis points. Warehouse operations and other businesses were lower by 17 basis points, largely attributable to leveraging increased sales. This includes the impact of the starting wage increase we instituted in October 2021, as well the increased wages and benefits that were effective on March 14, 2022, and July 4, 2022. SG&A expenses was benefited by a net of 16 basis points due to the positive impact of ceasing incremental wages related to COVID-19, partially offset by higher write-offs of certain information technology assets, and expenses related to granting our employees one additional day of paid time off. Central operating costs were lower by five basis points, and stock compensation expense was lower by one basis point. Changes in foreign currencies relative to the U.S. dollar decreased SG&A expenses by approximately $148, compared to 2021, primarily attributable to our Other International operations.

Interest Expense

	2022	2021	2020
Interest expense	$ 158	$ 171	$ 160

Interest expense primarily relates to Senior Notes and financing leases. Interest expense decreased in 2022 due to repayment of the 2.300% Senior Notes on December 1, 2021. For more information on our debt arrangements, refer to the consolidated financial statements included in Item 8 of this Report.

Interest Income and Other, Net

	2022	2021	2020
Interest income	$ 61	$ 41	$ 89
Foreign-currency transaction gains, net	106	56	7
Other, net	38	46	(4)
Interest income and other, net	$ 205	$ 143	$ 92

The increase in interest income in 2022 was primarily due to higher global interest rates. Foreign-currency transaction gains, net, include revaluation or settlement of monetary assets and liabilities by our Canadian and Other International operations and mark-to-market adjustments for forward foreign-exchange contracts. See Derivatives and Foreign Currency sections in Note 1 to the consolidated financial statements included in Item 8 of this Report.

Provision for Income Taxes

	2022		2021		2020	
Provision for income taxes	$	1,925	$	1,601	$	1,308
Effective tax rate		24.6 %		24.0 %		24.4 %

The effective tax rate for 2022 was impacted by net discrete tax benefits of $130. This included $94 of excess tax benefits related to stock compensation. Excluding discrete net tax benefits, the tax rate was 26.2% for 2022.

The effective tax rate for 2021 was impacted by net discrete tax benefits of $163. This included $75 of excess tax benefits related to stock compensation, $70 related to the special cash dividend paid through our 401(k) plan, and $19 related to a reduction in the valuation allowance against certain deferred tax assets. Excluding net discrete tax benefits, the tax rate was 26.4% for 2021.

LIQUIDITY AND CAPITAL RESOURCES

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

	2022		2021		2020	
Net cash provided by operating activities	$	7,392	$	8,958	$	8,861
Net cash used in investing activities		(3,915)		(3,535)		(3,891)
Net cash used in financing activities		(4,283)		(6,488)		(1,147)

Our primary sources of liquidity are cash flows generated from our operations, cash and cash equivalents, and short-term investments. Cash and cash equivalents and short-term investments were $11,049 and $12,175 at the end of 2022 and 2021, respectively. Of these balances, unsettled credit and debit card receivables represented approximately $2,010 and $1,816 at the end of 2022 and 2021. These receivables generally settle within four days. Changes in foreign exchange rates impacted cash and cash equivalents negatively by $249 in 2022, and positively by $46 and $70 in 2021 and 2020.

Material contractual obligations arising in the normal course of business primarily consist of purchase obligations, long-term debt and related interest payments, leases, and construction and land purchase obligations. See Notes 4 and 5 to the consolidated financial statements included in Item 8 of this Report for amounts outstanding on August 28, 2022, related to debt and leases.

Purchase obligations consist of contracts primarily related to merchandise, equipment, and third-party services, the majority of which are due in the next 12 months. Construction and land purchase obligations consist of contracts primarily related to the development and opening of new and relocated warehouses, the majority of which (other than leases) are due in the next 12 months.

Management believes that our cash and investment position and operating cash flows with capacity under existing and available credit agreements will be sufficient to meet our liquidity and capital requirements for the foreseeable future. We believe that our U.S. current and projected asset position is sufficient to meet our U.S. liquidity requirements.

Cash Flows from Operating Activities

Net cash provided by operating activities totaled $7,392 in 2022, compared to $8,958 in 2021. Our cash flow provided by operations is primarily from net sales and membership fees. Cash flow used in operations generally consists of payments to merchandise suppliers, warehouse operating costs, including payroll and employee benefits, utilities, and credit and debit card processing fees. Cash used in operations also includes payments for income taxes. Changes in our net investment in merchandise inventories (the difference between merchandise inventories and accounts payable) is impacted by

several factors, including how fast inventory is sold, the forward deployment of inventory to accelerate delivery times, payment terms with our suppliers, and early payments to obtain discounts from suppliers.

Cash Flows from Investing Activities

Net cash used in investing activities totaled $3,915 in 2022, compared to $3,535 in 2021, and is primarily related to capital expenditures. Net cash flows from investing activities also includes purchases and maturities of short-term investments.

Capital Expenditures

Our primary requirements for capital are acquiring land, buildings, and equipment for new and remodeled warehouses. Capital is also required for information systems, manufacturing and distribution facilities, initial warehouse operations, and working capital. In 2022, we spent $3,891 on capital expenditures, and it is our current intention to spend approximately $3,800 to $4,000 during fiscal 2023. These expenditures are expected to be financed with cash from operations, existing cash and cash equivalents, and short-term investments. We opened 26 new warehouses, including three relocations, in 2022, and plan to open approximately up to 29 additional new warehouses, including four relocations, in 2023. There can be no assurance that current expectations will be realized, and plans are subject to change upon further review of our capital expenditure needs or based on the economic environment.

Cash Flows from Financing Activities

Net cash used in financing activities totaled $4,283 in 2022, compared to $6,488 in 2021. Cash flows used in financing activities primarily related to the payment of dividends, payments to our former joint-venture partner for a dividend and the purchase of their equity interest in Taiwan, totaling $1,050 in the aggregate, repayments of our 2.300% Senior Notes, repurchases of common stock, and withholding taxes on stock awards.

Stock Repurchase Programs

During 2022 and 2021, we repurchased 863,000 and 1,358,000 shares of common stock, at average prices of $511.46 and $364.39, respectively, totaling approximately $442 and $495, respectively. These amounts may differ from the stock repurchase balances in the accompanying consolidated statements of cash flows due to changes in unsettled stock repurchases at the end of each fiscal year. Purchases are made from time-to-time, as conditions warrant, in the open market or in block purchases and pursuant to plans under SEC Rule 10b5-1. Repurchased shares are retired, in accordance with the Washington Business Corporation Act. The remaining amount available to be purchased under our approved plan was $2,808 at the end of 2022.

Dividends

Cash dividends declared in 2022 totaled $3.38 per share, as compared to $12.98 per share in 2021. Dividends in 2021 included a special dividend of $10.00 per share, aggregating approximately $4,430. In April 2022, the Board of Directors increased our quarterly cash dividend from $0.79 to $0.90 per share.

Bank Credit Facilities and Commercial Paper Programs

We maintain bank credit facilities for working capital and general corporate purposes. At August 28, 2022, we had borrowing capacity under these facilities of $1,257. Our international operations maintain $773 of this capacity under bank credit facilities, of which $176 is guaranteed by the Company. Short-term borrowings outstanding under the bank credit facilities were $88 and $41 at the end of 2022 and 2021.

The Company has letter of credit facilities, for commercial and standby letters of credit, totaling $224. The outstanding commitments under these facilities at the end of 2022 totaled $184, most of which were standby letters of credit that do not expire or have expiration dates within one year. The bank credit facilities have various expiration dates, most within one year, and we generally intend to renew these

facilities. The amount of borrowings available at any time under our bank credit facilities is reduced by the amount of standby and commercial letters of credit outstanding.

Off-Balance Sheet Arrangements

In the opinion of management, we have no off-balance sheet arrangements that have had or are reasonably likely to have a material current or future effect on our financial condition or financial statements.

Critical Accounting Estimates

The preparation of our consolidated financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP) requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and on assumptions that we believe to be reasonable, and we continue to review and evaluate these estimates. For further information on significant accounting policies, see discussion in Note 1 to the consolidated financial statements included in Item 8 of this Report.

Insurance/Self-insurance Liabilities

Claims for employee health-care benefits, workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, inventory loss, and other exposures are funded predominantly through self-insurance. Insurance coverage is maintained for certain risks to seek to limit exposures arising from very large losses. We use different risk management mechanisms, including a wholly-owned captive insurance subsidiary, and participate in a reinsurance program. Liabilities associated with the risks that we retain are not discounted and are estimated by using historical claims experience, demographic factors, severity factors, and other actuarial assumptions. The costs of claims are highly unpredictable and can fluctuate as a result of inflation rates, regulatory or legal changes, and unforeseen developments in claims. While we believe our estimates are reasonable and provide for a certain degree of coverage to account for these variables, actual claims and costs could differ significantly from recorded liabilities. Historically, adjustments to our estimates have not been material.

Recent Accounting Pronouncements

We do not expect that any recently issued accounting pronouncements will have a material effect on our financial statements.

Item 7A—Quantitative and Qualitative Disclosures About Market Risk (amounts in millions)

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

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment holdings that are diversified among various instruments considered to be cash equivalents, as defined in Note 1 to the consolidated financial statements included in Item 8 of this Report, as well as short-term investments in government and agency securities with effective maturities of generally three months to five years at the date of purchase. The primary objective of our investment activities is to preserve principal and secondarily to generate yields. The majority of our short-term investments are in fixed interest-rate securities. These securities are subject to changes in fair value due to interest rate fluctuations.

Our policy limits investments in the U.S. to direct U.S. government and government agency obligations, repurchase agreements collateralized by U.S. government and government agency obligations, U.S. government and government agency money market funds, and insured bank balances. Our wholly-owned captive insurance subsidiary invests in U.S. government and government agency obligations and U.S. government and government agency money market funds. Our Canadian and Other International subsidiaries' investments are primarily in money market funds, bankers' acceptances, and bank certificates of deposit, generally denominated in local currencies.

A 100 basis point change in interest rates as of the end of 2022 would have had an immaterial incremental change in fair market value. For those investments that are classified as available-for-sale, the unrealized gains or losses related to fluctuations in market volatility and interest rates are reflected within stockholders' equity in accumulated other comprehensive income in the consolidated balance sheets.

The nature and amount of our long-term debt may vary as a result of business requirements, market conditions, and other factors. As of the end of 2022, long-term debt with fixed interest rates was $6,590. Fluctuations in interest rates may affect the fair value of the fixed-rate debt. See Note 4 to the consolidated financial statements included in Item 8 of this Report for more information on our long-term debt.

Foreign Currency Risk

Our foreign subsidiaries conduct certain transactions in non-functional currencies, which exposes us to fluctuations in exchange rates. We manage these fluctuations, in part, through the use of forward foreign-exchange contracts, seeking to economically hedge the impact of these fluctuations on known future expenditures denominated in a non-functional foreign-currency. The contracts are intended primarily to economically hedge exposure to U.S. dollar merchandise inventory expenditures made by our international subsidiaries. We seek to mitigate risk with the use of these contracts and do not intend to engage in speculative transactions. For additional information related to the Company's forward foreign-exchange contracts, see Notes 1 and 3 to the consolidated financial statements included in Item 8 of this Report. A hypothetical 10% strengthening of the functional currency compared to the non-functional currency exchange rates at August 28, 2022, would have decreased the fair value of the contracts by $128 and resulted in an unrealized loss in the consolidated statements of income for the same amount.

Commodity Price Risk

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

Item 8—Financial Statements and Supplementary Data

COSTCO WHOLESALE CORPORATION

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors

Costco Wholesale Corporation:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Costco Wholesale Corporation and subsidiaries (the Company) as of August 28, 2022, and August 29, 2021, the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the 52-week periods ended August 28, 2022, August 29, 2021, and August 30, 2020, and the related notes (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of August 28, 2022, and August 29, 2021, and the results of its operations and its cash flows for each of the 52-week periods ended August 28, 2022, August 29, 2021, and August 30, 2020, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of August 28, 2022, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated October 4, 2022, expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of a critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Evaluation of workers' compensation self-insurance liabilities

As discussed in Note 1 to the consolidated financial statements, the Company estimates its self-insurance liabilities by considering historical claims experience, demographic factors, severity factors, and other actuarial assumptions. The estimated self-insurance liabilities as of August 28, 2022, were $1,364 million, a portion of which related to workers' compensation self-insurance liabilities for the United States operations.

We identified the evaluation of the Company's workers' compensation self-insurance liabilities for the United States operations as a critical audit matter because of the extent of specialized skill and knowledge needed to evaluate the underlying assumptions and judgments made by the Company in the actuarial models. Specifically, subjective auditor judgment was required to evaluate the Company's selected loss rates and initial expected losses used in the actuarial models.

The following are the primary procedures we performed to address this critical audit matter. We evaluated the design and tested the operating effectiveness of certain internal controls over the Company's self-insurance workers' compensation process. This included controls related to the development and selection of the assumptions listed above used in the actuarial calculation and review of the actuarial report. We involved actuarial professionals with specialized skills and knowledge who assisted in:

- Assessing the actuarial models used by the Company for consistency with generally accepted actuarial standards
- Evaluating the Company's ability to estimate self-insurance workers' compensation liabilities by comparing its historical estimates with actual incurred losses and paid losses
- Evaluating the above listed assumptions underlying the Company's actuarial estimates by developing an independent expectation of the self-insurance workers' compensation liabilities and comparing them to the amounts recorded by the Company

/s/ KPMG LLP

We have served as the Company's auditor since 2002.

Seattle, Washington

October 4, 2022

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors

Costco Wholesale Corporation:

Opinion on Internal Control Over Financial Reporting

We have audited Costco Wholesale Corporation and subsidiaries' (the Company) internal control over financial reporting as of August 28, 2022, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of August 28, 2022, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of August 28, 2022, and August 29, 2021, the related consolidated statements of income, comprehensive income, equity, and cash flows for each of the 52-week periods ended August 28, 2022, August 29, 2021, and August 30, 2020, and the related notes (collectively, the consolidated financial statements), and our report dated October 4, 2022, expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

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

Definition and Limitations of Internal Control Over Financial Reporting

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

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

/s/ KPMG LLP

Seattle, Washington

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

	52 Weeks Ended		
	August 28, 2022	August 29, 2021	August 30, 2020
REVENUE			
Net sales	$ 222,730	$ 192,052	$ 163,220
Membership fees	4,224	3,877	3,541
Total revenue	226,954	195,929	166,761
OPERATING EXPENSES			
Merchandise costs	199,382	170,684	144,939
Selling, general and administrative	19,779	18,537	16,387
Operating income	7,793	6,708	5,435
OTHER INCOME (EXPENSE)			
Interest expense	(158)	(171)	(160)
Interest income and other, net	205	143	92
INCOME BEFORE INCOME TAXES	7,840	6,680	5,367
Provision for income taxes	1,925	1,601	1,308
Net income including noncontrolling interests	5,915	5,079	4,059
Net income attributable to noncontrolling interests	(71)	(72)	(57)
NET INCOME ATTRIBUTABLE TO COSTCO	$ 5,844	$ 5,007	$ 4,002
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO:			
Basic	$ 13.17	$ 11.30	$ 9.05
Diluted	$ 13.14	$ 11.27	$ 9.02
Shares used in calculation (000’s)			
Basic	443,651	443,089	442,297
Diluted	444,757	444,346	443,901

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

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(amounts in millions)

	52 Weeks Ended		
	August 28, 2022	**August 29, 2021**	**August 30, 2020**
NET INCOME INCLUDING NONCONTROLLING INTERESTS	$ 5,915	$ 5,079	$ 4,059
Foreign-currency translation adjustment and other, net	(721)	181	162
Comprehensive income	5,194	5,260	4,221
Less: Comprehensive income attributable to noncontrolling interests	36	93	80
COMPREHENSIVE INCOME ATTRIBUTABLE TO COSTCO	$ 5,158	$ 5,167	$ 4,141

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

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

	August 28, 2022	August 29, 2021
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 10,203	$ 11,258
Short-term investments	846	917
Receivables, net	2,241	1,803
Merchandise inventories	17,907	14,215
Other current assets	1,499	1,312
Total current assets	32,696	29,505
OTHER ASSETS		
Property and equipment, net	24,646	23,492
Operating lease right-of-use assets	2,774	2,890
Other long-term assets	4,050	3,381
TOTAL ASSETS	$ 64,166	$ 59,268
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 17,848	$ 16,278
Accrued salaries and benefits	4,381	4,090
Accrued member rewards	1,911	1,671
Deferred membership fees	2,174	2,042
Current portion of long-term debt	73	799
Other current liabilities	5,611	4,561
Total current liabilities	31,998	29,441
OTHER LIABILITIES		
Long-term debt, excluding current portion	6,484	6,692
Long-term operating lease liabilities	2,482	2,642
Other long-term liabilities	2,555	2,415
TOTAL LIABILITIES	43,519	41,190
COMMITMENTS AND CONTINGENCIES		
EQUITY		
Preferred stock $0.005 par value; 100,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock $0.005 par value; 900,000,000 shares authorized; 442,664,000 and 441,825,000 shares issued and outstanding	2	4
Additional paid-in capital	6,884	7,031
Accumulated other comprehensive loss	(1,829)	(1,137)
Retained earnings	15,585	11,666
Total Costco stockholders' equity	20,642	17,564
Noncontrolling interests	5	514
TOTAL EQUITY	20,647	18,078
TOTAL LIABILITIES AND EQUITY	$ 64,166	$ 59,268

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

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF EQUITY
(amounts in millions)

	Common Stock							
	Shares (000's)	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Costco Stockholders' Equity	Noncontrolling Interests	Total Equity
BALANCE AT SEPTEMBER 1, 2019	439,625	$ 4	$ 6,417	$ (1,436)	$ 10,258	$ 15,243	$ 341	$ 15,584
Net income	—	—	—	—	4,002	4,002	57	4,059
Foreign-currency translation adjustment and other, net	—	—	—	139	—	139	23	162
Stock-based compensation	—	—	621	—	—	621	—	621
Release of vested restricted stock units (RSUs), including tax effects	2,273	—	(330)	—	—	(330)	—	(330)
Repurchases of common stock	(643)	—	(10)	—	(188)	(198)	—	(198)
Cash dividends declared and other	—	—	—	—	(1,193)	(1,193)	—	(1,193)
BALANCE AT AUGUST 30, 2020	441,255	4	6,698	(1,297)	12,879	18,284	421	18,705
Net income	—	—	—	—	5,007	5,007	72	5,079
Foreign-currency translation adjustment and other, net	—	—	—	160	—	160	21	181
Stock-based compensation	—	—	668	—	—	668	—	668
Release of vested RSUs, including tax effects	1,928	—	(312)	—	—	(312)	—	(312)
Repurchases of common stock	(1,358)	—	(23)	—	(472)	(495)	—	(495)
Cash dividends declared	—	—	—	—	(5,748)	(5,748)	—	(5,748)
BALANCE AT AUGUST 29, 2021	441,825	4	7,031	(1,137)	11,666	17,564	514	18,078
Net income	—	—	—	—	5,844	5,844	71	5,915
Foreign-currency translation adjustment and other, net	—	—	—	(686)	—	(686)	(35)	(721)
Stock-based compensation	—	—	728	—	—	728	—	728
Release of vested RSUs, including tax effects	1,702	—	(363)	—	—	(363)	—	(363)
Dividend to noncontrolling interest	—	—	—	—	—	—	(208)	(208)
Acquisition of noncontrolling interest	—	—	(499)	(6)	—	(505)	(337)	(842)
Repurchases of common stock	(863)	—	(15)	—	(427)	(442)	—	(442)
Cash dividends declared and other	—	(2)	2	—	(1,498)	(1,498)	—	(1,498)
BALANCE AT AUGUST 28, 2022	442,664	$ 2	$ 6,884	$ (1,829)	$ 15,585	$ 20,642	$ 5	$ 20,647

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

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(amounts in millions)

	52 Weeks Ended		
	August 28, 2022	August 29, 2021	August 30, 2020
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income including noncontrolling interests	$ 5,915	$ 5,079	$ 4,059
Adjustments to reconcile net income including noncontrolling interests to net cash provided by operating activities:			
Depreciation and amortization	1,900	1,781	1,645
Non-cash lease expense	377	286	194
Stock-based compensation	724	665	619
Other non-cash operating activities, net	76	85	42
Deferred income taxes	(37)	59	104
Changes in operating assets and liabilities:			
Merchandise inventories	(4,003)	(1,892)	(791)
Accounts payable	1,891	1,838	2,261
Other operating assets and liabilities, net	549	1,057	728
Net cash provided by operating activities	7,392	8,958	8,861
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of short-term investments	(1,121)	(1,331)	(1,626)
Maturities and sales of short-term investments	1,145	1,446	1,678
Additions to property and equipment	(3,891)	(3,588)	(2,810)
Acquisitions	—	—	(1,163)
Other investing activities, net	(48)	(62)	30
Net cash used in investing activities	(3,915)	(3,535)	(3,891)
CASH FLOWS FROM FINANCING ACTIVITIES			
Proceeds from issuance of long-term debt	—	—	3,992
Repayments of long-term debt	(800)	(94)	(3,200)
Tax withholdings on stock-based awards	(363)	(312)	(330)
Repurchases of common stock	(439)	(496)	(196)
Cash dividend payments	(1,498)	(5,748)	(1,479)
Dividend to noncontrolling interest	(208)	—	—
Acquisition of noncontrolling interest	(842)	—	—
Other financing activities, net	(133)	162	66
Net cash used in financing activities	(4,283)	(6,488)	(1,147)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(249)	46	70
Net change in cash and cash equivalents	(1,055)	(1,019)	3,893
CASH AND CASH EQUIVALENTS BEGINNING OF YEAR	11,258	12,277	8,384
CASH AND CASH EQUIVALENTS END OF YEAR	$ 10,203	$ 11,258	$ 12,277
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest	$ 145	$ 149	$ 124
Income taxes, net	$ 1,940	$ 1,527	$ 1,052
SUPPLEMENTAL DISCLOSURE OF NON-CASH ACTIVITIES:			
Capital expenditures included in liabilities	$ 156	$ 184	$ 204

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

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

Note 1—Summary of Significant Accounting Policies

Description of Business

Costco Wholesale Corporation (Costco or the Company), a Washington corporation, and its subsidiaries operate membership warehouses based on the concept that offering members low prices on a limited selection of nationally-branded and private-label products in a wide range of merchandise categories will produce high sales volumes and rapid inventory turnover. At August 28, 2022, Costco operated 838 warehouses worldwide: 578 in the United States (U.S.) located in 46 states, Washington, D.C., and Puerto Rico, 107 in Canada, 40 in Mexico, 31 in Japan, 29 in the United Kingdom (U.K.), 17 in Korea, 14 in Taiwan, 13 in Australia, four in Spain, two each in France and China, and one in Iceland. The Company operates e-commerce websites in the U.S., Canada, U.K., Mexico, Korea, Taiwan, Japan, and Australia.

Basis of Presentation

The consolidated financial statements include the accounts of Costco, its wholly-owned subsidiaries, and subsidiaries in which it has a controlling interest. The Company reports noncontrolling interests in consolidated entities as a component of equity separate from the Company's equity. All material inter-company transactions between and among the Company and its consolidated subsidiaries have been eliminated in consolidation. During 2022, the Company paid a cash dividend of $208 and purchased the equity interest of its Taiwan operations from its former joint-venture partner for $842, totaling $1,050 in the aggregate. The remaining noncontrolling interest represents the portion of equity interests in a consolidated joint venture that is not 100% owned by the Company. Unless otherwise noted, references to net income relate to net income attributable to Costco.

Fiscal Year End

The Company operates on a 52/53-week fiscal year basis with the year ending on the Sunday closest to August 31. References to 2022, 2021, and 2020 relate to the 52-week fiscal years ended August 28, 2022, August 29, 2021, and August 30, 2020, respectively.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions take into account historical and forward-looking factors that the Company believes are reasonable. Actual results could differ from those estimates and assumptions.

Reclassification

Reclassifications were made to our 2021 and 2020 consolidated statements of income and cash flows to conform with current year presentation.

Cash and Cash Equivalents

The Company considers as cash and cash equivalents all cash on deposit, highly liquid investments with a maturity of three months or less at the date of purchase, and proceeds due from credit and debit card transactions with settlement terms of up to four days. Credit and debit card receivables were $2,010 and $1,816 at the end of 2022 and 2021.

The Company provides for the daily replenishment of major bank accounts as payments are presented. Included in accounts payable at the end of 2022 and 2021, are $995 and $999 representing the excess of outstanding payments over cash on deposit at the banks on which the payments were drawn.

Short-Term Investments

Short-term investments generally consist of debt securities (U.S. Government and Agency Notes), with maturities at the date of purchase of three months to five years. Investments with maturities beyond five years may be classified, based on the Company's determination, as short-term based on their highly liquid nature and because they represent the investment of cash that is available for current operations. Short-term investments classified as available-for-sale are recorded at fair value using the specific identification method with the unrealized gains and losses reflected in accumulated other comprehensive income (loss) until realized. Realized gains and losses from the sale of available-for-sale securities, if any, are determined on a specific identification basis and are recorded in interest income and other, net in the consolidated statements of income. These available-for-sale investments have a low level of inherent credit risk given they are issued by the U.S. Government and Agencies. Changes in their fair value are primarily attributable to changes in interest rates and market liquidity. Short-term investments classified as held-to-maturity are financial instruments that the Company has the intent and ability to hold to maturity and are reported net of any related amortization and are not remeasured to fair value on a recurring basis.

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

Fair Value of Financial Instruments

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

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

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

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

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

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

value of the individual securities as of the beginning of the reporting period in which the transfer(s) occurred.

Current financial liabilities have fair values that approximate their carrying values. Long-term financial liabilities include the Company's long-term debt, which are recorded on the balance sheet at issuance price and adjusted for unamortized discounts or premiums and debt issuance costs, and are being amortized to interest expense over the term of the loan. The estimated fair value of the Company's long-term debt is based primarily on reported market values, recently completed market transactions, and estimates based upon interest rates, maturities, and credit.

Receivables, Net

Receivables consist primarily of vendor, credit card incentive, reinsurance, third-party pharmacy and other receivables. Vendor receivables include discounts and volume rebates. Balances are generally presented on a gross basis, separate from any related payable due. In certain circumstances, these receivables may be settled against the related payable to that vendor, in which case the receivables are presented on a net basis. Credit card incentive receivables primarily represent amounts earned under the co-branded credit card arrangements in the U.S. and Canada. Reinsurance receivables are held by the Company's wholly-owned captive insurance subsidiary and primarily represent amounts ceded through reinsurance arrangements gross of the amounts assumed under reinsurance, which are presented within other current liabilities in the consolidated balance sheets. Third-party pharmacy receivables generally relate to amounts due from members' insurers. Other receivables primarily consist of amounts due from governmental entities, mostly tax-related items.

The valuation allowance related to receivables was not material to our consolidated financial statements at the end of 2022, 2021, and 2020.

Merchandise Inventories

Merchandise inventories consist of the following:

	2022	2021
United States	$ 13,160	$ 10,248
Canada	1,966	1,456
Other International	2,781	2,511
Merchandise inventories	$ 17,907	$ 14,215

Merchandise inventories are stated at the lower of cost or market. U.S. merchandise inventories are valued by the cost method of accounting, using the last-in, first-out (LIFO) basis. The Company believes the LIFO method more fairly presents the results of operations by more closely matching current costs with current revenues. The Company records an adjustment each quarter, if necessary, for the projected annual effect of inflation or deflation, and these estimates are adjusted to actual results determined at year-end, after actual inflation or deflation rates and inventory levels have been determined. Due to inflation, a $438 charge was recorded during 2022 to merchandise costs to increase the cumulative LIFO valuation on merchandise inventories at August 28, 2022. An immaterial LIFO charge was recorded in 2021. Canadian and Other International merchandise inventories are predominantly valued using the cost and retail inventory methods, respectively, using the first-in, first-out (FIFO) basis.

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

Property and Equipment, Net

Property and equipment are stated at cost. Depreciation and amortization expense is computed primarily using the straight-line method over estimated useful lives. Leasehold improvements made after the beginning of the initial lease term are depreciated over the shorter of the estimated useful life of the asset or the remaining term of the initial lease plus any renewals that are reasonably certain at the date the leasehold improvements are made.

The Company capitalizes certain computer software and costs incurred in developing or obtaining software for internal use. During development, these costs are included in construction in progress. To the extent that the assets become ready for their intended use, these costs are included in equipment and fixtures and amortized on a straight-line basis over their estimated useful lives. In 2022 and 2021, the Company recognized in SG&A expenses write-offs of $118 and $84 for certain information technology assets.

Repair and maintenance costs are expensed when incurred. Expenditures for remodels, refurbishments and improvements that add to or change asset function or useful life are capitalized. Assets removed during the remodel, refurbishment or improvement are retired. Assets classified as held-for-sale at the end of 2022 and 2021 were immaterial.

The following table summarizes the Company's property and equipment balances at the end of 2022 and 2021:

	Estimated Useful Lives	2022	2021
Land	N/A	$ 7,955	$ 7,507
Buildings and improvements	5-50 years	20,120	19,139
Equipment and fixtures	3-20 years	10,275	9,505
Construction in progress	N/A	1,582	1,507
		39,932	37,658
Accumulated depreciation and amortization		(15,286)	(14,166)
Property and equipment, net		$ 24,646	$ 23,492

The Company evaluates long-lived assets for impairment on an annual basis, when relocating or closing a facility, or when events or changes in circumstances may indicate the carrying amount of the asset group, generally an individual warehouse, may not be fully recoverable. For asset groups held and used, including warehouses to be relocated, the carrying value of the asset group is considered recoverable when the estimated future undiscounted cash flows generated from the use and eventual disposition of the asset group exceed the respective carrying value. In the event that the carrying value is not considered recoverable, an impairment loss is recognized for the asset group to be held and used equal to the excess of the carrying value above the estimated fair value of the asset group. For asset groups classified as held-for-sale (disposal group), the carrying value is compared to the disposal group's fair value less costs to sell. The Company estimates fair value by obtaining market appraisals from third party brokers or using other valuation techniques. There were no impairment charges recognized in 2022 or 2020. Impairment charges recognized in 2021 were immaterial.

Leases

The Company leases land, buildings, and/or equipment at warehouses and certain other office and distribution facilities. Leases generally contain one or more of the following options, which the Company can exercise at the end of the initial term: (a) renew the lease for a defined number of years at the then-fair market rental rate or rate stipulated in the lease agreement; (b) purchase the property at the then-fair market value; or (c) a right of first refusal in the event of a third-party offer.

Some leases include free-rent periods and step-rent provisions, which are recognized on a straight-line basis over the original term of the lease and any extension options that the Company is reasonably certain to exercise from the date the Company has control of the property. Certain leases provide for periodic rent increases based on price indices or the greater of minimum guaranteed amounts or sales volume. Our leases do not contain any material residual value guarantees or material restrictive covenants.

The Company determines at inception whether a contract is or contains a lease. Non-lease components and the lease components to which they relate are accounted for together as a single lease component for all asset classes. The Company initially records right-of-use (ROU) assets and lease obligations for its finance and operating leases based on the discounted future minimum lease payments over the term. The lease term is defined as the noncancelable period of the lease plus any options to extend when it is reasonably certain that the Company will exercise the option. As the rate implicit in the Company's leases is not easily determinable, the present value of the sum of the lease payments is calculated using the Company's incremental borrowing rate. The rate is determined using a portfolio approach based on the rate of interest the Company would pay to borrow an amount equal to the lease payments on a collateralized basis over a similar term. The Company uses quoted interest rates from financial institutions to derive the incremental borrowing rate. Impairment of ROU assets is evaluated in a similar manner as described in Property and Equipment, net above.

The Company's asset retirement obligations (ARO) primarily relate to leasehold improvements that must be removed at the end of a lease. These obligations are generally recorded as a discounted liability, with an offsetting asset at the inception of the lease term, based upon the estimated fair value of the costs to remove the improvements. These liabilities are accreted over time to the projected future value of the obligation. The ARO assets are depreciated using the same depreciation method as the leasehold improvement assets and are included with buildings and improvements. Estimated ARO liabilities associated with these leases are included in other liabilities in the accompanying consolidated balance sheet.

Goodwill and Acquired Intangible Assets

Goodwill represents the excess of acquisition cost over the fair value of the net assets acquired and is not subject to amortization. The Company reviews goodwill annually in the fourth quarter for impairment or when circumstances indicate carrying value may exceed the fair value. This evaluation is performed at the reporting unit level. If a qualitative assessment indicates that it is more likely than not that the fair value is less than carrying value, a quantitative analysis is completed using either the income or market approach, or a combination of both. The income approach estimates fair value based on expected discounted future cash flows, while the market approach uses comparable public companies and transactions to develop metrics to be applied to historical and expected future operating results.

Goodwill is included in other long-term assets in the consolidated balance sheets. The following table summarizes goodwill by reportable segment:

	United States	Canada	Other International	Total
Balance at August 30, 2020	$ 947	$ 27	$ 14	$ 988
Changes in currency translation and other [1]	6	1	1	8
Balance at August 29, 2021	$ 953	$ 28	$ 15	$ 996
Changes in currency translation	—	(1)	(2)	(3)
Balance at August 28, 2022	$ 953	$ 27	$ 13	$ 993

(1) Other consists of changes to the purchase price allocation.

Definite-lived intangible assets, which are not material, are included in other long-term assets on the consolidated balance sheets and are amortized on a straight-line basis over their estimated lives, which approximates the pattern of expected economic benefit.

Insurance/Self-insurance Liabilities

Claims for employee health care benefits, workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, inventory loss, and other exposures are funded predominantly through self-insurance. Insurance coverage is maintained for certain risks to limit exposures arising from very large losses. The Company uses different risk management mechanisms, including a wholly-owned captive insurance subsidiary (the captive) and participates in a reinsurance program. Liabilities associated with the risks that are retained by the Company are not discounted and are estimated, in part, by considering historical claims experience, demographic factors, severity factors, and other actuarial assumptions. The estimated accruals for these liabilities could be significantly affected if future occurrences and claims differ from these assumptions and historical trends. At the end of 2022 and 2021, these insurance liabilities were $1,364 and $1,257 in the aggregate, respectively, and were included in accrued salaries and benefits and other current liabilities in the consolidated balance sheets, classified based on their nature.

The captive receives direct premiums, which are netted against the Company's premium costs in selling, general and administrative expenses, in the consolidated statements of income. The captive participates in a reinsurance program that includes other third-party participants. The reinsurance agreement is one year in duration, and new agreements are entered into by each participant at their discretion at the commencement of the next calendar year. The participant agreements and practices of the reinsurance program are designed to limit a participating members' individual risk. Income statement adjustments related to the reinsurance program and related impacts to the consolidated balance sheets are recognized as information becomes known. In the event the Company leaves the reinsurance program, the Company retains its primary obligation to the policyholders for prior activity.

Derivatives

The Company is exposed to foreign-currency exchange-rate fluctuations in the normal course of business. It manages these fluctuations, in part, through the use of forward foreign-exchange contracts, seeking to economically hedge the impact of fluctuations of foreign exchange on known future expenditures denominated in a non-functional foreign-currency. The contracts relate primarily to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries with functional currencies other than the U.S. dollar. Currently, these contracts do not qualify for derivative hedge accounting. The Company seeks to mitigate risk with the use of these contracts and does not intend to engage in speculative transactions. Some of these contracts contain credit-risk-related contingent features that require settlement of outstanding contracts upon certain triggering events. The aggregate fair value amounts of derivative instruments in a net liability position and the amount needed to settle the instruments immediately if the credit-risk-related contingent features were triggered were immaterial at the end of 2022. There were no derivative instruments in a net liability position at the end of 2021. The aggregate notional amounts of open, unsettled forward foreign-exchange contracts were $1,242 and $1,331 at the end of 2022 and 2021, respectively. See Note 3 for information on the fair value of unsettled forward foreign-exchange contracts at the end of 2022 and 2021.

The unrealized gains or losses recognized in interest income and other, net in the accompanying consolidated statements of income relating to the net changes in the fair value of unsettled forward foreign-exchange contracts were immaterial in 2022, 2021 and 2020.

The Company is exposed to fluctuations in prices for energy, particularly electricity and natural gas, and other commodity products used in retail and manufacturing operations, which it seeks to partially mitigate through the use of fixed-price contracts for certain of its warehouses and other facilities, primarily in the

U.S. and Canada. The Company also enters into variable-priced contracts for some purchases of natural gas, in addition to fuel for its gas stations, on an index basis. These contracts meet the characteristics of derivative instruments, but generally qualify for the “normal purchases and normal sales” exception under authoritative guidance and require no mark-to-market adjustment.

Foreign Currency

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

The Company recognizes foreign-currency transaction gains and losses related to revaluing or settling monetary assets and liabilities denominated in currencies other than the functional currency in interest income and other, net in the consolidated statements of income. Generally, these include the U.S. dollar cash and cash equivalents and the U.S. dollar payables of consolidated subsidiaries revalued to their functional currency. Also included are realized foreign-currency gains or losses from settlements of forward foreign-exchange contracts. These items were $84 in 2022 and immaterial in 2021 and 2020.

Revenue Recognition

The Company recognizes sales for the amount of consideration collected from the member, which includes gross shipping fees where applicable, and is net of sales taxes collected and remitted to government agencies and member returns. The Company reserves for estimated returns based on historical trends in merchandise returns and reduces sales and merchandise costs accordingly. The Company records, on a gross basis, a refund liability and an asset for recovery, which are included in other current liabilities and other current assets, respectively, in the consolidated balance sheets.

The Company offers merchandise in the following core merchandise categories: foods and sundries, non-foods, and fresh foods. The Company also provides expanded products and services through warehouse ancillary and other businesses. The majority of revenue from merchandise sales is recognized at the point of sale. Revenue generated through e-commerce or special orders is generally recognized upon shipment to the member. For merchandise shipped directly to the member, shipping and handling costs are expensed as incurred as fulfillment costs and included in merchandise costs in the consolidated statements of income. In certain ancillary businesses, revenue is deferred until the member picks up merchandise at the warehouse. Deferred sales are included in other current liabilities in the consolidated balance sheets.

The Company is the principal for the majority of its transactions and recognizes revenue on a gross basis. The Company is the principal when it has control of the merchandise or service before it is transferred to the member, which generally is established when Costco is primarily responsible for merchandising decisions, pricing discretion, and maintains the relationship with the member, including assurance of member service and satisfaction.

The Company accounts for membership fee revenue, net of refunds, on a deferred basis, ratably over the one-year membership period. Deferred membership fees at the end of 2022 and 2021 were $2,174 and $2,042, respectively.

In most countries, the Company's Executive members qualify for a 2% reward on qualified purchases, subject to an annual maximum value, which does not expire and is redeemable at Costco warehouses. The Company accounts for this reward as a reduction in sales, net of the estimated impact of non-redemptions (breakage), with the corresponding liability classified as accrued member rewards in the consolidated balance sheets. Estimated breakage is computed based on redemption data. For 2022, 2021, and 2020, the net reduction in sales was $2,307, $2,047, and $1,707 respectively.

The Company sells and otherwise provides proprietary shop cards that do not expire and are redeemable at the warehouse or online for merchandise or membership. Revenue from shop cards is recognized upon redemption, and estimated breakage is recognized based on redemption data. The Company accounts for outstanding shop card balances as a shop card liability, net of estimated breakage. Shop card liabilities are included in other current liabilities in the consolidated balance sheets.

Citibank, N.A. became the exclusive issuer of co-branded credit cards to U.S. members in June 2016. The Company receives various forms of consideration from Citibank, including a royalty on purchases made on the card outside of Costco. A portion of the royalty is used to fund the rebate that cardholders receive, after taking into consideration breakage, which is calculated based on rebate redemption data. The rebates are issued in February and expire on December 31. The Company also maintains co-branded credit card arrangements in Canada and certain other International subsidiaries.

Merchandise Costs

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

Vendor Consideration

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

Selling, General and Administrative Expenses

Selling, general and administrative expenses consist primarily of salaries, benefits and workers’ compensation costs for warehouse employees (other than fresh foods departments and certain ancillary businesses which are reflected in merchandise costs) as well as all regional and home office employees, including buying personnel. Selling, general and administrative expenses also include substantially all building and equipment depreciation, stock compensation expense, credit and debit card processing fees, utilities, preopening, as well as other operating costs incurred to support warehouse and e-commerce website operations.

Retirement Plans

The Company's 401(k) retirement plan is available to all U.S. employees over the age of 18 who have completed 90 days of employment. The plan allows participants to make wage deferral contributions, a portion of which the Company matches. In addition, the Company provides each eligible participant an annual discretionary contribution. The Company also has a defined contribution plan for employees in Canada and contributes a percentage of each employee's wages. Certain subsidiaries in the Company's Other International operations have defined benefit and defined contribution plans, which are not material. Amounts expensed under all plans were $824, $748, and $676 for 2022, 2021, and 2020, and are predominantly included in SG&A expenses in the consolidated statements of income.

Stock-Based Compensation

Restricted Stock Units (RSUs) granted to employees generally vest over five years and allow for quarterly vesting of the pro-rata number of stock-based awards that would vest on the next anniversary of the grant date in the event of retirement or voluntary termination. Actual forfeitures are recognized as they occur.

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

Stock-based compensation expense is predominantly included in SG&A expenses in the consolidated statements of income. Certain stock-based compensation costs are capitalized or included in the cost of merchandise. See Note 7 for additional information on the Company's stock-based compensation plans.

Income Taxes

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

The timing and amounts of deductible and taxable items and the probability of sustaining uncertain tax positions requires significant judgment. The benefits of uncertain tax positions are recorded in the Company's consolidated financial statements only after determining a more-likely-than-not probability that the uncertain tax positions will withstand challenge from tax authorities. When facts and circumstances change, the Company reassesses these probabilities and records any changes as appropriate.

Net Income per Common Share Attributable to Costco

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

Stock Repurchase Programs

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

Note 2—Investments

The Company's investments were as follows:

2022:	Cost Basis	Unrealized Losses, Net	Recorded Basis
Available-for-sale:			
Government and agency securities	$ 534	$ (5)	$ 529
Held-to-maturity:			
Certificates of deposit	317	—	317
Total short-term investments	$ 851	$ (5)	$ 846

2021:	Cost Basis	Unrealized Gains, Net	Recorded Basis
Available-for-sale:			
Government and agency securities	$ 375	$ 6	$ 381
Held-to-maturity:			
Certificates of deposit	536	—	536
Total short-term investments	$ 911	$ 6	$ 917

Gross unrecognized holding gains and losses on available-for-sale securities were not material for the years ended August 28, 2022, and August 29, 2021. At those dates, there were no available-for-sale securities in a material continuous unrealized-loss position. There were no sales of available-for-sale securities during 2022 or 2021.

The maturities of available-for-sale and held-to-maturity securities at the end of 2022 are as follows:

	Available-For-Sale		
	Cost Basis	Fair Value	Held-To-Maturity
Due in one year or less	$ 276	$ 274	$ 317
Due after one year through five years	197	195	—
Due after five years	61	60	—
Total	$ 534	$ 529	$ 317

Note 3—Fair Value Measurement

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The table below presents information regarding the Company’s financial assets and financial liabilities that are measured at fair value on a recurring basis and indicate the level within the hierarchy reflecting the valuation techniques utilized to determine such fair value.

	Level 2	
	2022	**2021**
Investment in government and agency securities[1]	$ 529	$ 393
Forward foreign-exchange contracts, in asset position[2]	34	17
Forward foreign-exchange contracts, in (liability) position[2]	(2)	(2)
Total	$ 561	$ 408

(1) At August 29, 2021, $12 cash and cash equivalents and $381 short-term investments are included in the consolidated balance sheets.
(2) The asset and the liability values are included in other current assets and other current liabilities, respectively, in the consolidated balance sheets.

At August 28, 2022, and August 29, 2021, the Company did not hold any Level 1 or 3 financial assets or liabilities that were measured at fair value on a recurring basis. There were no transfers between levels during 2022 or 2021.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Assets and liabilities recognized and disclosed at fair value on a nonrecurring basis include items such as financial assets measured at amortized cost and long-lived nonfinancial assets. These assets are measured at fair value if determined to be impaired. There were no fair value adjustments to nonfinancial assets during 2022 and in 2021 they were immaterial.

Note 4—Debt

Short-Term Borrowings

The Company maintains various short-term bank credit facilities, with a borrowing capacity of $1,257 and $1,050, in 2022 and 2021, respectively. Borrowings on these short-term facilities were immaterial during 2022 and 2021. Short-term borrowings outstanding were $88 and $41 at the end of 2022 and 2021.

Long-Term Debt

The Company's long-term debt consists primarily of Senior Notes, described below. On December 1, 2021, the Company repaid, prior to maturity, the 2.300% Senior Notes at a redemption price plus accrued interest as specified in the Notes' agreement.

The Company at its option may redeem the Senior Notes at any time, in whole or in part, at a redemption price plus accrued interest. The redemption price is equal to the greater of 100% of the principal amount or the sum of the present value of the remaining scheduled payments of principal and interest to maturity. Additionally, upon certain events, the holder has the right to require the Company to purchase this security at a price of 101% of the principal amount plus accrued and unpaid interest to the date of the event. Interest on all outstanding long-term debt is payable semi-annually. The estimated fair value of Senior Notes is valued using Level 2 inputs.

Other long-term debt consists of Guaranteed Senior Notes issued by the Company's Japanese subsidiary, valued using Level 3 inputs.

At the end of 2022 and 2021, the fair value of the Company's long-term debt, including the current portion, was approximately $6,033 and $7,692, respectively. The carrying value of long-term debt consisted of the following:

	2022	2021
2.300% Senior Notes due May 2022	$ —	$ 800
2.750% Senior Notes due May 2024	1,000	1,000
3.000% Senior Notes due May 2027	1,000	1,000
1.375% Senior Notes due June 2027	1,250	1,250
1.600% Senior Notes due April 2030	1,750	1,750
1.750% Senior Notes due April 2032	1,000	1,000
Other long-term debt	590	731
Total long-term debt	6,590	7,531
Less unamortized debt discounts and issuance costs	33	40
Less current portion[1]	73	799
Long-term debt, excluding current portion	$ 6,484	$ 6,692

(1) Net of unamortized debt discounts and issuance costs.

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

2023	$ 73
2024	1,088
2025	110
2026	81
2027	2,250
Thereafter	2,988
Total	$ 6,590

Note 5—Leases

The tables below present information regarding the Company's lease assets and liabilities.

	2022		2021	
Assets				
Operating lease right-of-use assets	$	2,774	$	2,890
Finance lease assets[1]		1,620		1,000
Total lease assets	$	4,394	$	3,890
Liabilities				
Current				
Operating lease liabilities[2]	$	239	$	222
Finance lease liabilities[2]		245		72
Long-term				
Operating lease liabilities		2,482		2,642
Finance lease liabilities[3]		1,383		980
Total lease liabilities	$	4,349	$	3,916

(1) Included in other long-term assets in the consolidated balance sheets.
(2) Included in other current liabilities in the consolidated balance sheets.
(3) Included in other long-term liabilities in the consolidated balance sheets.

	2022	2021
Weighted-average remaining lease term (years)		
Operating leases	20	21
Finance leases	17	22
Weighted-average discount rate		
Operating leases	2.26 %	2.16 %
Finance leases	3.97 %	4.91 %

The components of lease expense, excluding short-term lease costs and sublease income (which were not material), were as follows:

	2022		2021		2020	
Operating lease costs[1]	$	297	$	296	$	252
Finance lease costs:						
Amortization of lease assets[1]		128		50		31
Interest on lease liabilities[2]		45		37		33
Variable lease costs[1]		157		151		87
Total lease costs	$	627	$	534	$	403

(1) Included in selling, general and administrative expenses and merchandise costs in the consolidated statements of income.
(2) Included in interest expense and merchandise costs in the consolidated statements of income.

Supplemental cash flow information related to leases was as follows:

	2022	2021	2020
Cash paid for amounts included in the measurement of lease liabilities:			
Operating cash flows — operating leases	$ 277	$ 282	$ 258
Operating cash flows — finance leases	45	37	33
Financing cash flows — finance leases	176	67	49
Operating lease assets obtained in exchange for new or modified leases	231	350	354
Financing lease assets obtained in exchange for new or modified leases	794	399	317

As of August 28, 2022, future minimum payments during the next five fiscal years and thereafter are as follows:

	Operating Leases(1)	Finance Leases
2023	$ 277	$ 288
2024	256	253
2025	210	280
2026	207	119
2027	186	88
Thereafter	2,332	1,191
Total(2)	3,468	2,219
Less amount representing interest	747	591
Present value of lease liabilities	$ 2,721	$ 1,628

(1) Operating lease payments have not been reduced by future sublease income of $83.
(2) Excludes $660 of lease payments for leases that have been signed but not commenced.

Note 6—Equity

Dividends

Cash dividends declared in 2022 totaled $3.38 per share, as compared to $12.98 per share in 2021. Dividends in 2021 included a special dividend of $10.00 per share, aggregating approximately $4,430. The Company's current quarterly dividend rate is $0.90 per share.

Stock Repurchase Programs

The Company's stock repurchase program is conducted under a $4,000 authorization by the Board of Directors, which expires in April 2023. As of the end of 2022, the remaining amount available under the approved plan was $2,808. The following table summarizes the Company’s stock repurchase activity:

	Shares Repurchased (000’s)	Average Price per Share	Total Cost
2022	863	$ 511.46	$ 442
2021	1,358	364.39	495
2020	643	308.45	198

These amounts may differ from repurchases of common stock in the consolidated statements of cash flows due to changes in unsettled stock repurchases at the end of each fiscal year. Purchases are made from time to time, as conditions warrant, in the open market or in block purchases and pursuant to plans under SEC Rule 10b5-1.

Note 7—Stock-Based Compensation

The Company grants stock-based compensation, primarily to employees and non-employee directors. Grants to executive officers are generally performance-based. Through a series of shareholder approvals, there have been amended and restated plans and new provisions implemented by the Company. RSUs are subject to quarterly vesting upon retirement or voluntary termination. Employees who attain at least 25 years of service with the Company receive shares under accelerated vesting provisions on the annual vesting date. The 2019 Incentive Plan authorized the issuance of 17,500,000 shares (10,000,000 RSUs) of common stock for future grants, plus the remaining shares that were available for grant and the future forfeited shares from grants under the previous plan, up to a maximum aggregate of 27,800,000 shares (15,885,000 RSUs). The Company issues new shares of common stock upon vesting of RSUs. Shares for vested RSUs are generally delivered to participants annually, net of shares withheld for taxes.

Summary of Restricted Stock Unit Activity

RSUs granted to employees and to non-employee directors generally vest over five and three years, respectively. Additionally, the terms of the RSUs, including performance-based awards, provide for accelerated vesting for employees and non-employee directors who have attained 25 or more and five or more years of service with the Company, respectively. Recipients are not entitled to vote or receive dividends on unvested and undelivered shares. At the end of 2022, 10,445,000 shares were available to be granted as RSUs under the 2019 Incentive Plan.

The following awards were outstanding at the end of 2022:

- 3,328,000 time-based RSUs, which vest upon continued employment or service over specified periods of time; and
- 121,000 performance-based RSUs, of which 82,000 were granted to executive officers subject to the determination of the attainment of performance targets for 2022. This determination occurred in September 2022, at which time at least 33% of the units vested, as a result of the long service of all executive officers receiving performance-based RSUs. The remaining awards vest upon continued employment over specified periods of time.

The following table summarizes RSU transactions during 2022:

	Number of Units (in 000's)	Weighted-Average Grant Date Fair Value
Outstanding at the end of 2021	4,349	$ 257.88
Granted	1,679	476.06
Vested and delivered	(2,456)	290.18
Forfeited	(123)	332.84
Outstanding at the end of 2022	3,449	$ 338.41

The weighted-average grant date fair value of RSUs granted was $476.06, $369.15, and $294.08 in 2022, 2021, and 2020, respectively. The remaining unrecognized compensation cost related to non-vested RSUs at the end of 2022 was $758 and the weighted-average period of time over which this cost will be recognized is 1.6 years. Included in the outstanding balance at the end of 2022 were approximately 1,210,000 RSUs vested but not yet delivered.

Summary of Stock-Based Compensation

The following table summarizes stock-based compensation expense and the related tax benefits:

	2022	2021	2020
Stock-based compensation expense	$ 724	$ 665	$ 619
Less recognized income tax benefit	154	140	128
Stock-based compensation expense, net	$ 570	$ 525	$ 491

Note 8— Taxes

Income Taxes

Income before income taxes is comprised of the following:

		2022		2021		2020
Domestic	$	5,759	$	4,931	$	4,204
Foreign		2,081		1,749		1,163
Total	$	7,840	$	6,680	$	5,367

The provisions for income taxes are as follows:

		2022		2021		2020
Federal:						
Current	$	798	$	718	$	616
Deferred		(35)		84		77
Total federal		763		802		693
State:						
Current		333		265		230
Deferred		(5)		11		8
Total state		328		276		238
Foreign:						
Current		851		557		372
Deferred		(17)		(34)		5
Total foreign		834		523		377
Total provision for income taxes	$	1,925	$	1,601	$	1,308

The reconciliation between the statutory tax rate and the effective rate for 2022, 2021, and 2020 is as follows:

	2022		2021		2020	
Federal taxes at statutory rate	$ 1,646	21.0 %	$ 1,403	21.0 %	$ 1,127	21.0 %
State taxes, net	267	3.4	243	3.6	190	3.6
Foreign taxes, net	231	3.0	92	1.4	92	1.7
Employee stock ownership plan (ESOP)	(23)	(0.3)	(91)	(1.3)	(24)	(0.5)
Other	(196)	(2.5)	(46)	(0.7)	(77)	(1.4)
Total	$ 1,925	24.6 %	$ 1,601	24.0 %	$ 1,308	24.4 %

The Company recognized total net tax benefits of $130, $163 and $81 in 2022, 2021 and 2020. These include benefits of $94, $75 and $77, related to stock-based compensation. During 2021, there was a net tax benefit of $70 related to the portion of the special dividend paid through our 401(k) plan.

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

	2022	2021
Deferred tax assets:		
Equity compensation	$ 84	$ 72
Deferred income/membership fees	302	161
Foreign tax credit carry forward	201	146
Operating lease liabilities	727	769
Accrued liabilities and reserves	694	681
Other	5	62
Total deferred tax assets	2,013	1,891
Valuation allowance	(313)	(214)
Total net deferred tax assets	1,700	1,677
Deferred tax liabilities:		
Property and equipment	(962)	(935)
Merchandise inventories	(231)	(216)
Operating lease right-of-use assets	(701)	(744)
Foreign branch deferreds	(85)	(92)
Total deferred tax liabilities	(1,979)	(1,987)
Net deferred tax liabilities	$ (279)	$ (310)

The deferred tax accounts at the end of 2022 and 2021 include deferred income tax assets of $445 and $444, respectively, included in other long-term assets; and deferred income tax liabilities of $724 and $754, respectively, included in other long-term liabilities.

In 2022 and 2021, the Company had valuation allowances of $313 and $214, primarily related to foreign tax credits that the Company believes will not be realized due to carry forward limitations. The foreign tax credit carry forwards are set to expire beginning in fiscal 2030.

The Company generally no longer considers fiscal year earnings of non-U.S. consolidated subsidiaries after 2017 to be indefinitely reinvested (other than China and Taiwan) and has recorded the estimated incremental foreign withholding taxes (net of available foreign tax credits) and state income taxes payable assuming a hypothetical repatriation to the U.S. The Company continues to consider undistributed earnings of certain non-U.S. consolidated subsidiaries, which totaled $2,779, to be indefinitely reinvested and has not provided for withholding or state taxes.

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits for 2022 and 2021 is as follows:

	2022	2021
Gross unrecognized tax benefit at beginning of year	$ 33	$ 30
Gross increases—current year tax positions	1	2
Gross increases—tax positions in prior years	12	2
Gross decreases—tax positions in prior years	(12)	—
Gross decreases—settlements	(12)	—
Lapse of statute of limitations	(6)	(1)
Gross unrecognized tax benefit at end of year	$ 16	$ 33

The gross unrecognized tax benefit includes tax positions for which the ultimate deductibility is highly certain but there is uncertainty about the timing of such deductibility. At the end of 2022 and 2021, these amounts were immaterial. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of these tax positions would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority. The total amount of such unrecognized tax benefits that if recognized would favorably affect the effective income tax rate in future periods is $15 and $30 at the end of 2022 and 2021.

Accrued interest and penalties related to income tax matters are classified as a component of income tax expense. Accrued interest and penalties recognized during 2022 and 2021, and accrued at the end of each respective period were not material.

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

The Company files income tax returns in the United States, various state and local jurisdictions, in Canada, and in several other foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state or local examination for years before fiscal 2018. The Company is currently subject to examination in California for fiscal years 2013 to present.

Other Taxes

The Company is subject to multiple examinations for value added, sales-based, payroll, product, import or other non-income taxes in various jurisdictions. In certain cases, the Company has received assessments from the authorities. Possible losses or range of possible losses associated with these matters are either immaterial or an estimate of the possible loss or range of loss cannot be made at this time. If certain matters or a group of matters were to be decided adversely to the Company, it could result in a charge that might be material to the results of an individual fiscal quarter or year.

Note 9—Net Income per Common and Common Equivalent Share

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

	2022	2021	2020
Net income attributable to Costco	$ 5,844	$ 5,007	$ 4,002
Weighted average basic shares	443,651	443,089	442,297
RSUs	1,106	1,257	1,604
Weighted average diluted shares	444,757	444,346	443,901

Note 10—Commitments and Contingencies

Legal Proceedings

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

The Company is a defendant in an action commenced in July 2013 under the California Labor Code Private Attorneys General Act (PAGA) alleging violation of California Wage Order 7-2001 for failing to provide seating to employees who work at entrance and exit doors in California warehouses. *Canela v. Costco Wholesale Corp.* (Case No. 2013-1-CV-248813; Santa Clara Superior Court). The complaint seeks relief under the California Labor Code, including civil penalties and attorneys' fees. The Company filed an answer denying the material allegations of the complaint. A bench trial was held in June and July; no decision has been issued.

In June 2022, a business center employee raised similar claims alleging failure to provide seating to employees who work at membership refund desks in California warehouses and business centers. *Rodriguez v. Costco Wholesale Corp.* (Case No. 22CV012847; Alameda Superior Court). The complaint seeks relief under the California Labor Code, including civil penalties and attorneys' fees. The Company filed an answer denying the material allegations of the complaint.

In December 2018, a depot employee raised similar claims, alleging that depot employees in California did not receive suitable seating or reasonably comfortable workplace temperature conditions. *Lane v. Costco Wholesale Corp.* (Case No. CIVDS 1908816; San Bernardino Superior Court). The Company filed an answer denying the material allegations of the complaint. In October 2019, the parties settled for an immaterial amount the seating claims on a representative basis, which received court approval in

February 2020. The parties settled the temperature claims for an immaterial amount in April 2022, and court approval was received in May 2022.

In March 2019, employees filed a class action against the Company alleging claims under California law for failure to pay overtime, to provide meal and rest periods and itemized wage statements, to timely pay wages due to terminating employees, to pay minimum wages, and for unfair business practices. Relief is sought under the California Labor Code, including civil penalties and attorneys' fees. *Nevarez v. Costco Wholesale Corp.* (Case No. 2:19-cv-03454; C.D. Cal.). The Company filed an answer denying the material allegations of the complaint. In December 2019, the court issued an order denying class certification. In January 2020, the plaintiffs dismissed their Labor Code claims without prejudice, and the court remanded the action to state court. Settlement for an immaterial amount was agreed upon in February 2021. Final court approval of the settlement was granted on May 3, 2022. A proposed intervenor has appealed the denial of her motion to intervene.

In May 2019, an employee filed a class action against the Company alleging claims under California law for failure to pay overtime, to provide itemized wage statements, to timely pay wages due to terminating employees, to pay minimum wages, and for unfair business practices. *Rough v. Costco Wholesale Corp*. (Case No. 2:19-cv-01340; E.D. Cal.). Relief is sought under the California Labor Code, including civil penalties and attorneys' fees. In September 2021, the court granted Costco’s motion for partial summary judgment and denied class certification. In August 2019, the plaintiff filed a companion case in state court seeking penalties under PAGA. *Rough v. Costco Wholesale Corp.* (Case No. FCS053454; Sonoma County Superior Court). Relief is sought under the California Labor Code, including civil penalties and attorneys' fees. The state court action has been stayed pending resolution of the federal action.

In December 2020, a former employee filed suit against the Company asserting collective and class claims on behalf of non-exempt employees under the Fair Labor Standards Act and New York Labor Law for failure to pay for all hours worked, failure to pay certain non-exempt employees on a weekly basis, and failure to provide proper wage statements and notices. The plaintiff also asserted individual retaliation claims. *Cappadora v. Costco Wholesale Corp.* (Case No. 1:20-cv-06067; E.D.N.Y.). An amended complaint was filed, and the Company denied the material allegations of the amended complaint. Based on an agreement in principle concerning settlement of the matter, involving a proposed payment by the Company of an immaterial amount, the federal action has been dismissed. In April 2022, Cappadora and a second plaintiff filed an action against the Company in New York state court asserting the same class claims asserted in the federal action under the New York Labor Law and seeking preliminary approval of the class settlement. *Cappadora and Sancho v. Costco Wholesale Corp.* (Index No. 604757/2022; Nassau County Supreme Court).

In August 2021, a former employee filed a similar suit, asserting class claims on behalf of certain non-exempt employees under New York Labor Law for failure to pay on a weekly basis. *Umadat v. Costco Wholesale Corp.* (Case No. 2:21-cv-4814; E.D.N.Y.). The Company answered the complaint on October 21, 2021, denying the material allegations. In April 2022, a former employee filed a similar suit, asserting class claims on behalf of certain non-exempt employees under New York Labor Law, as well as under the Fair Labor Standards Act, for failure to pay on a weekly basis and failure to pay overtime. *Burian v. Costco Wholesale Corp.* (Case No. 2:22-cv-02108; E.D.N.Y.).

In February 2021, a former employee filed a class action against the Company alleging violations of California Labor Code regarding payment of wages, meal and rest periods, wage statements, reimbursement of expenses, payment of final wages to terminated employees, and for unfair business practices. *Edwards v. Costco Wholesale Corp.* (Case No. 5:21-cv-00716: C.D. Cal.). In May 2021, the Company filed a motion to dismiss the complaint, which was granted with leave to amend. In June 2021, the plaintiff filed an amended complaint, which the Company moved to dismiss later that month. The court granted the motion in part in July 2021 with leave to amend. In August 2021, the plaintiff filed a second amended complaint and filed a separate representative action under PAGA asserting the same Labor Code claims and seeking civil penalties and attorneys' fees. The Company filed an answer to the second

amended class action complaint, denying the material allegations. The Company also filed an answer to the PAGA representative action, denying the material allegations.

In July 2021, a former temporary staffing employee filed a class action against the Company and a staffing company alleging violations of the California Labor Code regarding payment of wages, meal and rest periods, wage statements, the timeliness of wages and final wages, and for unfair business practices. *Dimas v. Costco Wholesale Corp.* (Case No. STK-CV-UOE-2021-0006024; San Joaquin Superior Court). The Company has moved to compel arbitration of the plaintiff's individual claims and to dismiss the class action complaint. On September 7, 2021, the same former employee filed a separate representative action under PAGA asserting the same Labor Code violations and seeking civil penalties and attorneys' fees. The case has been stayed pending the motion to compel in the related case.

In September 2021, an employee filed a class action against the Company alleging violations of the California Labor Code regarding the alleged failure to provide sick pay, failure to timely pay wages due at separation from employment, and for violations of California's unfair competition law. *De Benning v. Costco Wholesale Corp.* (Case No. 34-2021-00309030-CU-OE-GDS; Sacramento Superior Court). The Company answered the complaint in January 2022, denying its material allegations. In April 2022, a settlement for an immaterial amount was agreed upon, subject to court approval.

In March 2022, an employee filed a class action against the Company alleging violations of the California Labor Code regarding the failure to: pay wages, provide meal and rest periods, provide accurate wage statements, timely pay final wages, and reimburse business expenses. *Diaz v. Costco Wholesale Corp.* (Case No. 22STCV09513; Los Angeles Superior Court). The Company filed an answer denying the material allegations.

In May 2022, an employee filed a PAGA-only representative action against the Company alleging claims under the California Labor Code regarding the payment of wages, meal and rest periods, the timeliness of wages and final wages, wage statements, accurate records and business expenses. *Gonzalez v. Costco Wholesale Corp.* (Case No. 22AHCV00255; Los Angeles Superior Court).

Beginning in December 2017, the United States Judicial Panel on Multidistrict Litigation consolidated numerous cases concerning the impacts of opioid abuses filed against various defendants by counties, cities, hospitals, Native American tribes, third-party payors, and others. *In re National Prescription Opiate Litigation* (MDL No. 2804) (N.D. Ohio). Included are cases that name the Company, including actions filed by counties and cities in Michigan, New Jersey, Oregon, Virginia and South Carolina, a third-party payor in Ohio, and a hospital in Texas, class actions filed on behalf of infants born with opioid-related medical conditions in 40 states, and class actions and individual actions filed on behalf of individuals seeking to recover alleged increased insurance costs associated with opioid abuse in 43 states and American Samoa. Claims against the Company in state courts in New Jersey, Oklahoma, Utah, and Arizona have been dismissed. The Company is defending all of the pending matters.

Members of the Board of Directors, six corporate officers and the Company are defendants in a shareholder derivative action related to chicken welfare and alleged breaches of fiduciary duties. Smith, et ano. v. Vachris, et al., Superior Court of the State of Washington, County of King, No, 22-2-08937-7SEA, (filed 6/14/22, as amended, 6/30/22); The complaint seeks from the individual defendants damages, injunctive relief, costs, and attorneys' fees. A motion to dismiss the amended complaint has been filed.

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

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Note 11—Segment Reporting

The Company is principally engaged in the operation of membership warehouses through wholly owned subsidiaries in the U.S., Canada, Mexico, Japan, U.K., Korea, Taiwan, Australia, Spain, France, China, and Iceland. Reportable segments are largely based on management's organization of the operating segments for operational decisions and assessments of financial performance, which considers geographic locations. The material accounting policies of the segments are as described in Note 1. Inter-segment net sales and expenses have been eliminated in computing total revenue and operating income. Effective for fiscal 2022, stock-based compensation was allocated to the segments in this reporting. This change reflected a decision to evaluate the financial performance of the segments inclusive of this expense. Operating income was restated in each of the segments for all prior periods to reflect this change.

The following table provides information for the Company's reportable segments:

	United States	Canada	Other International	Total
2022				
Total revenue	$ 165,294	$ 31,675	$ 29,985	$ 226,954
Operating income	5,268	1,346	1,179	7,793
Depreciation and amortization	1,436	180	284	1,900
Additions to property and equipment	2,795	388	708	3,891
Property and equipment, net	17,205	2,459	4,982	24,646
Total assets	44,904	6,558	12,704	64,166
2021				
Total revenue	$ 141,398	$ 27,298	$ 27,233	$ 195,929
Operating income	4,470	1,093	1,145	6,708
Depreciation and amortization	1,339	177	265	1,781
Additions to property and equipment	2,612	272	704	3,588
Property and equipment, net	15,993	2,317	5,182	23,492
Total assets	39,589	5,962	13,717	59,268
2020				
Total revenue	$ 122,142	$ 22,434	$ 22,185	$ 166,761
Operating income	3,822	778	835	5,435
Depreciation and amortization	1,248	155	242	1,645
Additions to property and equipment	2,060	258	492	2,810
Property and equipment, net	14,916	2,172	4,719	21,807
Total assets	38,366	5,270	11,920	55,556

Disaggregated Revenue

The following table summarizes net sales by merchandise category; sales from e-commerce websites and business centers have been allocated to the applicable merchandise categories:

	2022	2021	2020
Foods and Sundries	$ 85,629	$ 77,277	$ 68,659
Non-Foods	61,100	55,966	44,807
Fresh Foods	29,527	27,183	23,204
Warehouse Ancillary and Other Businesses	46,474	31,626	26,550
Total net sales	$ 222,730	$ 192,052	$ 163,220

Item 9—Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A—Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended) are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the SEC and to ensure that information required to be disclosed is accumulated and communicated to management, including our principal executive and financial officers, to allow timely decisions regarding disclosure. The Chief Executive Officer and the Chief Financial Officer, with assistance from other members of management, have reviewed the effectiveness of our disclosure controls and procedures as of August 28, 2022, and, based on their evaluation, have concluded that the disclosure controls and procedures were effective as of such date.

Management's Annual Report on Internal Control Over Financial Reporting

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

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

Under the supervision of and with the participation of our management, we assessed the effectiveness of our internal control over financial reporting as of August 28, 2022, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control—Integrated Framework (2013).

Based on its assessment, management has concluded that our internal control over financial reporting was effective as of August 28, 2022. The attestation of KPMG LLP, our independent registered public accounting firm, on the effectiveness of our internal control over financial reporting is included with the consolidated financial statements in Item 8 of this Report.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) or 15d-15(f) of the Exchange Act) that occurred during the fourth quarter of 2022 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

Item 9B—Other Information

None.

Item 9C—Disclosure Regarding Foreign Jurisdictions that Prevent Inspections

Not Applicable.

PART III

Item 10—Directors, Executive Officers and Corporate Governance

Information relating to the availability of our code of ethics for senior financial officers and a list of our executive officers appear in Part I, Item 1 of this Report. The information required by this Item concerning our directors and nominees for director is incorporated herein by reference to the sections entitled "Proposal 1: Election of Directors," "Directors" and "Committees of the Board" in Costco's Proxy Statement for its 2023 annual meeting of shareholders, which will be filed with the SEC within 120 days of the end of our fiscal year ("Proxy Statement").

Item 11—Executive Compensation

The information required by this Item is incorporated herein by reference to the sections entitled "Compensation of Directors," "Executive Compensation," and "Compensation Discussion and Analysis" in Costco's Proxy Statement.

Item 12—Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item is incorporated herein by reference to the section entitled "Principal Shareholders" and "Equity Compensation Plan Information" in Costco's Proxy Statement.

Item 13—Certain Relationships and Related Transactions, and Director Independence

The information required by this Item is incorporated herein by reference to the sections entitled "Proposal 1: Election of Directors," "Directors," "Committees of the Board," "Shareholder Communications to the Board," "Meeting Attendance," "Report of the Compensation Committee of the Board of Directors," "Certain Relationships and Transactions" and "Report of the Audit Committee" in Costco's Proxy Statement.

Item 14—Principal Accounting Fees and Services

Our independent registered public accounting firm is KPMG LLP, Seattle, WA, Auditor Firm ID: 185.

The information required by this Item is incorporated herein by reference to the sections entitled "Independent Public Accountants" in Costco's Proxy Statement.

PART IV

Item 15—Exhibits, Financial Statement Schedules

(a) Documents filed as part of this report are as follows:

1. Financial Statements:

   See the listing of Financial Statements included as a part of this Form 10-K in Item 8 of Part II.

2. Financial Statement Schedules:

   All schedules have been omitted because the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements, including the notes thereto.

(b) Exhibits: The required exhibits are filed as part of this Annual Report on Form 10-K or are incorporated herein by reference.

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference		
			Form	Period Ended	Filing Date
3.1	Articles of Incorporation as amended of Costco Wholesale Corporation	x			
3.2	Bylaws as amended of Costco Wholesale Corporation		10-Q	5/8/2022	6/2/2022
4.1	First Supplemental Indenture between Costco Wholesale Corporation and U.S. Bank National Association, as Trustee, dated as of March 20, 2002 (incorporated by reference to Exhibits 4.1 and 4.2 to the Company's Current Report on the Form 8-K filed on March 25, 2002)		8-K		3/25/2002
4.2	Form of 1.375% Senior Notes due June 20, 2027		8-K		4/17/2020
4.3	Form of 1.600% Senior Notes due April 20, 2030		8-K		4/17/2020
4.4	Form of 1.750% Senior Notes due April 20, 2032		8-K		4/17/2020
4.5	Form of 2.300% Senior Notes due May 18, 2022		8-K		5/16/2017
4.6	Form of 2.750% Senior Notes due May 18, 2024		8-K		5/16/2017
4.7	Form of 3.000% Senior Notes due May 18, 2027		8-K		5/16/2017
4.8	Description of Common Stock	x			
10.1*	Costco Wholesale Executive Health Plan		10-K	9/2/2012	10/19/2012
10.2*	2019 Incentive Plan		DEF 14		12/17/2019
10.3*	Seventh Restated 2002 Stock Incentive Plan		DEF 14A		12/19/2014
10.3.1*	2019 Stock Incentive Plan Restricted Stock Unit Award Agreement-Employee		10-Q	11/24/2019	12/23/2019
10.3.2*	2019 Stock Incentive Plan Restricted Stock Unit Award Agreement - Non-U.S. Employee		10-Q	11/24/2019	12/23/2019

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Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ended	Filing Date
10.3.3*	2019 Stock Incentive Plan Restricted Stock Unit Award Agreement-Non-Executive Director		10-Q	11/24/2019	12/23/2019
10.3.4*	2019 Stock Incentive Plan Letter Agreement for 2020 Performance-Based Restricted Stock Units-Executive		10-Q	11/24/2019	12/23/2019
10.4*	Fiscal 2022 Executive Bonus Plan		8-K		11/10/2021
10.5*	Executive Employment Agreement, effective January 1, 2017, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/20/2016	12/16/2016
10.5.1*	Extension of the Term of the Executive Employment Agreement, effective January 1, 2019, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/25/2018	12/20/2018
10.5.2*	Extension of the Term of the Executive Employment Agreement, effective January 1, 2020, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/24/2019	12/23/2019
10.5.3*	Extension of the Term of the Executive Employment Agreement, effective January 1, 2021, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/22/2020	12/16/2020
10.5.4*	Extension of the Term of the Executive Employment Agreement, effective January 1, 2022, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/22/2021	12/22/2021
10.6	Form of Indemnification Agreement		14A		12/13/1999
10.7*	Deferred Compensation Plan		10-K	9/1/2013	10/16/2013
10.8**	Citibank, N.A. Co-Branded Credit Card Agreement		10-Q/A	5/10/2015	8/31/2015
10.8.1**	First Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	11/22/2015	12/17/2015
10.8.2**	Second Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/14/2016	3/9/2016
10.8.3**	Third Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-K	8/28/2016	10/12/2016

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Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference		
			Form	Period Ended	Filing Date
10.8.4**	Fourth Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/18/2018	3/15/2018
10.8.5**	Fifth Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/17/2019	3/13/2019
10.8.6**	Sixth Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-K	9/1/2019	10/11/2019
10.8.7**	Seventh Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/14/2021	3/10/2021
10.8.8**	Eighth Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/13/2022	3/10/2022
21.1	Subsidiaries of the Company	x			
23.1	Consent of Independent Registered Public Accounting Firm	x			
31.1	Rule 13a – 14(a) Certifications	x			
32.1	Section 1350 Certifications	x			
101.INS	Inline XBRL Instance Document	x			
101.SCH	Inline XBRL Taxonomy Extension Schema Document	x			
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document	x			
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document	x			
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document	x			
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document	x			
104	Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101)	x			

* Management contract, compensatory plan or arrangement.
** Portions of this exhibit have been omitted under a confidential treatment order issued by the Securities and Exchange Commission.

(c) Financial Statement Schedules—None.

Item 16—Form 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

October 4, 2022

COSTCO WHOLESALE CORPORATION
(Registrant)

By /s/ RICHARD A. GALANTI
Richard A. Galanti
Executive Vice President, Chief Financial Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

October 4, 2022

By /s/ W. CRAIG JELINEK W. Craig Jelinek *Chief Executive Officer and Director*	By /s/ HAMILTON E. JAMES Hamilton E. James *Chairman of the Board*
By /s/ RICHARD A. GALANTI Richard A. Galanti *Executive Vice President, Chief Financial Officer and Director* *(Principal Financial Officer)*	By /s/ DANIEL M. HINES Daniel M. Hines *Senior Vice President and Corporate Controller* *(Principal Accounting Officer)*
By /s/ RON M. VACHRIS Ron M. Vachris *President, Chief Operating Officer and Director*	By /s/ SUSAN L. DECKER Susan L. Decker *Director*
By /s/ KENNETH D. DENMAN Kenneth D. Denman *Director*	By /s/ SALLY JEWELL Sally Jewell *Director*
By /s/ CHARLES T. MUNGER Charles T. Munger *Director*	By /s/ JEFFREY S. RAIKES Jeffrey S. Raikes *Director*
By /s/ JOHN W. STANTON John W. Stanton *Director*	By /s/ MARY (MAGGIE) A. WILDEROTTER Mary (Maggie) A. Wilderotter *Director*

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended August 29, 2021

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 0-20355

Costco Wholesale Corporation

(Exact name of registrant as specified in its charter)

Washington	**91-1223280**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

999 Lake Drive, Issaquah, WA 98027

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(425) 313-8100**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock, $.01 Par Value	COST	The NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☒	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

The aggregate market value of the voting stock held by non-affiliates of the registrant as of February 14, 2021 was $155,810,963,274.

The number of shares outstanding of the registrant's common stock as of September 28, 2021, was 441,823,811.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on January 20, 2022, are incorporated by reference into Part III of this Form 10-K.

COSTCO WHOLESALE CORPORATION
ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED AUGUST 29, 2021

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INFORMATION RELATING TO FORWARD LOOKING STATEMENTS

Certain statements contained in this Report constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. They include statements that address activities, events, conditions or developments that we expect or anticipate may occur in the future and may relate to such matters as sales growth, changes in comparable sales, cannibalization of existing locations by new openings, price or fee changes, earnings performance, earnings per share, stock-based compensation expense, warehouse openings and closures, capital spending, the effect of adopting certain accounting standards, future financial reporting, financing, margins, return on invested capital, strategic direction, expense controls, membership renewal rates, shopping frequency, litigation, and the demand for our products and services. Forward-looking statements may also be identified by the words "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "likely," "may," "might," "plan," "potential," "predict," "project," "seek," "should," "target," "will," "would," or similar expressions and the negatives of those terms. Such forward-looking statements involve risks and uncertainties that may cause actual events, results, or performance to differ materially from those indicated by such statements, including, without limitation, the factors set forth in the section titled "Item 1A-Risk Factors", and other factors noted in the section titled "Item 7-Management's Discussion and Analysis of Financial Condition and Results of Operations" and in the consolidated financial statements and related notes in Item 8 of this Report. Forward-looking statements speak only as of the date they are made, and we do not undertake to update these statements, except as required by law.

PART I

Item 1—Business

Costco Wholesale Corporation and its subsidiaries (Costco or the Company) began operations in 1983, in Seattle, Washington. We are principally engaged in the operation of membership warehouses in the United States (U.S.) and Puerto Rico, Canada, United Kingdom (U.K.), Mexico, Japan, Korea, Australia, Spain, France, Iceland, China, and through a majority-owned subsidiary in Taiwan. Costco operated 815, 795, and 782 warehouses worldwide at August 29, 2021, August 30, 2020, and September 1, 2019, respectively. The Company operates e-commerce websites in the U.S., Canada, Mexico, U.K., Korea, Taiwan, Japan, and Australia. Our common stock trades on the NASDAQ Global Select Market, under the symbol "COST."

We report on a 52/53-week fiscal year, consisting of thirteen four-week periods and ending on the Sunday nearest the end of August. The first three quarters consist of three periods each, and the fourth quarter consists of four periods (five weeks in the thirteenth period in a 53-week year). The material seasonal impact in our operations is increased net sales and earnings during the winter holiday season. References to 2021, 2020, and 2019 relate to the 52-week fiscal years ended August 29, 2021, August 30, 2020, and September 1, 2019, respectively.

General

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

We buy most of our merchandise directly from manufacturers and route it to cross-docking consolidation points (depots) or directly to our warehouses. Our depots receive large shipments from manufacturers and quickly ship these goods to warehouses. This process creates freight volume and handling efficiencies, lowering costs associated with traditional multiple-step distribution channels. For our e-

commerce operations we ship merchandise through our depots, our logistics operations for big and bulky items, as well as through drop-ship and other delivery arrangements with our suppliers.

Our average warehouse space is approximately 146,000 square feet, with newer units being slightly larger. Floor plans are designed for economy and efficiency in the use of selling space, the handling of merchandise, and the control of inventory. Because shoppers are attracted principally by the quality of merchandise and low prices, our warehouses are not elaborate. By strictly controlling the entrances and exits and using a membership format, we believe our inventory losses (shrinkage) are well below those of typical retail operations.

Our warehouses on average operate on a seven-day, 70-hour week. Gasoline operations generally have extended hours. Because the hours of operation are shorter than other retailers, and due to other efficiencies inherent in a warehouse-type operation, labor costs are lower relative to the volume of sales. Merchandise is generally stored on racks above the sales floor and displayed on pallets containing large quantities, reducing labor required. In general, with variations by country, our warehouses accept certain credit cards, including Costco co-branded cards, debit cards, cash and checks, co-brand cardholder rebates, Executive member 2% reward certificates and our proprietary stored-value card (shop card).

Our strategy is to provide our members with a broad range of high-quality merchandise at prices we believe are consistently lower than elsewhere. We seek to limit most items to fast-selling models, sizes, and colors. We carry less than 4,000 active stock keeping units (SKUs) per warehouse in our core warehouse business, significantly less than other broadline retailers. We average anywhere from 9,000 to 11,000 SKUs online, some of which are also available in our warehouses. Many consumable products are offered for sale in case, carton, or multiple-pack quantities only.

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

We offer merchandise and services in the following categories:

Core Merchandise Categories (or core business):

- **Foods and Sundries** (including sundries, dry grocery, candy, cooler, freezer, deli, liquor, and tobacco)
- **Non-Foods** (previously Hardlines and Softlines; including major appliances, electronics, health and beauty aids, hardware, garden and patio, sporting goods, tires, toys and seasonal, office supplies, automotive care, postage, tickets, apparel, small appliances, furniture, domestics, housewares, special order kiosk, and jewelry)
- **Fresh Foods** (including meat, produce, service deli, and bakery)

Warehouse Ancillary (includes gasoline, pharmacy, optical, food court, hearing aids, and tire installation) and **Other Businesses** (includes e-commerce, business centers, travel, and other)

Warehouse ancillary businesses operate primarily within or next to our warehouses, encouraging members to shop more frequently. The number of warehouses with gas stations varies significantly by country, and we have no gasoline business in Korea or China. We operated 636 gas stations at the end of 2021. Net sales for our gasoline business represented approximately 9% of total net sales in 2021.

Our other businesses sell products and services that complement our warehouse operations (core and warehouse ancillary businesses). Our e-commerce operations give members convenience and a broader selection of goods and services. Net sales for e-commerce represented approximately 7% of total net sales in 2021. This figure does not consider other services we offer online in certain countries such as business delivery, travel, same-day grocery, and various other services. Our business centers carry items tailored specifically for food services, convenience stores and offices, and offer walk-in shopping and deliveries. Business centers are included in our total warehouse count. Costco Travel offers vacation packages, hotels, cruises, and other travel products exclusively for Costco members (offered in the U.S., Canada, and the U.K.).

We have direct buying relationships with many producers of brand-name merchandise. We do not obtain a significant portion of merchandise from any one supplier. The COVID-19 pandemic created unprecedented supply constraints, including disruptions and delays that have impacted and could continue to impact the flow and availability of certain products. When sources of supply become unavailable, we seek alternative sources. We also purchase and manufacture private-label merchandise, as long as quality and member demand are high and the value to our members is significant.

Certain financial information for our segments and geographic areas is included in Note 12 to the consolidated financial statements included in Item 8 of this Report.

Membership

Our members may utilize their memberships at all of our warehouses and websites. Gold Star memberships are available to individuals; Business memberships are limited to businesses, including individuals with a business license, retail sales license or comparable document. Business members may add additional cardholders (affiliates), to which the same annual fee applies. Affiliates are not available for Gold Star members. Our annual fee for these memberships is $60 in our U.S. and Canadian operations and varies in other countries. All paid memberships include a free household card.

Our member renewal rate was 91% in the U.S. and Canada and 89% worldwide at the end of 2021. The majority of members renew within six months following their renewal date. Our renewal rate is a trailing calculation that captures renewals during the period seven to eighteen months prior to the reporting date. Our membership counts include active memberships as well as memberships that have not renewed within the 12 months prior to the reporting date. At the end of 2020, we standardized our membership count methodology globally to be consistent with the U.S. and Canada, which resulted in the addition to the count of approximately 2.0 million total cardholders for 2020, of which 1.3 million were paid members. The change did not impact 2019. Membership fee income and the renewal rate calculations were not affected. Our membership was made up of the following (in thousands):

	2021	2020	2019
Gold Star	50,200	46,800	42,900
Business, including affiliates	11,500	11,300	11,000
Total paid members	61,700	58,100	53,900
Household cards	49,900	47,400	44,600
Total cardholders	111,600	105,500	98,500

Paid cardholders (except affiliates) are eligible to upgrade to an Executive membership in the U.S. and Canada, for an additional annual fee of $60. Executive memberships are also available in Mexico, the U.K., Japan, Korea, and Taiwan, for which the additional annual fee varies. Executive members earn a 2% reward on qualified purchases (generally up to a maximum reward of $1,000 per year), which can be redeemed only at Costco warehouses. This program also offers (except in Mexico and Korea), access to additional savings and benefits on various business and consumer services, such as auto and home insurance, the Costco auto purchase program, and check printing. These services are generally provided by third parties and vary by state and country. Executive members totaled 25.6 million and represented 55% of paid members (excluding affiliates) in the U.S. and Canada and 17% of paid members (excluding affiliates) in our Other International operations at the end of 2021. They generally shop more frequently and spend more than other members.

Human Capital

Our Code of Ethics requires that we "Take Care of Our Employees," which is fundamental to the obligation to "Take Care of Our Members." We must also carefully control our selling, general and administrative (SG&A) expenses, so that we can sell high quality goods and services at low prices. Compensation and benefits for employees is our largest expense after the cost of merchandise and is carefully monitored.

At the end of 2021, we employed 288,000 employees worldwide. The large majority (approximately 95%) is employed in our membership warehouses and distribution channels and approximately 17,000 employees are represented by unions. We also utilize seasonal employees during peak periods. The total number of employees by segment is:

	Number of Employees	
	2021	2020
United States	192,000	181,000
Canada	47,000	46,000
Other International	49,000	46,000
Total employees	288,000	273,000

We believe that our warehouses are among the most productive in the retail industry, owing in substantial part to the commitment and efficiency of our employees. We seek to provide them not merely with employment but careers. Many attributes of our business contribute to the objective; the more significant include: competitive compensation and benefits for those working in our membership warehouses and distributions channels; a commitment to promoting from within; and maintaining a ratio of at least 50% of our employee base being full-time employees. These attributes contribute to what we consider, especially for the industry, a high retention rate. In 2021, in the U.S. that rate was above 90% for employees who have been with us for at least one year.

The commitment to "Take Care of Our Employees" is also the foundation of our approach to diversity, equity and inclusion and creating an inclusive and respectful workplace. In 2021, we added training and communication for managers on topics of race, bias and equity, and greater visibility of our employee demographics. Embracing differences is important to the growth of our Company. It leads to more opportunities, innovation, and employee satisfaction and connects us to the communities where we do business.

Costco is firmly committed to helping protect the health and safety of our members and employees and to serving our communities. In response to the COVID-19 pandemic and its associated challenges, we began providing premium pay to the majority of our hourly employees in March 2020 and continued for a full year through February 2021, at which time a portion of the premium was built permanently into our hourly wage scales in the U.S. In fall 2020, we also began offering employees additional paid time off to attend to child care and schooling needs through the 2021 school year. As the global effect of coronavirus (COVID-19) continues to evolve, we are closely monitoring the changing situation and complying with public health guidance.

For more detailed information regarding our programs and initiatives, see "Employees" within our Sustainability Commitment (located on our website). This report and other information on our website are not incorporated by reference into and do not form any part of this Annual Report.

Competition

Our industry is highly competitive, based on factors such as price, merchandise quality and selection, location, convenience, distribution strategy, and customer service. We compete on a worldwide basis with global, national, and regional wholesalers and retailers, including supermarkets, supercenters, internet retailers, gasoline stations, hard discounters, department and specialty stores, and operators selling a single category or narrow range of merchandise. Walmart, Target, Kroger, and Amazon are among our significant general merchandise retail competitors in the U.S. We also compete with other warehouse clubs including Walmart's Sam's Club and BJ's Wholesale Club, and many of the major metropolitan areas in the U.S. and certain of our Other International locations have multiple clubs.

Intellectual Property

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

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

Available Information

Our U.S. website is www.costco.com. We make available through the Investor Relations section of that site, free of charge, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements and Forms 3, 4 and 5, and any amendments to those reports, as soon as reasonably practicable after filing such materials with or furnishing such documents to the Securities and Exchange Commission (SEC). The information found on our website is not part of this or any other report filed with or furnished to the SEC. The SEC maintains a site that contains reports, proxy and information statements, and other information regarding issuers, such as the Company, that file electronically with the SEC at www.sec.gov.

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

Information about our Executive Officers

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

Name	Position	Executive Officer Since	Age
W. Craig Jelinek	President and Chief Executive Officer. Mr. Jelinek has been President and Chief Executive Officer since January 2012 and a director since February 2010. He was President and Chief Operating Officer from February 2010 to December 2011. Prior to that he was Executive Vice President, Chief Operating Officer, Merchandising since 2004.	1995	69
Richard A. Galanti	Executive Vice President and Chief Financial Officer. Mr. Galanti has been a director since January 1995.	1993	65
Jim C. Klauer	Executive Vice President, Chief Operating Officer, Northern Division. Mr. Klauer was Senior Vice President, Non-Foods and E-commerce Merchandise, from 2013 to January 2018.	2018	59
Patrick J. Callans	Executive Vice President, Administration. Mr. Callans was Senior Vice President, Human Resources and Risk Management, from 2013 to December 2018.	2019	59
Russ D. Miller	Executive Vice President, Chief Operating Officer, Southern Division and Mexico. Mr. Miller was Senior Vice President, Western Canada Region, from 2001 to January 2018.	2018	64
James P. Murphy	Executive Vice President, Chief Operating Officer, International. Mr. Murphy was Senior Vice President, International, from 2004 to October 2010.	2011	68
Joseph P. Portera	Executive Vice President, Chief Operating Officer, Eastern and Canadian Divisions. Mr. Portera has held these positions since 1994 and has been the Chief Diversity	1994	69

Item 1A—Risk Factors

The risks described below could materially and adversely affect our business, financial condition and results of operations. We could also be affected by additional risks that apply to all companies operating in the U.S. and globally, as well as other risks that are not presently known to us or that we currently consider to be immaterial. These Risk Factors should be carefully reviewed in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 and our consolidated financial statements and related notes in Item 8 of this Report.

Business and Operating Risks

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

Our financial and operational performance is highly dependent on our U.S. and Canadian operations, which comprised 86% and 81% of net sales and operating income in 2021, respectively. Within the U.S., we are highly dependent on our California operations, which comprised 28% of U.S. net sales in 2021. Our California market, in general, has a larger percentage of higher volume warehouses as compared to our other domestic markets. Any substantial slowing or sustained decline in these operations could materially adversely affect our business and financial results. Declines in financial performance of our U.S. operations, particularly in California, and our Canadian operations could arise from, among other things: slow growth or declines in comparable warehouse sales (comparable sales); negative trends in operating expenses, including increased labor, healthcare and energy costs; failing to meet targets for warehouse openings; cannibalizing existing locations with new warehouses; shifts in sales mix toward lower gross margin products; changes or uncertainties in economic conditions in our markets, including higher levels of unemployment and depressed home values; and failing to consistently provide high quality and innovative new products.

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

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

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

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

We have made and may continue to make investments and acquisitions to improve the speed, accuracy and efficiency of our supply chains and delivery channels. The effectiveness of these investments can be less predictable than opening new locations and might not provide the anticipated benefits or desired rates of return.

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

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

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

Disruptions in merchandise distribution or processing, packaging, manufacturing, and other facilities could adversely affect sales and member satisfaction.

We depend on the orderly operation of the merchandise receiving and distribution process, primarily through our depots. We also rely upon processing, packaging, manufacturing and other facilities to support our business, which includes the production of certain private-label items. Although we believe that our operations are efficient, disruptions due to fires, tornadoes, hurricanes, earthquakes, pandemics or other extreme weather conditions or catastrophic events, labor issues or other shipping problems may result in delays in the production and delivery of merchandise to our warehouses, which could adversely affect sales and the satisfaction of our members. Our e-commerce business depends heavily on third-party and in-house logistics providers and that business is negatively affected when these providers are unable to provide services in a timely fashion.

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

It is difficult to consistently and successfully predict the products and services that our members will desire. Our success depends, in part, on our ability to identify and respond to trends in demographics and consumer preferences. Failure to identify timely or effectively respond to changing consumer tastes, preferences (including those relating to environmental, social and governance practices) and spending patterns could negatively affect our relationship with our members, the demand for our products and services, and our market share. If we are not successful at predicting our sales trends and adjusting our purchases accordingly, we may have excess inventory, which could result in additional markdowns, or we may experience out-of-stock positions and delivery delays, which could result in higher costs, both of which would reduce our operating performance. This could have an adverse effect on net sales, gross margin and operating income.

Availability and performance of our information technology (IT) systems are vital to our business. Failure to successfully execute IT projects and have IT systems available to our business would adversely impact our operations.

IT systems play a crucial role in conducting our business. These systems are utilized to process a very high volume of transactions, conduct payment transactions, track and value our inventory and produce reports critical for making business decisions. Failure or disruption of these systems could have an adverse impact on our ability to buy products and services from our suppliers, produce goods in our manufacturing plants, move the products in an efficient manner to our warehouses and sell products to our members. We are undertaking large technology and IT transformation projects. The failure of these projects could adversely impact our business plans and potentially impair our day to day business operations. Given the high volume of transactions we process, it is important that we build strong digital resiliency to prevent disruption from events such as power outages, computer and telecommunications failures, viruses, internal or external security breaches, errors by employees, and catastrophic events such as fires, earthquakes, tornadoes and hurricanes. Any debilitating failure of our critical IT systems, data centers and backup systems would require significant investments in resources to restore IT services and may cause serious impairment in our business operations including loss of business services, increased cost of moving merchandise and failure to provide service to our members. We are currently making substantial investments in maintaining and enhancing our digital resiliency and failure or delay in these projects could be costly and harmful to our business. Failure to deliver IT transformation efforts efficiently and effectively could result in the loss of our competitive position and adversely impact our financial condition and results of operations.

We are required to maintain the privacy and security of personal and business information amidst multiplying threat landscapes and in compliance with privacy and data protection regulations globally. Failure to do so could damage our business, including our reputation with members, suppliers and employees, cause us to incur substantial additional costs, and become subject to litigation and regulatory action.

Increased security threats and more sophisticated cyber misconduct pose a risk to our systems, networks, products and services. We rely upon IT systems and networks, some of which are managed by third parties, in connection with virtually all of our business activities. Additionally, we collect, store and process sensitive information relating to our business, members, suppliers and employees. Operating these IT systems and networks, and processing and maintaining this data, in a secure manner, is critical to our business operations and strategy. Increased remote work due to the COVID-19 pandemic has also increased the possible attack surfaces. Threats designed to gain unauthorized access to systems, networks and data, both ours and third parties with whom we work, are increasing in frequency and sophistication. Cybersecurity attacks may range from random attempts to coordinated and targeted attacks, including sophisticated computer crimes and advanced persistent threats. Phishing attacks have emerged as particularly prominent, including as vectors for ransomware attacks, which have increased in breadth and frequency. While we train our employees as part of our security efforts, that training cannot be completely effective. These threats pose a risk to the security of our systems and networks and the confidentiality, integrity, and availability of our data. It is possible that our IT systems and networks, or those managed by third parties such as cloud providers or suppliers that otherwise host confidential information, could have vulnerabilities, which could go unnoticed for a period of time. While our cybersecurity and compliance efforts seek to mitigate such risks, there can be no guarantee that the actions and controls we and our third-party service providers have implemented and are implementing, will be sufficient to protect our systems, information or other property.

The potential impacts of a material cybersecurity attack include reputational damage, litigation, government enforcement actions, penalties, disruption to systems, unauthorized release of confidential or otherwise protected information, corruption of data, diminution in the value of our investment in IT systems and increased cybersecurity protection and remediation costs. This could adversely affect our competitiveness, results of operations and financial condition and, critically in light of our business model, loss of member confidence. Further, the insurance coverage we maintain and indemnification arrangements with third-parties may be inadequate to cover claims, costs, and liabilities relating to cybersecurity incidents. In addition, data we collect, store and process is subject to a variety of U.S. and international laws and regulations, such as the European Union's General Data Protection Regulation, California Consumer Privacy Act, Health Insurance Portability and Accountability Act, and other emerging privacy and cybersecurity laws across the various states and around the globe, which may carry significant potential penalties for noncompliance.

We are subject to payment-related risks.

We accept payments using a variety of methods, including select credit and debit cards, cash and checks, co-brand cardholder rebates, Executive member 2% reward certificates, and our shop card. As we offer new payment options to our members, we may be subject to additional rules, regulations, compliance requirements, and higher fraud losses. For certain payment methods, we pay interchange and other related acceptance fees, along with additional transaction processing fees. We rely on third parties to provide payment transaction processing services for credit and debit cards and our shop card. It could disrupt our business if these parties become unwilling or unable to provide these services to us. We are also subject to evolving payment card association and network operating rules, including data security rules, certification requirements and rules governing electronic funds transfers. For example, we are subject to Payment Card Industry Data Security Standards, which contain compliance guidelines and standards with regard to our security surrounding the physical and electronic storage, processing and transmission of individual cardholder data. If our internal systems are breached or compromised, we may be liable for card re-issuance costs, subject to fines and higher transaction fees and lose our ability to accept card payments from our members, and our business and operating results could be adversely affected.

We might sell products that cause illness or injury to our members, harm to our reputation, and expose us to litigation.

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

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

Omnichannel retailing is rapidly evolving, and we must keep pace with changing member expectations and new developments by our competitors. Our members are increasingly using mobile phones, tablets, computers, and other devices to shop and to interact with us through social media, particularly in the wake of COVID-19. We are making investments in our websites and mobile applications. If we are unable to make, improve, or develop relevant member-facing technology in a timely manner, our ability to compete and our results of operations could be adversely affected.

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

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

We may incur property, casualty or other losses not covered by our insurance.

Claims for employee health care benefits, workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, inventory loss, and other exposures are funded predominantly through self-insurance. Insurance coverage is maintained for certain risks to limit exposures arising from very large losses. The types and amounts of insurance may vary from time to time based on our decisions with respect to risk retention and regulatory requirements. Significant claims or events, regulatory changes, a substantial rise in costs of health care or costs to maintain our insurance or the failure to maintain adequate insurance coverage could have an adverse impact on our financial condition and results of operations.

Although we maintain specific coverages for catastrophic property losses, we still bear a significant portion of the risk of losses incurred as a result of any physical damage to, or the destruction of, any warehouses, depots, manufacturing or home office facilities, loss or spoilage of inventory, and business interruption. Such losses could materially impact our cash flows and results of operations.

Market and Other External Risks

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

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

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

Higher energy and gasoline costs, inflation, levels of unemployment, healthcare costs, consumer debt levels, foreign-currency exchange rates, unsettled financial markets, weaknesses in housing and real estate markets, reduced consumer confidence, changes and uncertainties related to government fiscal

and tax policies including changes in tax rates, duties, tariffs, or other restrictions, sovereign debt crises, pandemics and other health crises, and other economic factors could adversely affect demand for our products and services, require a change in product mix, or impact the cost of or ability to purchase inventory. Additionally, actions in various countries, particularly China, the United States and the United Kingdom, have raised the cost of many items and created uncertainty with respect to tariff impacts on the costs of some of our merchandise. The degree of our exposure is dependent on (among other things) the type of goods, rates imposed, and timing of the tariffs. The impact to our net sales and gross margin is influenced in part by our merchandising and pricing strategies in response to potential cost increases. While these potential impacts are uncertain, they could have an adverse impact on our results.

Prices of certain commodities, including gasoline and consumable goods used in manufacturing and our warehouse retail operations, are historically volatile and are subject to fluctuations arising from changes in domestic and international supply and demand, inflationary pressures, labor costs, competition, market speculation, government regulations, taxes and periodic delays in delivery. Rapid and significant changes in commodity prices and our ability and desire to pass them through to our members may affect our sales and profit margins. These factors could also increase our merchandise costs and selling, general and administrative expenses, and otherwise adversely affect our operations and financial results. General economic conditions can also be affected by events like the outbreak of war or acts of terrorism.

Inflationary factors such as increases in merchandise costs may adversely affect our business, financial condition and results of operations. If inflation on merchandise increases beyond our ability to control we may not be able to adjust prices to sufficiently offset the effect of the various cost increases without negatively impacting consumer demand. Certain merchandise categories were impacted by inflation higher than what we have experienced in recent years due to, among other things, the continuing impacts of the pandemic and uncertain economic environment.

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

We depend heavily on our ability to purchase quality merchandise in sufficient quantities at competitive prices. As the quantities we require continue to grow, we have no assurances of continued supply, appropriate pricing or access to new products, and any supplier has the ability to change the terms upon which they sell to us or discontinue selling to us. Member demands may lead to out-of-stock positions causing a loss of sales and profits.

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

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

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

During 2021, our international operations, including Canada, generated 28% and 36% of our net sales and operating income, respectively. Our international operations have accounted for an increasing portion of our warehouses, and we plan to continue international growth. To prepare our consolidated financial statements, we translate the financial statements of our international operations from local currencies into U.S. dollars using current exchange rates. Future fluctuations in exchange rates that are unfavorable to us may adversely affect the financial performance of our Canadian and Other International operations and have a corresponding adverse period-over-period effect on our results of operations. As we continue to expand internationally, our exposure to fluctuations in foreign exchange rates may increase.

A portion of the products we purchase is paid for in a currency other than the local currency of the country in which the goods are sold. Currency fluctuations may increase our merchandise costs and may not be passed on to members. Consequently, fluctuations in currency exchange rates may adversely affect our results of operations.

Natural disasters, extreme weather conditions, public health emergencies or other catastrophic events could negatively affect our business, financial condition, and results of operations.

Natural disasters and extreme weather conditions, such as hurricanes, typhoons, floods, earthquakes, wildfires, droughts; acts of terrorism or violence, including active shooter situations; energy shortages; public health issues, including pandemics and quarantines, particularly in California or Washington state, where our centralized operating systems and administrative personnel are located, could negatively affect our operations and financial performance. Such events could result in physical damage to our properties, limitations on store operating hours, less frequent visits by members to physical locations, the temporary closure of warehouses, depots, manufacturing or home office facilities, the temporary lack of an adequate work force, disruptions to our IT systems, the temporary or long-term disruption in the supply of products from some local or overseas suppliers, the temporary disruption in the transport of goods to or from overseas, delays in the delivery of goods to our warehouses or depots, and the temporary reduction in the availability of products in our warehouses. Public health issues, whether occurring in the U.S. or abroad, could disrupt our operations, disrupt the operations of suppliers or members, or have an adverse impact on consumer spending and confidence levels. These events could also reduce demand for our products or make it difficult or impossible to procure products. We may be required to suspend operations in some or all of our locations, which could have a material adverse effect on our business, financial condition and results of operations.

The COVID-19 pandemic continues to affect our business, financial condition and results of operations in many respects.

The continuing impacts of the COVID-19 pandemic are highly unpredictable and volatile and are affecting certain business operations, demand for our products and services, in-stock positions, costs of doing business, availability of labor, access to inventory, supply chain operations, our ability to predict future performance, exposure to litigation, and our financial performance, among other things.

The pandemic has resulted in widespread and continuing impacts on the global economy and on our employees, members, suppliers and other people and entities with which we do business. There is considerable uncertainty regarding the extent to which COVID-19 will continue to spread and the extent and duration of measures to try to contain the virus, such as travel bans and restrictions, quarantines, shelter-in-place orders, and business and government shutdowns. The pandemic and any preventative or protective actions that governments or we may take may result in business disruption, reduced member traffic and reduced sales in certain merchandise categories, and increased operating expenses.

The pandemic is continuing to impact the global supply chain, with restrictions and limitations on business activities causing disruption and delay, which have strained certain domestic and international supply chains, and could continue to negatively affect the flow or availability of certain products. Member demand for certain products has and may continue to fluctuate as the pandemic progresses and member

behaviors change, which may challenge our ability to anticipate and/or adjust inventory levels to meet that demand. Similarly, increased demand for online purchases of products has impacted our fulfillment operations, resulting in delays in deliveries and lost sales from being out of stock for certain SKUs.

Failure to appropriately respond, or the perception of an inadequate response to evolving events around the pandemic, could cause reputational harm to our brand and subject us to lost sales, as well as claims from employees, members, suppliers, regulators or other parties. Additionally, a future outbreak of confirmed cases of COVID-19 in our facilities could result in temporary or sustained workforce shortages or facility closures, which would negatively impact our business and results of operations. Some jurisdictions have taken measures intended to expand the availability of workers compensation or to change the presumptions applicable to workers compensation measures. These actions may increase our exposure to claims and increase our costs.

Other factors and uncertainties include, but are not limited to:

- The severity and duration of the pandemic, including future mutations or related variants of the virus in areas in which we operate;
- Evolving macroeconomic factors, including general economic uncertainty, unemployment rates, and recessionary pressures;
- Changes in labor markets affecting us and our suppliers;
- Unknown consequences on our business performance and initiatives stemming from the substantial investment of time and other resources to the pandemic response;
- The pace of recovery when the pandemic subsides.
- The long-term impact of the pandemic on our business, including consumer behaviors; and
- Disruption and volatility within the financial and credit markets.

To the extent that COVID-19 continues to adversely affect the U.S. and global economy, our business, results of operations, cash flows, or financial condition, it may also heighten other risks described in this section, including but not limited to those related to consumer behavior and expectations, competition, brand reputation, implementation of strategic initiatives, cybersecurity threats, payment-related risks, technology systems disruption, supply chain disruptions, labor availability and cost, litigation, operational risk as a result of remote work arrangements and regulatory requirements.

Factors associated with climate change could adversely affect our business.

We use natural gas, diesel fuel, gasoline, and electricity in our distribution and warehouse operations. Government regulations limiting carbon dioxide and other greenhouse gas emissions may increase compliance and merchandise costs, and other regulation affecting energy inputs could materially affect our profitability. Climate change, extreme weather conditions, wildfires, droughts and rising sea levels could affect our ability to procure commodities at costs and in quantities we currently experience. We also sell a substantial amount of gasoline, the demand for which could be impacted by concerns about climate change and which face increased regulation.

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

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

Legal and Regulatory Risks

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

At the end of 2021, we operated 251 warehouses outside of the U.S., and we plan to continue expanding our international operations. Future operating results internationally could be negatively affected by a variety of factors, many similar to those we face in the U.S., certain of which are beyond our control. These factors include political and economic conditions, regulatory constraints, currency regulations, policy changes such as the withdrawal of the U.K. from the European Union, and other matters in any of the countries or regions in which we operate, now or in the future. Other factors that may impact international operations include foreign trade (including tariffs and trade sanctions), monetary and fiscal policies and the laws and regulations of the U.S. and foreign governments, agencies and similar organizations, and risks associated with having major facilities in locations which have been historically less stable than the U.S. Risks inherent in international operations also include, among others, the costs and difficulties of managing international operations, adverse tax consequences, and difficulty in enforcing intellectual property rights.

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

Accounting principles and related pronouncements, implementation guidelines, and interpretations we apply to a wide range of matters that are relevant to our business, including self-insurance liabilities, are highly complex and involve subjective assumptions, estimates and judgments by our management. Changes in rules or interpretation or changes in underlying assumptions, estimates or judgments by our management could significantly change our reported or expected financial performance and have a material impact on our consolidated financial statements.

We are exposed to risks relating to evaluations of controls required by Section 404 of the Sarbanes-Oxley Act.

Section 404 of the Sarbanes-Oxley Act of 2002 requires management assessments of the effectiveness of internal control over financial reporting and disclosure controls and procedures. If we are unable to maintain effective internal control over financial reporting or disclosure controls and procedures, our ability to record, process and report financial information accurately and to prepare financial statements within required time periods could be adversely affected, which could subject us to litigation or investigations requiring management resources and payment of legal and other expenses, negatively affect investor confidence in our financial statements and adversely impact our stock price.

Changes in tax rates, new U.S. or foreign tax legislation, and exposure to additional tax liabilities could adversely affect our financial condition and results of operations.

We are subject to a variety of taxes and tax collection and remittance obligations in the U.S. and numerous foreign jurisdictions. Additionally, at any point in time, we may be under examination for value added, sales-based, payroll, product, import or other non-income taxes. We may recognize additional tax expense, be subject to additional tax liabilities, or incur losses and penalties, due to changes in laws, regulations, administrative practices, principles, assessments by authorities and interpretations related to tax, including tax rules in various jurisdictions. We compute our income tax provision based on enacted tax rates in the countries in which we operate. As tax rates vary among countries, a change in earnings attributable to the various jurisdictions in which we operate could result in an unfavorable change in our overall tax provision. Additionally, changes in the enacted tax rates or adverse outcomes in tax audits, including transfer pricing disputes, could have a material adverse effect on our financial condition and results of operations.

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

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

Operations at our facilities require the treatment and disposal of wastewater, stormwater and agricultural and food processing wastes, the use and maintenance of refrigeration systems, including ammonia-based chillers, noise, odor and dust management, the operation of mechanized processing equipment, and other operations that potentially could affect the environment and public health and safety. Failure to comply with current and future environmental, health and safety standards could result in the imposition of fines and penalties, illness or injury of our employees, and claims or lawsuits related to such illnesses or injuries, and temporary closures or limits on the operations of facilities.

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

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

Item 1B—Unresolved Staff Comments

None.

Item 2—Properties

Warehouse Properties

At August 29, 2021, we operated 815 membership warehouses:

	Own Land and Building	Lease Land and/or Building[1]	Total
United States and Puerto Rico	454	110	564
Canada	89	16	105
Other International	101	45	146
Total	644	171	815

(1) 121 of the 171 leases are land-only leases, where Costco owns the building.

At the end of 2021, our warehouses contained approximately 118.9 million square feet of operating floor space: 83.2 million in the U.S.; 14.9 million in Canada; and 20.8 million in Other International. Total square feet associated with distribution and logistics facilities were approximately 31.4 million. Additionally, we operate various processing, packaging, manufacturing and other facilities to support our business, which includes the production of certain private-label items.

Item 3—Legal Proceedings

See discussion of Legal Proceedings in Note 11 to the consolidated financial statements included in Item 8 of this Report.

Item 4—Mine Safety Disclosures

Not applicable.

PART II

Item 5—Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information and Dividend Policy

Our common stock is traded on the NASDAQ Global Select Market under the symbol "COST." On September 28, 2021, we had 9,958 stockholders of record.

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

Issuer Purchases of Equity Securities

The following table sets forth information on our common stock repurchase activity for the fourth quarter of 2021 (dollars in millions, except per share data):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program[(1)]	Maximum Dollar Value of Shares that May Yet be Purchased under the Program
May 10—June 6, 2021	102,000	$ 381.50	102,000	$ 3,338
June 7—July 4, 2021	108,000	387.32	108,000	3,296
July 5—August 1, 2021	63,000	412.73	63,000	3,270
August 2—August 29, 2021	45,000	446.15	45,000	3,250
Total fourth quarter	318,000	$ 398.76	318,000	

(1) The repurchase program is conducted under a $4,000 authorization approved by our Board of Directors in April 2019, which expires in April 2023.

Performance Graph

The following graph compares the cumulative total shareholder return (stock price appreciation and the reinvestment of dividends) on an investment of $100 in Costco common stock, S&P 500 Index, and the S&P 500 Retail Index over the five years from August 28, 2016, through August 29, 2021.
cost-20210829_g1.jpg
The following graph provides information concerning average sales per warehouse over a 10 year period.

Average Sales Per Warehouse*

(Sales In Millions)

Year Opened	# of Whses	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
2021	**20**										$ 140
2020	**13**									$ 132	152
2019	**20**								$ 129	138	172
2018	**21**							$ 116	119	141	172
2017	**26**						$ 121	142	158	176	206
2016	**29**					$ 87	97	118	131	145	173
2015	**23**				$ 83	85	94	112	122	136	163
2014	**30**			$ 108	109	115	125	140	144	155	182
2013	**26**		$ 99	109	113	116	124	137	144	158	186
2012 & Before	**607**	$ 155	163	169	170	169	175	188	195	205	232
Totals	**815**	155	160	164	162	159	163	176	182	192	217

Fiscal Year

*First year sales annualized.

2017 was a 53-week fiscal year

Item 6—Reserved

Item 7—Management's Discussion and Analysis of Financial Conditions and Results of Operations
(amounts in millions, except per share, share, membership fee, and warehouse count data)

The following Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to promote understanding of the results of operations and financial condition. MD&A is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and the accompanying Notes to Financial Statements (Part II, Item 8 of this Form 10-K). This section generally discusses the results of operations for 2021 compared to 2020. For discussion related to the results of operations and changes in financial condition for 2020 compared to 2019 refer to Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in our fiscal year 2020 Form 10-K, which was filed with the United States Securities and Exchange Commission (SEC) on October 7, 2020. In 2021, we combined the hardlines and softlines merchandise categories into non-foods. This change did not have a material impact on the discussion of our results of operations.

Overview

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

Our philosophy is to provide our members with quality goods and services at competitive prices. We do not focus in the short-term on maximizing prices charged, but instead seek to maintain what we believe is a perception among our members of our “pricing authority” on quality goods – consistently providing the most competitive values. Our investments in merchandise pricing may include reducing prices on merchandise to drive sales or meet competition and holding prices steady despite cost increases instead of passing the increases on to our members, all negatively impacting gross margin as a percentage of net sales (gross margin percentage). We believe our gasoline business draws members, but it generally has a lower gross margin percentage relative to our non-gasoline business. It also has lower SG&A expenses as a percent of net sales compared to our non-gasoline business. A higher penetration of gasoline sales will generally lower our gross margin percentage. Rapidly changing gasoline prices may significantly impact our near-term net sales growth. Generally, rising gasoline prices benefit net sales growth which, given the higher sales base, negatively impacts our gross margin percentage but decreases our SG&A expenses as a percentage of net sales. A decline in gasoline prices has the inverse effect. Additionally, actions in various countries, particularly China, the United States and the United Kingdom, have created

uncertainty with respect to how tariffs will affect the costs of some of our merchandise. The degree of our exposure is dependent on (among other things) the type of goods, rates imposed, and timing of the tariffs. Certain merchandise categories were impacted by inflation higher than what we have experienced in recent years. The impact to our net sales and gross margin is influenced in part by our merchandising and pricing strategies in response to cost increases. While these potential impacts are uncertain, they could have an adverse impact on our results.

We also achieve net sales growth by opening new warehouses. As our warehouse base grows, available and desirable sites become more difficult to secure, and square footage growth becomes a comparatively less substantial component of growth. The negative aspects of such growth, however, including lower initial operating profitability relative to existing warehouses and cannibalization of sales at existing warehouses when openings occur in existing markets, are continuing to decline in significance as they relate to the results of our total operations. Our rate of operating floor space square footage growth is generally higher in foreign markets, due to the smaller base in those markets, and we expect that to continue. Our e-commerce business growth, domestically and internationally, has also increased our sales but it generally has a lower gross margin percentage relative to our warehouse operations.

The membership format is an integral part of our business and has a significant effect on our profitability. This format is designed to reinforce member loyalty and provide continuing fee revenue. The extent to which we achieve growth in our membership base, increase the penetration of our Executive members, and sustain high renewal rates materially influences our profitability. Our paid membership growth rate may be adversely impacted when warehouse openings occur in existing markets as compared to new markets.

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

Our operating model is generally the same across our U.S., Canadian, and Other International operating segments (see Note 12 to the consolidated financial statements included in Item 8 of this Report). Certain operations in the Other International segment have relatively higher rates of square footage growth, lower wage and benefit costs as a percentage of sales, less or no direct membership warehouse competition, or lack an e-commerce business.

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

Our fiscal year ends on the Sunday closest to August 31. References to 2021, 2020, and 2019 relate to the 52-week fiscal years ended August 29, 2021, August 30, 2020, and September 1, 2019, respectively. Certain percentages presented are calculated using actual results prior to rounding. Unless otherwise noted, references to net income relate to net income attributable to Costco.

Highlights for 2021 included:

- We opened 22 new warehouses, including 2 relocations: 12 net new in the U.S., 4 net new in our Canadian segment, and 4 new in our Other International segment, compared to 16 new warehouses, including 3 relocations in 2020;
- Net sales increased 18% to $192,052 driven by a 16% increase in comparable sales and sales at new warehouses opened in 2020 and 2021;
- Membership fee revenue increased 9% to $3,877, driven by sign-ups and upgrades to Executive membership;
- Gross margin percentage decreased seven basis points, driven primarily by a shift in sales penetration from our core merchandise categories to our warehouse ancillary and other businesses;
- SG&A expenses as a percentage of net sales decreased 40 basis points, primarily due to leveraging increased sales and decreased incremental wages related to COVID-19;
- The effective tax rate in 2021 was 24.0% compared to 24.4% in 2020;
- Net income increased 25% to $5,007, or $11.27 per diluted share compared to $4,002, or $9.02 per diluted share in 2020;
- We paid a special cash dividend of $10.00 per share in December 2020 and in April 2021, increased the quarterly cash dividend from $0.70 to $0.79 per share totaling $5,748.

COVID-19

During 2021, our sales mix began returning to pre-pandemic levels. This included sales increases in non-foods and in many of our warehouse ancillary and other businesses, certain of which experienced closures or restrictions in 2020. COVID-related supply and logistics constraints have adversely affected some merchandise categories and are expected to do so for the foreseeable future.

We paid $515 in incremental wages during 2021 related to COVID-19. The incremental wage and benefit costs associated with COVID-19, which began on March 1, 2020 and ended on February 28, 2021, totaled approximately $825.

Effective March 1, 2021, we permanently increased wages for hourly and most salaried warehouse employees. The estimated annualized pre-tax cost is approximately $400. Additionally, in certain areas in the United States governments have mandated or are considering mandating extra pay for classes of employees that include our employees, which has and will result in higher costs.

RESULTS OF OPERATIONS

Net Sales

	2021	2020	2019
Net Sales	$ 192,052	$ 163,220	$ 149,351
Increases in net sales:			
U.S.	16 %	9 %	9 %
Canada	22 %	5 %	3 %
Other International	23 %	13 %	5 %
Total Company	18 %	9 %	8 %
Increases in comparable sales:			
U.S.	15 %	8 %	8 %
Canada	20 %	5 %	2 %
Other International	19 %	9 %	2 %
Total Company	16 %	8 %	6 %
Increases in comparable sales excluding the impact of changes in foreign currency and gasoline prices[(1)]:			
U.S.	14 %	9 %	6 %
Canada	12 %	7 %	5 %
Other International	13 %	11 %	6 %
Total Company	13 %	9 %	6 %

(1) Excluding the impact of the revenue recognition standard for the year ended September 1, 2019.

Net Sales

Net sales increased $28,832 or 18% during 2021. The improvement was attributable to an increase in comparable sales of 16%, and sales at new warehouses opened in 2020 and 2021. While sales in all core merchandise categories increased, sales were particularly strong in non-foods. Sales increases were also strong in our warehouse ancillary and other businesses, predominantly e-commerce and gasoline. Certain merchandise categories were impacted by inflation higher than what we have experienced in recent years.

Changes in foreign currencies relative to the U.S. dollar positively impacted net sales by approximately $2,759, or 169 basis points, compared to 2020, attributable to our Canadian and Other International operations. Changes in gasoline prices positively impacted net sales by $1,636, or 100 basis points, compared to 2020, due to a 12% increase in the average price per gallon. The volume of gasoline sold increased approximately 10%, positively impacting net sales by $1,469, or 90 basis points.

Comparable Sales

Comparable sales increased 16% during 2021 and were positively impacted by increases in shopping frequency and average ticket. There was an increase of 44% in e-commerce comparable sales in 2021, driven by an increase of 80% in the first half of the year.

Membership Fees

	2021	2020	2019
Membership fees	$ 3,877	$ 3,541	$ 3,352
Membership fees increase	9 %	6 %	7 %

Membership fees increased 9% in 2021, driven by sign-ups and upgrades to Executive membership. Excluding the positive impact of changes in foreign currencies relative to the U.S. dollar, membership fees increased 8%. At the end of 2021, our member renewal rates were 91% in the U.S. and Canada and 89% worldwide. Our renewal rate is a trailing calculation that captures renewals during the period seven to eighteen months prior to the reporting date. We account for membership fee revenue on a deferred basis, recognized ratably over the one-year membership period.

Gross Margin

	2021	2020	2019
Net sales	$ 192,052	$ 163,220	$ 149,351
Less merchandise costs	170,684	144,939	132,886
Gross margin	$ 21,368	$ 18,281	$ 16,465
Gross margin percentage	11.13 %	11.20 %	11.02 %

The gross margin of our core merchandise categories (foods and sundries, non-foods and fresh foods), when expressed as a percentage of core merchandise sales (rather than total net sales), increased 23 basis points. This measure eliminates the impact of changes in sales penetration and gross margins from our warehouse ancillary and other businesses. The increase was across all categories, most significantly in non-foods.

Total gross margin percentage decreased seven basis points compared to 2020. Excluding the impact of gasoline price inflation on net sales in 2021, gross margin percentage was 11.22%, an increase of two basis points. This increase was due to a two basis point improvement in our core merchandise categories, predominantly non-foods, and in our warehouse ancillary and other businesses, largely e-commerce. The comparison was also positively impacted by a three basis point reserve on inventory recorded in 2020 with no such reserve this year. Gross margin percentage was negatively impacted three basis points due to increased 2% rewards and two basis points due to a LIFO charge for higher merchandise costs. Changes in foreign currencies relative to the U.S. dollar positively impacted gross margin by approximately $301 in 2021.

Gross margin on a segment basis, when expressed as a percentage of the segment's own sales and excluding the impact of changes in gasoline prices on net sales (segment gross margin percentage), decreased in our U.S. segment, due to our warehouse ancillary and other businesses, our core merchandise categories, and the LIFO charge, partially offset by the reserve for certain inventory in 2020. Our Canadian and Other International segments increased, primarily due to our warehouse ancillary and other businesses and certain of our core merchandise categories. These increases were partially offset by increased 2% rewards.

Selling, General and Administrative Expenses

	2021	2020	2019
SG&A expenses	$ 18,461	$ 16,332	$ 14,994
SG&A expenses as a percentage of net sales	9.61 %	10.01 %	10.04 %

SG&A expenses as a percentage of net sales decreased 40 basis points compared to 2020. SG&A expenses as a percentage of net sales excluding the impact of gasoline price inflation was 9.69%, a decrease of 32 basis points. Warehouse operations and other businesses were lower by 24 basis points, largely attributable to payroll leveraging increased sales. Incremental wages as a result of COVID-19, which ended on February 28, 2021, were lower by eight basis points. Central operating costs were lower by five basis points. Stock compensation expense was lower by three basis points, and costs associated with the acquisition of Innovel were lower by one basis point. These decreases were offset by an increase of five basis points related to a partial reversal of a product tax assessment in 2020, as well as an increase of four basis points related to a write-off of certain information technology assets in the fourth quarter of 2021 that are no longer expected to be utilized as part of the modernization of our information systems. Changes in foreign currencies relative to the U.S. dollar increased our SG&A expenses by approximately $228 in 2021.

Preopening

	2021	2020	2019
Preopening expenses	$ 76	$ 55	$ 86
Warehouse openings, including relocations			
United States	13	9	18
Canada	5	4	3
Other International	4	3	4
Total warehouse openings, including relocations	22	16	25

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

Interest Expense

	2021	2020	2019
Interest expense	$ 171	$ 160	$ 150

Interest expense primarily relates to Senior Notes. For more information on our debt arrangements, refer to the consolidated financial statements included in Item 8 of this Report.

Interest Income and Other, Net

	2021	2020	2019
Interest income	$ 41	$ 89	$ 126
Foreign-currency transaction gains, net	56	7	27
Other, net	46	(4)	25
Interest income and other, net	$ 143	$ 92	$ 178

The decrease in interest income in 2021 was primarily due to lower interest rates in the U.S. and Canada, partially offset by higher average cash and investment balances. Foreign-currency transaction gains, net include mark-to-market adjustments for forward foreign-exchange contracts and revaluation or settlement of monetary assets and liabilities by our Canadian and Other International operations. See Derivatives and Foreign Currency sections in Note 1 to the consolidated financial statements included in Item 8 of this Report. During 2020, other, net was impacted by a $36 charge related to the repayment of certain Senior Notes.

Provision for Income Taxes

	2021	2020	2019
Provision for income taxes	$ 1,601	$ 1,308	$ 1,061
Effective tax rate	24.0 %	24.4 %	22.3 %

The effective tax rate for 2021 included discrete net tax benefits of $163, including a benefit of $75 due to excess benefits from stock compensation, $70 related to the special dividend payable through our 401(k) plan, and $19 related to a reduction in the valuation allowance against certain deferred tax assets. Excluding these benefits, the tax rate was 26.4% for 2021.

LIQUIDITY AND CAPITAL RESOURCES

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

	2021	2020	2019
Net cash provided by operating activities	$ 8,958	$ 8,861	$ 6,356
Net cash used in investing activities	(3,535)	(3,891)	(2,865)
Net cash used in financing activities	(6,488)	(1,147)	(1,147)

Our primary sources of liquidity are cash flows generated from our operations, cash and cash equivalents, and short-term investments. Cash and cash equivalents and short-term investments were $12,175 and $13,305 at the end of 2021 and 2020, respectively. Of these balances, unsettled credit and debit card receivables represented approximately $1,816 and $1,636 at the end of 2021 and 2020, respectively. These receivables generally settle within four days. Cash and cash equivalents were positively impacted by a change in exchange rates of $46 and $70 in 2021 and 2020, respectively, and negatively impacted by $15 in 2019.

Material contractual obligations arising in the normal course of business primarily consist of purchase obligations, long-term debt and related interest payments, leases, and construction and land purchase obligations. See Notes 5 and 6 to the consolidated financial statements included in Item 8 of this Report for amounts outstanding on August 29, 2021, related to debt and leases.

Purchase obligations consist of contracts primarily related to merchandise, equipment, and third-party services, the majority of which are due in the next 12 months. Construction and land purchase obligations consist of contracts primarily related to the development and opening of new and relocated warehouses, the majority of which (other than leases) are due in the next 12 months.

Management believes that our cash and investment position and operating cash flows as well as capacity under existing and available credit agreements will be sufficient to meet our liquidity and capital requirements for the foreseeable future. We believe that our U.S. current and projected asset position is sufficient to meet our U.S. liquidity requirements.

Cash Flows from Operating Activities

Net cash provided by operating activities totaled $8,958 in 2021, compared to $8,861 in 2020. Our cash flow provided by operations is primarily from net sales and membership fees. Cash flow used in operations generally consists of payments to merchandise suppliers, warehouse operating costs, including payroll and employee benefits, utilities, and credit and debit card processing fees. Cash used in operations also includes payments for income taxes. Changes in our net investment in merchandise inventories (the difference between merchandise inventories and accounts payable) is impacted by several factors, including how fast inventory is sold, the forward deployment of inventory to accelerate delivery times, payment terms with our suppliers, and early payments to obtain discounts from suppliers.

Cash Flows from Investing Activities

Net cash used in investing activities totaled $3,535 in 2021, compared to $3,891 in 2020, and is primarily related to capital expenditures. In 2020, we acquired Innovel (Costco Wholesale Logistics) and a minority interest in Navitus. Net cash flows from investing activities also includes purchases and maturities of short-term investments.

Capital Expenditures

Our primary requirements for capital are acquiring land, buildings, and equipment for new and remodeled warehouses. Capital is also required for information systems, manufacturing and distribution facilities, initial warehouse operations, and working capital. In 2021, we spent $3,588 on capital expenditures, and it is our current intention to spend approximately $3,800 to $4,200 during fiscal 2022. These expenditures are expected to be financed with cash from operations, existing cash and cash equivalents, and short-term investments. We opened 22 new warehouses, including two relocations, in 2021, and plan to open approximately up to 35 additional new warehouses, including five relocations, in 2022. We have experienced delays in real estate and construction activities due to COVID-19. There can be no assurance that current expectations will be realized and plans are subject to change upon further review of our capital expenditure needs or based on the current economic environment.

Cash Flows from Financing Activities

Net cash used in financing activities totaled $6,488 in 2021, compared to $1,147 in 2020. Cash flows used in financing activities primarily related to the payment of dividends, repurchases of common stock, and withholding taxes on stock-based awards.

In 2020, we issued $4,000 in aggregate principal amount of Senior Notes and repaid $3,200 of Senior Notes.

Stock Repurchase Programs

During 2021 and 2020, we repurchased 1,358,000 and 643,000 shares of common stock, at average prices of $364.39 and $308.45, respectively, totaling approximately $495 and $198, respectively. These amounts may differ from the stock repurchase balances in the accompanying consolidated statements of cash flows due to changes in unsettled stock repurchases at the end of each fiscal year. Purchases are made from time-to-time, as conditions warrant, in the open market or in block purchases and pursuant to plans under SEC Rule 10b5-1. Repurchased shares are retired, in accordance with the Washington Business Corporation Act. The remaining amount available to be purchased under our approved plan was $3,250 at the end of 2021.

Dividends

Cash dividends declared in 2021 totaled $12.98 per share, as compared to $2.70 per share in 2020. Dividends in 2021 included a special dividend of $10.00 per share, resulting in an aggregate payment of approximately $4,430. In April 2021, the Board of Directors increased our quarterly cash dividend from $0.70 to $0.79 per share.

Bank Credit Facilities and Commercial Paper Programs

We maintain bank credit facilities for working capital and general corporate purposes. At August 29, 2021, we had borrowing capacity under these facilities of $1,050. Our international operations maintain $574 of the total borrowing capacity under bank credit facilities, of which $201 is guaranteed by the Company. Short-term borrowings outstanding under the bank credit facilities at the end of 2021 were immaterial, and there were none outstanding at the end of 2020.

The Company has letter of credit facilities, for commercial and standby letters of credit, totaling $235. The outstanding commitments under these facilities at the end of 2021 totaled $197, most of which were standby letters of credit which do not expire or have expiration dates within one year. The bank credit facilities have various expiration dates, most of which are within one year, and we generally intend to renew these facilities. The amount of borrowings available at any time under our bank credit facilities is reduced by the amount of standby and commercial letters of credit outstanding.

Off-Balance Sheet Arrangements

In the opinion of management, we have no off-balance sheet arrangements that have had or are reasonably likely to have a material current or future effect on our financial condition or financial statements.

Critical Accounting Estimates

The preparation of our consolidated financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP) requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and on assumptions that we believe to be reasonable, and we continue to review and evaluate these estimates. For further information on significant accounting policies, see discussion in Note 1 to the consolidated financial statements included in Item 8 of this Report.

Insurance/Self-insurance Liabilities

Claims for employee health-care benefits, workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, inventory loss, and other exposures are funded predominantly through self-insurance. Insurance coverage is maintained for certain risks to seek to limit exposures arising from very large losses. We use different risk management mechanisms, including a wholly-owned captive insurance subsidiary, and participate in a reinsurance program. Liabilities associated with the risks that we retain are not discounted and are estimated by using historical claims experience, demographic factors, severity factors, and other actuarial assumptions. The costs of claims are highly unpredictable and can fluctuate as a result of inflation rates, regulatory or legal changes, and unforeseen developments in claims over time. While we believe our estimates are reasonable and provide for a certain degree of coverage to account for these variables, actual claims and costs could differ significantly from recorded liabilities. Historically, adjustments to our estimates have not been material.

Recent Accounting Pronouncements

We do not expect that any recently issued accounting pronouncements will have a material effect on our financial statements.

Item 7A—Quantitative and Qualitative Disclosures About Market Risk (amounts in millions)

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

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment holdings that are diversified among various instruments considered to be cash equivalents, as defined in Note 1 to the consolidated financial statements included in Item 8 of this Report, as well as short-term investments in government and agency securities with effective maturities of generally three months to five years at the date of purchase. The primary objective of our investment activities is to preserve principal and secondarily to generate yields. The majority of our short-term investments are in fixed interest-rate securities. These securities are subject to changes in fair value due to interest rate fluctuations.

Our policy limits investments in the U.S. to direct U.S. government and government agency obligations, repurchase agreements collateralized by U.S. government and government agency obligations, U.S. government and government agency money market funds, and insured bank balances. Our wholly-owned captive insurance subsidiary invests in U.S. government and government agency obligations and U.S. government and government agency money market funds. Our Canadian and Other International subsidiaries' investments are primarily in money market funds, bankers' acceptances, and bank certificates of deposit, generally denominated in local currencies.

A 100 basis point change in interest rates as of the end of 2021 would have had an immaterial incremental change in fair market value. For those investments that are classified as available-for-sale, the unrealized gains or losses related to fluctuations in market volatility and interest rates are reflected within stockholders' equity in accumulated other comprehensive income in the consolidated balance sheets.

The nature and amount of our long-term debt may vary as a result of business requirements, market conditions, and other factors. As of the end of 2021, long-term debt with fixed interest rates was $7,531. Fluctuations in interest rates may affect the fair value of the fixed-rate debt. See Note 5 to the consolidated financial statements included in Item 8 of this Report for more information on our long-term debt.

Foreign Currency Risk

Our foreign subsidiaries conduct certain transactions in non-functional currencies, which exposes us to fluctuations in exchange rates. We manage these fluctuations, in part, through the use of forward foreign-exchange contracts, seeking to economically hedge the impact of these fluctuations on known future expenditures denominated in a non-functional foreign-currency. The contracts are intended primarily to economically hedge exposure to U.S. dollar merchandise inventory expenditures made by our international subsidiaries whose functional currency is other than the U.S. dollar. We seek to mitigate risk with the use of these contracts and do not intend to engage in speculative transactions. For additional information related to the Company's forward foreign-exchange contracts, see Notes 1 and 4 to the consolidated financial statements included in Item 8 of this Report. A hypothetical 10% strengthening of the functional currency compared to the non-functional currency exchange rates at August 29, 2021, would have decreased the fair value of the contracts by $149 and resulted in an unrealized loss in the consolidated statements of income for the same amount.

Commodity Price Risk

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

Item 8—Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors

Costco Wholesale Corporation:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Costco Wholesale Corporation and subsidiaries (the Company) as of August 29, 2021 and August 30, 2020, the related consolidated statements of income, comprehensive income, equity, and cash flows for the 52-week periods ended August 29, 2021, August 30, 2020 and September 1, 2019, and the related notes (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of August 29, 2021 and August 30, 2020, and the results of its operations and its cash flows for the 52-week periods ended August 29, 2021, August 30, 2020 and September 1, 2019, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of August 29, 2021, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated October 5, 2021 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Change in Accounting Principle

The Company changed its method of accounting for leases as of September 2, 2019, due to the adoption of Accounting Standards Update 2016-02 – Leases (ASC 842).

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of a critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Evaluation of workers' compensation self-insurance liabilities

As discussed in Note 1 to the consolidated financial statements, the Company estimates its self-insurance liabilities by considering historical claims experience, demographic factors, severity factors, and other actuarial assumptions. The estimated self-insurance liabilities as of August 29, 2021 were $1,257 million, a portion of which related to workers' compensation self-insurance liabilities for the United States operations.

We identified the evaluation of the Company's workers' compensation self-insurance liabilities for the United States operations as a critical audit matter because of the extent of specialized skill and knowledge needed to evaluate the underlying assumptions and judgments made by the Company in the actuarial models. Specifically, subjective auditor judgment was required to evaluate the Company's selected loss rates and initial expected losses used in the actuarial models.

The following are the primary procedures we performed to address this critical audit matter. We evaluated the design and tested the operating effectiveness of certain internal controls over the Company's self-insurance workers' compensation process. This included controls related to the development and selection of the assumptions listed above used in the actuarial calculation and review of the actuarial report. We involved actuarial professionals with specialized skills and knowledge who assisted in:

- Assessing the actuarial models used by the Company for consistency with generally accepted actuarial standards
- Evaluating the Company's ability to estimate self-insurance workers' compensation liabilities by comparing its historical estimates with actual incurred losses and paid losses
- Evaluating the above listed assumptions underlying the Company's actuarial estimates by developing an independent expectation of the self-insurance workers' compensation liabilities and comparing them to the amounts recorded by the Company

/s/ KPMG LLP

We have served as the Company's auditor since 2002.

Seattle, Washington

October 5, 2021

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors

Costco Wholesale Corporation:

Opinion on Internal Control Over Financial Reporting

We have audited Costco Wholesale Corporation and subsidiaries' (the Company) internal control over financial reporting as of August 29, 2021, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of August 29, 2021, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of August 29, 2021 and August 30, 2020, the related consolidated statements of income, comprehensive income, equity, and cash flows for the 52-week periods ended August 29, 2021, August 30, 2020 and September 1, 2019, and the related notes (collectively, the consolidated financial statements), and our report dated October 5, 2021 expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

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

Definition and Limitations of Internal Control Over Financial Reporting

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

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

/s/ KPMG LLP

Seattle, Washington

October 5, 2021

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

	52 Weeks Ended August 29, 2021	52 Weeks Ended August 30, 2020	52 Weeks Ended September 1, 2019
REVENUE			
Net sales	$ 192,052	$ 163,220	$ 149,351
Membership fees	3,877	3,541	3,352
Total revenue	195,929	166,761	152,703
OPERATING EXPENSES			
Merchandise costs	170,684	144,939	132,886
Selling, general and administrative	18,461	16,332	14,994
Preopening expenses	76	55	86
Operating income	6,708	5,435	4,737
OTHER INCOME (EXPENSE)			
Interest expense	(171)	(160)	(150)
Interest income and other, net	143	92	178
INCOME BEFORE INCOME TAXES	6,680	5,367	4,765
Provision for income taxes	1,601	1,308	1,061
Net income including noncontrolling interests	5,079	4,059	3,704
Net income attributable to noncontrolling interests	(72)	(57)	(45)
NET INCOME ATTRIBUTABLE TO COSTCO	$ 5,007	$ 4,002	$ 3,659
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO:			
Basic	$ 11.30	$ 9.05	$ 8.32
Diluted	$ 11.27	$ 9.02	$ 8.26
Shares used in calculation (000's)			
Basic	443,089	442,297	439,755
Diluted	444,346	443,901	442,923

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

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(amounts in millions)

	52 Weeks Ended August 29, 2021	52 Weeks Ended August 30, 2020	52 Weeks Ended September 1, 2019
NET INCOME INCLUDING NONCONTROLLING INTERESTS	$ 5,079	$ 4,059	$ 3,704
Foreign-currency translation adjustment and other, net	181	162	(245)
Comprehensive income	5,260	4,221	3,459
Less: Comprehensive income attributable to noncontrolling interests	93	80	37
COMPREHENSIVE INCOME ATTRIBUTABLE TO COSTCO	$ 5,167	$ 4,141	$ 3,422

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

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

	August 29, 2021	August 30, 2020
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 11,258	$ 12,277
Short-term investments	917	1,028
Receivables, net	1,803	1,550
Merchandise inventories	14,215	12,242
Other current assets	1,312	1,023
Total current assets	29,505	28,120
OTHER ASSETS		
Property and equipment, net	23,492	21,807
Operating lease right-of-use assets	2,890	2,788
Other long-term assets	3,381	2,841
TOTAL ASSETS	$ 59,268	$ 55,556
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 16,278	$ 14,172
Accrued salaries and benefits	4,090	3,605
Accrued member rewards	1,671	1,393
Deferred membership fees	2,042	1,851
Current portion of long-term debt	799	95
Other current liabilities	4,561	3,728
Total current liabilities	29,441	24,844
OTHER LIABILITIES		
Long-term debt, excluding current portion	6,692	7,514
Long-term operating lease liabilities	2,642	2,558
Other long-term liabilities	2,415	1,935
TOTAL LIABILITIES	41,190	36,851
COMMITMENTS AND CONTINGENCIES		
EQUITY		
Preferred stock $0.01 par value; 100,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock $0.01 par value; 900,000,000 shares authorized; 441,825,000 and 441,255,000 shares issued and outstanding	4	4
Additional paid-in capital	7,031	6,698
Accumulated other comprehensive loss	(1,137)	(1,297)
Retained earnings	11,666	12,879
Total Costco stockholders' equity	17,564	18,284
Noncontrolling interests	514	421
TOTAL EQUITY	18,078	18,705
TOTAL LIABILITIES AND EQUITY	$ 59,268	$ 55,556

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

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF EQUITY
(amounts in millions)

	Common Stock							
	Shares (000's)	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Costco Stockholders' Equity	Noncontrolling Interests	Total Equity
BALANCE AT SEPTEMBER 2, 2018	438,189	$ 4	$ 6,107	$ (1,199)	$ 7,887	$ 12,799	$ 304	$ 13,103
Net income	—	—	—	—	3,659	3,659	45	3,704
Foreign-currency translation adjustment and other, net	—	—	—	(237)	—	(237)	(8)	(245)
Stock-based compensation	—	—	598	—	—	598	—	598
Release of vested restricted stock units (RSUs), including tax effects	2,533	—	(272)	—	—	(272)	—	(272)
Repurchases of common stock	(1,097)	—	(16)	—	(231)	(247)	—	(247)
Cash dividends declared and other	—	—	—	—	(1,057)	(1,057)	—	(1,057)
BALANCE AT SEPTEMBER 1, 2019	439,625	4	6,417	(1,436)	10,258	15,243	341	15,584
Net income	—	—	—	—	4,002	4,002	57	4,059
Foreign-currency translation adjustment and other, net	—	—	—	139	—	139	23	162
Stock-based compensation	—	—	621	—	—	621	—	621
Release of vested RSUs, including tax effects	2,273	—	(330)	—	—	(330)	—	(330)
Repurchases of common stock	(643)	—	(10)	—	(188)	(198)	—	(198)
Cash dividends declared	—	—	—	—	(1,193)	(1,193)	—	(1,193)
BALANCE AT AUGUST 30, 2020	441,255	4	6,698	(1,297)	12,879	18,284	421	18,705
Net income	—	—	—	—	5,007	5,007	72	5,079
Foreign-currency translation adjustment and other, net	—	—	—	160	—	160	21	181
Stock-based compensation	—	—	668	—	—	668	—	668
Release of vested RSUs, including tax effects	1,928	—	(312)	—	—	(312)	—	(312)
Repurchases of common stock	(1,358)	—	(23)	—	(472)	(495)	—	(495)
Cash dividends declared	—	—	—	—	(5,748)	(5,748)	—	(5,748)
BALANCE AT AUGUST 29, 2021	441,825	$ 4	$ 7,031	$ (1,137)	$ 11,666	$ 17,564	$ 514	$ 18,078

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

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(amounts in millions)

	52 Weeks Ended August 29, 2021	52 Weeks Ended August 30, 2020	52 Weeks Ended September 1, 2019
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income including noncontrolling interests	$ 5,079	$ 4,059	$ 3,704
Adjustments to reconcile net income including noncontrolling interests to net cash provided by operating activities:			
Depreciation and amortization	1,781	1,645	1,492
Non-cash lease expense	286	194	—
Stock-based compensation	665	619	595
Other non-cash operating activities, net	85	42	9
Deferred income taxes	59	104	147
Changes in operating assets and liabilities:			
Merchandise inventories	(1,892)	(791)	(536)
Accounts payable	1,838	2,261	322
Other operating assets and liabilities, net	1,057	728	623
Net cash provided by operating activities	8,958	8,861	6,356
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of short-term investments	(1,331)	(1,626)	(1,094)
Maturities and sales of short-term investments	1,446	1,678	1,231
Additions to property and equipment	(3,588)	(2,810)	(2,998)
Acquisitions	—	(1,163)	—
Other investing activities, net	(62)	30	(4)
Net cash used in investing activities	(3,535)	(3,891)	(2,865)
CASH FLOWS FROM FINANCING ACTIVITIES			
Change in bank payments outstanding	188	137	210
Proceeds from short-term borrowings	41	—	—
Proceeds from issuance of long-term debt	—	3,992	298
Repayments of long-term debt	(94)	(3,200)	(89)
Tax withholdings on stock-based awards	(312)	(330)	(272)
Repurchases of common stock	(496)	(196)	(247)
Cash dividend payments	(5,748)	(1,479)	(1,038)
Other financing activities, net	(67)	(71)	(9)
Net cash used in financing activities	(6,488)	(1,147)	(1,147)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	46	70	(15)
Net change in cash and cash equivalents	(1,019)	3,893	2,329
CASH AND CASH EQUIVALENTS BEGINNING OF YEAR	12,277	8,384	6,055
CASH AND CASH EQUIVALENTS END OF YEAR	$ 11,258	$ 12,277	$ 8,384
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest	$ 149	$ 124	$ 141
Income taxes, net	$ 1,527	$ 1,052	$ 1,187
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:			
Cash dividend declared, but not yet paid	$ —	$ —	$ 286

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

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

Note 1—Summary of Significant Accounting Policies

Description of Business

Costco Wholesale Corporation (Costco or the Company), a Washington corporation, and its subsidiaries operate membership warehouses based on the concept that offering members low prices on a limited selection of nationally-branded and private-label products in a wide range of merchandise categories will produce high sales volumes and rapid inventory turnover. At August 29, 2021, Costco operated 815 warehouses worldwide: 564 in the United States (U.S.) located in 46 states, Washington, D.C., and Puerto Rico, 105 in Canada, 39 in Mexico, 30 in Japan, 29 in the United Kingdom (U.K.), 16 in Korea, 14 in Taiwan, 12 in Australia, three in Spain, and one each in Iceland, France and China. The Company operates e-commerce websites in the U.S., Canada, U.K., Mexico, Korea, Taiwan, Japan, and Australia.

Basis of Presentation

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

Fiscal Year End

The Company operates on a 52/53-week fiscal year basis with the year ending on the Sunday closest to August 31. References to 2021, 2020, and 2019 relate to the 52-week fiscal years ended August 29, 2021, August 30, 2020, and September 1, 2019, respectively.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions take into account historical and forward-looking factors that the Company believes are reasonable, including but not limited to the potential impacts arising from the novel coronavirus (COVID-19) and related public and private sector policies and initiatives. Actual results could differ from those estimates and assumptions.

Cash and Cash Equivalents

The Company considers as cash and cash equivalents all cash on deposit, highly liquid investments with a maturity of three months or less at the date of purchase, and proceeds due from credit and debit card transactions with settlement terms of up to four days. Credit and debit card receivables were $1,816 and $1,636 at the end of 2021 and 2020, respectively.

The Company provides for the daily replenishment of major bank accounts as payments are presented. Included in accounts payable at the end of 2021 and 2020, are $999 and $810, respectively, representing the excess of outstanding payments over cash on deposit at the banks on which the payments were drawn.

Short-Term Investments

Short-term investments generally consist of debt securities (U.S. Government and Agency Notes), with maturities at the date of purchase of three months to five years. Investments with maturities beyond five years may be classified, based on the Company's determination, as short-term based on their highly liquid nature and because they represent the investment of cash that is available for current operations. Short-term investments classified as available-for-sale are recorded at fair value using the specific identification method with the unrealized gains and losses reflected in accumulated other comprehensive income (loss) until realized. Realized gains and losses from the sale of available-for-sale securities, if any, are determined on a specific identification basis and are recorded in interest income and other, net in the consolidated statements of income. These available-for-sale investments have a low level of inherent credit risk given they are issued by the U.S. Government and Agencies. Changes in their fair value are primarily attributable to changes in interest rates and market liquidity. Short-term investments classified as held-to-maturity are financial instruments that the Company has the intent and ability to hold to maturity and are reported net of any related amortization and are not remeasured to fair value on a recurring basis.

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

Fair Value of Financial Instruments

The Company accounts for certain assets and liabilities at fair value. The carrying value of the Company's financial instruments, including cash and cash equivalents, receivables and accounts payable, approximate fair value due to their short-term nature or variable interest rates. See Notes 3, 4, and 5 for the carrying value and fair value of the Company's investments, derivative instruments, and fixed-rate debt, respectively.

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

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

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

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

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

value of the individual securities as of the beginning of the reporting period in which the transfer(s) occurred.

Current financial liabilities have fair values that approximate their carrying values. Long-term financial liabilities include the Company's long-term debt, which are recorded on the balance sheet at issuance price and adjusted for unamortized discounts or premiums and debt issuance costs, and are being amortized to interest expense over the term of the loan. The estimated fair value of the Company's long-term debt is based primarily on reported market values, recently completed market transactions, and estimates based upon interest rates, maturities, and credit.

Receivables, Net

Receivables consist primarily of vendor, reinsurance, credit card incentive, third-party pharmacy and other receivables. Vendor receivables include discounts and volume rebates. Balances are generally presented on a gross basis, separate from any related payable due. In certain circumstances, these receivables may be settled against the related payable to that vendor, in which case the receivables are presented on a net basis. Reinsurance receivables are held by the Company’s wholly-owned captive insurance subsidiary and primarily represent amounts ceded through reinsurance arrangements gross of the amounts assumed under reinsurance, which are presented within other current liabilities in the consolidated balance sheets. Credit card incentive receivables primarily represent amounts earned under the co-branded credit card arrangement in the U.S. Third-party pharmacy receivables generally relate to amounts due from members’ insurers. Other receivables primarily consist of amounts due from governmental entities, mostly tax-related items.

Receivables are recorded net of an allowance for credit losses which considers creditworthiness of vendors and third parties, historical experience and current economic trends. Write-offs of receivables were immaterial in 2021, 2020, and 2019.

Merchandise Inventories

Merchandise inventories consist of the following:

	2021	2020
United States	$ 10,248	$ 8,871
Canada	1,456	1,310
Other International	2,511	2,061
Merchandise inventories	$ 14,215	$ 12,242

Merchandise inventories are stated at the lower of cost or market. U.S. merchandise inventories are valued by the cost method of accounting, using the last-in, first-out (LIFO) basis. The Company believes the LIFO method more fairly presents the results of operations by more closely matching current costs with current revenues. The Company records an adjustment each quarter, if necessary, for the projected annual effect of inflation or deflation, and these estimates are adjusted to actual results determined at year-end, after actual inflation or deflation rates and inventory levels have been determined. An immaterial charge was recorded to merchandise costs to increase the cumulative LIFO valuation on merchandise inventories at August 29, 2021. As of August 30, 2020, U.S. merchandise inventories valued at LIFO approximated first-in, first-out (FIFO) after considering the lower of cost or market principle. Canadian and Other International merchandise inventories are predominantly valued using the cost and retail inventory methods, respectively, using the FIFO basis.

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

Property and Equipment, Net

Property and equipment are stated at cost. Depreciation and amortization expense is computed primarily using the straight-line method over estimated useful lives. Leasehold improvements made after the beginning of the initial lease term are depreciated over the shorter of the estimated useful life of the asset or the remaining term of the initial lease plus any renewals that are reasonably certain at the date the leasehold improvements are made.

The Company capitalizes certain computer software and costs incurred in developing or obtaining software for internal use. During development, these costs are included in construction in progress. To the extent that the assets become ready for their intended use, these costs are included in equipment and fixtures and amortized on a straight-line basis over their estimated useful lives. In the fourth quarter of 2021, the Company recognized an $84 write-off of certain information technology assets, which was recorded in selling, general and administrative expenses, in the consolidated statements of income.

Repair and maintenance costs are expensed when incurred. Expenditures for remodels, refurbishments and improvements that add to or change the way an asset functions or that extend the useful life are capitalized. Assets removed during the remodel, refurbishment or improvement are retired. Assets classified as held-for-sale at the end of 2021 and 2020 were immaterial. The following table summarizes the Company's property and equipment balances at the end of 2021 and 2020:

	Estimated Useful Lives	2021	2020
Land	N/A	$ 7,507	$ 6,696
Buildings and improvements	5-50 years	19,139	17,982
Equipment and fixtures	3-20 years	9,505	8,749
Construction in progress	N/A	1,507	1,276
		37,658	34,703
Accumulated depreciation and amortization		(14,166)	(12,896)
Property and equipment, net		$ 23,492	$ 21,807

The Company evaluates long-lived assets for impairment on an annual basis, when relocating or closing a facility, or when events or changes in circumstances may indicate the carrying amount of the asset group, generally an individual warehouse, may not be fully recoverable. For asset groups held and used, including warehouses to be relocated, the carrying value of the asset group is considered recoverable when the estimated future undiscounted cash flows generated from the use and eventual disposition of the asset group exceed the respective carrying value. In the event that the carrying value is not considered recoverable, an impairment loss is recognized for the asset group to be held and used equal to the excess of the carrying value above the estimated fair value of the asset group. For asset groups classified as held-for-sale (disposal group), the carrying value is compared to the disposal group’s fair value less costs to sell. The Company estimates fair value by obtaining market appraisals from third party brokers or using other valuation techniques. Impairment charges recognized in 2021 were immaterial. There were no impairment charges recognized in 2020 or 2019.

Leases

The Company leases land and/or buildings at warehouses and certain other office and distribution facilities. Leases generally contain one or more of the following options, which the Company can exercise at the end of the initial term: (a) renew the lease for a defined number of years at the then-fair market rental rate or rate stipulated in the lease agreement; (b) purchase the property at the then-fair market value; or (c) a right of first refusal in the event of a third-party offer.

Some leases include free-rent periods and step-rent provisions, which are recognized on a straight-line basis over the original term of the lease and any extension options that the Company is reasonably certain to exercise from the date the Company has control of the property. Certain leases provide for periodic rent increases based on price indices or the greater of minimum guaranteed amounts or sales volume. Our leases do not contain any material residual value guarantees or material restrictive covenants.

The Company determines at inception whether a contract is or contains a lease. The Company initially records right-of-use (ROU) assets and lease obligations for its finance and operating leases based on the discounted future minimum lease payments over the term. The lease term is defined as the noncancelable period of the lease plus any options to extend when it is reasonably certain that the Company will exercise the option. As the rate implicit in the Company's leases is not easily determinable, the present value of the sum of the lease payments is calculated using the Company's incremental borrowing rate. The rate is determined using a portfolio approach based on the rate of interest the Company would pay to borrow an amount equal to the lease payments on a collateralized basis over a similar term. The Company uses quoted interest rates from financial institutions to derive the incremental borrowing rate. Impairment of ROU assets is evaluated in a similar manner as described in Property and Equipment, net above.

The Company's asset retirement obligations (ARO) primarily relate to leasehold improvements that at the end of a lease must be removed. These obligations are generally recorded as a discounted liability, with an offsetting asset at the inception of the lease term based upon the estimated fair value of the costs to remove the improvements. These liabilities are accreted over time to the projected future value of the obligation. The ARO assets are depreciated using the same depreciation method as the leasehold improvement assets and are included with buildings and improvements. Estimated ARO liabilities associated with these leases are included in other liabilities in the accompanying consolidated balance sheet.

Goodwill and Acquired Intangible Assets

Goodwill represents the excess of acquisition cost over the fair value of the net assets acquired and is not subject to amortization. The Company reviews goodwill annually in the fourth quarter for impairment or when circumstances indicate carrying value may exceed the fair value. This evaluation is performed at the reporting unit level. If a qualitative assessment indicates that it is more likely than not that the fair value is less than carrying value, a quantitative analysis is completed using either the income or market approach, or a combination of both. The income approach estimates fair value based on expected discounted future cash flows, while the market approach uses comparable public companies and transactions to develop metrics to be applied to historical and expected future operating results.

Goodwill is included in other long-term assets in the consolidated balance sheets. The following table summarizes goodwill by reportable segment:

	United States Operations	Canadian Operations	Other International Operations	Total
Balance at September 1, 2019	$ 13	$ 27	$ 13	$ 53
Changes in currency translation	—	—	1	1
Acquisition	934	—	—	934
Balance at August 30, 2020	$ 947	$ 27	$ 14	$ 988
Changes in currency translation and other [(1)]	6	1	1	8
Balance at August 29, 2021	$ 953	$ 28	$ 15	$ 996

(1) Other consists of changes to the purchase price allocation. See Note 2.

Definite-lived intangible assets, which are not material, are included in other long-term assets on the consolidated balance sheets and are amortized on a straight-line basis over their estimated lives, which approximates the pattern of expected economic benefit.

Insurance/Self-insurance Liabilities

Claims for employee health care benefits, workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, inventory loss, and other exposures are funded predominantly through self-insurance. Insurance coverage is maintained for certain risks to limit exposures arising from very large losses. The Company uses different risk management mechanisms, including a wholly-owned captive insurance subsidiary (the captive) and participates in a reinsurance program. Liabilities associated with the risks that are retained by the Company are not discounted and are estimated, in part, by considering historical claims experience, demographic factors, severity factors, and other actuarial assumptions. The estimated accruals for these liabilities could be significantly affected if future occurrences and claims differ from these assumptions and historical trends. At the end of 2021 and 2020, these insurance liabilities were $1,257 and $1,188 in the aggregate, respectively, and were included in accrued salaries and benefits and other current liabilities in the consolidated balance sheets, classified based on their nature.

The captive receives direct premiums, which are netted against the Company's premium costs in selling, general and administrative expenses, in the consolidated statements of income. The captive participates in a reinsurance program that includes other third-party participants. The reinsurance agreement is one year in duration, and new agreements are entered into by each participant at their discretion at the commencement of the next calendar year. The participant agreements and practices of the reinsurance program limit a participating members' individual risk. Income statement adjustments related to the reinsurance program and related impacts to the consolidated balance sheets are recognized as information becomes known. In the event the Company leaves the reinsurance program, the Company retains its primary obligation to the policyholders for prior activity.

Derivatives

The Company is exposed to foreign-currency exchange-rate fluctuations in the normal course of business. It manages these fluctuations, in part, through the use of forward foreign-exchange contracts, seeking to economically hedge the impact of fluctuations of foreign exchange on known future expenditures denominated in a non-functional foreign-currency. The contracts relate primarily to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries with functional currencies other than the U.S. dollar. Currently, these contracts do not qualify for derivative hedge accounting. The Company seeks to mitigate risk with the use of these contracts and does not intend to engage in speculative transactions. Some of these contracts contain credit-risk-related contingent features that require settlement of outstanding contracts upon certain triggering events. There were no derivative instruments in a net liability position at the end of 2021 and for those in a net liability position at the end of 2020, the amount needed to settle the instruments immediately if the credit-risk-related contingent features were triggered was immaterial. The aggregate notional amounts of open, unsettled forward foreign-exchange contracts were $1,331 and $1,036 at the end of 2021 and 2020, respectively. See Note 4 for information on the fair value of unsettled forward foreign-exchange contracts at the end of 2021 and 2020.

The unrealized gains or losses recognized in interest income and other, net in the accompanying consolidated statements of income relating to the net changes in the fair value of unsettled forward foreign-exchange contracts were immaterial in 2021, 2020 and 2019.

The Company is exposed to fluctuations in prices for energy, particularly electricity and natural gas, and other commodity products used in retail and manufacturing operations, which it seeks to partially mitigate through the use of fixed-price contracts for certain of its warehouses and other facilities, primarily in the

U.S. and Canada. The Company also enters into variable-priced contracts for some purchases of natural gas, in addition to fuel for its gas stations, on an index basis. These contracts meet the characteristics of derivative instruments, but generally qualify for the "normal purchases and normal sales" exception under authoritative guidance and require no mark-to-market adjustment.

Foreign Currency

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

The Company recognizes foreign-currency transaction gains and losses related to revaluing or settling monetary assets and liabilities denominated in currencies other than the functional currency in interest income and other, net in the consolidated statements of income. Generally, these include the U.S. dollar cash and cash equivalents and the U.S. dollar payables of consolidated subsidiaries revalued to their functional currency. Also included are realized foreign-currency gains or losses from settlements of forward foreign-exchange contracts. These items were immaterial in 2021, 2020, and 2019.

Revenue Recognition

The Company adopted Accounting Standards Update (ASU) 2014-09 in 2019, which provided for changes in the recognition of revenue from contracts with customers. The Company recognizes sales for the amount of consideration collected from the member, which includes gross shipping fees where applicable, and is net of sales taxes collected and remitted to government agencies and member returns. The Company reserves for estimated returns based on historical trends in merchandise returns and reduces sales and merchandise costs accordingly. The Company records, on a gross basis, a refund liability and an asset for recovery, which are included in other current liabilities and other current assets, respectively, in the consolidated balance sheets.

The Company offers merchandise in the following core merchandise categories: foods and sundries, non-foods (previously hardlines and softlines), and fresh foods. The Company also provides expanded products and services through warehouse ancillary and other businesses. The majority of revenue from merchandise sales is recognized at the point of sale. Revenue generated through e-commerce or special orders is generally recognized upon shipment to the member. For merchandise shipped directly to the member, shipping and handling costs are expensed as incurred as fulfillment costs and included in merchandise costs in the consolidated statements of income. In certain ancillary businesses, revenue is deferred until the member picks up merchandise at the warehouse. Deferred sales are included in other current liabilities in the consolidated balance sheets.

The Company is the principal for the majority of its transactions and recognizes revenue on a gross basis. The Company is the principal when it has control of the merchandise or service before it is transferred to the member, which generally is established when Costco is primarily responsible for merchandising decisions, maintains the relationship with the member, including assurance of member service and satisfaction, and has pricing discretion.

The Company accounts for membership fee revenue, net of refunds, on a deferred basis, ratably over the one-year membership period. Deferred membership fees at the end of 2021 and 2020 were $2,042 and $1,851, respectively.

In most countries, the Company's Executive members qualify for a 2% reward on qualified purchases, subject to an annual maximum value, which does not expire and can be redeemed only at Costco warehouses. The Company accounts for this reward as a reduction in sales, net of the estimated impact of non-redemptions (breakage), with the corresponding liability classified as accrued member rewards in the consolidated balance sheets. Estimated breakage is computed based on redemption data. For 2021, 2020, and 2019, the net reduction in sales was $2,047, $1,707, and $1,537 respectively.

The Company sells and otherwise provides proprietary shop cards that do not expire and are redeemable at the warehouse or online for merchandise or membership. Revenue from shop cards is recognized upon redemption, and estimated breakage is recognized based on redemption data. The Company accounts for outstanding shop card balances as a shop card liability, net of estimated breakage. Shop card liabilities are included in other current liabilities in the consolidated balance sheets.

Citibank, N.A. became the exclusive issuer of co-branded credit cards to U.S. members in June 2016. The Company receives various forms of consideration, including a royalty on purchases made on the card outside of Costco, a portion of which, after giving rise to estimated breakage, is used to fund the rebate that cardholders receive. The rebates are issued in February and expire on December 31. Breakage is estimated based on redemption data.

Merchandise Costs

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

Vendor Consideration

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

Selling, General and Administrative Expenses

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

Retirement Plans

The Company's 401(k) retirement plan is available to all U.S. employees over the age of 18 who have completed 90 days of employment. The plan allows participants to make wage deferral contributions, a portion of which the Company matches. In addition, the Company provides each eligible participant an annual discretionary contribution. The Company also has a defined contribution plan for Canadian employees and contributes a percentage of each employee's wages. Certain subsidiaries in the Company's Other International operations have defined benefit and defined contribution plans, which are not material. Amounts expensed under all plans were $748, $676, and $614 for 2021, 2020, and 2019, respectively, and are predominantly included in selling, general and administrative expenses in the consolidated statements of income.

Stock-Based Compensation

RSUs granted to employees generally vest over five years and allow for quarterly vesting of the pro-rata number of stock-based awards that would vest on the next anniversary of the grant date in the event of retirement or voluntary termination. Actual forfeitures are recognized as they occur.

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

Stock-based compensation expense is predominantly included in selling, general and administrative expenses in the consolidated statements of income. Certain stock-based compensation costs are capitalized or included in the cost of merchandise. See Note 8 for additional information on the Company's stock-based compensation plans.

Preopening Expenses

Preopening expenses include startup costs for new warehouses and relocations, developments in new international markets, new manufacturing and distribution facilities, and expansions at existing warehouses and corporate facilities and are expensed as incurred.

Income Taxes

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

The timing and amounts of deductible and taxable items and the probability of sustaining uncertain tax positions requires significant judgment. The benefits of uncertain tax positions are recorded in the Company's consolidated financial statements only after determining a more-likely-than-not probability that the uncertain tax positions will withstand challenge from tax authorities. When facts and circumstances change, the Company reassesses these probabilities and records any changes as appropriate.

Net Income per Common Share Attributable to Costco

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

Stock Repurchase Programs

Repurchased shares of common stock are retired, in accordance with the Washington Business Corporation Act. The par value of repurchased shares is deducted from common stock and the excess repurchase price over par value is deducted by allocation to additional paid-in capital and retained earnings. The amount allocated to additional paid-in capital is the current value of additional paid-in capital per share outstanding and is applied to the number of shares repurchased. Any remaining amount is allocated to retained earnings. See Note 7 for additional information.

Note 2—Acquisition of Innovel

On March 17, 2020, the Company acquired Innovel Solutions for $999, using existing cash and cash equivalents. Innovel (now known as Costco Wholesale Logistics or CWL) provides final-mile delivery, installation and white-glove capabilities for big and bulky products in the United States and Puerto Rico. Its financial results have been included in the Company's consolidated financial statements from the date of acquisition.

The net purchase price of $999 has been allocated to the tangible and intangible assets of $294 and liabilities assumed of $235, based on fair values on the acquisition date. The remaining unallocated net purchase price of $940 was recorded as goodwill. Goodwill represents the acquisition's benefits to the Company, which include the ability to serve more members and improve delivery times, enabling growth in certain segments of our U.S. e-commerce operations. The Company assigned this goodwill, which is deductible for tax purposes, to reporting units within the U.S. segment. Changes to the purchase price allocation originally recorded in 2020 were not material.

Note 3—Investments

The Company's investments were as follows:

2021:	Cost Basis	Unrealized Gains, Net	Recorded Basis
Available-for-sale:			
Government and agency securities	$ 375	$ 6	$ 381
Held-to-maturity:			
Certificates of deposit	536	—	536
Total short-term investments	$ 911	$ 6	$ 917

2020:	Cost Basis	Unrealized Gains, Net	Recorded Basis
Available-for-sale:			
Government and agency securities	$ 436	$ 12	$ 448
Held-to-maturity:			
Certificates of deposit	580	—	580
Total short-term investments	$ 1,016	$ 12	$ 1,028

Gross unrecognized holding gains and losses on available-for-sale securities were not material for the years ended August 29, 2021, and August 30, 2020. At the end of 2021 and 2020, there were no available-for-sale securities in a continuous unrealized-loss position. There were no sales of available-for-sale securities during 2021 or 2020.

The maturities of available-for-sale and held-to-maturity securities at the end of 2021 are as follows:

	Available-For-Sale		
	Cost Basis	Fair Value	Held-To-Maturity
Due in one year or less	$ 190	$ 191	$ 536
Due after one year through five years	185	190	—
Total	$ 375	$ 381	$ 536

Note 4—Fair Value Measurement

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The table below presents information regarding the Company’s financial assets and financial liabilities that are measured at fair value on a recurring basis and indicate the level within the hierarchy reflecting the valuation techniques utilized to determine such fair value.

	Level 2	
	2021	2020
Investment in government and agency securities[1]	$ 393	$ 508
Forward foreign-exchange contracts, in asset position[2]	17	1
Forward foreign-exchange contracts, in (liability) position[2]	(2)	(21)
Total	$ 408	$ 488

(1) At August 29, 2021, $12 cash and cash equivalents and $381 short-term investments are included in the accompanying consolidated balance sheets. At August 30, 2020, $60 cash and cash equivalents and $448 short-term investments are included in the consolidated balance sheets.

(2) The asset and the liability values are included in other current assets and other current liabilities, respectively, in the consolidated balance sheets.

At August 29, 2021, and August 30, 2020, the Company did not hold any Level 1 or 3 financial assets or liabilities that were measured at fair value on a recurring basis. There were no transfers between levels during 2021 or 2020.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Assets and liabilities recognized and disclosed at fair value on a nonrecurring basis include items such as financial assets measured at amortized cost and long-lived nonfinancial assets. These assets are measured at fair value if determined to be impaired. Fair value adjustments to nonfinancial assets during 2021 were immaterial and there were no fair value adjustments to these items during 2020.

Note 5—Debt

Short-Term Borrowings

The Company maintains various short-term bank credit facilities, with a borrowing capacity of $1,050 and $967, in 2021 and 2020, respectively. Borrowings on these short-term facilities were immaterial during 2021 and 2020. Short-term borrowings outstanding were $41 at the end of 2021. There were no outstanding balances at the end of 2020.

Long-Term Debt

The Company's long-term debt consists primarily of Senior Notes, described below. The Company at its option may redeem the Senior Notes at any time, in whole or in part, at a redemption price plus accrued interest. The redemption price is equal to the greater of 100% of the principal amount or the sum of the present value of the remaining scheduled payments of principal and interest to maturity. Additionally, upon certain events, the holder has the right to require the Company to purchase this security at a price of 101% of the principal amount plus accrued and unpaid interest to the date of the event. Interest on all outstanding long-term debt is payable semi-annually. The estimated fair value of Senior Notes is valued using Level 2 inputs.

Other long-term debt consists of Guaranteed Senior Notes issued by the Company's Japanese subsidiary, valued using Level 3 inputs. In June 2021, the Japanese subsidiary repaid approximately $94 of its Guaranteed Senior Notes.

In April 2020, the Company issued $4,000 in aggregate principal amount of Senior Notes as follows: $1,250 of 1.375% due June 2027; $1,750 of 1.600% due April 2030; and $1,000 of 1.750% due April 2032. In May 2020, a portion of the proceeds from the issuance were used to repay, prior to maturity, the outstanding $1,000 and $500 principal balances and interest on the 2.150% and 2.250% Senior Notes, respectively. The early redemption resulted in a $36 charge which was recorded in interest income and other, net in 2020.

At the end of 2021 and 2020, the fair value of the Company's long-term debt, including the current portion, was approximately $7,692 and $7,987, respectively. The carrying value of long-term debt consisted of the following:

	2021	2020
2.300% Senior Notes due May 2022	$ 800	$ 800
2.750% Senior Notes due May 2024	1,000	1,000
3.000% Senior Notes due May 2027	1,000	1,000
1.375% Senior Notes due June 2027	1,250	1,250
1.600% Senior Notes due April 2030	1,750	1,750
1.750% Senior Notes due April 2032	1,000	1,000
Other long-term debt	731	857
Total long-term debt	7,531	7,657
Less unamortized debt discounts and issuance costs	40	48
Less current portion[(1)]	799	95
Long-term debt, excluding current portion	$ 6,692	$ 7,514

(1) Net of unamortized debt discounts and issuance costs.

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

2022	$ 800
2023	91
2024	1,109
2025	136
2026	100
Thereafter	5,295
Total	$ 7,531

Note 6—Leases

The tables below present information regarding the Company's lease assets and liabilities.

	2021	2020
Assets		
Operating lease right-of-use assets	$ 2,890	$ 2,788
Finance lease assets[1]	1,000	592
Total lease assets	$ 3,890	$ 3,380
Liabilities		
Current		
Operating lease liabilities[2]	$ 222	$ 231
Finance lease liabilities[2]	72	31
Long-term		
Operating lease liabilities	2,642	2,558
Finance lease liabilities[3]	980	657
Total lease liabilities	$ 3,916	$ 3,477

(1) Included in other long-term assets in the consolidated balance sheets.
(2) Included in other current liabilities in the consolidated balance sheets.
(3) Included in other long-term liabilities in the consolidated balance sheets.

	2021	2020
Weighted-average remaining lease term (years)		
Operating leases	21	21
Finance leases	22	20
Weighted-average discount rate		
Operating leases	2.16 %	2.23 %
Finance leases	4.91 %	6.34 %

The components of lease expense, excluding short-term lease costs and sublease income (which were not material), were as follows:

	2021	2020
Operating lease costs[1]	$ 296	$ 252
Finance lease costs:		
Amortization of lease assets[1]	50	31
Interest on lease liabilities[2]	37	33
Variable lease costs[3]	151	87
Total lease costs	$ 534	$ 403

(1) Included in selling, general and administrative expenses and merchandise costs in the consolidated statements of income.
(2) Included in interest expense in the consolidated statements of income.
(3) Included in selling, general and administrative expenses and merchandise costs in the consolidated statements of income.

Supplemental cash flow information related to leases was as follows:

	2021	2020
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows — operating leases	$ 282	$ 258
Operating cash flows — finance leases	37	33
Financing cash flows — finance leases	67	49
Leased assets obtained in exchange for operating lease liabilities	350	354
Leased assets obtained in exchange for finance lease liabilities	399	317

As of August 29, 2021, future minimum payments during the next five fiscal years and thereafter are as follows:

	Operating Leases[1]	Finance Leases
2022	$ 260	$ 107
2023	273	92
2024	232	87
2025	191	159
2026	192	74
Thereafter	2,507	1,070
Total[2]	3,655	1,589
Less amount representing interest	791	537
Present value of lease liabilities	$ 2,864	$ 1,052

(1) Operating lease payments have not been reduced by future sublease income of $99.

(2) Excludes $665 of lease payments for leases that have been signed but not commenced.

Note 7—Equity

Dividends

Cash dividends declared in 2021 totaled $12.98 per share, as compared to $2.70 per share in 2020. Dividends in 2021 included a special dividend of $10.00 per share, resulting in an aggregate payment of approximately $4,430. The Company's current quarterly dividend rate is $0.79 per share.

Stock Repurchase Programs

The Company's stock repurchase program is conducted under a $4,000 authorization by the Board of Directors, which expires in April 2023. As of the end of 2021, the remaining amount available under the approved plan was $3,250. The following table summarizes the Company’s stock repurchase activity:

	Shares Repurchased (000’s)	Average Price per Share	Total Cost
2021	1,358	$ 364.39	$ 495
2020	643	308.45	198
2019	1,097	225.16	247

These amounts may differ from repurchases of common stock in the consolidated statements of cash flows due to changes in unsettled stock repurchases at the end of each fiscal year. Purchases are made from time to time, as conditions warrant, in the open market or in block purchases and pursuant to plans under SEC Rule 10b5-1.

Note 8—Stock-Based Compensation

The Company grants stock-based compensation, primarily to employees and non-employee directors. Grants to all executive officers are generally performance-based. Through a series of shareholder approvals, there have been amended and restated plans and new provisions implemented by the Company. RSUs are subject to quarterly vesting upon retirement or voluntary termination. Employees who attain at least 25 years of service with the Company receive shares under accelerated vesting provisions on the annual vesting date. The 2019 Incentive Plan authorized the issuance of 17,500,000 shares (10,000,000 RSUs) of common stock for future grants, plus the remaining shares that were available for grant and the future forfeited shares from grants under the previous plan, up to a maximum aggregate of 27,800,000 shares (15,885,000 RSUs). The Company issues new shares of common stock upon vesting of RSUs. Shares for vested RSUs are generally delivered to participants annually, net of shares withheld for taxes.

In conjunction with a special cash dividend paid in the second quarter of 2021, and in accordance with the plans, the number of shares subject to outstanding RSUs was increased on the dividend record date to preserve their value. They were adjusted by multiplying the number of outstanding shares by a factor of 1.019 (rounded up to a whole share), representing the ratio of the Nasdaq closing price of $391.77 on November 30, 2020, which was the last trading day immediately prior to the ex-dividend date, to the Nasdaq opening price of $384.50 on the ex-dividend date, December 1, 2020. The outstanding RSUs increased by approximately 94,000. The adjustment did not result in additional stock-based compensation expense, as the fair value of the awards did not change. As further required by the plans, the maximum number of shares issuable was proportionally adjusted, which resulted in an additional 220,000 RSU shares available to be granted.

Summary of Restricted Stock Unit Activity

RSUs granted to employees and to non-employee directors generally vest over five and three years, respectively. Additionally, the terms of the RSUs, including performance-based awards, provide for accelerated vesting for employees and non-employee directors who have attained 25 or more and five or more years of service with the Company, respectively. Recipients are not entitled to vote or receive dividends on unvested and undelivered shares. At the end of 2021, 12,001,000 shares were available to be granted as RSUs under the 2019 Incentive Plan.

The following awards were outstanding at the end of 2021:

- 4,218,000 time-based RSUs, which vest upon continued employment or service over specified periods of time; and
- 131,000 performance-based RSUs, of which 104,000 were granted to executive officers subject to the determination of the attainment of performance targets for 2021. This determination occurred in September 2021, at which time at least 33% of the units vested, as a result of the long service of all executive officers. The remaining awards vest upon continued employment over specified periods of time.

The following table summarizes RSU transactions during 2021:

	Number of Units (in 000's)	Weighted-Average Grant Date Fair Value
Outstanding at the end of 2020	5,174	$ 207.55
Granted	1,982	369.15
Vested and delivered	(2,764)	235.64
Forfeited	(137)	253.53
Special cash dividend	94	N/A
Outstanding at the end of 2021	4,349	$ 257.88

The weighted-average grant date fair value of RSUs granted was $369.15, $294.08, and $224.00 in 2021, 2020, and 2019, respectively. The remaining unrecognized compensation cost related to non-vested RSUs at the end of 2021 was $728 and the weighted-average period of time over which this cost will be recognized is 1.6 years. Included in the outstanding balance at the end of 2021 were approximately 1,516,000 RSUs vested but not yet delivered.

Summary of Stock-Based Compensation

The following table summarizes stock-based compensation expense and the related tax benefits:

	2021	2020	2019
Stock-based compensation expense	$ 665	$ 619	$ 595
Less recognized income tax benefit	140	128	128
Stock-based compensation expense, net	$ 525	$ 491	$ 467

Note 9— Taxes

Income Taxes

Income before income taxes is comprised of the following:

	2021	2020	2019
Domestic	$ 4,931	$ 4,204	$ 3,591
Foreign	1,749	1,163	1,174
Total	$ 6,680	$ 5,367	$ 4,765

The provisions for income taxes are as follows:

	2021	2020	2019
Federal:			
Current	$ 718	$ 616	$ 328
Deferred	84	77	222
Total federal	802	693	550
State:			
Current	265	230	178
Deferred	11	8	26
Total state	276	238	204
Foreign:			
Current	557	372	405
Deferred	(34)	5	(98)
Total foreign	523	377	307
Total provision for income taxes	$ 1,601	$ 1,308	$ 1,061

Except for certain provisions, the Tax Cuts and Jobs Act (2017 Tax Act) was effective for tax years beginning on or after January 1, 2018. Most provisions became effective for the Company for 2019, including limitations on the ability to claim foreign tax credits, repeal of the domestic manufacturing deduction, and limitations on certain business deductions. Provisions with significant impacts that were effective starting in the second quarter of 2018 and throughout 2019 included: a lower U.S. federal income tax rate, remeasurement of certain net deferred tax liabilities, and a transition tax on deemed repatriation of certain foreign earnings. The lower U.S. tax rate of 21.0% was effective for all of 2021, 2020, and 2019.

The reconciliation between the statutory tax rate and the effective rate for 2021, 2020, and 2019 is as follows:

	2021		2020		2019	
Federal taxes at statutory rate	$ 1,403	21.0 %	$ 1,127	21.0 %	$ 1,001	21.0 %
State taxes, net	243	3.6	190	3.6	171	3.6
Foreign taxes, net	92	1.4	92	1.7	(1)	—
Employee stock ownership plan (ESOP)	(91)	(1.3)	(24)	(0.5)	(18)	(0.4)
2017 Tax Act	—	—	—	—	(123)	(2.6)
Other	(46)	(0.7)	(77)	(1.4)	31	0.7
Total	$ 1,601	24.0 %	$ 1,308	24.4 %	$ 1,061	22.3 %

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During 2019, the Company recognized net tax benefits of $123 related to the 2017 Tax Act. This benefit included $105 related to U.S. taxation of deemed foreign dividends, partially offset by losses of current year foreign tax credits.

The Company recognized total net tax benefits of $163, $81 and $221 in 2021, 2020 and 2019, respectively. These include benefits of $75, $77 and $59, respectively, related to the stock-based compensation accounting standard adopted in 2018, in addition to the impacts of the 2017 Tax Act noted above. During 2021, there was a net tax benefit of $70 related to the portion of the special dividend paid through our 401(k) plan.

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

	2021	2020
Deferred tax assets:		
Equity compensation	$ 72	$ 80
Deferred income/membership fees	161	144
Foreign tax credit carry forward	146	101
Operating lease liabilities	769	832
Accrued liabilities and reserves	681	639
Other	62	—
Total deferred tax assets	1,891	1,796
Valuation allowance	(214)	(105)
Total net deferred tax assets	1,677	1,691
Deferred tax liabilities:		
Property and equipment	(935)	(800)
Merchandise inventories	(216)	(228)
Operating lease right-of-use assets	(744)	(801)
Foreign branch deferreds	(92)	(81)
Other	—	(40)
Total deferred tax liabilities	(1,987)	(1,950)
Net deferred tax liabilities	$ (310)	$ (259)

The deferred tax accounts at the end of 2021 and 2020 include deferred income tax assets of $444 and $406, respectively, included in other long-term assets; and deferred income tax liabilities of $754 and $665, respectively, included in other long-term liabilities.

In 2021 and 2020, the Company had valuation allowances of $214 and $105, respectively, primarily related to foreign tax credits that the Company believes will not be realized due to carry forward limitations. The foreign tax credit carry forwards are set to expire beginning in fiscal 2030.

The Company no longer considers fiscal year earnings of non-U.S. consolidated subsidiaries after 2017 to be indefinitely reinvested (other than China) and has recorded the estimated incremental foreign withholding taxes (net of available foreign tax credits) and state income taxes payable assuming a hypothetical repatriation to the U.S. The Company continues to consider undistributed earnings of certain non-U.S. consolidated subsidiaries, which totaled $3,070, to be indefinitely reinvested and has not provided for withholding or state taxes.

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A reconciliation of the beginning and ending amount of gross unrecognized tax benefits for 2021 and 2020 is as follows:

	2021	2020
Gross unrecognized tax benefit at beginning of year	$ 30	$ 27
Gross increases—current year tax positions	2	1
Gross increases—tax positions in prior years	2	8
Gross decreases—tax positions in prior years	—	(3)
Lapse of statute of limitations	(1)	(3)
Gross unrecognized tax benefit at end of year	$ 33	$ 30

The gross unrecognized tax benefit includes tax positions for which the ultimate deductibility is highly certain but there is uncertainty about the timing of such deductibility. At the end of 2021 and 2020, these amounts were immaterial. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of these tax positions would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority. The total amount of such unrecognized tax benefits that if recognized would favorably affect the effective income tax rate in future periods is $30 and $28 at the end of 2021 and 2020, respectively.

Accrued interest and penalties related to income tax matters are classified as a component of income tax expense. Accrued interest and penalties recognized during 2021 and 2020, and accrued at the end of each respective period were not material.

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

The Company files income tax returns in the United States, various state and local jurisdictions, in Canada, and in several other foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state or local examination for years before fiscal 2017. The Company is currently subject to examination in California for fiscal years 2013 to present.

Other Taxes

The Company is subject to multiple examinations for value added, sales-based, payroll, product, import or other non-income taxes in various jurisdictions. In certain cases, the Company has received assessments from the authorities. In the fourth quarter of 2020, the Company reached an agreement on a product tax audit resulting in a benefit of $84. The Company recorded a charge of $123 in 2019 regarding this matter. Other possible losses or range of possible losses associated with these examinations are either immaterial or an estimate of the possible loss or range of loss cannot be made at this time. If certain matters or a group of matters were to be decided adversely to the Company, it could result in a charge that might be material to the results of an individual fiscal quarter or year.

Note 10—Net Income per Common and Common Equivalent Share

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

	2021	2020	2019
Net income attributable to Costco	$ 5,007	$ 4,002	$ 3,659
Weighted average basic shares	443,089	442,297	439,755
RSUs	1,257	1,604	3,168
Weighted average diluted shares	444,346	443,901	442,923

Note 11—Commitments and Contingencies

Legal Proceedings

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

The Company is a defendant in an action commenced in August 2013 under the California Labor Code Private Attorneys General Act (PAGA) alleging violation of California Wage Order 7-2001 for failing to provide seating to employees who work at entrance and exit doors in California warehouses. *Canela v. Costco Wholesale Corp., et al.* (Case No. 2013-1-CV-248813; Santa Clara Superior Court). The complaint seeks relief under the California Labor Code, including civil penalties and attorneys' fees. The Company filed an answer denying the material allegations of the complaint.

In December 2018, a depot employee raised similar claims, alleging that depot employees in California did not receive suitable seating or reasonably comfortable workplace temperature conditions. *Lane v. Costco Wholesale Corp.* (Case No. CIVDS 1908816; San Bernardino Superior Court). The Company filed an answer denying the material allegations of the complaint. In October 2019, the parties reached an agreement to settle for an immaterial amount the seating claims on a representative basis, which received court approval in February 2020. The workplace temperature claims continue in litigation.

In January 2019, a former seasonal employee filed a class action, alleging failure to provide California seasonal employees meal and rest breaks, proper wage statements, and appropriate wages. *Jadan v. Costco Wholesale Corp.* (Case No. 19-CV-340438; Santa Clara Superior Court). The complaint seeks relief under the California Labor Code, including civil penalties and attorneys' fees. In October 2019, the parties reached an agreement on a class settlement for an immaterial amount, which received court approval in January 2021.

In March 2019, employees filed a class action against the Company alleging claims under California law for failure to pay overtime, to provide meal and rest periods and itemized wage statements, to timely pay wages due to terminating employees, to pay minimum wages, and for unfair business practices. Relief is sought under the California Labor Code, including civil penalties and attorneys' fees. *Nevarez v. Costco Wholesale Corp.* (Case No. 2:19-cv-03454; C.D. Cal.). The Company filed an answer denying the material allegations of the complaint. In December 2019, the court issued an order denying class certification. In January 2020, the plaintiffs dismissed their Labor Code claims without prejudice, and the court remanded the action to state court. The remand was appealed; the appeal is in abeyance due to a pending settlement for an immaterial amount that was agreed upon in February 2021. The preliminary approval hearing of the settlement is scheduled for October 2021.

In May 2019, an employee filed a class action against the Company alleging claims under California law for failure to pay overtime, to provide itemized wage statements, to timely pay wages due to terminating employees, to pay minimum wages, and for unfair business practices. *Rough v. Costco Wholesale Corp*. (Case No. 2:19-cv-01340; E.D. Cal.). Relief is sought under the California Labor Code, including civil penalties and attorneys' fees. The Company has moved for partial summary judgement, and the parties have filed competing motions regarding class certification. In August 2019, the plaintiff filed a companion case in state court seeking penalties under PAGA. *Rough v. Costco Wholesale Corp.* (Case No. FCS053454; Sonoma County Superior Court). Relief is sought under the California Labor Code, including civil penalties and attorneys' fees. The state court action has been stayed pending resolution of the federal action.

In June 2019, an employee filed a class action against the Company alleging claims under California law for failure to pay overtime, to provide meal and rest periods, itemized wage statements, to timely pay wages due to terminating employees, to pay minimum wages, and for unfair business practices. *Martinez v. Costco Wholesale Corp*. (Case No. 3:19-cv-05624-EMC; N.D. Cal.). The Company filed an answer denying the material allegations of the complaint. In June 2021, the plaintiff agreed to dismiss his claims for failure to provide meal and rest breaks and to pay minimum wages. In July 2021, the parties reached an agreement settling for an immaterial amount the remaining claim and related derivative claims.

In April 2020, an employee, alleging underpayment of sick pay, filed a class and representative action against the Company, alleging claims under California law for failure to pay all wages at termination and for Labor Code penalties under PAGA. *Kristy v. Costco Wholesale Corp.* (Case No. 5:20-cv-04119; N.D. Cal.). The case was stayed due to the plaintiff's bankruptcy, and his individual claim was settled for an immaterial amount. A request for dismissal of the class and representative action is pending.

In July 2020, an employee filed an action under PAGA on behalf of all California non-exempt employees alleging violations of California Labor Code provisions regarding meal and rest periods, minimum wage, overtime, wage statements, reimbursement of expenses, and payment of wages at termination. *Schwab v. Costco Wholesale Corporation* (Case No. 37-2020-00023551-CU-OE-CTL; San Diego County Superior Court). In August 2020, the Company filed a motion to strike portions of the complaint, which was denied, and an answer has been filed denying the material allegations of the complaint.

In December 2020, a former employee filed suit against the Company asserting collective and class claims on behalf of non-exempt employees under the Fair Labor Standards Act and New York Labor Law for failure to pay for all hours worked on a weekly basis and failure to provide proper wage statements and notices. The plaintiff also asserts individual retaliation claims. *Cappadora v. Costco Wholesale Corp.* (Case No. 1:20-cv-06067; E.D.N.Y.). An amended complaint was filed, and the Company has denied the material allegations of the amended complaint. In August 2021, a former employee filed a similar suit, asserting collective and class claims on behalf of non-exempt employees under the FLSA and New York law. *Umadat v. Costco Wholesale Corp.* (Case No. 2:21-cv-4814; E.D.N.Y.). The Company has not yet responded to the complaint.

In February 2021, a former employee filed a class action against the Company alleging violations of California Labor Code regarding payment of wages, meal and rest periods, wage statements, reimbursement of expenses, payment of final wages to terminated employees, and for unfair business practices. *Edwards v. Costco Wholesale Corp.* (Case No. 5:21-cv-00716: C.D. Cal.). In May 2021, the Company filed a motion to dismiss the complaint, which was granted with leave to amend. In June 2021, the plaintiff filed an amended complaint, which the Company moved to dismiss later that month. The court granted the motion in part in July 2021 with leave to amend. In August 2021, the plaintiff filed a second amended complaint and filed a separate representative action under PAGA asserting the same Labor Code claims and seeking civil penalties and attorneys' fees. The Company has filed an answer to the second amended class action complaint denying the material allegations.

In July 2021, a former temporary staffing employee filed a class action against the Company and a staffing company alleging violations of the California Labor Code regarding payment of wages, meal and rest periods, wage statements, the timeliness of wages and final wages, and for unfair business practices. *Dimas v. Costco Wholesale Corp.* (Case No. STK-CV-UOE-2021-0006024; San Joaquin Superior Court). The Company has not yet responded to the complaint.

Beginning in December 2017, the United States Judicial Panel on Multidistrict Litigation has consolidated numerous cases concerning the impacts of opioid abuses filed against various defendants by counties, cities, hospitals, Native American tribes, third-party payors, and others. *In re National Prescription Opiate Litigation* (MDL No. 2804) (N.D. Ohio). Included are cases that name the Company, including actions filed by counties and cities in Michigan, New Jersey, Oregon, Virginia and South Carolina, a third-party payor in Ohio, and a hospital in Texas, class actions filed on behalf of infants born with opioid-related medical conditions in 40 states, and class actions and individual actions filed on behalf of individuals seeking to recover alleged increased insurance costs associated with opioid abuse in 43 states and American Samoa. Claims against the Company in state courts in New Jersey, Oklahoma, Utah, and Arizona have been dismissed. The Company is defending all of the pending matters.

The Company and its CEO and CFO were defendants in putative class actions brought on behalf of shareholders who acquired Company stock between June 6 and October 25, 2018. *Johnson v. Costco Wholesale Corp., et al.* (W.D. Wash.; filed Nov. 5, 2018); *Chen v. Costco Wholesale Corp., et al.* (W.D. Wash.; filed Dec. 11, 2018). The complaints alleged violations of the federal securities laws stemming from the Company’s disclosures concerning internal control over financial reporting. A consolidated amended complaint was filed on April 16, 2019. On November 26, 2019, the court entered an order dismissing the consolidated amended complaint and granting the plaintiffs leave to file a further amended complaint. A further amended complaint was filed on March 9, which the court dismissed with prejudice on August 19, 2020. On July 20, 2021, the Ninth Circuit affirmed the dismissal.

Members of the Board of Directors, one other individual, and the Company were defendants in a shareholder derivative action related to the internal controls and related disclosures identified in the putative class actions, alleging that the individual defendants breached their fiduciary duties. *Wedekind v. Hamilton James, Susan Decker, Kenneth Denman, Richard Galanti, Craig Jelinek, Richard Libenson, John Meisenbach, Charles Munger, Jeffrey Raikes, John Stanton, Mary Agnes Wilderotter, and Costco Wholesale Corp.* (W.D. Wash.; filed Dec. 11, 2018). Similar actions were filed in King County Superior Court on February 20, 2019, *Elliott v. Hamilton James, Susan Decker, Kenneth Denman, Richard Galanti, Craig Jelinek, Richard Libenson, John Meisenbach, Charles Munger, Jeffrey Raikes, John Stanton, Mary Agnes Wilderotter, and Costco Wholesale Corp.* (Case No. 19-2-04824-7), April 16, 2019, *Brad Shuman, et ano. v. Hamilton James, Susan Decker, Kenneth Denman, Richard Galanti, Craig Jelinek, John Meisenbach, Charles Munger, Jeffrey Raikes, John Stanton, Mary Agnes Wilderotter, and Costco Wholesale Corp.* (Case No. 19-2-10460-1), and June 12, 2019, *Rahul Modi v. Hamilton James, Susan Decker, Kenneth Denman, Richard Galanti, Craig Jelinek, John Meisenbach, Charles Munger, Jeffrey Raikes, John Stanton, Mary Agnes Wilderotter, and Costco Wholesale Corp.* (Case No. 19-2-15514-1). In light of the dismissal in Johnson noted above, the plaintiffs in the derivative actions agreed voluntarily to dismiss their complaints.

On June 23, 2020, a putative class action was filed against the Company, the “Board of Directors,” the “Costco Benefits Committee” and others under the Employee Retirement Income Security Act, in the United States District Court for the Eastern District of Wisconsin. *Dustin S. Soulek v. Costco Wholesale, et al.*, Case No. 1:20-cv-937. The class is alleged to be beneficiaries of the Costco 401(k) plan from June 23, 2014, and the claims are that the defendants breached their fiduciary duties in the operation and oversight of the plan. The complaint seeks injunctive relief, damages, interest, costs, and attorneys' fees. On September 11, 2020, the defendants filed a motion to dismiss the complaint, and on September 21 the plaintiffs filed an amended complaint, which the defendants have also moved to dismiss.

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

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Note 12—Segment Reporting

The Company is principally engaged in the operation of membership warehouses through wholly owned subsidiaries in the U.S., Canada, Mexico, Japan, U.K., Korea, Australia, Spain, Iceland, France, and China and through a majority-owned subsidiary in Taiwan. Reportable segments are largely based on management's organization of the operating segments for operational decisions and assessments of financial performance, which considers geographic locations. The material accounting policies of the segments are as described in Note 1. Inter-segment net sales and expenses have been eliminated in computing total revenue and operating income. Certain operating expenses, predominantly stock-based compensation, incurred on behalf of the Company's Canadian and Other International operations, are included in the U.S. operations because those costs generally come under the responsibility of U.S. management.

The following table provides information for the Company's reportable segments:

	United States Operations	Canadian Operations	Other International Operations	Total
2021				
Total revenue	$ 141,398	$ 27,298	$ 27,233	$ 195,929
Operating income	4,262	1,176	1,270	6,708
Depreciation and amortization	1,339	177	265	1,781
Additions to property and equipment	2,612	272	704	3,588
Property and equipment, net	15,993	2,317	5,182	23,492
Total assets	39,589	5,962	13,717	59,268
2020				
Total revenue	$ 122,142	$ 22,434	$ 22,185	$ 166,761
Operating income	3,633	860	942	5,435
Depreciation and amortization	1,248	155	242	1,645
Additions to property and equipment	2,060	258	492	2,810
Property and equipment, net	14,916	2,172	4,719	21,807
Total assets	38,366	5,270	11,920	55,556
2019				
Total revenue	$ 111,751	$ 21,366	$ 19,586	$ 152,703
Operating income	3,063	924	750	4,737
Depreciation and amortization	1,126	143	223	1,492
Additions to property and equipment	2,186	303	509	2,998
Property and equipment, net	14,367	2,044	4,479	20,890
Total assets	32,162	4,369	8,869	45,400

Disaggregated Revenue

The following table summarizes net sales by merchandise category; sales from e-commerce websites and business centers have been allocated to their respective merchandise categories:

	2021	2020	2019
Foods and Sundries	$ 77,277	$ 68,659	$ 59,672
Non-Foods	55,966	44,807	41,160
Fresh Foods	27,183	23,204	19,948
Warehouse Ancillary and Other Businesses	31,626	26,550	28,571
Total net sales	$ 192,052	$ 163,220	$ 149,351

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Item 9—Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A—Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended) are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the SEC and to ensure that information required to be disclosed is accumulated and communicated to management, including our principal executive and financial officers, to allow timely decisions regarding disclosure. The Chief Executive Officer and the Chief Financial Officer, with assistance from other members of management, have reviewed the effectiveness of our disclosure controls and procedures as of August 29, 2021 and, based on their evaluation, have concluded that the disclosure controls and procedures were effective as of such date.

Management's Annual Report on Internal Control Over Financial Reporting

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

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

Under the supervision of and with the participation of our management, we assessed the effectiveness of our internal control over financial reporting as of August 29, 2021, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control—Integrated Framework (2013).

Based on its assessment, management has concluded that our internal control over financial reporting was effective as of August 29, 2021. The attestation of KPMG LLP, our independent registered public accounting firm, on the effectiveness of our internal control over financial reporting is included with the consolidated financial statements in Item 8 of this Report.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) or 15d-15(f) of the Exchange Act) that occurred during the fourth quarter of 2021 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9B—Other Information

None.

PART III

Item 10—Directors, Executive Officers and Corporate Governance

Information relating to the availability of our code of ethics for senior financial officers and a list of our executive officers appear in Part I, Item 1 of this Report. The information required by this Item concerning our directors and nominees for director is incorporated herein by reference to the sections entitled "Proposal 1: Election of Directors," "Directors" and "Committees of the Board" in Costco's Proxy Statement for its 2022 annual meeting of shareholders, which will be filed with the SEC within 120 days of the end of our fiscal year ("Proxy Statement").

Item 11—Executive Compensation

The information required by this Item is incorporated herein by reference to the sections entitled "Compensation of Directors," "Executive Compensation," and "Compensation Discussion and Analysis" in Costco's Proxy Statement.

Item 12—Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item is incorporated herein by reference to the section entitled "Principal Shareholders" and "Equity Compensation Plan Information" in Costco's Proxy Statement.

Item 13—Certain Relationships and Related Transactions, and Director Independence

The information required by this Item is incorporated herein by reference to the sections entitled "Proposal 1: Election of Directors," "Directors," "Committees of the Board," "Shareholder Communications to the Board," "Meeting Attendance," "Report of the Compensation Committee of the Board of Directors," "Certain Relationships and Transactions" and "Report of the Audit Committee" in Costco's Proxy Statement.

Item 14—Principal Accounting Fees and Services

The information required by this Item is incorporated herein by reference to the sections entitled "Independent Public Accountants" in Costco's Proxy Statement.

PART IV

Item 15—Exhibits, Financial Statement Schedules

(a) Documents filed as part of this report are as follows:

1. Financial Statements:

   See the listing of Financial Statements included as a part of this Form 10-K in Item 8 of Part II.

2. Financial Statement Schedules:

   All schedules have been omitted because the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements, including the notes thereto.

(b) Exhibits: The required exhibits are filed as part of this Annual Report on Form 10-K or are incorporated herein by reference.

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference		
			Form	Period Ended	Filing Date
3.1	Articles of Incorporation as amended of Costco Wholesale Corporation		10-Q	2/16/2020	3/12/2020
3.2	Bylaws as amended of Costco Wholesale Corporation		8-K		1/29/2020
3.2.1	Amendments to Sections 3.3, 3.4, and 3.6 of the Bylaws of Costco Wholesale Corporation (to be effective and first apply with respect to the Company's 2022 Annual Meeting of Shareholders)		8-K		9/16/2020
4.1	First Supplemental Indenture between Costco Wholesale Corporation and U.S. Bank National Association, as Trustee, dated as of March 20, 2002 (incorporated by reference to Exhibits 4.1 and 4.2 to the Company's Current Report on the Form 8-K filed on March 25, 2002)		8-K		3/25/2002
4.2	Form of 1.375% Senior Notes due June 20, 2027		8-K		4/17/2020
4.3	Form of 1.600% Senior Notes due April 20, 2030		8-K		4/17/2020
4.4	Form of 1.750% Senior Notes due April 20, 2032		8-K		4/17/2020
4.5	Form of 2.300% Senior Notes due May 18, 2022		8-K		5/16/2017
4.6	Form of 2.750% Senior Notes due May 18, 2024		8-K		5/16/2017
4.7	Form of 3.000% Senior Notes due May 18, 2027		8-K		5/16/2017
4.8	Description of Common Stock		10-K	8/30/2020	10/7/2020
10.1*	Costco Wholesale Executive Health Plan		10-K	9/2/2012	10/19/2012
10.2*	2019 Incentive Plan		DEF 14		12/17/2019
10.3*	Seventh Restated 2002 Stock Incentive Plan		DEF 14A		12/19/2014
10.3.1*	2019 Stock Incentive Plan Restricted Stock Unit Award Agreement-Employee		10-Q	11/24/2019	12/23/2019
10.3.2*	2019 Stock Incentive Plan Restricted Stock Unit Award Agreement - Non-U.S. Employee		10-Q	11/24/2019	12/23/2019

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ended	Filing Date
10.3.3*	2019 Stock Incentive Plan Restricted Stock Unit Award Agreement-Non-Executive Director		10-Q	11/24/2019	12/23/2019
10.3.4*	2019 Stock Incentive Plan Letter Agreement for 2020 Performance-Based Restricted Stock Units-Executive		10-Q	11/24/2019	12/23/2019
10.4*	Fiscal 2021 Executive Bonus Plan		8-K		10/15/2020
10.5*	Executive Employment Agreement, effective January 1, 2017, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/20/2016	12/16/2016
10.5.1*	Extension of the Term of the Executive Employment Agreement, effective January 1, 2019, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/25/2018	12/20/2018
10.5.2*	Extension of the Term of the Executive Employment Agreement, effective January 1, 2020, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/24/2019	12/23/2019
10.5.3*	Extension of the Term of the Executive Employment Agreement, effective January 1, 2021, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/22/2020	12/16/2020
10.6	Form of Indemnification Agreement		14A		12/13/1999
10.7*	Deferred Compensation Plan		10-K	9/1/2013	10/16/2013
10.8**	Citibank, N.A. Co-Branded Credit Card Agreement		10-Q/A	5/10/2015	8/31/2015
10.8.1**	First Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	11/22/2015	12/17/2015
10.8.2**	Second Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/14/2016	3/9/2016
10.8.3**	Third Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-K	8/28/2016	10/12/2016
10.8.4**	Fourth Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/18/2018	3/15/2018
10.8.5**	Fifth Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/17/2019	3/13/2019

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference		
			Form	Period Ended	Filing Date
10.8.6**	Sixth Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-K	9/1/2019	10/11/2019
10.8.7**	Seventh Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/14/2021	3/10/2021
21.1	Subsidiaries of the Company	x			
23.1	Consent of Independent Registered Public Accounting Firm	x			
31.1	Rule 13a – 14(a) Certifications	x			
32.1	Section 1350 Certifications	x			
101.INS	Inline XBRL Instance Document	x			
101.SCH	Inline XBRL Taxonomy Extension Schema Document	x			
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document	x			
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document	x			
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document	x			
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document	x			
104	Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101)	x			

* Management contract, compensatory plan or arrangement.
** Portions of this exhibit have been omitted under a confidential treatment order issued by the Securities and Exchange Commission.

(c) Financial Statement Schedules—None.

Item 16—Form 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

October 5, 2021

COSTCO WHOLESALE CORPORATION
(Registrant)

By /s/ RICHARD A. GALANTI
Richard A. Galanti
Executive Vice President, Chief Financial Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

October 5, 2021

By /s/ W. CRAIG JELINEK W. Craig Jelinek *President, Chief Executive Officer and Director*	By /s/ HAMILTON E. JAMES Hamilton E. James *Chairman of the Board*
By /s/ RICHARD A. GALANTI Richard A. Galanti *Executive Vice President, Chief Financial Officer and Director* *(Principal Financial Officer)*	By /s/ DANIEL M. HINES Daniel M. Hines *Senior Vice President and Corporate Controller* *(Principal Accounting Officer)*
By /s/ SUSAN L. DECKER Susan L. Decker *Director*	By /s/ KENNETH D. DENMAN Kenneth D. Denman *Director*
By /s/ SALLY JEWELL Sally Jewell *Director*	By /s/ CHARLES T. MUNGER Charles T. Munger *Director*
By /s/ JEFFREY S. RAIKES Jeffrey S. Raikes *Director*	By /s/ JOHN W. STANTON John W. Stanton *Director*
By /s/ MARY (MAGGIE) A. WILDEROTTER Mary (Maggie) A. Wilderotter *Director*	

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended August 30, 2020

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 0-20355

Costco Wholesale Corporation

(Exact name of registrant as specified in its charter)

Washington	**91-1223280**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

999 Lake Drive, Issaquah, WA 98027

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(425) 313-8100**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock, $.01 Par Value	COST	The NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	☒	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐
		Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant has filed a report on and attestation to its management's assessment of the effectiveness of its internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act (15 U.S.C. 7262(b)) by the registered public accounting firm that prepared or issued its audit report. ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ☐ No ☒

The aggregate market value of the voting stock held by non-affiliates of the registrant as of February 16, 2020 was $140,245,657,604.

The number of shares outstanding of the registrant's common stock as of September 29, 2020 was 441,228,027.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on January 21, 2021, are incorporated by reference into Part III of this Form 10-K.

COSTCO WHOLESALE CORPORATION
ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED AUGUST 30, 2020

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INFORMATION RELATING TO FORWARD LOOKING STATEMENTS

Certain statements contained in this Report constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. They include statements that address activities, events, conditions or developments that we expect or anticipate may occur in the future and may relate to such matters as sales growth, changes in comparable sales, cannibalization of existing locations by new openings, price or fee changes, earnings performance, earnings per share, stock-based compensation expense, warehouse openings and closures, capital spending, the effect of adopting certain accounting standards, future financial reporting, financing, margins, return on invested capital, strategic direction, expense controls, membership renewal rates, shopping frequency, litigation, and the demand for our products and services. Forward-looking statements may also be identified by the words “anticipate,” “believe,” “continue,” “could,” “estimate,” “expect,” “intend,” "likely," “may,” “might,” “plan,” “potential,” “predict,” “project,” “seek,” “should,” “target,” “will,” “would,” or similar expressions and the negatives of those terms. Such forward-looking statements involve risks and uncertainties that may cause actual events, results, or performance to differ materially from those indicated by such statements, including, without limitation, the factors set forth in the section titled “Item 1A-Risk Factors”, and other factors noted in the section titled “Item 7-Management's Discussion and Analysis of Financial Condition and Results of Operations” and in the consolidated financial statements and related notes in Item 8 of this Report. Forward-looking statements speak only as of the date they are made, and we do not undertake to update these statements, except as required by law.

PART I

Item 1—Business

Costco Wholesale Corporation and its subsidiaries (Costco or the Company) began operations in 1983, in Seattle, Washington. We are principally engaged in the operation of membership warehouses in the United States (U.S.) and Puerto Rico, Canada, United Kingdom (U.K.), Mexico, Japan, Korea, Australia, Spain, France, Iceland, China, and through a majority-owned subsidiary in Taiwan. Costco operated 795, 782, and 762 warehouses worldwide at August 30, 2020, September 1, 2019, and September 2, 2018, respectively. The Company operates e-commerce websites in the U.S., Canada, Mexico, U.K., Korea, Taiwan, Japan, and Australia. Our common stock trades on the NASDAQ Global Select Market, under the symbol “COST.”

We report on a 52/53-week fiscal year, consisting of thirteen four-week periods and ending on the Sunday nearest the end of August. The first three quarters consist of three periods each, and the fourth quarter consists of four periods (five weeks in the thirteenth period in a 53-week year). The material seasonal impact in our operations is increased net sales and earnings during the winter holiday season. References to 2020, 2019, and 2018 relate to the 52-week fiscal years ended August 30, 2020, September 1, 2019, and September 2, 2018, respectively.

General

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

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

Our average warehouse space is approximately 146,000 square feet, with newer units being slightly larger. Floor plans are designed for economy and efficiency in the use of selling space, the handling of merchandise, and the control of inventory. Because shoppers are attracted principally by the quality of merchandise and low prices, our warehouses are not elaborate. By strictly controlling the entrances and exits and using a membership format, we believe our inventory losses (shrinkage) are well below those of typical retail operations.

Our warehouses on average operate on a seven-day, 70-hour week. Gasoline operations generally have extended hours. Because the hours of operation are shorter than other retailers, and due to other efficiencies inherent in a warehouse-type operation, labor costs are lower relative to the volume of sales. Merchandise is generally stored on racks above the sales floor and displayed on pallets containing large quantities, reducing labor required. In general, with variations by country, our warehouses accept certain credit cards, including Costco co-branded cards, debit cards, cash and checks, co-brand cardholder rebates, executive member 2% reward certificates and our proprietary stored-value card (shop card).

Our strategy is to provide our members with a broad range of high-quality merchandise at prices we believe are consistently lower than elsewhere. We seek to limit most items to fast-selling models, sizes, and colors. We carry an average of approximately 3,700 active stock keeping units (SKUs) per warehouse in our core warehouse business, significantly less than other broadline retailers. We average anywhere from 8,000 to 10,000 SKUs online, some of which are also available in our warehouses. Many consumable products are offered for sale in case, carton, or multiple-pack quantities only.

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

We offer merchandise in the following categories:

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

Ancillary businesses within or next to our warehouses provide expanded products and services, encouraging members to shop more frequently. These businesses include gas stations, pharmacies, optical dispensing centers, food courts, and hearing-aid centers. The number of warehouses with gas stations varies significantly by country, and we do not currently operate our gasoline business in Korea or China. We operated 615 gas stations at the end of 2020. Net sales for our gasoline business represented approximately 9% of total net sales in 2020.

Our e-commerce operations allow us to connect with our members online and provide additional products and services, many not found in our warehouses. Net sales for e-commerce represented approximately 6% of total net sales in 2020. This figure does not consider other services we offer online in certain countries such as business delivery, travel, same-day grocery, and various other services.

We have direct buying relationships with many producers of national brand-name merchandise. We do not obtain a significant portion of merchandise from any one supplier. The COVID-19 pandemic created unprecedented supply constraints including disruptions and delays that have impacted and could continue to impact the flow and availability of certain products. When sources of supply become unavailable, we seek alternative sources. We also purchase and manufacture private-label merchandise, as long as quality and member demand are high and the value to our members is significant.

Certain financial information for our segments and geographic areas is included in Note 12 to the consolidated financial statements included in Item 8 of this Report.

Membership

Our members may utilize their memberships at our warehouses worldwide. Gold Star memberships are available to individuals; Business memberships are limited to businesses, including individuals with a business license, retail sales license or comparable document. Business members may add additional cardholders (affiliates), to which the same annual fee applies. Affiliates are not available for Gold Star members. Our annual fee for these memberships is $60 in our U.S. and Canadian operations and varies in other countries. All paid memberships include a free household card.

Our member renewal rate was 91% in the U.S. and Canada and 88% on a worldwide basis at the end of 2020. The majority of members renew within six months following their renewal date. Our renewal rate is a trailing calculation that captures renewals during the period seven to eighteen months prior to the reporting date.

Our membership counts include active memberships as well as memberships that have not renewed within the 12 months prior to the reporting date. At the end of 2020, we standardized our membership count methodology globally to be consistent with the U.S. and Canada, which resulted in the addition to the count of approximately 2.0 million total cardholders for 2020, of which 1.3 million were paid members. The change did not impact 2019 or 2018. Membership fee income and the renewal rate calculations were not affected. Our membership was made up of the following (in thousands):

	2020	2019	2018
Gold Star	46,800	42,900	40,700
Business, including affiliates	11,300	11,000	10,900
Total paid members	58,100	53,900	51,600
Household cards	47,400	44,600	42,700
Total cardholders	105,500	98,500	94,300

Paid cardholders (except affiliates) are eligible to upgrade to an Executive membership in the U.S. and Canada, for an additional annual fee of $60. Executive memberships are also available in Mexico, the U.K., Japan, Korea, and Taiwan, for which the additional annual fee varies. Executive members earn a 2% reward on qualified purchases (generally up to a maximum reward of $1,000 per year), which can be redeemed only at Costco warehouses. This program also offers (except in Mexico, Japan, and Korea), access to additional savings and benefits on various business and consumer services, such as auto and home insurance, the Costco auto purchase program, and check printing. These services are generally provided by third parties and vary by state and country. Executive members, who totaled 22.6 million and represented 39% of paid members at the end of 2020, generally shop more frequently and spend more than other members.

Labor

Our employee count was as follows:

	2020	2019	2018
Full-time employees	156,000	149,000	143,000
Part-time employees	117,000	105,000	102,000
Total employees	273,000	254,000	245,000

Approximately 17,100 employees are union employees. We consider our employee relations to be very good.

Competition

Our industry is highly competitive, based on factors such as price, merchandise quality and selection, location, convenience, distribution strategy, and customer service. We compete on a worldwide basis with global, national, and regional wholesalers and retailers, including supermarkets, supercenters, internet retailers, gasoline stations, hard discounters, department and specialty stores, and operators selling a single category or narrow range of merchandise. Walmart, Target, Kroger, and Amazon are among our significant general merchandise retail competitors. We also compete with other warehouse clubs (primarily Walmart's Sam's Club and BJ's Wholesale Club), and many of the major metropolitan areas in the U.S. and certain of our Other International locations have multiple clubs.

Intellectual Property

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

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

Available Information

Our U.S. website is www.costco.com. We make available through the Investor Relations section of that site, free of charge, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements and Forms 3, 4 and 5, and any amendments to those reports, as soon as reasonably practicable after filing such materials with or furnishing such documents to the Securities and Exchange Commission (SEC). The information found on our website is not part of this or any other report filed with or furnished to the SEC. The SEC maintains a site that contains reports, proxy and information statements, and other information regarding issuers, such as the Company, that file electronically with the SEC at www.sec.gov.

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

Information about our Executive Officers

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

Name	Position	Executive Officer Since	Age
W. Craig Jelinek	President and Chief Executive Officer. Mr. Jelinek has been President and Chief Executive Officer since January 2012 and a director since February 2010. He was President and Chief Operating Officer from February 2010 to December 2011. Prior to that he was Executive Vice President, Chief Operating Officer, Merchandising since 2004.	1995	68
Richard A. Galanti	Executive Vice President and Chief Financial Officer. Mr. Galanti has been a director since January 1995.	1993	64
Jim C. Klauer	Executive Vice President, Chief Operating Officer, Northern Division. Mr. Klauer was Senior Vice President, Non Foods and E-commerce Merchandise, from 2013 to January 2018.	2018	58
Patrick J. Callans	Executive Vice President, Administration. Mr. Callans was Senior Vice President, Human Resources and Risk Management, from 2013 to December 2018.	2019	58
Russ D. Miller	Executive Vice President, Chief Operating Officer, Southern Division and Mexico. Mr. Miller was Senior Vice President, Western Canada Region, from 2001 to January 2018.	2018	63
Paul G. Moulton	Executive Vice President, Chief Information Officer. Mr. Moulton was Executive Vice President, Real Estate Development, from 2001 until March 2010.	2001	69
James P. Murphy	Executive Vice President, Chief Operating Officer, International. Mr. Murphy was Senior Vice President, International, from 2004 to October	2011	67

Item 1A—Risk Factors

The risks described below could materially and adversely affect our business, financial condition and results of operations. We could also be affected by additional risks that apply to all companies operating in the U.S. and globally, as well as other risks that are not presently known to us or that we currently consider to be immaterial. These Risk Factors should be carefully reviewed in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 and our consolidated financial statements and related notes in Item 8 of this Report.

Business and Operating Risks

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

Our financial and operational performance is highly dependent on our U.S. and Canadian operations, which comprised 87% and 83% of net sales and operating income in 2020, respectively. Within the U.S., we are highly dependent on our California operations, which comprised 29% of U.S. net sales in 2020. Our California market, in general, has a larger percentage of higher volume warehouses as compared to our other domestic markets. Any substantial slowing or sustained decline in these operations could materially adversely affect our business and financial results. Declines in financial performance of our U.S. operations, particularly in California, and our Canadian operations could arise from, among other things: slow growth or declines in comparable warehouse sales (comparable sales); negative trends in operating expenses, including increased labor, healthcare and energy costs; failing to meet targets for warehouse openings; cannibalizing existing locations with new warehouses; shifts in sales mix toward lower gross margin products; changes or uncertainties in economic conditions in our markets, including higher levels of unemployment and depressed home values; and failing to consistently provide high quality and innovative new products.

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

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

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

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

We have made and may continue to make investments and acquisitions to improve the speed, accuracy and efficiency of our supply chains. The effectiveness of these investments can be less predictable than opening new locations and might not provide the anticipated benefits or desired rates of return.

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

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

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

Disruptions in merchandise distribution or processing, packaging, manufacturing, and other facilities could adversely affect sales and member satisfaction.

We depend on the orderly operation of the merchandise receiving and distribution process, primarily through our depots. We also rely upon processing, packaging, manufacturing and other facilities to support our business, which includes the production of certain private-label items. Although we believe that our operations are efficient, disruptions due to fires, tornadoes, hurricanes, earthquakes, pandemics or other extreme weather conditions or catastrophic events, labor issues or other shipping problems may result in delays in the production and delivery of merchandise to our warehouses, which could adversely affect sales and the satisfaction of our members. Our e-commerce business depends heavily on third-party logistics providers and that business is negatively affected when these providers are unable to provide services in a timely fashion.

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

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

Availability and performance of our information technology (IT) systems are vital for our business to operate efficiently. Failure to execute complex IT projects, and have these IT systems available to our business will adversely impact our operations.

IT systems play a crucial role in conducting our business on a daily basis. These systems are utilized to process a very high volume of transactions, conduct payment transactions, track and value our inventory and produce reports which are critical for making business decisions on a daily, weekly and periodic basis. Failure or disruption of these IT systems could have an adverse impact on our ability to buy products from our suppliers, produce goods in our manufacturing plants, move the products in an efficient manner to our warehouses and sell products to our members. We are undertaking large technology and IT transformation projects. The failure of these projects could adversely impact our business plans and potentially impair our day to day business operations. Given the high volume of transactions we process, it is important that we build strong digital resiliency for our business-critical systems to prevent disruption from events such as power outages, computer and telecommunications failures, computer viruses, internal or external security breaches, errors by employees, and catastrophic events such as fires, earthquakes tornadoes and hurricanes. Any debilitating failure of our critical IT systems, data centers and backup systems would require significant investments in resources to restore IT services and may cause serious impairment in our business operations including loss of business services, increased cost of moving merchandise and failure to provide service to our members. We are currently making significant investments in enhancing our digital resiliency and failure or delay in execution of these projects could delay our ability to be resilient to disruptive events. Failure to deliver our IT transformation efforts efficiently and effectively could result in the loss of our competitive position and adversely impact our financial condition and results of operations.

We are required to maintain the privacy and security of personal and business information amidst evolving threat landscapes and in compliance with emerging privacy and data protection regulations globally. Failure to meet the requirements could damage our reputation with members, suppliers and employees, cause us to incur substantial additional costs, and become subject to litigation.

Increased IT security threats and more sophisticated computer crime pose a risk to our systems, networks, products and services. We rely upon IT systems and networks, some of which are managed by third parties, in connection with a variety of business activities. Additionally, we collect, store and process sensitive information relating to our business, members, suppliers and employees. Operating these IT systems and networks, and processing and maintaining this data, in a secure manner, is critical to our business operations and strategy. The increased use of remote work infrastructure due to the COVID-19 pandemic has also increased the possible attack surfaces. Security threats designed to gain unauthorized access to our systems, networks and data, are increasing in frequency and sophistication. Cybersecurity attacks may range from random attempts to coordinated and targeted attacks, including sophisticated computer crimes and advanced persistent threats. These threats pose a risk to the security of our systems and networks and the confidentiality, integrity, and availability of our data. It is possible that our IT systems and networks, or those managed by third parties such as cloud providers, could have vulnerabilities, which could go unnoticed for a period of time. While our cybersecurity and compliance posture seeks to mitigate such risks, there can be no guarantee that the actions and controls we and our third-party service providers have implemented and are implementing, will be sufficient to protect our systems, information or other property.

The potential impacts of a future material cybersecurity attack includes reputational damage, litigation, government enforcement actions, penalties, disruption to systems, unauthorized release of confidential or otherwise protected information, corruption of data, diminution in the value of our investment in IT systems and increased cybersecurity protection and remediation costs. This could adversely affect our competitiveness, results of operations and financial condition and loss of member confidence. Further, the amount of insurance coverage we maintain may be inadequate to cover claims or liabilities relating to a cybersecurity attack. In addition, data we collect, store and process is subject to a variety of U.S. and international laws and regulations, such as the European Union's General Data Protection Regulation, California Consumer Privacy Act, Health Insurance Portability and Accountability Act, China cybersecurity law and other emerging privacy and cybersecurity laws across the various states and around the globe, which may carry significant potential penalties for noncompliance.

We are subject to payment-related risks.

We accept payments using a variety of methods, including select credit and debit cards, cash and checks, co-brand cardholder rebates, executive member 2% reward certificates, and our shop card. As we offer new payment options to our members, we may be subject to additional rules, regulations, compliance requirements, and higher fraud losses. For certain payment methods, we pay interchange and other related acceptance fees, along with additional transaction processing fees. We rely on third parties to

provide payment transaction processing services for credit and debit cards and our shop card. It could disrupt our business if these parties become unwilling or unable to provide these services to us. We are also subject to evolving payment card association and network operating rules, including data security rules, certification requirements and rules governing electronic funds transfers. For example, we are subject to Payment Card Industry Data Security Standards, which contain compliance guidelines and standards with regard to our security surrounding the physical and electronic storage, processing and transmission of individual cardholder data. If our internal systems are breached or compromised, we may be liable for card re-issuance costs, subject to fines and higher transaction fees and lose our ability to accept card payments from our members, and our business and operating results could be adversely affected.

We might sell products that cause illness or injury to our members, harm to our reputation, and expose us to litigation.

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

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

Omnichannel retailing is rapidly evolving, and we must keep pace with changing member expectations and new developments by our competitors. Our members are increasingly using mobile phones, tablets, computers, and other devices to shop and to interact with us through social media, particularly in the wake of COVID-19. We are making investments in our websites and mobile applications. If we are unable to make, improve, or develop relevant member-facing technology in a timely manner, our ability to compete and our results of operations could be adversely affected.

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

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

We may incur property, casualty or other losses not covered by our insurance.

Claims for employee health care benefits, workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, inventory loss, and other exposures are funded predominantly through self-insurance. Insurance coverage is maintained in certain instances to limit exposures arising from very large losses. The types and amounts of insurance may vary from time to time based on our decisions with respect to risk retention and regulatory requirements. Significant claims or events, regulatory changes, a substantial rise in costs of health care or costs to maintain our insurance or the failure to maintain adequate insurance coverage could have an adverse impact on our financial condition and results of operations.

Although we maintain specific coverages for catastrophic property losses, we still bear a significant portion of the risk of losses incurred as a result of any physical damage to, or the destruction of, any warehouses, depots, manufacturing or home office facilities, loss or spoilage of inventory, and business interruption. Such losses could materially impact our cash flows and results of operations.

Market and Other External Risks

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

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

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

Higher energy and gasoline costs, inflation, levels of unemployment, healthcare costs, consumer debt levels, foreign-currency exchange rates, unsettled financial markets, weaknesses in housing and real estate markets, reduced consumer confidence, changes and uncertainties related to government fiscal and tax policies including changes in tax rates, duties, tariffs, or other restrictions, sovereign debt crises, pandemics and other health crises, and other economic factors could adversely affect demand for our products and services, require a change in product mix, or impact the cost of or ability to purchase inventory. Additionally, actions in various countries, particularly China and the United States, have raised the cost of many items and created uncertainty with respect to tariff impacts on the costs of some of our merchandise. The degree of our exposure is dependent on (among other things) the type of goods, rates imposed, and timing of the tariffs. The impact to our business, including net sales and gross margin, will be influenced in part by merchandising and pricing strategies in response to potential cost increases by us and our competitors. While these potential impacts are uncertain, they could have an adverse impact on our financial results.

Prices of certain commodities, including gasoline and consumable goods used in manufacturing and our warehouse retail operations, are historically volatile and are subject to fluctuations arising from changes in domestic and international supply and demand, labor costs, competition, market speculation, government regulations, taxes and periodic delays in delivery. Rapid and significant changes in commodity prices and

our ability and desire to pass them through to our members may affect our sales and profit margins. These factors could also increase our merchandise costs and selling, general and administrative expenses, and otherwise adversely affect our operations and financial results. General economic conditions can also be affected by events like the outbreak of war or acts of terrorism.

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

We depend heavily on our ability to purchase quality merchandise in sufficient quantities at competitive prices. As the quantities we require continue to grow, we have no assurances of continued supply, appropriate pricing or access to new products, and any supplier has the ability to change the terms upon which they sell to us or discontinue selling to us. Member demands may lead to out-of-stock positions causing a loss of sales and profits.

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

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

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

During 2020, our international operations, including Canada, generated 27% and 33% of our net sales and operating income, respectively. Our international operations have accounted for an increasing portion of our warehouses, and we plan to continue international growth. To prepare our consolidated financial statements, we translate the financial statements of our international operations from local currencies into U.S. dollars using current exchange rates. Future fluctuations in exchange rates that are unfavorable to us may adversely affect the financial performance of our Canadian and Other International operations and have a corresponding adverse period-over-period effect on our results of operations. As we continue to expand internationally, our exposure to fluctuations in foreign exchange rates may increase.

A portion of the products we purchase is paid for in a currency other than the local currency of the country in which the goods are sold. Currency fluctuations may increase our cost of goods and may not be passed on to members. Consequently, fluctuations in currency exchange rates may adversely affect our results of operations.

Natural disasters, extreme weather conditions, public health emergencies or other catastrophic events could negatively affect our business, financial condition, and results of operations.

Natural disasters and extreme weather conditions, such as hurricanes, typhoons, floods, earthquakes; acts of terrorism or violence, including active shooter situations; public health issues, including pandemics and quarantines, particularly in California or Washington state, where our centralized operating systems and administrative personnel are located, could negatively affect our operations and financial performance. Such events could result in physical damage to our properties, limitations on store operating hours, less frequent visits by members to physical locations, the temporary closure of warehouses,

depots, manufacturing or home office facilities, the temporary lack of an adequate work force, disruptions to our IT systems, the temporary or long-term disruption in the supply of products from some local or overseas suppliers, the temporary disruption in the transport of goods to or from overseas, delays in the delivery of goods to our warehouses or depots, and the temporary reduction in the availability of products in our warehouses. Public health issues, whether occurring in the U.S. or abroad, could disrupt our operations, disrupt the operations of suppliers or members, or have an adverse impact on consumer spending and confidence levels. These events could also reduce demand for our products or make it difficult or impossible to procure products. We may be required to suspend operations in some or all of our locations, which could have a material adverse effect on our business, financial condition and results of operations.

The COVID-19 pandemic is affecting our business, financial condition and results of operations in many respects.

The continuing impacts of the COVID-19 pandemic are highly unpredictable and volatile, and are affecting certain business operations, demand for our products and services, in-stock positions, costs of doing business, availability of labor, access to inventory, supply chain operations, our ability to predict future performance, exposure to litigation, and our financial performance, among other things.

The COVID-19 pandemic has resulted in widespread and continuing impacts on the global economy and on our employees, members, suppliers and other people and entities with which we do business. There is considerable uncertainty regarding the extent to which COVID-19 will continue to spread and the extent and duration of measures to try to contain the virus, such as travel bans and restrictions, quarantines, shelter-in-place orders and business and government shutdowns. We are taking precautionary measures intended to help minimize the risk of the virus to our employees, including temporarily requiring some employees to work remotely. To reward our employees for exemplary service in difficult times we temporarily increased compensation levels and otherwise incurred increased spending for wages and benefits, including overtime pay. The pandemic and any preventative or protective actions that governments or we may take are likely to result in a period of business disruption, reduced member traffic and reduced sales in certain merchandise categories, and increased operating expenses.

The pandemic has significantly impacted the global supply chain, with restrictions and limitations on business activities causing disruption and delay. These disruptions and delays have strained certain domestic and international supply chains, which have affected and could continue to negatively affect the flow or availability of certain products. Member demand for certain products has also fluctuated as the pandemic has progressed and member behaviors have changed, which has challenged our ability to anticipate and/or adjust inventory levels to meet that demand. These factors have resulted in higher out-of-stock positions in certain products, as well as delays in delivering those products. Even if we are able to find alternate sources for certain products, they may cost more or require us to incur higher transportation costs, adversely impacting our profitability and financial condition. Similarly, increased demand for online purchases of products has impacted our fulfillment operations, resulting in delays in delivering products to members.

If we do not respond appropriately to the pandemic, or if our members do not participate in social distancing and other safety measures, the well-being of our employees and members could be at risk, and a failure to appropriately respond, or the perception of an inadequate response, could cause reputational harm to our brand and subject us to lost sales and claims from employees, members, suppliers, regulators or other parties. Additionally, a future outbreak of confirmed cases of COVID-19 in our facilities could result in temporary or sustained workforce shortages or facility closures, which would negatively impact our business and results of operations. Some jurisdictions have taken measures intended to expand the availability of workers compensation or to change the presumptions applicable to workers compensation measures. These actions may increase our exposure to claims and increase our costs.

In an effort to strengthen our liquidity position, during the year we issued $4,000 million Senior Notes, a portion of which was used to repay, prior to maturity, $1,500 million of our 2.150% and 2.250% Senior Notes. Financial and credit markets have experienced and may continue to experience significant volatility and turmoil. Our continued access to external sources of liquidity depends on multiple factors, including the condition of debt capital markets, our operating performance, and maintaining strong credit ratings. If the impacts of the pandemic continue to disrupt the financial markets, or if rating agencies lower our credit ratings, it could adversely affect our ability to access the debt markets, our cost of funds, and other terms for new debt or other sources of external liquidity, if needed.

Other factors and uncertainties include, but are not limited to:

- The severity and duration of the pandemic, including whether there is a “second wave” caused by additional periods of increases or spikes in the number of COVID-19 cases, future mutations or related strains of the virus in areas in which we operate;
- Evolving macroeconomic factors, including general economic uncertainty, unemployment rates, and recessionary pressures;
- Unknown consequences on our business performance and initiatives stemming from the substantial investment of time and other resources to the pandemic response;
- The pace of recovery when the pandemic subsides; and
- The long-term impact of the pandemic on our business, including consumer behaviors.

To the extent that COVID-19 continues to adversely affect the U.S. and global economy, our business, results of operations, cash flows, or financial condition, it may also heighten other risks described in this section, including but not limited to those related to consumer behavior and expectations, competition, brand reputation, implementation of strategic initiatives, cybersecurity threats, payment-related risks, technology systems disruption, supply chain disruptions, labor availability and cost, litigation, operational risk as a result of remote work arrangements and regulatory requirements.

Factors associated with climate change could adversely affect our business.

We use natural gas, diesel fuel, gasoline, and electricity in our distribution and warehouse operations. Government regulations limiting carbon dioxide and other greenhouse gas emissions may increase compliance and merchandise costs, and other regulation affecting energy inputs could materially affect our profitability. Climate change, extreme weather conditions, and rising sea levels could affect our ability to procure commodities at costs and in quantities we currently experience. We also sell a substantial amount of gasoline, the demand for which could be impacted by concerns about climate change and which face increased regulation.

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

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

<u>Legal and Regulatory Risks</u>

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

At the end of 2020, we operated 243 warehouses outside of the U.S., and we plan to continue expanding our international operations. Future operating results internationally could be negatively affected by a variety of factors, many similar to those we face in the U.S., certain of which are beyond our control.

These factors include political and economic conditions, regulatory constraints, currency regulations, policy changes such as the withdrawal of the U.K. from the European Union, and other matters in any of the countries or regions in which we operate, now or in the future. Other factors that may impact international operations include foreign trade (including tariffs and trade sanctions), monetary and fiscal policies and the laws and regulations of the U.S. and foreign governments, agencies and similar organizations, and risks associated with having major facilities in locations which have been historically less stable than the U.S. Risks inherent in international operations also include, among others, the costs and difficulties of managing international operations, adverse tax consequences, and difficulty in enforcing intellectual property rights.

We are exposed to risks relating to evaluations of controls required by Section 404 of the Sarbanes-Oxley Act.

Section 404 of the Sarbanes-Oxley Act of 2002 requires management assessments of the effectiveness of internal control over financial reporting and disclosure controls and procedures. If we are unable to maintain effective internal control over financial reporting or disclosure controls and procedures, our ability to record, process and report financial information accurately and to prepare financial statements within required time periods could be adversely affected, which could subject us to litigation or investigations requiring management resources and payment of legal and other expenses, negatively affect investor confidence in our financial statements and adversely impact our stock price.

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

Accounting principles and related pronouncements, implementation guidelines, and interpretations we apply to a wide range of matters that are relevant to our business, including self-insurance liabilities, are highly complex and involve subjective assumptions, estimates and judgments by our management. Changes in rules or interpretation or changes in underlying assumptions, estimates or judgments by our management could significantly change our reported or expected financial performance and have a material impact on our consolidated financial statements.

We could be subject to additional tax liabilities.

We are subject to a variety of taxes and tax collection and remittance obligations in the U.S. and numerous foreign jurisdictions. Additionally, at any point in time, we may be under examination for value added, sales-based, payroll, product, import or other non-income taxes. We may recognize additional tax expense, be subject to additional tax liabilities, or incur losses and penalties, due to changes in laws, regulations, administrative practices, principles, assessments by authorities and interpretations related to tax, including tax rules in various jurisdictions. We compute our income tax provision based on enacted tax rates in the countries in which we operate. As tax rates vary among countries, a change in earnings attributable to the various jurisdictions in which we operate could result in an unfavorable change in our overall tax provision. Additionally, changes in the enacted tax rates or adverse outcomes in tax audits, including transfer pricing disputes, could have a material adverse effect on our financial condition and results of operations.

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

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

Operations at our facilities require the treatment and disposal of wastewater, stormwater and agricultural and food processing wastes, the use and maintenance of refrigeration systems, including ammonia-based chillers, noise, odor and dust management, the operation of mechanized processing equipment, and other operations that potentially could affect the environment and public health and safety. Failure to comply with current and future environmental, health and safety standards could result in the imposition of fines and penalties, illness or injury of our employees, and claims or lawsuits related to such illnesses or injuries, and temporary closures or limits on the operations of facilities.

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

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

Item 1B—Unresolved Staff Comments

None.

Item 2—Properties

Warehouse Properties

At August 30, 2020, we operated 795 membership warehouses:

	Own Land and Building	Lease Land and/or Building[1]	Total
United States and Puerto Rico	443	109	552
Canada	87	14	101
Other International	99	43	142
Total	629	166	795

(1) 119 of the 166 leases are land-only leases, where Costco owns the building.

At the end of 2020, our warehouses contained approximately 116.1 million square feet of operating floor space: 81.4 million in the U.S.; 14.3 million in Canada; and 20.4 million in Other International. Total square feet associated with distribution and logistics facilities were approximately 28.0 million. Additionally, we operate various processing, packaging, manufacturing and other facilities to support our business, which includes the production of certain private-label items.

Item 3—Legal Proceedings

See discussion of Legal Proceedings in Note 11 to the consolidated financial statements included in Item 8 of this Report.

Item 4—Mine Safety Disclosures

Not applicable.

PART II

Item 5—Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information and Dividend Policy

Our common stock is traded on the NASDAQ Global Select Market under the symbol "COST." On September 29, 2020, we had 9,690 stockholders of record.

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

Issuer Purchases of Equity Securities

The following table sets forth information on our common stock repurchase activity for the fourth quarter of 2020 (dollars in millions, except per share data):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program(1)	Maximum Dollar Value of Shares that May Yet be Purchased under the Program
May 11—June 7, 2020	—	$ —	—	$ 3,833
June 8—July 5, 2020	94,000	301.79	94,000	3,805
July 6—August 2, 2020	93,000	324.51	93,000	3,775
August 3—August 30, 2020	88,000	340.17	88,000	3,745
Total fourth quarter	275,000	$ 321.73	275,000	

(1) The repurchase program is conducted under a $4,000 authorization approved by our Board of Directors in April 2019, which expires in April 2023.

Performance Graph

The following graph compares the cumulative total shareholder return (stock price appreciation and the reinvestment of dividends) on an investment of $100 in Costco common stock, S&P 500 Index, and the S&P 500 Retail Index over the five years from August 30, 2015, through August 30, 2020.
cost-20200830_g1.jpg

Item 6—Selected Financial Data

The following graph provides information concerning average sales per warehouse over a 10 year period.

Average Sales Per Warehouse*

(Sales In Millions)

Year Opened	# of Whses	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
2020	**13**										$ 132
2019	**20**									$ 129	$ 138
2018	**21**								$ 116	$ 119	$ 141
2017	**26**							$ 121	$ 142	$ 158	$ 176
2016	**29**						$ 87	$ 97	$ 118	$ 131	$ 145
2015	**23**					$ 83	$ 85	$ 94	$ 112	$ 122	$ 136
2014	**30**				$ 108	$ 109	$ 115	$ 125	$ 140	$ 144	$ 155
2013	**26**			$ 99	$ 109	$ 113	$ 116	$ 124	$ 137	$ 144	$ 158
2012	**15**		$ 105	$ 115	$ 124	$ 128	$ 130	$ 139	$ 152	$ 158	$ 173
2011 & Before	**592**	$ 146	$ 156	$ 164	$ 171	$ 171	$ 170	$ 176	$ 189	$ 196	$ 206
Totals	**795**	$ 146	$ 155	$ 160	$ 164	$ 162	$ 159	$ 163	$ 176	$ 182	$ 192

Fiscal Year

*First year sales annualized.

2012 and 2017 were 53-week fiscal years

The following table sets forth information concerning our consolidated financial condition, operating results, and key operating metrics. This information should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, included in Item 7 of this Report, and our consolidated financial statements and notes thereto, included in Item 8 of this Report.

SELECTED FINANCIAL DATA

(dollars in millions, except per share data)

As of and for the year ended	Aug. 30, 2020 (52 weeks)	Sept. 1, 2019 (52 weeks)	Sept. 2, 2018 (52 weeks)	Sept. 3, 2017 (53 weeks)	Aug. 28, 2016 (52 weeks)
RESULTS OF OPERATIONS					
Net sales	$ 163,220	$ 149,351	$ 138,434	$ 126,172	$ 116,073
Membership fees	3,541	3,352	3,142	2,853	2,646
Gross margin[1] as a percentage of net sales	11.20 %	11.02 %	11.04 %	11.33 %	11.35 %
Selling, general and administrative expenses as a percentage of net sales	10.01 %	10.04 %	10.02 %	10.26 %	10.40 %
Operating income	$ 5,435	$ 4,737	$ 4,480	$ 4,111	$ 3,672
Net income attributable to Costco	4,002	3,659	3,134	2,679	2,350
Net income per diluted common share attributable to Costco	9.02	8.26	7.09	6.08	5.33
Cash dividends declared per common share	2.70	2.44	2.14	8.90	1.70
Changes in comparable sales[2]					
United States	8 %	8 %	9 %	4 %	1 %
Canada	5 %	2 %	9 %	5 %	(3)%
Other International	9 %	2 %	11 %	2 %	(3)%
Total Company	8 %	6 %	9 %	4 %	0 %
Changes in Total Company comparable sales excluding the impact of changes in foreign currency and gasoline prices [3]	9 %	6 %	7 %	4 %	4 %
BALANCE SHEET DATA					
Net property and equipment	$ 21,807	$ 20,890	$ 19,681	$ 18,161	$ 17,043
Total assets	55,556	45,400	40,830	36,347	33,163
Long-term debt, excluding current portion	7,514	5,124	6,487	6,573	4,061
Costco stockholders' equity	18,284	15,243	12,799	10,778	12,079
WAREHOUSE INFORMATION					
Warehouses in Operation					
Beginning of year	782	762	741	715	686
Opened	16	25	25	28	33
Closed due to relocation	(3)	(5)	(4)	(2)	(4)
End of year	795	782	762	741	715
MEMBERSHIP INFORMATION					
Total paid members (000's) [4]	58,100	53,900	51,600	49,400	47,600
Total executive members (000's) [5]	22,600	20,800	19,300	18,500	17,400

(1) Net sales less merchandise costs.
(2) Includes net sales from warehouses and websites operating for more than one year. For 2017, the prior year includes the comparable 53 weeks.
(3) Excluding the impact of the revenue recognition standard for the year ended September 1, 2019.
(4) 2020 includes an additional 1.3 million due to standardizing our membership count methodology globally to be consistent with the U.S. and Canada. See Item 1.
(5) Counts are included in total paid members

Item 7—Management's Discussion and Analysis of Financial Conditions and Results of Operations
(amounts in millions, except per share, share, membership fee, and warehouse count data)

Overview

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

Our philosophy is to provide our members with quality goods and services at competitive prices. We do not focus in the short-term on maximizing prices charged, but instead seek to maintain what we believe is a perception among our members of our “pricing authority” on quality goods – consistently providing the most competitive values. Our investments in merchandise pricing may include reducing prices on merchandise to drive sales or meet competition and holding prices steady despite cost increases instead of passing the increases on to our members, all negatively impacting gross margin as a percentage of net sales (gross margin percentage). We believe our gasoline business draws members, but it generally has a lower gross margin percentage relative to our non-gasoline business. It also has lower SG&A expenses as a percent of net sales compared to our non-gasoline business. A higher penetration of gasoline sales will generally lower our gross margin percentage. Rapidly changing gasoline prices may significantly impact our near-term net sales growth. Generally, rising gasoline prices benefit net sales growth which, given the higher sales base, negatively impacts our gross margin percentage but decreases our SG&A expenses as a percentage of net sales. A decline in gasoline prices has the inverse effect. Additionally, actions in various countries, particularly China and the United States, have created uncertainty with respect to how tariffs will affect the costs of some of our merchandise. The degree of our exposure is dependent on (among other things) the type of goods, rates imposed, and timing of the tariffs. The impact to our net sales and gross margin will be influenced in part by our merchandising and pricing strategies in response to cost increases. While these potential impacts are uncertain, they could have an adverse impact on our results.

We also achieve net sales growth by opening new warehouses. As our warehouse base grows, available and desirable sites become more difficult to secure, and square footage growth becomes a comparatively less substantial component of growth. The negative aspects of such growth, however, including lower initial operating profitability relative to existing warehouses and cannibalization of sales at existing warehouses when openings occur in existing markets, are continuing to decline in significance as they relate to the results of our total operations. Our rate of operating floor space square footage growth is generally higher in foreign markets, due to the smaller base in those markets, and we expect that to

continue. Our e-commerce business growth, domestically and internationally, has also increased our sales but it generally has a lower gross margin percentage relative to our warehouse business.

The membership format is an integral part of our business and has a significant effect on our profitability. This format is designed to reinforce member loyalty and provide continuing fee revenue. The extent to which we achieve growth in our membership base, increase the penetration of our Executive members, and sustain high renewal rates materially influences our profitability. Our paid membership growth rate may be adversely impacted when warehouse openings occur in existing markets as compared to new markets.

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

Our operating model is generally the same across our U.S., Canada, and Other International operating segments (see Note 12 to the consolidated financial statements included in Item 8 of this Report). Certain countries in the Other International segment have relatively higher rates of square footage growth, lower wage and benefit costs as a percentage of country sales, less or no direct membership warehouse competition, and may lack an e-commerce business.

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

Our fiscal year ends on the Sunday closest to August 31. References to 2020, 2019, and 2018 relate to the 52-week fiscal years ended August 30, 2020, September 1, 2019, and September 2, 2018, respectively. Certain percentages presented are calculated using actual results prior to rounding. Unless otherwise noted, references to net income relate to net income attributable to Costco.

For discussion related to the results of operations and changes in financial condition for 2019 compared to 2018 refer to Part II, Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in our fiscal year 2019 Form 10-K, which was filed with the United States Securities and Exchange Commission on October 11, 2019.

Highlights for 2020 included:

- We opened 16 new warehouses, including 3 relocations: 9 new in the U.S., 3 new in our Other International segment, and 1 net new location in our Canadian segment, compared to 25 new warehouses, including 5 relocations in 2019;
- Net sales increased 9% to $163,220 driven by a 8% increase in comparable sales and sales at new warehouses opened in 2019 and 2020;
- Membership fee revenue increased 6% to $3,541, primarily due to membership sign-ups at existing and new warehouses;
- Gross margin percentage increased 18 basis points, driven primarily by certain core merchandise categories, partially offset by certain ancillary and other businesses, which were negatively impacted by COVID-19 related closures or restrictions;
- SG&A expenses as a percentage of net sales decreased three basis points primarily due to leveraging increased sales and partial reversal of a previous year tax assessment. These benefits were partially offset by incremental wage and sanitation costs as a result of COVID-19;
- The effective tax rate in 2020 was 24.4% compared to 22.3% in 2019;
- Net income increased 9% to $4,002, or $9.02 per diluted share compared to $3,659, or $8.26 per diluted share in 2019;
- In February 2020, we acquired a 35% interest in Navitus Health Solutions, a pharmacy benefit manager. In March 2020, we acquired Innovel Solutions, a company that provides final-mile delivery, installation and white-glove capabilities for big and bulky products across the United States and Puerto Rico;
- In April 2020, we issued $4,000 in aggregate principal amount of Senior Notes, some proceeds of which were used to repay $1,500 of Senior Notes; and
- In April 2020, the Board of Directors approved an increase in the quarterly cash dividend from $0.65 to $0.70 per share.

COVID-19

On March 11, 2020, the World Health Organization announced that COVID-19 infections had become a pandemic, and shortly afterward the U.S. declared a National Emergency. The outbreak has led to widespread and continuing impacts on the global economy and is affecting many aspects of our business and the operations of others with which we do business. In our response to the pandemic and in an effort to protect our members and employees, we have taken several measures, as described in Item 1A Risk Factors, and their implications on our results of operations have impacted us across all our reportable segments to varying degrees. Throughout the pandemic our warehouses have largely remained open as a result of being deemed an “essential business” in most markets and resulted in strong sales increases in our food and sundries and fresh foods merchandise categories compared to pre-pandemic time periods. This growth in certain of our core business categories has led to improved gross margin and SG&A percentages as we leveraged these sales to achieve greater efficiency. Our e-commerce business has also benefited, as more members have shopped online during the pandemic. Conversely, we have experienced decreases in both the sales and profitability of many of our ancillary and other businesses due to temporary closures or limited demand. Additionally, we paid $564 in incremental wage and sanitation costs during 2020 related to COVID-19.

RESULTS OF OPERATIONS

Net Sales

	2020	2019	2018
Net Sales	$ 163,220	$ 149,351	$ 138,434
Changes in net sales:			
U.S.	9 %	9 %	9 %
Canada	5 %	3 %	10 %
Other International	13 %	5 %	14 %
Total Company	9 %	8 %	10 %
Changes in comparable sales:			
U.S.	8 %	8 %	9 %
Canada	5 %	2 %	9 %
Other International	9 %	2 %	11 %
Total Company	8 %	6 %	9 %
Increases in comparable sales excluding the impact of changes in foreign currency and gasoline prices[(1)]:			
U.S.	9 %	6 %	7 %
Canada	7 %	5 %	4 %
Other International	11 %	6 %	7 %
Total Company	9 %	6 %	7 %

(1) Excluding the impact of the revenue recognition standard for the year ended September 1, 2019.

Net Sales

Net sales increased $13,869 or 9% during 2020, primarily due to an 8% increase in comparable sales and sales at new warehouses opened in 2019 and 2020. During the second half of 2020, we experienced a significant sales shift from certain of our ancillary and other businesses to our core merchandise categories, primarily food and sundries and fresh foods, as a result of COVID-19. This shift was largely driven by price deflation and lower volume in our gasoline business; temporary closures of most of our optical, hearing aid and photo departments; limited service in our food courts; and minimal demand in our travel business.

Changes in gasoline prices negatively impacted net sales by $1,504, or 101 basis points, compared to 2019, due to a 10% decrease in the average price per gallon. The volume of gasoline sold decreased approximately 4%, negatively impacting net sales by $699, or 47 basis points. Changes in foreign currencies relative to the U.S. dollar negatively impacted net sales by approximately $663, or 44 basis points, compared to 2019, attributable to our Canadian and Other International Operations.

Comparable Sales

Comparable sales increased 8% during 2020 and were positively impacted by increases in average ticket. While traffic increased slightly in 2020, it decreased in the second half of the year due to capacity restrictions and regulations related to COVID-19. There was an increase of 50% in e-commerce comparable sales in 2020, with an increase of 80% in the second half of the year.

Membership Fees

	2020	2019	2018
Membership fees	$ 3,541	$ 3,352	$ 3,142
Membership fees increase	6 %	7 %	10 %
Membership fees as a percentage of net sales	2.17 %	2.24 %	2.27 %

The increase in membership fees was primarily due to membership sign-ups at existing and new warehouses. At the end of 2020, our member renewal rates were 91% in the U.S. and Canada and 88% worldwide. Our renewal rate is a trailing calculation that captures renewals during the period seven to eighteen months prior to the reporting date.

We account for membership fee revenue on a deferred basis, recognized ratably over the one-year membership period. Our membership counts include active memberships as well as memberships that have not renewed within the 12 months prior to the reporting date.

Gross Margin

	2020	2019	2018
Net sales	$ 163,220	$ 149,351	$ 138,434
Less merchandise costs	144,939	132,886	123,152
Gross margin	$ 18,281	$ 16,465	$ 15,282
Gross margin percentage	11.20 %	11.02 %	11.04 %

The gross margin of our core merchandise categories (food and sundries, hardlines, softlines and fresh foods), when expressed as a percentage of core merchandise sales (rather than total net sales), increased 16 basis points, primarily due to increases in fresh foods and softlines, partially offset by a decrease in hardlines. This measure eliminates the impact of changes in sales penetration and gross margins from our warehouse ancillary and other businesses. Fresh foods gross margin increased as a result of efficiencies from increased sales, partially offset by operating losses from our poultry complex.

Total gross margin percentage increased 18 basis points compared to 2019. Excluding the impact of gasoline price deflation on net sales, gross margin percentage was 11.10%, an increase of eight basis points. This increase was primarily due to a 32 basis point increase in our core merchandise categories, predominantly fresh foods and food and sundries, partially offset by a decrease in softlines and hardlines. This increase was also positively impacted by our co-branded credit card program, which included an adjustment in 2019 to our estimate of breakage on rewards earned. These increases were partially offset by a decrease of 14 basis points in our warehouse ancillary and other businesses, predominantly certain ancillary businesses that were negatively impacted by COVID-19 related closures or restrictions. However, certain of our ancillary and other businesses, such as tire shop, gasoline and e-commerce businesses, did improve. Gross margin was also negatively impacted by incremental wage and sanitation costs related to COVID-19 of six basis points, a reserve for certain inventory of three basis points, and increased spending by members under the Executive Membership 2% reward program of one basis point. Changes in foreign currencies relative to the U.S. dollar negatively impacted gross margin by approximately $68 in 2020.

Gross margin on a segment basis, when expressed as a percentage of the segment's own sales and excluding the impact of changes in gasoline prices on net sales (segment gross margin percentage), was impacted by increases in fresh foods and food and sundries and decreases in softlines and hardlines in each of our U.S., Canadian, and Other International segments. Each of our segments were also negatively impacted by the incremental wage and sanitation costs as a result of COVID-19. The segment gross margin percentage increased in our U.S. operations, predominantly in our core merchandise categories which includes the impact from our co-branded credit card program, as discussed above,

partially offset by certain ancillary businesses that were negatively impacted by COVID-19 related closures or restrictions. Our Canadian segment gross margin percentage decreased primarily due to certain of our warehouse ancillary and other businesses that were negatively impacted by COVID-19 related closures or restrictions. The segment gross margin percentage increased in our Other International operations primarily due to core merchandise categories, as discussed above, and was also positively impacted by certain warehouse ancillary and other businesses, predominantly e-commerce. These increases were partially offset by increased spending by members under the Executive Membership 2% reward program.

Selling, General and Administrative Expenses

	2020	2019	2018
SG&A expenses	$ 16,332	$ 14,994	$ 13,876
SG&A expenses as a percentage of net sales	10.01 %	10.04 %	10.02 %

SG&A expenses as a percentage of net sales decreased three basis points compared to 2019. SG&A expenses as a percentage of net sales, excluding the impact of gasoline price deflation, was 9.91%, a decrease of 13 basis points. SG&A expenses were negatively impacted by approximately $456, or 28 basis points, due to incremental wage and sanitation costs as a result of COVID-19, and approximately $24 or one basis point due to costs associated with the acquisition of Innovel (see Note 2 to the consolidated financial statements). Operating costs related to warehouse operations and other businesses, which include e-commerce and travel, were lower by 26 basis points, primarily due to leveraging increased sales. SG&A expenses were also benefited by 13 basis points related to a product tax assessment charge in 2019 which was partially reversed in 2020. Stock compensation was lower by two basis points, and central operating costs were lower by one basis point. Our Canadian segment SG&A percentage was higher compared to 2019 due primarily to the incremental wage and sanitation costs related to COVID as outlined above. Changes in foreign currencies relative to the U.S. dollar positively impacted SG&A expenses by approximately $58.

Preopening

	2020	2019	2018
Preopening expenses	$ 55	$ 86	$ 68
Warehouse openings, including relocations			
United States	9	18	17
Canada	4	3	3
Other International	3	4	5
Total warehouse openings, including relocations	16	25	25

Preopening expenses include costs for startup operations related to new warehouses and relocations, developments in new international markets, new manufacturing and distribution facilities, and expansions at existing warehouses. Preopening expenses vary due to the number of warehouse and facility openings, the timing of the opening relative to our year-end, whether a warehouse is owned or leased, and whether openings are in an existing, new, or international market. In 2020, operations commenced at our new poultry processing plant, and in 2019, we opened our first warehouse in China.

Interest Expense

	2020	2019	2018
Interest expense	$ 160	$ 150	$ 159

Interest expense primarily relates to Senior Notes. In December 2019 and February 2020, we repaid $1,200 and $500 in total outstanding principal of the 1.700% and 1.750% Senior Notes, respectively. In

April 2020, we issued $4,000 in aggregate principal amount of long-term debt consisting of $1,250 of 1.375% Senior Notes due June 2027; $1,750 of 1.600% Senior Notes due April 2030; and $1,000 of 1.750% Senior Notes due April 2032. A portion of the proceeds was used to repay, prior to maturity, $1,000 and $500 of the 2.150% and 2.250% Senior Notes. For more information on our debt arrangements refer to Note 5 to the consolidated financial statements.

Interest Income and Other, Net

	2020	2019	2018
Interest income	$ 89	$ 126	$ 75
Foreign-currency transaction gains, net	7	27	23
Other, net	(4)	25	23
Interest income and other, net	$ 92	$ 178	$ 121

The decrease in interest income in 2020 was primarily due to lower interest rates in the U.S. and Canada, partially offset by higher average cash and investment balances. Foreign-currency transaction gains, net include the revaluation and settlement of monetary assets and liabilities and mark-to-market adjustments for forward foreign-exchange contracts by our Canadian and Other International operations. See Derivatives and Foreign Currency sections in Note 1 to the consolidated financial statements. Other, net was impacted by a $36 charge related to the repayment of certain Senior Notes, as discussed above and in Note 5.

Provision for Income Taxes

	2020	2019	2018
Provision for income taxes	$ 1,308	$ 1,061	$ 1,263
Effective tax rate	24.4 %	22.3 %	28.4 %

The effective tax rate for 2020 included discrete net tax benefits of $81, including a benefit of $77 due to excess tax benefits from stock compensation. Excluding these benefits, the tax rate was 25.9% for 2020.

The effective tax rate for 2019 included discrete net tax benefits of $221, including a benefit of $59 due to excess tax benefits from stock compensation. This also included a tax benefit of $105 related to U.S. taxation of deemed foreign dividends, offset by losses of foreign tax credits, which impacted the effective tax rate. Excluding these benefits, the tax rate was 26.9% for 2019.

LIQUIDITY AND CAPITAL RESOURCES

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

	2020	2019	2018
Net cash provided by operating activities	$ 8,861	$ 6,356	$ 5,774
Net cash used in investing activities	(3,891)	(2,865)	(2,947)
Net cash used in financing activities	(1,147)	(1,147)	(1,281)

Our primary sources of liquidity are cash flows generated from our operations, cash and cash equivalents, and short-term investments. Cash and cash equivalents and short-term investments were $13,305 and $9,444 at the end of 2020 and 2019, respectively. Of these balances, unsettled credit and debit card receivables represented approximately $1,636 and $1,434 at the end of 2020 and 2019, respectively. These receivables generally settle within four days. Cash and cash equivalents were positively impacted by a change in exchange rates of $70 in 2020, and negatively impacted by $15 and $37 in 2019 and 2018, respectively.

Management believes that our cash position and operating cash flows will be sufficient to meet our liquidity and capital requirements for the foreseeable future. We believe that our U.S. current and projected asset position is sufficient to meet our U.S. liquidity requirements. We no longer consider earnings after 2017 of our non-U.S. consolidated subsidiaries to be indefinitely reinvested.

Cash Flows from Operating Activities

Net cash provided by operating activities totaled $8,861 in 2020, compared to $6,356 in 2019. Our cash flow provided by operations is primarily derived from net sales and membership fees. Cash flow used in operations generally consists of payments to our merchandise suppliers, warehouse operating costs, including payroll and employee benefits, utilities, and credit and debit card processing fees. Cash used in operations also includes payments for income taxes. Changes in our net investment in merchandise inventories (the difference between merchandise inventories and accounts payable) is impacted by several factors, including how fast inventory is sold, payment terms with our suppliers, and the amount of payables paid early to obtain discounts from our suppliers.

Cash Flows from Investing Activities

Net cash used in investing activities totaled $3,891 in 2020, compared to $2,865 in 2019, and primarily related to capital expenditures. In 2020, we acquired Innovel and a minority interest in Navitus. For more information see Notes 1 and 2 to the consolidated financial statements. Net cash flows from investing activities also includes maturities and purchases of short-term investments.

Capital Expenditures

Our primary requirement for capital is acquiring land, buildings, and equipment for new and remodeled warehouses. Capital is also required for information systems, manufacturing and distribution facilities, initial warehouse operations, and working capital. In 2020, we spent $2,810 on capital expenditures, and it is our current intention to spend approximately $3,000 to $3,200 during fiscal 2021. These expenditures are expected to be financed with cash from operations, existing cash and cash equivalents, and short-term investments. We opened 16 new warehouses, including three relocations, in 2020, and plan to open approximately 23 additional new warehouses, including three relocations, in 2021. We have experienced delays in real estate and construction activities due to COVID-19. There can be no assurance that current expectations will be realized and plans are subject to change upon further review of our capital expenditure needs or based on the current economic environment.

Cash Flows from Financing Activities

Net cash used in financing activities totaled $1,147 in both 2020 and 2019. In April 2020, we issued $4,000 in aggregate principal amount of Senior Notes as follows: $1,250 of 1.375% due June 2027; $1,750 of 1.600% due April 2030; and $1,000 of 1.750% due April 2032. A portion of the proceeds was used to repay, prior to maturity, the outstanding $1,000 and $500 principal balances on the 2.150% and 2.250% Senior Notes, respectively, at a redemption price plus accrued interest as specified in the Notes' agreements. The remaining funds are intended for general corporate purposes.

Financing activities also included $1,200 and $500 repayment of our 1.700% and 1.750% Senior Notes, respectively, payment of dividends, withholding taxes on stock-based awards, and repurchases of common stock.

Stock Repurchase Programs

During 2020 and 2019, we repurchased 643,000 and 1,097,000 shares of common stock, at average prices of $308.45 and $225.16, respectively, totaling approximately $198 and $247, respectively. These amounts may differ from the stock repurchase balances in the accompanying consolidated statements of cash flows due to changes in unsettled stock repurchases at the end of each fiscal year. Purchases are made from time-to-time, as conditions warrant, in the open market or in block purchases and pursuant to plans under SEC Rule 10b5-1. Repurchased shares are retired, in accordance with the Washington

Business Corporation Act. The remaining amount available to be purchased under our approved plan was $3,745 at the end of 2020.

Dividends

Cash dividends declared in 2020 totaled $2.70 per share, as compared to $2.44 per share in 2019. Dividends totaling $1,479 were paid during 2020, of which $286 related to the dividend declared in August 2019. In April 2020, the Board of Directors increased our quarterly cash dividend from $0.65 to $0.70 per share. In July 2020, the Board of Directors declared a quarterly cash dividend in the amount of $0.70 per share, which was paid on August 14, 2020.

Bank Credit Facilities and Commercial Paper Programs

We maintain bank credit facilities for working capital and general corporate purposes. At August 30, 2020, we had borrowing capacity under these facilities of $967. Our international operations maintain $500 of the total borrowing capacity under bank credit facilities, of which $204 is guaranteed by the Company. There were no outstanding short-term borrowings under the bank credit facilities at the end of 2020 and 2019.

The Company has letter of credit facilities, for commercial and standby letters of credit, totaling $183. The outstanding commitments under these facilities at the end of 2020 totaled $166, most of which were standby letters of credit which do not expire or have expiration dates within one year. The bank credit facilities have various expiration dates, most of which are within one year, and we generally intend to renew these facilities. The amount of borrowings available at any time under our bank credit facilities is reduced by the amount of standby and commercial letters of credit outstanding.

Contractual Obligations

At August 30, 2020, our commitments to make future payments under contractual obligations were as follows:

	Payments Due by Fiscal Year				
Contractual obligations	**2021**	**2022 to 2023**	**2024 to 2025**	**2026 and thereafter**	**Total**
Purchase obligations[1]	$ 12,575	$ 9	$ —	$ —	$ 12,584
Long-term debt[2]	241	1,163	1,475	5,776	8,655
Operating leases [3] [4]	273	499	388	2,410	3,570
Construction and land obligations	979	35	—	—	1,014
Finance lease obligations[4]	61	128	197	742	1,128
Purchase obligations (equipment, services and other)[5]	674	205	72	187	1,138
Other[6]	60	36	28	108	232
Total	$ 14,863	$ 2,075	$ 2,160	$ 9,223	$ 28,321

(1) Includes open purchase orders primarily related to merchandise and supplies.
(2) Includes contractual interest payments and excludes deferred issuance costs.
(3) Operating lease payments have not been reduced by future sublease income of $101.
(4) Includes amounts representing interest.
(5) Excludes certain services negotiated at the individual warehouse or regional level that are not significant and generally contain clauses allowing for cancellation without significant penalty.
(6) Includes asset retirement obligations and deferred compensation obligations. The amount excludes $25 of non-current unrecognized tax contingencies and $48 of other obligations due to uncertainty regarding the timing of future cash payments.

Off-Balance Sheet Arrangements

In the opinion of management, we have no off-balance sheet arrangements that have had or are reasonably likely to have a material current or future effect on our financial condition or financial statements.

Critical Accounting Estimates

The preparation of our consolidated financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP) requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and on assumptions that we believe to be reasonable, and we continue to review and evaluate these estimates. For further information on significant accounting policies, see discussion in Note 1 to the consolidated financial statements included in Item 8 of this Report.

Insurance/Self-insurance Liabilities

Claims for employee health-care benefits, workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, inventory loss, and other exposures are funded predominantly through self-insurance. Insurance coverage is maintained in certain instances to seek to limit exposures arising from very large losses. We use different risk management mechanisms, including a wholly-owned captive insurance subsidiary, and participate in a reinsurance program. Liabilities associated with the risks that we retain are not discounted and are estimated by using historical claims experience, demographic factors, severity factors, and other actuarial assumptions. The costs of claims are highly unpredictable and can fluctuate as a result of inflation rates, regulatory or legal changes, and unforeseen developments in claims over time. While we believe our estimates are reasonable and provide for a certain degree of coverage to account for these variables, actual claims and costs could differ significantly from recorded liabilities. Historically, adjustments to our estimates have not been material.

Recent Accounting Pronouncements

See Note 1 to the consolidated financial statements included in Item 8 of this Report for a detailed description of recent accounting pronouncements.

Item 7A—Quantitative and Qualitative Disclosures About Market Risk (amounts in millions)

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

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment holdings that are diversified among various instruments considered to be cash equivalents, as defined in Note 1 to the consolidated financial statements included in Item 8 of this Report, as well as short-term investments in government and agency securities with effective maturities of generally three months to five years at the date of purchase. The primary objective of our investment activities is to preserve principal and secondarily to generate yields. The majority of our short-term investments are in fixed interest-rate securities. These securities are subject to changes in fair value due to interest rate fluctuations.

Our policy limits investments in the U.S. to direct U.S. government and government agency obligations, repurchase agreements collateralized by U.S. government and government agency obligations, U.S. government and government agency money market funds, and insured bank balances. Our wholly-owned captive insurance subsidiary invests in U.S. government and government agency obligations and U.S. government and government agency money market funds. Our Canadian and Other International subsidiaries' investments are primarily in money market funds, bankers' acceptances, and bank certificates of deposit, generally denominated in local currencies.

A 100 basis point change in interest rates as of the end of 2020 would have had an immaterial incremental change in fair market value. For those investments that are classified as available-for-sale, the unrealized gains or losses related to fluctuations in market volatility and interest rates are reflected within stockholders' equity in accumulated other comprehensive income in the consolidated balance sheets.

The nature and amount of our long-term debt may vary as a result of business requirements, market conditions, and other factors. As of the end of 2020, long-term debt with fixed interest rates was $7,657. Fluctuations in interest rates may affect the fair value of the fixed-rate debt. See Note 5 to the consolidated financial statements included in Item 8 of this Report for more information on our long-term debt.

Foreign Currency Risk

Our foreign subsidiaries conduct certain transactions in non-functional currencies, which exposes us to fluctuations in exchange rates. We manage these fluctuations, in part, through the use of forward foreign-exchange contracts, seeking to economically hedge the impact of these fluctuations on known future expenditures denominated in a non-functional foreign-currency. The contracts are intended primarily to economically hedge exposure to U.S. dollar merchandise inventory expenditures made by our international subsidiaries whose functional currency is other than the U.S. dollar. We seek to mitigate risk with the use of these contracts and do not intend to engage in speculative transactions. For additional information related to the Company's forward foreign-exchange contracts, see Notes 1 and 4 to the consolidated financial statements included in Item 8 of this Report. A hypothetical 10% strengthening of the functional currency compared to the non-functional currency exchange rates at August 30, 2020, would have decreased the fair value of the contracts by $111 and resulted in an unrealized loss in the consolidated statements of income for the same amount.

Commodity Price Risk

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

Item 8—Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors
Costco Wholesale Corporation:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Costco Wholesale Corporation and subsidiaries (the Company) as of August 30, 2020 and September 1, 2019, the related consolidated statements of income, comprehensive income, equity, and cash flows for the 52-week periods ended August 30, 2020, September 1, 2019 and September 2, 2018, and the related notes (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of August 30, 2020 and September 1, 2019, and the results of its operations and its cash flows for the 52-week periods ended August 30, 2020, September 1, 2019 and September 2, 2018, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of August 30, 2020, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated October 6, 2020 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Change in Accounting Principle

As discussed in Note 1 to the consolidated financial statements, the Company has changed its method of accounting for leases as of September 2, 2019 due to the adoption of Accounting Standards Update 2016-02 – Leases (ASC 842).

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matter

The critical audit matter communicated below is a matter arising from the current period audit of the consolidated financial statements that was communicated or required to be communicated to the audit committee and that: (1) relates to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of a critical audit matter does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matter below, providing a separate opinion on the critical audit matter or on the accounts or disclosures to which it relates.

Evaluation of self-insurance liabilities

As discussed in Note 1 to the consolidated financial statements, the Company estimates its self-insurance liabilities by considering historical claims experience, demographic factors, severity factors, and other actuarial assumptions. The estimated insurance/self-insurance liabilities as of August 30, 2020 were $1,188 million, a portion of which related to workers' compensation and general liability self-insurance liabilities for the United States and Canadian operations.

We identified the evaluation of the Company's workers' compensation and general liability self-insurance liabilities for the United States and Canadian operations as a critical audit matter because of the extent of specialized skill and knowledge needed to evaluate the Company's actuarial models and the judgments required to assess the underlying assumptions made by the Company. Specifically, subjective auditor judgment was required to evaluate certain assumptions underlying the Company's actuarial estimates, including reporting and payment patterns used in the projections of the ultimate loss; loss and exposure trends; the selected loss rates and initial expected losses used in the Paid and Incurred Bornhuetter-Ferguson methods; and the selection of the ultimate loss derived from the various methods.

The following are the primary procedures we performed to address this critical audit matter. We evaluated the design and tested operating effectiveness of certain internal controls over the Company's self-insurance process. This included controls related to the development and selection of the assumptions listed above used in the actuarial calculation and review of the actuarial report. We involved actuarial professionals with specialized skills and knowledge who assisted in:

- Assessing the actuarial models used by the Company for consistency with generally accepted actuarial standards
- Evaluating the Company's ability to estimate self-insurance liabilities by comparing its historical estimate with actual incurred losses and paid losses
- Evaluating the above listed assumptions underlying the Company's actuarial estimates by developing an independent expectation of the self-insurance liabilities and comparing them to the amounts recorded by the Company

/s/ KPMG LLP

We have served as the Company's auditor since 2002.

Seattle, Washington
October 6, 2020

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors
Costco Wholesale Corporation:

Opinion on Internal Control Over Financial Reporting

We have audited Costco Wholesale Corporation and subsidiaries' (the Company) internal control over financial reporting as of August 30, 2020, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of August 30, 2020, based on criteria established in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of August 30, 2020 and September 1, 2019, the related consolidated statements of income, comprehensive income, equity, and cash flows for the 52-week periods ended August 30, 2020, September 1, 2019 and September 2, 2018, and the related notes (collectively, the consolidated financial statements), and our report dated October 6, 2020 expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

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

Definition and Limitations of Internal Control Over Financial Reporting

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

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

/s/ KPMG LLP

Seattle, Washington
October 6, 2020

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

	52 Weeks Ended August 30, 2020	52 Weeks Ended September 1, 2019	52 Weeks Ended September 2, 2018
REVENUE			
Net sales	$ 163,220	$ 149,351	$ 138,434
Membership fees	3,541	3,352	3,142
Total revenue	166,761	152,703	141,576
OPERATING EXPENSES			
Merchandise costs	144,939	132,886	123,152
Selling, general and administrative	16,332	14,994	13,876
Preopening expenses	55	86	68
Operating income	5,435	4,737	4,480
OTHER INCOME (EXPENSE)			
Interest expense	(160)	(150)	(159)
Interest income and other, net	92	178	121
INCOME BEFORE INCOME TAXES	5,367	4,765	4,442
Provision for income taxes	1,308	1,061	1,263
Net income including noncontrolling interests	4,059	3,704	3,179
Net income attributable to noncontrolling interests	(57)	(45)	(45)
NET INCOME ATTRIBUTABLE TO COSTCO	$ 4,002	$ 3,659	$ 3,134
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO:			
Basic	$ 9.05	$ 8.32	$ 7.15
Diluted	$ 9.02	$ 8.26	$ 7.09
Shares used in calculation (000's)			
Basic	442,297	439,755	438,515
Diluted	443,901	442,923	441,834

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

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(amounts in millions)

	52 Weeks Ended August 30, 2020	52 Weeks Ended September 1, 2019	52 Weeks Ended September 2, 2018
NET INCOME INCLUDING NONCONTROLLING INTERESTS	$ 4,059	$ 3,704	$ 3,179
Foreign-currency translation adjustment and other, net	162	(245)	(192)
Comprehensive income	4,221	3,459	2,987
Less: Comprehensive income attributable to noncontrolling interests	80	37	38
COMPREHENSIVE INCOME ATTRIBUTABLE TO COSTCO	$ 4,141	$ 3,422	$ 2,949

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

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

	August 30, 2020	September 1, 2019
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 12,277	$ 8,384
Short-term investments	1,028	1,060
Receivables, net	1,550	1,535
Merchandise inventories	12,242	11,395
Other current assets	1,023	1,111
Total current assets	28,120	23,485
OTHER ASSETS		
Property and equipment, net	21,807	20,890
Operating lease right-of-use assets	2,788	—
Other long-term assets	2,841	1,025
TOTAL ASSETS	$ 55,556	$ 45,400
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 14,172	$ 11,679
Accrued salaries and benefits	3,605	3,176
Accrued member rewards	1,393	1,180
Deferred membership fees	1,851	1,711
Current portion of long-term debt	95	1,699
Other current liabilities	3,728	3,792
Total current liabilities	24,844	23,237
OTHER LIABILITIES		
Long-term debt, excluding current portion	7,514	5,124
Long-term operating lease liabilities	2,558	—
Other long-term liabilities	1,935	1,455
TOTAL LIABILITIES	36,851	29,816
COMMITMENTS AND CONTINGENCIES		
EQUITY		
Preferred stock $0.01 par value; 100,000,000 shares authorized; no shares issued and outstanding	—	—
Common stock $0.01 par value; 900,000,000 shares authorized; 441,255,000 and 439,625,000 shares issued and outstanding	4	4
Additional paid-in capital	6,698	6,417
Accumulated other comprehensive loss	(1,297)	(1,436)
Retained earnings	12,879	10,258
Total Costco stockholders' equity	18,284	15,243
Noncontrolling interests	421	341
Total equity	18,705	15,584
TOTAL LIABILITIES AND EQUITY	$ 55,556	$ 45,400

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

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF EQUITY
(amounts in millions)

	Common Stock							
	Shares (000's)	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Costco Stockholders' Equity	Noncontrolling Interests	Total Equity
BALANCE AT SEPTEMBER 3, 2017	437,204	$ 4	$ 5,800	$ (1,014)	$ 5,988	$ 10,778	$ 301	$ 11,079
Net income	—	—	—	—	3,134	3,134	45	3,179
Foreign-currency translation adjustment and other, net	—	—	—	(185)	—	(185)	(7)	(192)
Stock-based compensation	—	—	547	—	—	547	—	547
Release of vested restricted stock units (RSUs), including tax effects	2,741	—	(217)	—	—	(217)	—	(217)
Repurchases of common stock	(1,756)	—	(26)	—	(296)	(322)	—	(322)
Cash dividends declared and other	—	—	3	—	(939)	(936)	(35)	(971)
BALANCE AT SEPTEMBER 2, 2018	438,189	4	6,107	(1,199)	7,887	12,799	304	13,103
Net income	—	—	—	—	3,659	3,659	45	3,704
Foreign-currency translation adjustment and other, net	—	—	—	(237)	—	(237)	(8)	(245)
Stock-based compensation	—	—	598	—	—	598	—	598
Release of vested RSUs, including tax effects	2,533	—	(272)	—	—	(272)	—	(272)
Repurchases of common stock	(1,097)	—	(16)	—	(231)	(247)	—	(247)
Cash dividends declared and other	—	—	—	—	(1,057)	(1,057)	—	(1,057)
BALANCE AT SEPTEMBER 1, 2019	439,625	4	6,417	(1,436)	10,258	15,243	341	15,584
Net income	—	—	—	—	4,002	4,002	57	4,059
Foreign-currency translation adjustment and other, net	—	—	—	139	—	139	23	162
Stock-based compensation	—	—	621	—	—	621	—	621
Release of vested RSUs, including tax effects	2,273	—	(330)	—	—	(330)	—	(330)
Repurchases of common stock	(643)	—	(10)	—	(188)	(198)	—	(198)
Cash dividends declared	—	—	—	—	(1,193)	(1,193)	—	(1,193)
BALANCE AT AUGUST 30, 2020	441,255	$ 4	$ 6,698	$ (1,297)	$ 12,879	$ 18,284	$ 421	$ 18,705

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

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(amounts in millions)

	52 Weeks Ended August 30, 2020	52 Weeks Ended September 1, 2019	52 Weeks Ended September 2, 2018
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income including noncontrolling interests	$ 4,059	$ 3,704	$ 3,179
Adjustments to reconcile net income including noncontrolling interests to net cash provided by operating activities:			
Depreciation and amortization	1,645	1,492	1,437
Non-cash lease expense	194	—	—
Stock-based compensation	619	595	544
Other non-cash operating activities, net	42	9	(6)
Deferred income taxes	104	147	(49)
Changes in operating assets and liabilities:			
Merchandise inventories	(791)	(536)	(1,313)
Accounts payable	2,261	322	1,561
Other operating assets and liabilities, net	728	623	421
Net cash provided by operating activities	8,861	6,356	5,774
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of short-term investments	(1,626)	(1,094)	(1,060)
Maturities and sales of short-term investments	1,678	1,231	1,078
Additions to property and equipment	(2,810)	(2,998)	(2,969)
Acquisitions	(1,163)	—	—
Other investing activities, net	30	(4)	4
Net cash used in investing activities	(3,891)	(2,865)	(2,947)
CASH FLOWS FROM FINANCING ACTIVITIES			
Change in bank payments outstanding	137	210	80
Proceeds from issuance of long-term debt	3,992	298	—
Repayments of long-term debt	(3,200)	(89)	(86)
Tax withholdings on stock-based awards	(330)	(272)	(217)
Repurchases of common stock	(196)	(247)	(328)
Cash dividend payments	(1,479)	(1,038)	(689)
Other financing activities, net	(71)	(9)	(41)
Net cash used in financing activities	(1,147)	(1,147)	(1,281)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	70	(15)	(37)
Net change in cash and cash equivalents	3,893	2,329	1,509
CASH AND CASH EQUIVALENTS BEGINNING OF YEAR	8,384	6,055	4,546
CASH AND CASH EQUIVALENTS END OF YEAR	$ 12,277	$ 8,384	$ 6,055
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest	$ 124	$ 141	$ 143
Income taxes, net	$ 1,052	$ 1,187	$ 1,204
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:			
Cash dividend declared, but not yet paid	$ —	$ 286	$ 250

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

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

Note 1—Summary of Significant Accounting Policies

Description of Business

Costco Wholesale Corporation (Costco or the Company), a Washington corporation, and its subsidiaries operate membership warehouses based on the concept that offering members low prices on a limited selection of nationally-branded and private-label products in a wide range of merchandise categories will produce high sales volumes and rapid inventory turnover. At August 30, 2020, Costco operated 795 warehouses worldwide: 552 in the United States (U.S.) located in 45 states, Washington, D.C., and Puerto Rico, 101 in Canada, 39 in Mexico, 29 in the United Kingdom (U.K.), 27 in Japan, 16 in Korea, 13 in Taiwan, 12 in Australia, three in Spain, and one each in Iceland, France and China. The Company operates e-commerce websites in the U.S., Canada, Mexico, U.K., Korea, Taiwan, Japan, and Australia.

Basis of Presentation

The consolidated financial statements include the accounts of Costco, its wholly-owned subsidiaries, and subsidiaries in which it has a controlling interest. The Company reports noncontrolling interests in consolidated entities as a component of equity separate from the Company's equity. All material inter-company transactions between and among the Company and its consolidated subsidiaries have been eliminated in consolidation. In February 2020, the Company acquired a 35% interest in Navitus Health Solutions, a pharmacy benefit manager. This investment is included in other long-term assets and is accounted for using the equity-method with earnings/losses recorded in other income in the consolidated statement of income. The Company's net income excludes income attributable to the noncontrolling interest in Taiwan. Unless otherwise noted, references to net income relate to net income attributable to Costco.

Fiscal Year End

The Company operates on a 52/53 week fiscal year basis with the year ending on the Sunday closest to August 31. References to 2020, 2019, and 2018 relate to the 52-week fiscal years ended August 30, 2020, September 1, 2019, and September 2, 2018, respectively.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. These estimates and assumptions take into account historical and forward looking factors that the Company believes are reasonable, including but not limited to the potential impacts arising from the novel coronavirus (COVID-19) and related public and private sector policies and initiatives. Actual results could differ from those estimates and assumptions.

Cash and Cash Equivalents

The Company considers as cash and cash equivalents all cash on deposit, highly liquid investments with a maturity of three months or less at the date of purchase, and proceeds due from credit and debit card transactions with settlement terms of up to four days. Credit and debit card receivables were $1,636 and $1,434 at the end of 2020 and 2019, respectively.

The Company provides for the daily replenishment of major bank accounts as payments are presented. Included in accounts payable at the end of 2020 and 2019 are $810 and $673, respectively, representing the excess of outstanding payments over cash on deposit at the banks on which the payments were drawn.

Short-Term Investments

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

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

Fair Value of Financial Instruments

The Company accounts for certain assets and liabilities at fair value. The carrying value of the Company's financial instruments, including cash and cash equivalents, receivables and accounts payable, approximate fair value due to their short-term nature or variable interest rates. See Notes 3, 4, and 5 for the carrying value and fair value of the Company's investments, derivative instruments, and fixed-rate debt, respectively.

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

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

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

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

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

Current financial liabilities have fair values that approximate their carrying values. Long-term financial liabilities include the Company's long-term debt, which are recorded on the balance sheet at issuance price and adjusted for unamortized discounts or premiums and debt issuance costs, and are being amortized to interest expense over the term of the loan. The estimated fair value of the Company's long-term debt is based primarily on reported market values, recently completed market transactions, and estimates based upon interest rates, maturities, and credit.

Receivables, Net

Receivables consist primarily of vendor, reinsurance, credit card incentive, third-party pharmacy and other receivables. Vendor receivables include discounts and volume rebates. Balances are generally presented on a gross basis, separate from any related payable due. In certain circumstances, these receivables may be settled against the related payable to that vendor, in which case the receivables are presented on a net basis. Reinsurance receivables are held by the Company's wholly-owned captive insurance subsidiary and primarily represent amounts ceded through reinsurance arrangements gross of the amounts assumed under reinsurance, which are presented within other current liabilities in the consolidated balance sheets. Credit card incentive receivables primarily represent amounts earned under the co-branded credit card arrangement in the U.S. Third-party pharmacy receivables generally relate to amounts due from members' insurers. Other receivables primarily consist of amounts due from governmental entities, mostly tax-related items.

Receivables are recorded net of an allowance for doubtful accounts. The allowance is based on historical experience and application of the specific identification method. Write-offs of receivables were immaterial in 2020, 2019, and 2018.

Merchandise Inventories

Merchandise inventories consist of the following:

	2020	2019
United States	$ 8,871	$ 8,415
Canada	1,310	1,123
Other International	2,061	1,857
Merchandise inventories	$ 12,242	$ 11,395

Merchandise inventories are stated at the lower of cost or market. U.S. merchandise inventories are valued by the cost method of accounting, using the last-in, first-out (LIFO) basis. The Company believes the LIFO method more fairly presents the results of operations by more closely matching current costs with current revenues. The Company records an adjustment each quarter, if necessary, for the projected annual effect of inflation or deflation, and these estimates are adjusted to actual results determined at year-end, after actual inflation or deflation rates and inventory levels have been determined. As of August 30, 2020, and September 1, 2019, U.S. merchandise inventories valued at LIFO approximated first-in, first-out (FIFO) after considering the lower of cost or market principle. Canadian and Other International merchandise inventories are predominantly valued using the cost and retail inventory methods, respectively, using the FIFO basis.

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

Property and Equipment, Net

Property and equipment are stated at cost. Depreciation and amortization expense is computed primarily using the straight-line method over estimated useful lives. Leasehold improvements made after the beginning of the initial lease term are depreciated over the shorter of the estimated useful life of the asset or the remaining term of the initial lease plus any renewals that are reasonably certain at the date the leasehold improvements are made.

The Company capitalizes certain computer software and costs incurred in developing or obtaining software for internal use. During development, these costs are included in construction in progress. When the assets are ready for their intended use, these costs are included in equipment and fixtures and amortized on a straight-line basis over their estimated useful lives.

Repair and maintenance costs are expensed when incurred. Expenditures for remodels, refurbishments and improvements that add to or change the way an asset functions or that extend the useful life are capitalized. Assets removed during the remodel, refurbishment or improvement are retired. Assets classified as held-for-sale at the end of 2020 and 2019 were immaterial. The following table summarizes the Company's property and equipment balances at the end of 2020 and 2019:

	Estimated Useful Lives	2020	2019
Land	N/A	$ 6,696	$ 6,417
Buildings and improvements	5-50 years	17,982	17,136
Equipment and fixtures	3-20 years	8,749	7,801
Construction in progress	N/A	1,276	1,272
		34,703	32,626
Accumulated depreciation and amortization		(12,896)	(11,736)
Property and equipment, net		$ 21,807	$ 20,890

The Company evaluates long-lived assets for impairment on an annual basis, when relocating or closing a facility, or when events or changes in circumstances may indicate the carrying amount of the asset group, generally an individual warehouse, may not be fully recoverable. For asset groups held and used, including warehouses to be relocated, the carrying value of the asset group is considered recoverable when the estimated future undiscounted cash flows generated from the use and eventual disposition of the asset group exceed the respective carrying value. In the event that the carrying value is not considered recoverable, an impairment loss is recognized for the asset group to be held and used equal to the excess of the carrying value above the estimated fair value of the asset group. For asset groups classified as held-for-sale (disposal group), the carrying value is compared to the disposal group's fair value less costs to sell. The Company estimates fair value by obtaining market appraisals from third party brokers or using other valuation techniques. There were no impairment charges recognized in 2020, 2019 or 2018.

Leases

The Company leases land and/or buildings at warehouses and certain other office and distribution facilities. Leases generally contain one or more of the following options, which the Company can exercise at the end of the initial term: (a) renew the lease for a defined number of years at the then-fair market rental rate or rate stipulated in the lease agreement; (b) purchase the property at the then-fair market value; or (c) a right of first refusal in the event of a third-party offer.

Some leases include free-rent periods and step-rent provisions, which are recognized on a straight-line basis over the original term of the lease and any extension options that the Company is reasonably certain to exercise from the date the Company has control of the property. Certain leases provide for periodic rent increases based on price indices or the greater of minimum guaranteed amounts or sales volume. Our leases do not contain any material residual value guarantees or material restrictive covenants.

The Company determines at inception whether a contract is or contains a lease. The Company initially records right-of-use (ROU) assets and lease obligations for its finance and operating leases based on the discounted future minimum lease payments over the term. As the rate implicit in the Company's leases is not easily determinable, the present value of the sum of the lease payments is calculated using the Company's incremental borrowing rate. The rate is determined using a portfolio approach based on the rate of interest the Company would pay to borrow an amount equal to the lease payments on a collateralized basis over a similar term. The Company uses quoted interest rates from financial institutions to derive the incremental borrowing rate. The lease term is defined as the noncancelable period of the lease plus any options to extend when it is reasonably certain that the Company will exercise the option. Impairment of ROU assets is evaluated in a similar manner as described in Property and Equipment, Net above.

The Company's asset retirement obligations (ARO) primarily relate to leasehold improvements that at the end of a lease must be removed. These obligations are generally recorded as a discounted liability, with an offsetting asset at the inception of the lease term based upon the estimated fair value of the costs to remove the improvements. These liabilities are accreted over time to the projected future value of the obligation. The ARO assets are depreciated using the same depreciation method as the leasehold improvement assets and are included with buildings and improvements. Estimated ARO liabilities associated with these leases are included in other liabilities in the accompanying consolidated balance sheet.

Goodwill and Acquired Intangible Assets

Goodwill represents the excess of acquisition cost over the fair value of the net assets acquired and is not subject to amortization. The Company reviews goodwill annually in the fourth quarter for impairment or when circumstances indicate carrying value may exceed the fair value. This evaluation is performed at the reporting unit level. If a qualitative assessment indicates that it is more likely than not that the fair value is less than carrying value, a quantitative analysis is completed using either the income or market approach, or a combination of both. The income approach estimates fair value based on expected discounted future cash flows, while the market approach uses comparable public companies and transactions to develop metrics to be applied to historical and expected future operating results.

Goodwill is included in other long-term assets in the consolidated balance sheets. The following table summarizes goodwill by reportable segment:

	United States Operations	Canadian Operations	Other International Operations	Total
Balance at September 1, 2019	$ 13	$ 27	$ 13	$ 53
Changes in currency translation	—	—	1	1
Acquisition	934	—	—	934
Balance at August 30, 2020	$ 947	$ 27	$ 14	$ 988

Definite-lived intangible assets, which are not material, are included in other long-term assets on the consolidated balance sheets and are amortized on a straight-line basis over their estimated lives, which approximates the pattern of expected economic benefit.

Insurance/Self-insurance Liabilities

Claims for employee health care benefits, workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, inventory loss, and other exposures are funded predominantly through self-insurance. Insurance coverage is maintained in certain instances to limit exposures arising from very large losses. It uses different risk management mechanisms, including a wholly-owned captive insurance subsidiary (the captive) and participates in a reinsurance program. Liabilities associated with the risks that are retained by the Company are not discounted and are estimated, in part, by considering historical claims experience, demographic factors, severity factors, and other actuarial assumptions. The estimated accruals for these liabilities could be significantly affected if future occurrences and claims differ from these assumptions and historical trends. At the end of 2020 and 2019, these insurance liabilities were $1,188 and $1,222 in the aggregate, respectively, and were included in accrued salaries and benefits and other current liabilities in the consolidated balance sheets, classified based on their nature.

The captive receives direct premiums, which are netted against the Company's premium costs in selling, general and administrative expenses, in the consolidated statements of income. The captive participates in a reinsurance program that includes other third-party participants. The reinsurance agreement is one year in duration, and new agreements are entered into by each participant at their discretion at the commencement of the next calendar year. The participant agreements and practices of the reinsurance program limit a participating members' individual risk. Income statement adjustments related to the reinsurance program and related impacts to the consolidated balance sheets are recognized as information becomes known. In the event the Company leaves the reinsurance program, the Company retains its primary obligation to the policyholders for prior activity.

Derivatives

The Company is exposed to foreign-currency exchange-rate fluctuations in the normal course of business. It manages these fluctuations, in part, through the use of forward foreign-exchange contracts, seeking to economically hedge the impact of fluctuations of foreign exchange on known future expenditures denominated in a non-functional foreign-currency. The contracts relate primarily to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries with functional currencies other than the U.S. dollar. Currently, these contracts do not qualify for derivative hedge accounting. The Company seeks to mitigate risk with the use of these contracts and does not intend to engage in speculative transactions. Some of these contracts contain credit-risk-related contingent features that require settlement of outstanding contracts upon certain triggering events. The aggregate fair value amounts of derivative instruments in a net liability position and the amount needed to settle the instruments immediately if the credit-risk-related contingent features were triggered were immaterial at the end of 2020 and 2019. The aggregate notional amounts of open, unsettled forward foreign-exchange contracts were $1,036 and $704 at the end of 2020 and 2019, respectively. See Note 4 for information on the fair value of unsettled forward foreign-exchange contracts at the end of 2020 and 2019.

The unrealized gains or losses recognized in interest income and other, net in the accompanying consolidated statements of income relating to the net changes in the fair value of unsettled forward foreign-exchange contracts were immaterial in 2020, 2019 and 2018.

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

Foreign Currency

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

The Company recognizes foreign-currency transaction gains and losses related to revaluing or settling monetary assets and liabilities denominated in currencies other than the functional currency in interest income and other, net in the consolidated statements of income. Generally, these include the U.S. dollar cash and cash equivalents and the U.S. dollar payables of consolidated subsidiaries revalued to their functional currency. Also included are realized foreign-currency gains or losses from settlements of forward foreign-exchange contracts. These items were immaterial in 2020, 2019, and 2018.

Revenue Recognition

The Company adopted Accounting Standards Update (ASU) 2014-09 in 2019, which provided for changes in the recognition of revenue from contracts with customers. The Company recognizes sales for the amount of consideration collected from the member, which includes gross shipping fees where applicable, and is net of sales taxes collected and remitted to government agencies and member returns. The Company reserves for estimated returns based on historical trends in merchandise returns and reduces sales and merchandise costs accordingly. The Company records, on a gross basis, a refund liability and an asset for recovery, which are included in other current liabilities and other current assets, respectively, in the consolidated balance sheets.

The Company offers merchandise in the following core merchandise categories: food and sundries, hardlines, softlines, and fresh foods. The Company also provides expanded products and services through warehouse ancillary and other businesses. The majority of revenue from merchandise sales is recognized at the point of sale. Revenue generated through e-commerce or special orders is generally recognized upon shipment to the member. For merchandise shipped directly to the member, shipping and handling costs are expensed as incurred as fulfillment costs and included in merchandise costs in the consolidated statements of income. In certain ancillary businesses, revenue is deferred until the member picks up merchandise at the warehouse. Deferred sales are included in other current liabilities in the consolidated balance sheets.

The Company is the principal for the majority of its transactions and recognizes revenue on a gross basis. The Company is the principal when it has control of the merchandise or service before it is transferred to the member, which generally is established when Costco is primarily responsible for merchandising decisions, maintains the relationship with the member, including assurance of member service and satisfaction, and has pricing discretion.

The Company accounts for membership fee revenue, net of refunds, on a deferred basis, ratably over the one-year membership period. Deferred membership fees at the end of 2020 and 2019 were $1,851 and $1,711, respectively.

In most countries, the Company's Executive members qualify for a 2% reward on qualified purchases (up to a maximum of approximately $1,000 per year), which does not expire and can be redeemed only at Costco warehouses. The Company accounts for this reward as a reduction in sales, net of the estimated impact of non-redemptions (breakage), with the corresponding liability classified as accrued member rewards in the consolidated balance sheets. Estimated breakage is computed based on redemption data. For 2020, 2019 and 2018, the net reduction in sales was $1,707, $1,537, and $1,394 respectively.

The Company sells and otherwise provides proprietary shop cards that do not expire and are redeemable at the warehouse or online for merchandise or membership. Revenue from shop cards is recognized upon redemption, and estimated breakage is recognized based on redemption data. The Company accounts for outstanding shop card balances as a shop card liability, net of estimated breakage.

Citibank, N.A. ("Citi") became the exclusive issuer of co-branded credit cards to U.S. members in June 2016. The Company receives various forms of consideration, including a royalty on purchases made on the card outside of Costco, a portion of which, after giving rise to estimated breakage, is used to fund the rebate that cardholders receive. The rebates are issued in February and expire on December 31. Breakage is estimated based on redemption data.

Merchandise Costs

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

Vendor Consideration

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

Selling, General and Administrative Expenses

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

Retirement Plans

The Company's 401(k) retirement plan is available to all U.S. employees over the age of 18 who have completed 90 days of employment. The plan allows participants to make wage deferral contributions, a portion of which the Company matches. In addition, the Company provides each eligible participant an annual discretionary contribution. The Company also has a defined contribution plan for Canadian employees and contributes a percentage of each employee's wages. Certain subsidiaries in the Company's Other International operations have defined benefit and defined contribution plans that are not material. Amounts expensed under all plans were $676, $614, and $578 for 2020, 2019, and 2018, respectively, and are predominantly included in selling, general and administrative expenses in the consolidated statements of income.

Stock-Based Compensation

RSUs granted to employees generally vest over five years and allow for quarterly vesting of the pro-rata number of stock-based awards that would vest on the next anniversary of the grant date in the event of retirement or voluntary termination. Actual forfeitures are recognized as they occur.

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

Stock-based compensation expense is predominantly included in selling, general and administrative expenses in the consolidated statements of income. Certain stock-based compensation costs are capitalized or included in the cost of merchandise. See Note 8 for additional information on the Company's stock-based compensation plans.

Preopening Expenses

Preopening expenses include costs for startup operations related to new warehouses and relocations, developments in new international markets, new manufacturing and distribution facilities, and expansions at existing warehouses and are expensed as incurred.

Income Taxes

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

The timing and amounts of deductible and taxable items and the probability of sustaining uncertain tax positions requires significant judgment. The benefits of uncertain tax positions are recorded in the Company's consolidated financial statements only after determining a more-likely-than-not probability that the uncertain tax positions will withstand challenge from tax authorities. When facts and circumstances change, the Company reassesses these probabilities and records any changes as appropriate.

Net Income per Common Share Attributable to Costco

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

Stock Repurchase Programs

Repurchased shares of common stock are retired, in accordance with the Washington Business Corporation Act. The par value of repurchased shares is deducted from common stock and the excess repurchase price over par value is deducted by allocation to additional paid-in capital and retained earnings. The amount allocated to additional paid-in capital is the current value of additional paid-in capital per share outstanding and is applied to the number of shares repurchased. Any remaining amount is allocated to retained earnings. See Note 7 for additional information.

Recent Accounting Pronouncements Adopted

In February 2016, the Financial Accounting Standards Board (FASB) issued ASU 2016-02 - Leases (ASC 842), which required recognition on the balance sheet for the rights and obligations created by leases with terms greater than 12 months. The Company adopted ASC 842, using the modified retrospective transition method and used September 2, 2019, as the date of initial application. Consequently, the comparative periods presented continue to be in accordance with ASC 840, Leases, previously in effect.

The Company elected the package of practical expedients permitted under the transition guidance, allowing the Company to carry forward conclusions related to: (a) whether expired or existing contracts contain leases; (b) lease classification; and (c) initial direct costs for existing leases. The Company has elected not to record operating lease right-of-use assets or lease liabilities associated with leases with durations of 12 months or less. The Company elected the practical expedient allowing aggregation of non-lease components with related lease components when evaluating the accounting treatment for all classes of underlying assets.

Adoption of the new standard resulted in an initial increase to assets and liabilities of $2,632, related to recognition of operating lease right-of-use assets and operating lease obligations as of September 2, 2019. Other impacts in the Company's consolidated balance sheet were not material. The standard did not materially impact the consolidated statements of income and cash flows. For more information on the Company's lease arrangements refer to Note 6.

Note 2—Acquisition of Innovel

On March 17, 2020, the Company acquired Innovel Solutions for $998, using existing cash and cash equivalents. Cash paid excludes the final settlement of certain holdbacks and provisional amounts, discussed below. As part of the acquisition, in the fourth quarter of 2020, a payment of $25 was made relating to certain holdbacks. Innovel provides final-mile delivery, installation and white-glove capabilities for big and bulky products across the United States and Puerto Rico. Its financial results have been included in the Company's consolidated financial statements from the date of acquisition. Innovel's results of operations were not material to the Company's consolidated results during 2020. Pro forma results are thus not considered meaningful.

As of August 30, 2020, the initial accounting for the acquisition was incomplete, pending determination of the final purchase price, working capital adjustments, the fair value of operating lease right-of-use assets, operating lease liabilities, and other assumed obligations. The net purchase price of $998 was allocated to tangible and intangible assets of $283 and liabilities assumed of $219, based on their preliminary fair values on the acquisition date. The remaining unallocated net purchase price of $934 was recorded as goodwill. Goodwill represents the acquisition's benefits to the Company, which include the ability to serve more members and improve delivery times, enabling growth in certain segments of our U.S. e-commerce operations. The Company assigned this goodwill, which is deductible for tax purposes, to reporting units within the U.S. segment. The changes to the purchase price allocation originally recorded in the third quarter of 2020 were not material. As additional information becomes available, the provisional fair value estimates will be refined.

Note 3—Investments

The Company's investments were as follows:

2020:	Cost Basis	Unrealized Gains, Net	Recorded Basis
Available-for-sale:			
Government and agency securities	$ 436	$ 12	$ 448
Held-to-maturity:			
Certificates of deposit	580	—	580
Total short-term investments	$ 1,016	$ 12	$ 1,028

2019:	Cost Basis	Unrealized Gains, Net	Recorded Basis
Available-for-sale:			
Government and agency securities	$ 716	$ 6	$ 722
Held-to-maturity:			
Certificates of deposit	338	—	338
Total short-term investments	$ 1,054	$ 6	$ 1,060

Gross unrecognized holding gains and losses on available-for-sale securities were not material for the years ended August 30, 2020, and September 1, 2019. At the end of 2020, there were no available-for-sale securities in a continuous unrealized-loss position. At the end of 2019, available-for-sale securities that were in a continuous unrealized-loss position were not material. There were no sales of available-for-sale securities during 2020 or 2019.

The maturities of available-for-sale and held-to-maturity securities at the end of 2020 are as follows:

	Available-For-Sale		
	Cost Basis	Fair Value	Held-To-Maturity
Due in one year or less	$ 172	$ 173	$ 580
Due after one year through five years	264	275	—
Total	$ 436	$ 448	$ 580

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Note 4—Fair Value Measurement

Assets and Liabilities Measured at Fair Value on a Recurring Basis

The table below presents information regarding the Company's financial assets and financial liabilities that are measured at fair value on a recurring basis and indicate the level within the hierarchy reflecting the valuation techniques utilized to determine such fair value.

	Level 2	
	2020	2019
Investment in government and agency securities[1]	$ 508	$ 766
Forward foreign-exchange contracts, in asset position[2]	1	15
Forward foreign-exchange contracts, in (liability) position[2]	(21)	(4)
Total	$ 488	$ 777

(1) At August 30, 2020, $60 cash and cash equivalents and $448 short-term investments are included in the accompanying consolidated balance sheets. At September 1, 2019, $44 cash and cash equivalents and $722 short-term investments are included in the consolidated balance sheets.
(2) The asset and the liability values are included in other current assets and other current liabilities, respectively, in the consolidated balance sheets.

At August 30, 2020, and September 1, 2019, the Company did not hold any Level 1 or 3 financial assets or liabilities that were measured at fair value on a recurring basis. There were no transfers between levels during 2020 or 2019.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Assets and liabilities recognized and disclosed at fair value on a nonrecurring basis include items such as financial assets measured at amortized cost and long-lived nonfinancial assets. These assets are measured at fair value if determined to be impaired. There were no fair value adjustments to these items during 2020 or 2019.

Note 5—Debt

Short-Term Borrowings

The Company maintains various short-term bank credit facilities, with a borrowing capacity of $967 and $865, in 2020 and 2019, respectively. Borrowings on these short-term facilities were immaterial during 2020 and 2019, and there were no outstanding borrowings at the end of 2020 and 2019.

Long-Term Debt

The Company's long-term debt consists primarily of Senior Notes, described below. The Company at its option may redeem the Senior Notes at any time, in whole or in part, at a redemption price plus accrued interest. The redemption price is equal to the greater of 100% of the principal amount or the sum of the present value of the remaining scheduled payments of principal and interest to maturity. Additionally, upon certain events, the holder has the right to require the Company to purchase this security at a price of 101% of the principal amount plus accrued and unpaid interest to the date of the event. Interest on all outstanding long-term debt is payable semi-annually. The estimated fair value of Senior Notes is valued using Level 2 inputs.

In April 2020, the Company issued $4,000 in aggregate principal amount of Senior Notes as follows: $1,250 of 1.375% due June 2027; $1,750 of 1.600% due April 2030; and $1,000 of 1.750% due April 2032. In May 2020, a portion of the proceeds from the issuance were used to repay, prior to maturity, the outstanding $1,000 and $500 principal balances and interest on the 2.150% and 2.250% Senior Notes, respectively. The early redemption resulted in a $36 charge which was recorded in interest income and other, net in 2020. The remaining funds are intended for general corporate purposes.

In December 2019, the Company paid the outstanding $1,200 principal balance and interest on the 1.700% Senior Notes, with existing sources of cash and cash equivalents and short-term investments. In February 2020, the Company paid the outstanding $500 principal balance and interest on the 1.750% Senior Notes, with existing sources of cash and cash equivalents and short-term investments.

Other long-term debt consists of Guaranteed Senior Notes issued by the Company's Japanese subsidiary, valued using Level 3 inputs. In August 2019, the Company's Japanese subsidiary issued approximately $200 and $100 of Guaranteed Senior Notes at fixed interest rates of 0.28% and 0.42%, respectively. Interest is payable semi-annually, and principal is due in August 2029 and August 2034, respectively.

At the end of 2020 and 2019, the fair value of the Company's long-term debt, including the current portion, was approximately $7,987 and $6,997, respectively. The carrying value of long-term debt consisted of the following:

	2020	2019
1.700% Senior Notes due December 2019	$ —	$ 1,200
1.750% Senior Notes due February 2020	—	500
2.150% Senior Notes due May 2021	—	1,000
2.250% Senior Notes due February 2022	—	500
2.300% Senior Notes due May 2022	800	800
2.750% Senior Notes due May 2024	1,000	1,000
3.000% Senior Notes due May 2027	1,000	1,000
1.375% Senior Notes due June 2027	1,250	—
1.600% Senior Notes due April 2030	1,750	—
1.750% Senior Notes due April 2032	1,000	—
Other long-term debt	857	852
Total long-term debt	7,657	6,852
Less unamortized debt discounts and issuance costs	48	29
Less current portion[(1)]	95	1,699
Long-term debt, excluding current portion	$ 7,514	$ 5,124

(1) Net of unamortized debt discounts and issuance costs.

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

2021	$ 95
2022	800
2023	95
2024	1,114
2025	142
Thereafter	5,411
Total	$ 7,657

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Note 6—Leases

The tables below present information regarding the Company's lease assets and liabilities.

		2020
Assets		
Operating lease right-of-use assets	$	2,788
Finance lease assets[1]		592
Total lease assets	$	3,380
Liabilities		
Current		
Operating lease liabilities[2]	$	231
Finance lease liabilities[2]		31
Long-term		
Operating lease liabilities		2,558
Finance lease liabilities[3]		657
Total lease liabilities	$	3,477

(1) Included in other long-term assets in the consolidated balance sheets.
(2) Included in other current liabilities in the consolidated balance sheets.
(3) Included in other long-term liabilities in the consolidated balance sheets.

	2020
Weighted-average remaining lease term (years)	
Operating leases	21
Finance leases	20
Weighted-average discount rate	
Operating leases	2.23 %
Finance leases	6.34 %

The components of lease expense, excluding short-term lease costs and sublease income (which were not material), were as follows:

		2020
Operating lease costs[1]	$	252
Finance lease costs:		
Amortization of lease assets[1]		31
Interest on lease liabilities[2]		33
Variable lease costs[3]		87
Total lease costs	$	403

(1) Included in selling, general and administrative expenses and merchandise costs in the consolidated statements of income.
(2) Included in interest expense in the consolidated statements of income.

(3) Included in selling, general and administrative expenses and merchandise costs in the consolidated statements of income. Amount excludes property taxes, which were immaterial.

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Supplemental cash flow information related to leases was as follows:

		2020
Cash paid for amounts included in the measurement of lease liabilities:		
Operating cash flows — operating leases	$	258
Operating cash flows — finance leases		33
Financing cash flows — finance leases		49
Leased assets obtained in exchange for operating lease liabilities		354
Leased assets obtained in exchange for finance lease liabilities		317

As of August 30, 2020, future minimum payments during the next five fiscal years and thereafter are as follows:

		Operating Leases[(1)]		Finance Leases
2021	$	273	$	61
2022		253		62
2023		246		66
2024		212		63
2025		176		134
Thereafter		2,410		742
Total[(2)]		3,570		1,128
Less amount representing interest		781		440
Present value of lease liabilities	$	2,789	$	688

(1) Operating lease payments have not been reduced by future sublease income of $101.
(2) Excludes $280 of lease payments for leases that have been signed but not commenced.

As of September 1, 2019, future minimum payments, net of sub-lease income of $105, under noncancelable operating leases with terms of at least one year and capital leases reported under ASC 840 were as follows:

		Operating Leases		Capital Leases
2020	$	239	$	51
2021		229		53
2022		202		38
2023		193		39
2024		181		39
Thereafter		2,206		544
Total	$	3,250		764
Less amount representing interest				343
Net present value of minimum lease payments			$	421

Note 7—Stockholders' Equity

Dividends

Cash dividends declared in 2020 totaled $2.70 per share, as compared to $2.44 per share in 2019. The Company's current quarterly dividend rate is $0.70 per share.

Stock Repurchase Programs

The Company's stock repurchase program is conducted under a $4,000 authorization by the Board of Directors, which expires in April 2023. As of the end of 2020, the remaining amount available under the approved plan was $3,745. The following table summarizes the Company's stock repurchase activity:

	Shares Repurchased (000's)	Average Price per Share	Total Cost
2020	643	$ 308.45	$ 198
2019	1,097	225.16	247
2018	1,756	183.13	322

These amounts may differ from repurchases of common stock in the consolidated statements of cash flows due to changes in unsettled stock repurchases at the end of each fiscal year. Purchases are made from time to time, as conditions warrant, in the open market or in block purchases and pursuant to plans under SEC Rule 10b5-1.

Note 8—Stock-Based Compensation Plans

The Company grants stock-based compensation, primarily to employees and non-employee directors. Grants to all executive officers are performance-based. Through a series of shareholder approvals, there have been amended and restated plans and new provisions implemented by the Company. RSUs are subject to quarterly vesting upon retirement or voluntary termination. Employees who attain at least 25 years of service with the Company receive shares under accelerated vesting provisions on the annual vesting date. The 2019 Incentive Plan authorized the issuance of 17,500,000 shares (10,000,000 RSUs) of common stock for future grants, plus the remaining shares that were available for grant and the future forfeited shares from grants under the previous plan, up to a maximum aggregate of 27,800,000 shares (15,885,000 RSUs). The Company issues new shares of common stock upon vesting of RSUs. Shares for vested RSUs are generally delivered to participants annually, net of shares withheld for taxes.

Summary of Restricted Stock Unit Activity

RSUs granted to employees and to non-employee directors generally vest over five and three years, respectively. Additionally, the terms of the RSUs, including performance-based awards, provide for accelerated vesting for employees and non-employee directors who have attained 25 or more and five or more years of service with the Company, respectively. Recipients are not entitled to vote or receive dividends on unvested and undelivered shares. At the end of 2020, 13,624,000 shares were available to be granted as RSUs under the 2019 Incentive Plan.

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The following awards were outstanding at the end of 2020:

- 5,021,000 time-based RSUs that vest upon continued employment over specified periods of time;
- 153,000 performance-based RSUs, of which 123,000 were granted to executive officers subject to the determination of the attainment of performance targets for 2020. This determination occurred in September 2020, at which time at least 33% of the units vested, as a result of the long service of all executive officers. The remaining awards vest upon continued employment over specified periods of time.

The following table summarizes RSU transactions during 2020:

	Number of Units (in 000's)	Weighted-Average Grant Date Fair Value
Outstanding at the end of 2019	6,496	$ 167.55
Granted	2,252	294.08
Vested and delivered	(3,374)	188.92
Forfeited	(200)	197.45
Outstanding at the end of 2020	5,174	$ 207.55

The weighted-average grant date fair value of RSUs granted was $294.08, $224.00, and $156.19 in 2020, 2019, and 2018, respectively. The remaining unrecognized compensation cost related to non-vested RSUs at the end of 2020 was $697 and the weighted-average period of time over which this cost will be recognized is 1.6 years. Included in the outstanding balance at the end of 2020 were approximately 1,733,000 RSUs vested but not yet delivered.

Summary of Stock-Based Compensation

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

	2020	2019	2018
Stock-based compensation expense	$ 619	$ 595	$ 544
Less recognized income tax benefit	128	128	116
Stock-based compensation expense, net	$ 491	$ 467	$ 428

Note 9— Taxes

Income Taxes

Income before income taxes is comprised of the following:

	2020	2019	2018
Domestic	$ 4,204	$ 3,591	$ 3,182
Foreign	1,163	1,174	1,260
Total	$ 5,367	$ 4,765	$ 4,442

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The provisions for income taxes are as follows:

	2020	2019	2018
Federal:			
Current	$ 616	$ 328	$ 636
Deferred	77	222	(35)
Total federal	693	550	601
State:			
Current	230	178	190
Deferred	8	26	22
Total state	238	204	212
Foreign:			
Current	372	405	487
Deferred	5	(98)	(37)
Total foreign	377	307	450
Total provision for income taxes	$ 1,308	$ 1,061	$ 1,263

Except for certain provisions, the Tax Cuts and Jobs Act (2017 Tax Act) is effective for tax years beginning on or after January 1, 2018. The Company is a fiscal-year taxpayer, so most provisions became effective for fiscal 2019, including limitations on the Company's ability to claim foreign tax credits, repeal of the domestic manufacturing deduction, and limitations on certain business deductions. Provisions with significant impacts that were effective starting in the second quarter of fiscal 2018 and throughout fiscal 2019 included: a decrease in the U.S. federal income tax rate, remeasurement of certain net deferred tax liabilities, and a transition tax on deemed repatriation of certain foreign earnings. The decrease in the U.S. federal statutory income tax rate to 21.0% was effective for all of 2020 and 2019 and resulted in a blended rate for the Company of 25.6% for 2018.

The reconciliation between the statutory tax rate and the effective rate for 2020, 2019, and 2018 is as follows:

	2020		2019		2018	
Federal taxes at statutory rate	$ 1,127	21.0 %	$ 1,001	21.0 %	$ 1,136	25.6 %
State taxes, net	190	3.6	171	3.6	154	3.4
Foreign taxes, net	92	1.7	(1)	—	32	0.7
Employee stock ownership plan (ESOP)	(24)	(0.5)	(18)	(0.4)	(14)	(0.3)
2017 Tax Act	—	—	(123)	(2.6)	19	0.4
Other	(77)	(1.4)	31	0.7	(64)	(1.4)
Total	$ 1,308	24.4 %	$ 1,061	22.3 %	$ 1,263	28.4 %

During 2019, the Company recognized net tax benefits of $123 related to the 2017 Tax Act. This benefit primarily included $105 related to U.S. taxation of deemed foreign dividends, partially offset by losses of current year foreign tax credits. During 2018, the Company recognized a net tax expense of $19 related to the 2017 Tax Act. This expense included $142 for the estimated tax on deemed repatriation of foreign earnings, and $43 for the reduction in foreign tax credits and other immaterial items, largely offset by a tax benefit of $166 for the remeasurement of certain deferred tax liabilities.

The Company recognized total net tax benefits of $81, $221 and $57 in 2020, 2019 and 2018, respectively. These amounts include a benefit of $77, $59 and $33, respectively, related to the stock-based compensation accounting standard adopted in 2018 in addition to the impacts of the 2017 Tax Act noted above.

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

	2020	2019
Deferred tax assets:		
Equity compensation	$ 80	$ 74
Deferred income/membership fees	144	180
Foreign tax credit carry forward	101	65
Operating lease liabilities	832	—
Accrued liabilities and reserves	639	566
Total deferred tax assets	1,796	885
Valuation allowance	(105)	(76)
Total net deferred tax assets	1,691	809
Deferred tax liabilities:		
Property and equipment	(800)	(677)
Merchandise inventories	(228)	(187)
Operating lease right-of-use assets	(801)	—
Foreign branch deferreds	(81)	(69)
Other	(40)	(21)
Total deferred tax liabilities	$ (1,950)	$ (954)
Net deferred tax liabilities	$ (259)	$ (145)

The deferred tax accounts at the end of 2020 and 2019 include deferred income tax assets of $406 and $398, respectively, included in other long-term assets; and deferred income tax liabilities of $665 and $543, respectively, included in other long-term liabilities.

In 2020 and 2019, the Company recorded valuation allowances of $105 and $76, respectively, primarily related to foreign tax credits that the Company believes will not be realized due to limitations on the ability to claim the credits during the carry forward period. The foreign tax credit carry forwards are set to expire beginning in fiscal 2030.

The Company no longer considers fiscal year earnings of non-U.S. consolidated subsidiaries after 2017 to be indefinitely reinvested and has recorded the estimated incremental foreign withholding (net of available foreign tax credits) on fiscal year earnings and state income taxes payable assuming a hypothetical repatriation to the U.S. The Company continues to consider undistributed earnings of certain non-U.S. consolidated subsidiaries prior to 2018, which totaled $2,955, to be indefinitely reinvested and has not provided for withholding or state taxes.

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits for 2020 and 2019 is as follows:

	2020	2019
Gross unrecognized tax benefit at beginning of year	$ 27	$ 36
Gross increases—current year tax positions	1	5
Gross increases—tax positions in prior years	8	2
Gross decreases—tax positions in prior years	(3)	—
Settlements	—	(4)
Lapse of statute of limitations	(3)	(12)
Gross unrecognized tax benefit at end of year	$ 30	$ 27

The gross unrecognized tax benefit includes tax positions for which the ultimate deductibility is highly certain but there is uncertainty about the timing of such deductibility. At the end of 2020 and 2019, these amounts were immaterial. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of these tax positions would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority. The total amount of such unrecognized tax benefits that, if recognized, would favorably affect the effective income tax rate in future periods is $28 and $24 at the end of 2020 and 2019, respectively.

Accrued interest and penalties related to income tax matters are classified as a component of income tax expense. Accrued interest and penalties recognized during 2020 and 2019 and accrued at the end of each respective period were not material.

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

The Company files income tax returns in the United States, various state and local jurisdictions, in Canada, and in several other foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state or local examination for years before fiscal 2017. The Company is currently subject to examination in California for fiscal years 2013 to present.

Other Taxes

The Company is subject to multiple examinations for value added, sales-based, payroll, product, import or other non-income taxes in various jurisdictions. In certain cases, the Company has received assessments from the authorities. Subsequent to the end of 2019, the Company received an assessment related to a product tax audit covering multiple years. The Company recorded a charge of $123 in 2019. In the fourth quarter of 2020, the Company reached an agreement with the tax authority on this matter, resulting in a benefit of $84. Other possible losses or range of possible losses associated with these matters are either immaterial or an estimate of the possible loss or range of loss cannot be made at this time. If certain matters or a group of matters were to be decided adversely to the Company, it could result in a charge that might be material to the results of an individual fiscal quarter or year.

Note 10—Net Income per Common and Common Equivalent Share

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

	2020	2019	2018
Net income attributable to Costco	$ 4,002	$ 3,659	$ 3,134
Weighted average basic shares	442,297	439,755	438,515
RSUs	1,604	3,168	3,319
Weighted average diluted shares	443,901	442,923	441,834

Note 11—Commitments and Contingencies

Legal Proceedings

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

The Company is a defendant in an action under the California Labor Code Private Attorneys General Act (PAGA) alleging violation of California Wage Order 7-2001 for failing to provide seating to member service assistants who act as greeters in the Company's California warehouses. *Canela v. Costco Wholesale Corp., et al.* (Case No. 5:13-CV-03598; N.D. Cal.; filed July 1, 2013). The complaint seeks relief under the California Labor Code, including civil penalties and attorneys' fees. The Company filed an answer denying the material allegations of the complaint. The action has been remanded to state court.

In January 2019, an employee brought similar claims for relief concerning Costco employees engaged at member services counters in California. *Rodriguez v. Costco Wholesale Corp.* (Case No. RG19001310; Alameda Superior Court). The Company filed an answer denying the material allegations of the complaint. In December 2018, a depot employee raised similar claims, alleging that depot employees in California did not receive suitable seating or appropriate workplace temperature conditions. *Lane v. Costco Wholesale Corp.* (Dec. 6, 2018 Notice to California Labor and Workforce Development Agency). The Company filed an answer denying the material allegations of the complaint. In October 2019, the parties reached an agreement to settle the seating claims on a representative basis, which received court approval in February 2020.

In January 2019, a former seasonal employee filed a class action, alleging failure to provide California seasonal employees meal and rest breaks, proper wage statements, and appropriate wages. *Jadan v. Costco Wholesale Corp.* (Case No. 19-CV-340438; Santa Clara Superior Court). The complaint seeks relief under the California Labor Code, including civil penalties and attorneys' fees. In October 2019, the parties reached an agreement on a class settlement, which received preliminary court approval in July 2020.

In March 2019, employees filed a class action against the Company alleging claims under California law for failure to pay overtime, to provide meal and rest periods and itemized wage statements, to timely pay wages due to terminating employees, to pay minimum wages, and for unfair business practices. Relief is sought under the California Labor Code, including civil penalties and attorneys' fees. *Nevarez v. Costco Wholesale Corp.* (Case No. 2:19-cv-03454; C.D. Cal.). The Company filed an answer denying the material allegations of the complaint. In December 2019, the court issued an order denying class certification. In January 2020, the plaintiffs dismissed their Labor Code claims without prejudice, and the court remanded the action to state court. The remand is being appealed.

In May 2019, an employee filed a class action against the Company alleging claims under California law for failure to pay overtime, to provide itemized wage statements, to timely pay wages due to terminating employees, to pay minimum wages, and for unfair business practices. *Rough v. Costco Wholesale Corp*. (Case No. 2:19-cv-01340; E.D. Cal.). Relief is sought under the California Labor Code, including civil penalties and attorneys' fees. In August 2019, Rough filed a companion case in state court seeking penalties under PAGA. *Rough v. Costco Wholesale Corp.* (Case No. FCS053454; Sonoma County Superior Court). Relief is sought under the California Labor Code, including civil penalties and attorneys' fees. The state court action has been stayed pending resolution of the federal action.

In June 2019, an employee filed a class action against the Company alleging claims under California law for failure to pay overtime, to provide meal and rest periods, itemized wage statements, to timely pay wages due to terminating employees, to pay minimum wages, and for unfair business practices. *Martinez v. Costco Wholesale Corp*. (Case No. 3:19-cv-05624; N.D. Cal.). The Company filed an answer denying the material allegations of the complaint.

In April 2020, an employee, alleging underpayment of sick pay, filed a class and representative action against the Company, alleging claims under California law for failure to pay all wages at termination and for Labor Code penalties under PAGA. *Kristy v. Costco Wholesale Corp.* (Case No. 20CV366341; Santa Clara County Superior Court). A motion to dismiss was filed as to plaintiff's amended complaint, the case has been stayed due to the plaintiff's bankruptcy.

In July 2020, an employee filed an action under PAGA on behalf of all California non-exempt employees alleging violations of California Labor Code provisions regarding meal and rest periods, minimum wage, overtime, wage statements, reimbursement of expenses, and payment of wages at termination. *Schwab v. Costco Wholesale Corporation* (Case No. 37-2020-00023551-CU-OE-CTL; San Diego County Superior Court). In August 2020, the Company filed a motion to strike portions of the complaint.

In December 2017, the United States Judicial Panel on Multidistrict Litigation consolidated numerous cases concerning the impacts of opioid abuses filed against various defendants by counties, cities, hospitals, Native American tribes, third-party payors, and others. *In re National Prescription Opiate Litigation* (MDL No. 2804) (N.D. Ohio). Included are federal cases that name the Company, including actions filed by counties and cities in Michigan, New Jersey, Oregon, Virginia and South Carolina, a third-party payor in Ohio, and class actions filed on behalf of infants born with opioid-related medical conditions in 40 states, and class actions and individual actions filed on behalf of individuals seeking to recover alleged increased insurance costs associated with opioid abuse in 43 states and American Samoa. In 2019, similar actions were commenced against the Company in state court in Utah. Claims against the Company in state courts in New Jersey, Oklahoma, and Arizona have been dismissed. The Company is defending all of these matters.

The Company and its CEO and CFO are defendants in putative class actions brought on behalf of shareholders who acquired Company stock between June 6 and October 25, 2018. *Johnson v. Costco Wholesale Corp., et al.* (W.D. Wash.; filed Nov. 5, 2018); *Chen v. Costco Wholesale Corp., et al.* (W.D. Wash.; filed Dec. 11, 2018). The complaints allege violations of the federal securities laws stemming from the Company's disclosures concerning internal control over financial reporting. They seek unspecified damages, equitable relief, interest, and costs and attorneys' fees. On January 30, 2019, an order was entered consolidating the actions, and a consolidated amended complaint was filed on April 16, 2019. On November 26, 2019, the court entered an order dismissing the consolidated amended complaint and granting the plaintiffs leave to file a further amended complaint. A further amended complaint was filed on March 9, which the court dismissed with prejudice on August 19, 2020. Plaintiffs filed a notice of appeal in September 2020.

Members of the Board of Directors, one other individual, and the Company are defendants in a shareholder derivative action related to the internal controls and related disclosures identified in the putative class actions, alleging that the individual defendants breached their fiduciary duties. *Wedekind v. Hamilton James, Susan Decker, Kenneth Denman, Richard Galanti, Craig Jelinek, Richard Libenson, John Meisenbach, Charles Munger, Jeffrey Raikes, John Stanton, Mary Agnes Wilderotter, and Costco Wholesale Corp.* (W.D. Wash.; filed Dec. 11, 2018). The complaint seeks unspecified damages, disgorgement of compensation, corporate governance changes, and costs and attorneys' fees. Because the complaint is derivative in nature, it does not seek monetary damages from the Company, which is a nominal defendant. By agreement among the parties the action has been stayed pending further proceedings in the class action. Similar actions were filed in King County Superior Court on February 20, 2019, *Elliott v. Hamilton James, Susan Decker, Kenneth Denman, Richard Galanti, Craig Jelinek, Richard Libenson, John Meisenbach, Charles Munger, Jeffrey Raikes, John Stanton, Mary Agnes Wilderotter, and Costco Wholesale Corp.* (Case No. 19-2-04824-7), April 16, 2019, *Brad Shuman, et ano. v. Hamilton James, Susan Decker, Kenneth Denman, Richard Galanti, Craig Jelinek, John Meisenbach, Charles Munger, Jeffrey Raikes, John Stanton, Mary Agnes Wilderotter, and Costco Wholesale Corp.* (Case No. 19-2-10460-1), and June 12, 2019, *Rahul Modi v. Hamilton James, Susan Decker, Kenneth Denman, Richard Galanti, Craig Jelinek, John Meisenbach, Charles Munger, Jeffrey Raikes, John Stanton, Mary Agnes Wilderotter, and Costco Wholesale Corp.* (Case No. 19-2-15514-1). These actions have also been stayed.

On June 23, 2020, a putative class action was filed against the Company, the "Board of Directors," the "Costco Benefits Committee" and others under the Employee Retirement Income Security Act, in the United States District Court for the Eastern District of Wisconsin. *Dustin S. Soulek v. Costco Wholesale, et al.*, Case No. 20-cv-937. The class is alleged to be beneficiaries of the Costco 401(k) plan from June 23, 2014, and the claims are that the defendants breached their fiduciary duties in the operation and oversight of the plan. The complaint seeks injunctive relief, damages, interest, costs, and attorneys' fees. On September 11, the defendants filed a motion to dismiss the complaint, and on September 21 the plaintiffs filed an amended complaint.

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

Note 12—Segment Reporting

The Company and its subsidiaries are principally engaged in the operation of membership warehouses in the U.S., Canada, Mexico, U.K., Japan, Korea, Australia, Spain, Iceland, France, and China and through a majority-owned subsidiary in Taiwan. Reportable segments are largely based on management's organization of the operating segments for operational decisions and assessments of financial performance, which considers geographic locations. The material accounting policies of the segments are as described in Note 1. Inter-segment net sales and expenses have been eliminated in computing total revenue and operating income. Certain operating expenses, predominantly stock-based compensation, incurred on behalf of the Company's Canadian and Other International operations, are included in the U.S. operations because those costs generally come under the responsibility of U.S. management.

The following table provides information for the Company's reportable segments:

	United States Operations	Canadian Operations	Other International Operations	Total
2020				
Total revenue	$ 122,142	$ 22,434	$ 22,185	$ 166,761
Operating income	3,633	860	942	5,435
Depreciation and amortization	1,248	155	242	1,645
Additions to property and equipment	2,060	258	492	2,810
Property and equipment, net	14,916	2,172	4,719	21,807
Total assets	38,366	5,270	11,920	55,556
2019				
Total revenue	$ 111,751	$ 21,366	$ 19,586	$ 152,703
Operating income	3,063	924	750	4,737
Depreciation and amortization	1,126	143	223	1,492
Additions to property and equipment	2,186	303	509	2,998
Property and equipment, net	14,367	2,044	4,479	20,890
Total assets	32,162	4,369	8,869	45,400
2018				
Total revenue	$ 102,286	$ 20,689	$ 18,601	$ 141,576
Operating income	2,787	939	754	4,480
Depreciation and amortization	1,078	135	224	1,437
Additions to property and equipment	2,046	268	655	2,969
Property and equipment, net	13,353	1,900	4,428	19,681
Total assets	28,207	4,303	8,320	40,830

Disaggregated Revenue

The following table summarizes net sales by merchandise category; sales from business centers and e-commerce websites have been allocated to their respective categories:

	2020	2019	2018
Food and sundries	$ 68,659	$ 59,672	$ 56,073
Hardlines	27,729	24,570	22,620
Fresh foods	23,204	19,948	18,879
Softlines	17,078	16,590	15,387
Ancillary and other	26,550	28,571	25,475
Total net sales	$ 163,220	$ 149,351	$ 138,434

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Note 13—Quarterly Financial Data (Unaudited)

The two tables that follow reflect the unaudited quarterly results of operations for 2020 and 2019.

	52 Weeks Ended August 30, 2020					
	First Quarter (12 Weeks)	Second Quarter (12 Weeks)	Third Quarter (12 Weeks)	Fourth Quarter (16 Weeks)		Total (52 Weeks)
REVENUE						
Net sales	$ 36,236	$ 38,256	$ 36,451	$ 52,277		$ 163,220
Membership fees	804	816	815	1,106		3,541
Total revenue	37,040	39,072	37,266	53,383		166,761
OPERATING EXPENSES						
Merchandise costs (1)	32,233	34,056	32,249	46,401		144,939
Selling, general and administrative (2)	3,732	3,743	3,830	5,027	(3)	16,332
Preopening expenses	14	7	8	26		55
Operating income	1,061	1,266	1,179	1,929		5,435
OTHER INCOME (EXPENSE)						
Interest expense	(38)	(34)	(37)	(51)		(160)
Interest income and other, net	35	45	21	(9)		92
INCOME BEFORE INCOME TAXES	1,058	1,277	1,163	1,869		5,367
Provision for income taxes	202	330	311	465		1,308
Net income including noncontrolling interests	856	947	852	1,404		4,059
Net income attributable to noncontrolling interests	(12)	(16)	(14)	(15)		(57)
NET INCOME ATTRIBUTABLE TO COSTCO	$ 844	$ 931	$ 838	$ 1,389		$ 4,002
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO:						
Basic	$ 1.91	$ 2.10	$ 1.90	$ 3.14		$ 9.05
Diluted	$ 1.90	$ 2.10	$ 1.89	$ 3.13		$ 9.02
Shares used in calculation (000's)						
Basic	441,818	442,021	442,322	442,843		442,297
Diluted	443,680	443,727	443,855	444,231		443,901

(1) Includes $108 of incremental wage and sanitation costs as a result of COVID-19 of which $44 and $64 were recorded in the third and fourth quarters, respectively.

(2) Includes $456 of incremental wage and sanitation costs as a result of COVID-19 of which $239 and $217 were recorded in the third and fourth quarters, respectively.

(3) Includes a $84 benefit due to a partial reversal of an accrual for a product tax assessment in 2019.

	52 Weeks Ended September 1, 2019				
	First Quarter (12 Weeks)	Second Quarter (12 Weeks)	Third Quarter (12 Weeks)	Fourth Quarter (16 Weeks)	Total (52 Weeks)
REVENUE					
Net sales	$ 34,311	$ 34,628	$ 33,964	$ 46,448	$ 149,351
Membership fees	758	768	776	1,050	3,352
Total revenue	35,069	35,396	34,740	47,498	152,703
OPERATING EXPENSES					
Merchandise costs	30,623	30,720	30,233	41,310	132,886
Selling, general and administrative	3,475	3,464	3,371	4,684 (1)	14,994
Preopening expenses	22	9	14	41	86
Operating income	949	1,203	1,122	1,463	4,737
OTHER INCOME (EXPENSE)					
Interest expense	(36)	(34)	(35)	(45)	(150)
Interest income and other, net	22	46	36	74	178
INCOME BEFORE INCOME TAXES	935	1,215	1,123	1,492	4,765
Provision for income taxes	158	314	207	382	1,061
Net income including noncontrolling interests	777	901	916	1,110	3,704
Net income attributable to noncontrolling interests	(10)	(12)	(10)	(13)	(45)
NET INCOME ATTRIBUTABLE TO COSTCO	$ 767	$ 889	$ 906	$ 1,097	$ 3,659
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO:					
Basic	$ 1.75	$ 2.02	$ 2.06	$ 2.49	$ 8.32
Diluted	$ 1.73	$ 2.01	$ 2.05	$ 2.47	$ 8.26
Shares used in calculation (000's)					
Basic	439,157	440,284	439,859	439,727	439,755
Diluted	442,749	442,337	442,642	443,400	442,923

(1) Includes a $123 charge for a product tax assessment.

Item 9—Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A—Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended) are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the SEC and to ensure that information required to be disclosed is accumulated and communicated to management, including our principal executive and financial officers, to allow timely decisions regarding disclosure. The Chief Executive Officer and the Chief Financial Officer, with assistance from other members of management, have reviewed the effectiveness of our disclosure controls and procedures as of August 30, 2020 and, based on their evaluation, have concluded that the disclosure controls and procedures were effective as of such date.

Management's Annual Report on Internal Control Over Financial Reporting

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

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

Under the supervision of and with the participation of our management, we assessed the effectiveness of our internal control over financial reporting as of August 30, 2020, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control—Integrated Framework (2013).

Based on its assessment, management has concluded that our internal control over financial reporting was effective as of August 30, 2020. The attestation of KPMG LLP, our independent registered public accounting firm, on the effectiveness of our internal control over financial reporting is included with the consolidated financial statements in Item 8 of this Report.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) or 15d-15(f) of the Exchange Act) that occurred during the fourth quarter of 2020 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

/s/ W. CRAIG JELINEK

W. Craig Jelinek
President, Chief Executive Officer and Director

/s/ RICHARD A. GALANTI

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

Item 9B—Other Information

None.

PART III

Item 10—Directors, Executive Officers and Corporate Governance

Information relating to the availability of our code of ethics for senior financial officers and a list of our executive officers appear in Part I, Item 1 of this Report. The information required by this Item concerning our directors and nominees for director is incorporated herein by reference to the sections entitled "Proposal 1: Election of Directors," "Directors" and "Committees of the Board" in Costco's Proxy Statement for its 2021 annual meeting of shareholders, which will be filed with the SEC within 120 days of the end of our fiscal year ("Proxy Statement").

Item 11—Executive Compensation

The information required by this Item is incorporated herein by reference to the sections entitled "Compensation of Directors," "Executive Compensation," and "Compensation Discussion and Analysis" in Costco's Proxy Statement.

Item 12—Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item is incorporated herein by reference to the section entitled "Principal Shareholders" and "Equity Compensation Plan Information" in Costco's Proxy Statement.

Item 13—Certain Relationships and Related Transactions, and Director Independence

The information required by this Item is incorporated herein by reference to the sections entitled "Proposal 1: Election of Directors," "Directors," "Committees of the Board," "Shareholder Communications to the Board," "Meeting Attendance," "Report of the Compensation Committee of the Board of Directors," "Certain Relationships and Transactions" and "Report of the Audit Committee" in Costco's Proxy Statement.

Item 14—Principal Accounting Fees and Services

The information required by this Item is incorporated herein by reference to the sections entitled "Independent Public Accountants" in Costco's Proxy Statement.

PART IV

Item 15—Exhibits, Financial Statement Schedules

(a) Documents filed as part of this report are as follows:

1. Financial Statements:

   See the listing of Financial Statements included as a part of this Form 10-K in Item 8 of Part II.

2. Financial Statement Schedules:

   All schedules have been omitted because the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements, including the notes thereto.

(b) Exhibits: The required exhibits are filed as part of this Annual Report on Form 10-K or are incorporated herein by reference.

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference		
			Form	Period Ended	Filing Date
3.1	Articles of Incorporation as amended of Costco Wholesale Corporation		10-Q	2/16/2020	3/12/2020
3.2	Bylaws as amended of Costco Wholesale Corporation		8-K		1/29/2020
3.2.1	Amendments to Sections 3.3, 3.4, and 3.6 of the Bylaws of Costco Wholesale Corporation (to be effective and first apply with respect to the Company's 2022 Annual Meeting of Shareholders)		8-K		9/16/2020
4.1	First Supplemental Indenture between Costco Wholesale Corporation and U.S. Bank National Association, as Trustee, dated as of March 20, 2002 (incorporated by reference to Exhibits 4.1 and 4.2 to the Company's Current Report on the Form 8-K filed on March 25, 2002)		8-K		3/25/2002
4.2	Form of 1.375% Senior Notes due June 20, 2027		8-K		4/17/2020
4.3	Form of 1.600% Senior Notes due April 20, 2030		8-K		4/17/2020
4.4	Form of 1.750% Senior Notes due April 20, 2032		8-K		4/17/2020
4.5	Form of 2.300% Senior Notes due May 18, 2022		8-K		5/16/2017
4.6	Form of 2.750% Senior Notes due May 18, 2024		8-K		5/16/2017

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Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ended	Filing Date
4.7	Form of 3.000% Senior Notes due May 18, 2027		8-K		5/16/2017
4.8	Description of Common Stock	x			
10.1*	Costco Wholesale Executive Health Plan		10-K	9/2/2012	10/19/2012
10.2*	2019 Incentive Plan		DEF 14		12/17/2019
10.3*	Seventh Restated 2002 Stock Incentive Plan		DEF 14A		12/19/2014
10.3.1*	2019 Stock Incentive Plan Restricted Stock Unit Award Agreement-Employee		10-Q	11/24/2019	12/23/2019
10.3.2*	2019 Stock Incentive Plan Restricted Stock Unit Award Agreement - Non-U.S. Employee		10-Q	11/24/2019	12/23/2019
10.3.3*	2019 Stock Incentive Plan Restricted Stock Unit Award Agreement-Non-Executive Director		10-Q	11/24/2019	12/23/2019
10.3.4*	2019 Stock Incentive Plan Letter Agreement for 2020 Performance-Based Restricted Stock Units-Executive		10-Q	11/24/2019	12/23/2019
10.4*	Fiscal 2020 Executive Bonus Plan		8-K		10/21/2019
10.5*	Executive Employment Agreement, effective January 1, 2017, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/20/2016	12/16/2016
10.5.1*	Extension of the Term of the Executive Employment Agreement, effective January 1, 2019, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/25/2018	12/20/2018
10.5.2*	Extension of the Term of the Executive Employment Agreement, effective January 1, 2020, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/24/2019	12/23/2019
10.6	Form of Indemnification Agreement		14A		12/13/1999
10.7*	Deferred Compensation Plan		10-K	9/1/2013	10/16/2013
10.8**	Citibank, N.A. Co-Branded Credit Card Agreement		10-Q/A	5/10/2015	8/31/2015
10.8.1**	First Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	11/22/2015	12/17/2015

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Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ended	Filing Date
10.8.2**	Second Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/14/2016	3/9/2016
10.8.3**	Third Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-K	8/28/2016	10/12/2016
10.8.4**	Fourth Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/18/2018	3/15/2018
10.8.5**	Fifth Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/17/2019	3/13/2019
10.8.6**	Sixth Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-K	9/1/2019	10/11/2019
21.1	Subsidiaries of the Company	x			
23.1	Consent of Independent Registered Public Accounting Firm	x			
31.1	Rule 13a – 14(a) Certifications	x			
32.1	Section 1350 Certifications	x			
101.INS	Inline XBRL Instance Document	x			
101.SCH	Inline XBRL Taxonomy Extension Schema Document	x			
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document	x			
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document	x			
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document	x			
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document	x			
104	Cover Page Interactive Data File (formatted as inline XBRL and contained in Exhibit 101)	x			

* Management contract, compensatory plan or arrangement.
** Portions of this exhibit have been omitted under a confidential treatment order issued by the Securities and Exchange Commission.

(c) Financial Statement Schedules—None.

Item 16—Form 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

October 6, 2020

COSTCO WHOLESALE CORPORATION
(Registrant)

By /s/ RICHARD A. GALANTI
Richard A. Galanti
Executive Vice President, Chief Financial Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

October 6, 2020

By /s/ W. CRAIG JELINEK W. Craig Jelinek *President, Chief Executive Officer and Director*	By /s/ HAMILTON E. JAMES Hamilton E. James *Chairman of the Board*
By /s/ RICHARD A. GALANTI Richard A. Galanti *Executive Vice President, Chief Financial Officer and Director* *(Principal Financial Officer)*	By /s/ DANIEL M. HINES Daniel M. Hines *Senior Vice President and Corporate Controller* *(Principal Accounting Officer)*
By /s/ SUSAN L. DECKER Susan L. Decker *Director*	By /s/ KENNETH D. DENMAN Kenneth D. Denman *Director*
By /s/ SALLY JEWELL Sally Jewell *Director*	By /s/ CHARLES T. MUNGER Charles T. Munger *Director*
By /s/ JEFFREY S. RAIKES Jeffrey S. Raikes *Director*	By /s/ JOHN W. STANTON John W. Stanton *Director*
By /s/ MARY (MAGGIE) A. WILDEROTTER Mary (Maggie) A. Wilderotter *Director*	

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended September 1, 2019

or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 0-20355

Costco Wholesale Corporation

(Exact name of registrant as specified in its charter)

Washington	**91-1223280**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

999 Lake Drive, Issaquah, WA 98027

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(425) 313-8100**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Trading Symbol	Name of each exchange on which registered
Common Stock, $.01 Par Value	COST	The NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ☒ NO ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ☐ NO ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES ☒ NO ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES ☒ NO ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒	Accelerated filer ☐
Non-accelerated filer ☐	Smaller reporting company ☐
Emerging growth company ☐	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES ☐ NO ☒

The aggregate market value of the voting stock held by non-affiliates of the registrant as of February 17, 2019 was 95,005,703,244.

The number of shares outstanding of the registrant's common stock as of October 3, 2019 was 439,656,950.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company's Proxy Statement for the Annual Meeting of Shareholders to be held on January 22, 2020, are incorporated by reference into Part III of this Form 10-K.

COSTCO WHOLESALE CORPORATION
ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED SEPTEMBER 1, 2019

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INFORMATION RELATING TO FORWARD LOOKING STATEMENTS

Certain statements contained in this Report constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. They include statements that address activities, events, conditions or developments that we expect or anticipate may occur in the future and may relate to such matters as sales growth, changes in comparable sales, cannibalization of existing locations by new openings, price or fee changes, earnings performance, earnings per share, stock-based compensation expense, warehouse openings and closures, capital spending, the effect of adopting certain accounting standards, future financial reporting, financing, margins, return on invested capital, strategic direction, expense controls, membership renewal rates, shopping frequency, litigation, and the demand for our products and services. Forward-looking statements may also be identified by the words "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "may," "might," "likely," "plan," "potential," "predict," "project," "seek," "should," "target," "will," "would," or similar expressions and the negatives of those terms. Such forward-looking statements involve risks and uncertainties that may cause actual events, results, or performance to differ materially from those indicated by such statements, including, without limitation, the factors set forth in the section titled "Item 1A-Risk Factors", and other factors noted in the section titled "Item 7-Management's Discussion and Analysis of Financial Condition and Results of Operations" and in the consolidated financial statements and related notes in Item 8 of this Report. Forward-looking statements speak only as of the date they are made, and we do not undertake to update these statements, except as required by law.

PART I

Item 1—Business

Costco Wholesale Corporation and its subsidiaries (Costco or the Company) began operations in 1983, in Seattle, Washington. We are principally engaged in the operation of membership warehouses in the United States (U.S.) and Puerto Rico, Canada, United Kingdom (U.K.), Mexico, Japan, Korea, Australia, Spain, France, Iceland, China, and through a majority-owned subsidiary in Taiwan. Costco operated 782, 762, and 741 warehouses worldwide at September 1, 2019, September 2, 2018, and September 3, 2017, respectively. Our common stock trades on the NASDAQ Global Select Market, under the symbol "COST."

We report on a 52/53-week fiscal year, consisting of thirteen four-week periods and ending on the Sunday nearest the end of August. The first three quarters consist of three periods each, and the fourth quarter consists of four periods (five weeks in the thirteenth period in a 53-week year). The material seasonal impact in our operations is increased net sales and earnings during the winter holiday season. References to 2019 and 2018 relate to the 52-week fiscal years ended September 1, 2019, and September 2, 2018, respectively. References to 2017 relate to the 53-week fiscal year ended September 3, 2017.

General

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

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

Our average warehouse space is approximately 146,000 square feet, with newer units being slightly larger. Floor plans are designed for economy and efficiency in the use of selling space, the handling of merchandise, and the control of inventory. Because shoppers are attracted principally by the quality of merchandise and low prices, our warehouses are not elaborate. By strictly controlling the entrances and exits and using a membership format, we believe our inventory losses (shrinkage) are well below those of typical retail operations.

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

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

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

We offer merchandise in the following categories:

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

Ancillary businesses within or next to our warehouses provide expanded products and services, encouraging members to shop more frequently. These businesses include gas stations, pharmacies, optical dispensing centers, food courts, and hearing-aid centers. The number of warehouses with gas stations varies significantly by country, and we do not currently operate our gasoline business in Korea, France or China. We operated 593 gas stations at the end of 2019. Net sales for our gasoline business represented approximately 11% of total net sales in 2019.

Our e-commerce operations allow us to connect with our members online and provide additional products and services, many not found in our warehouses. At the end of 2019, we operated e-commerce websites in the U.S., Canada, Mexico, U.K., Korea, and Taiwan. Net sales for e-commerce represented approximately 4% of total net sales in 2019. Additionally, we offer business delivery, travel and various other services online in certain countries.

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

Certain financial information for our segments and geographic areas is included in Note 11 to the consolidated financial statements included in Item 8 of this Report.

Membership

Our members may utilize their memberships at our warehouses worldwide. Gold Star memberships are available to individuals; Business memberships are limited to businesses, including individuals with a business license, retail sales license or comparable document. Business members may add additional cardholders (affiliates), to which the same annual fee applies. Affiliates are not available for Gold Star members. Our annual fee for these memberships is $60 in our U.S. and Canadian operations and varies in other countries. All paid memberships include a free household card.

Our member renewal rate was 91% in the U.S. and Canada and 88% on a worldwide basis at the end of 2019. The majority of members renew within six months following their renewal date. Our renewal rate is a trailing calculation that captures renewals during the period seven to eighteen months prior to the reporting date.

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

	2019	2018	2017
Gold Star	42,900	40,700	38,600
Business, including affiliates	11,000	10,900	10,800
Total paid members	53,900	51,600	49,400
Household cards	44,600	42,700	40,900
Total cardholders	98,500	94,300	90,300

Paid cardholders (except affiliates) are eligible to upgrade to an Executive membership in the U.S. and Canada, for an additional annual fee of $60. Executive memberships are also available in Mexico, the U.K., and Korea, for which the additional annual fee varies. Executive members earn a 2% reward on qualified purchases (up to a maximum reward of $1,000 per year in the U.S. and Canada and varies in Mexico, the U.K. and Korea), which can be redeemed only at Costco warehouses. This program also offers (except in Mexico and Korea), access to additional savings and benefits on various business and consumer services, such as auto and home insurance, the Costco auto purchase program, and check printing. These services are generally provided by third parties and vary by state and country. Executive members, who represented 39% of paid members at the end of 2019, generally shop more frequently and spend more than other members.

Labor

Our employee count was as follows:

	2019	2018	2017
Full-time employees	149,000	143,000	133,000
Part-time employees	105,000	102,000	98,000
Total employees	254,000	245,000	231,000

Approximately 16,000 employees are union employees. We consider our employee relations to be very good.

Competition

Our industry is highly competitive, based on factors such as price, merchandise quality and selection, location, convenience, distribution strategy, and customer service. We compete on a worldwide basis with global, national, and regional wholesalers and retailers, including supermarkets, supercenters, internet retailers, gasoline stations, hard discounters, department and specialty stores, and operators selling a single category or narrow range of merchandise. Walmart, Target, Kroger, and Amazon.com are among our significant general merchandise retail competitors. We also compete with other warehouse clubs (primarily Walmart's Sam's Club and BJ's Wholesale Club), and many of the major metropolitan areas in the U.S. and certain of our Other International locations have multiple club operations.

Intellectual Property

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

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

Available Information

Our U.S. website is www.costco.com. We make available through the Investor Relations section of that site, free of charge, our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, Proxy Statements and Forms 3, 4 and 5, and any amendments to those reports, as soon as reasonably practicable after filing such materials with or furnishing such documents to the Securities and Exchange Commission (SEC). The information found on our website is not part of this or any other report filed with or furnished to the SEC. The SEC maintains a site that contains reports, proxy and information statements, and other information regarding issuers, such as the Company, that file electronically with the SEC at www.sec.gov.

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

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Information about our Executive Officers

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

Name	Position	Executive Officer Since	Age
W. Craig Jelinek	President and Chief Executive Officer. Mr. Jelinek has been President and Chief Executive Officer since January 2012 and a director since February 2010. He was President and Chief Operating Officer from February 2010 to December 2011. Prior to that he was Executive Vice President, Chief Operating Officer, Merchandising since 2004.	1995	67
Richard A. Galanti	Executive Vice President and Chief Financial Officer. Mr. Galanti has been a director since January 1995.	1993	63
Jim C. Klauer	Executive Vice President, Chief Operating Officer, Northern Division. Mr. Klauer was Senior Vice President, Non Foods and E-commerce merchandise, from 2013 to January 2018.	2018	57
Patrick J. Callans	Executive Vice President, Administration. Mr. Callans was Senior Vice President, Human Resources and Risk Management, from 2013 to December 2018.	2019	57
Russ D. Miller	Executive Vice President, Chief Operating Officer, Southern Division and Mexico. Mr. Miller was Senior Vice President, Western Canada Region, from 2001 to January 2018.	2018	62
Paul G. Moulton	Executive Vice President, Chief Information Officer. Mr. Moulton was Executive Vice President, Real Estate Development, from 2001 until March 2010.	2001	68
James P. Murphy	Executive Vice President, Chief Operating Officer, International. Mr. Murphy was Senior Vice President, International, from 2004 to October 2010.	2011	66
Joseph P. Portera	Executive Vice President, Chief Operating Officer, Eastern and Canadian Divisions. Mr. Portera has held these positions since 1994 and has been the Chief Diversity Officer since 2010.	1994	67
Timothy L. Rose	Executive Vice President, Ancillary Businesses, Manufacturing, and Business Centers. Mr. Rose was Senior Vice President, Merchandising, Food and Sundries and Private Label, from 1995 to December 2012.	2013	67
Ron M. Vachris	Executive Vice President, Chief Operating Officer, Merchandising. Mr. Vachris was Senior Vice President, Real Estate Development, from August 2015 to June 2016, and Senior Vice President, General Manager, Northwest Region, from 2010 to July 2015.	2016	54

Item 1A—Risk Factors

The risks described below could materially and adversely affect our business, financial condition and results of operations. We could also be affected by additional risks that apply to all companies operating in the U.S. and globally, as well as other risks that are not presently known to us or that we currently consider to be immaterial. These Risk Factors should be carefully reviewed in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 and our consolidated financial statements and related notes in Item 8 of this Report.

Business and Operating Risks

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

Our financial and operational performance is highly dependent on our U.S. and Canadian operations, which comprised 87% and 84% of net sales and operating income in 2019, respectively. Within the U.S., we are highly dependent on our California operations, which comprised 30% of U.S. net sales in 2019. Our California market, in general, has a larger percentage of higher volume warehouses as compared to our other domestic markets. Any substantial slowing or sustained decline in these operations could materially adversely affect our business and financial results. Declines in financial performance of our U.S. operations, particularly in California, and our Canadian operations could arise from, among other things: slow growth or declines in comparable warehouse sales (comparable sales); negative trends in operating expenses, including increased labor, healthcare and energy costs; failing to meet targets for warehouse openings; cannibalizing existing locations with new warehouses; shifts in sales mix toward lower gross margin products; changes or uncertainties in economic conditions in our markets, including higher levels of unemployment and depressed home values; and failing to consistently provide high quality and innovative new products.

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

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

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

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

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

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

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

Disruptions in our merchandise distribution or processing, packaging, manufacturing, and other facilities could adversely affect sales and member satisfaction.

We depend on the orderly operation of the merchandise receiving and distribution process, primarily through our depots. We also rely upon processing, packaging, manufacturing and other facilities to support our business, which includes the production of certain private-label items. Although we believe that our operations are efficient, disruptions due to fires, tornadoes, hurricanes, earthquakes or other catastrophic events, labor issues or other shipping problems may result in delays in the production and delivery of merchandise to our warehouses, which could adversely affect sales and the satisfaction of our members.

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

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

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

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

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

We previously identified a material weakness in our internal control related to ineffective information technology general controls and if we fail to maintain an effective system of internal control in the future, this could result in loss of investor confidence and adversely impact our stock price.

Internal controls related to the operation of technology systems are critical to maintaining adequate internal control over financial reporting. We reported in our Annual Report on Form 10-K as of September 2, 2018, a material weakness in internal control related to ineffective information technology general controls (ITGCs) in the areas of user access and program change-management over certain information technology systems that support the Company’s financial reporting processes. During 2019, we completed the remediation measures related to the material weakness and concluded that our internal control over financial reporting was effective as of September 1, 2019. Completion of remediation does not provide assurance that our remediation or other controls will continue to operate properly. If we are unable to maintain effective internal control over financial reporting or disclosure controls and procedures, our ability to record, process and report financial information accurately, and to prepare financial statements within required time periods could be adversely affected, which could subject us to litigation or investigations requiring management resources and payment of legal and other expenses, negatively affect investor confidence in our financial statements and adversely impact our stock price.

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

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

The use of data by our business and our business associates is highly regulated in all of our operating countries. Privacy and information-security laws and regulations change, and compliance with them may result in cost increases due to, among other things, systems changes and the development of new processes. If we or those with whom we share information fail to comply with laws and regulations, such as the General Data Protection Regulation (GDPR) and California Consumer Privacy Act (CCPA), our reputation could be damaged, possibly resulting in lost business, and we could be subjected to additional legal risk or financial losses as a result of non-compliance.

We have security measures and controls to protect personal and business information and continue to make investments to secure access to our information technology network. These measures may be undermined, however, due to the actions of outside parties, employee error, internal or external malfeasance, or otherwise, and, as a result an unauthorized party may obtain access to our data systems and misappropriate business and personal information. Because the techniques used to obtain unauthorized access, disable or degrade service, or sabotage systems change frequently and may not immediately produce signs of intrusion, we may be unable to anticipate these techniques, timely discover or counter them, or implement adequate

preventative measures. Any such breach or unauthorized access could result in significant legal and financial exposure, damage to our reputation, and potentially have an adverse effect on our business and results of operations.

We are subject to payment-related risks.

We accept payments using a variety of methods, including cash and checks, select credit and debit cards, and our shop card. As we offer new payment options to our members, we may be subject to additional rules, regulations, compliance requirements, and higher fraud losses. For certain payment methods, we pay interchange and other related acceptance fees, along with additional transaction processing fees. We rely on third parties to provide payment transaction processing services for credit and debit cards and our shop card. It could disrupt our business if these companies become unwilling or unable to provide these services to us. We are also subject to evolving payment card association and network operating rules, including data security rules, certification requirements and rules governing electronic funds transfers. For example, we are subject to Payment Card Industry Data Security Standards ("PCI DSS"), which contain compliance guidelines and standards with regard to our security surrounding the physical and electronic storage, processing and transmission of individual cardholder data. If our internal systems are breached or compromised, we may be liable for card re-issuance costs, subject to fines and higher transaction fees and lose our ability to accept card payments from our members, and our business and operating results could be adversely affected.

We might sell products that cause illness or injury to our members, harm to our reputation, and expose us to litigation.

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

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

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

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

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

We may incur property, casualty or other losses not covered by our insurance.

The Company is predominantly self-insured for employee health care benefits, workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, and inventory loss. Insurance coverage is maintained in certain instances to limit exposures arising from very large losses. The types and amounts of insurance may vary from time to time based on our decisions with respect to risk retention and regulatory requirements. Significant claims or events, regulatory changes, a substantial rise in costs of health care or costs to maintain our insurance or the failure to maintain adequate insurance coverage could have an adverse impact on our financial condition and results of operations.

Although we maintain specific coverages for catastrophic property losses, we still bear the risk of losses incurred as a result of any physical damage to, or the destruction of, any warehouses, depots, manufacturing or home office facilities, loss or spoilage of inventory, and business interruption caused by any such events to the extent they are below catastrophic levels of coverage, as well as any losses to the extent they exceed our aggregate limits of applicable coverages. Such losses could materially impact our cash flows and results of operations.

Market and Other External Risks

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

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

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

Higher energy and gasoline costs, inflation, levels of unemployment, healthcare costs, consumer debt levels, foreign-currency exchange rates, unsettled financial markets, weaknesses in housing and real estate markets, reduced consumer confidence, changes and uncertainties related to government fiscal and tax policies including changes in tax rates, duties, tariffs, or other restrictions, sovereign debt crises, and other

economic factors could adversely affect demand for our products and services, require a change in product mix, or impact the cost of or ability to purchase inventory. Additionally, actions in various countries, particularly China and the United States, have created uncertainty with respect to tariff impacts on the costs of some of our merchandise. The degree of our exposure is dependent on (among other things) the type of goods, rates imposed, and timing of the tariffs. The impact to our business, including net sales and gross margin, will be influenced in part by merchandising and pricing strategies in response to potential cost increases by us and our competitors. While these potential impacts are uncertain, they could have an adverse impact on our financial results.

Prices of certain commodities, including gasoline and consumable goods used in manufacturing and our warehouse retail operations, are historically volatile and are subject to fluctuations arising from changes in domestic and international supply and demand, labor costs, competition, market speculation, government regulations, taxes and periodic delays in delivery. Rapid and significant changes in commodity prices and our ability and desire to pass them through to our members may affect our sales and profit margins. These factors could also increase our merchandise costs and selling, general and administrative expenses, and otherwise adversely affect our operations and financial results. General economic conditions can also be affected by events like the outbreak of war or acts of terrorism.

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

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

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

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

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

During 2019, our international operations, including Canada, generated 27% and 35% of our net sales and operating income, respectively. Our international operations have accounted for an increasing portion of our warehouses, and we plan to continue international growth. To prepare our consolidated financial statements, we translate the financial statements of our international operations from local currencies into U.S. dollars using current exchange rates. Future fluctuations in exchange rates that are unfavorable to us may adversely affect the financial performance of our Canadian and Other International operations and have a corresponding adverse period-over-period effect on our results of operations. As we continue to expand internationally, our exposure to fluctuations in foreign exchange rates may increase.

A portion of the products we purchase is paid for in a currency other than the local currency of the country in which the goods are sold. Currency fluctuations may increase our cost of goods and may not be passed on to members. Consequently, fluctuations in currency exchange rates may adversely affect our results of operations.

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

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

Factors associated with climate change could adversely affect our business.

We use natural gas, diesel fuel, gasoline, and electricity in our distribution and warehouse operations. U.S. and foreign government regulations limiting carbon dioxide and other greenhouse gas emissions may increase compliance and merchandise costs, and other regulation affecting energy inputs could materially affect our profitability. Climate change and extreme weather conditions, such as hurricanes, thunderstorms, tornadoes, and snow or ice storms, as well as rising sea levels could affect our ability to procure commodities at costs and in quantities we currently experience. We also sell a substantial amount of gasoline, the demand for which could be impacted by concerns about climate change and which could face increased regulation.

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

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

Legal and Regulatory Risks

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

At the end of 2019, we operated 239 warehouses outside of the U.S., and we plan to continue expanding our international operations. Future operating results internationally could be negatively affected by a variety of factors, many similar to those we face in the U.S., certain of which are beyond our control. These factors include political and economic conditions, regulatory constraints, currency regulations, policy changes such as the U.K.'s vote to withdraw from the European Union, commonly known as "Brexit", and other matters in any of the countries or regions in which we operate, now or in the future. Other factors that may impact international operations include foreign trade (including tariffs and trade sanctions), monetary and fiscal policies and the laws and regulations of the U.S. and foreign governments, agencies and similar organizations, and risks associated with having major facilities in locations which have been historically less stable than the U.S. Risks inherent in international operations also include, among others, the costs and difficulties of managing international operations, adverse tax consequences, and difficulty in enforcing intellectual property rights.

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

Accounting principles and related pronouncements, implementation guidelines, and interpretations we apply to a wide range of matters that are relevant to our business, including self-insurance liabilities and income taxes, are highly complex and involve subjective assumptions, estimates and judgments by our management. Changes in rules or interpretation or changes in underlying assumptions, estimates or judgments by our management could significantly change our reported or expected financial performance and have a material impact on our consolidated financial statements.

We could be subject to additional tax liabilities.

We are subject to a variety of taxes and tax collection and remittance obligations in the U.S. and numerous foreign jurisdictions. Additionally, at any point in time, we may be under examination for value added, sales-based, payroll, product, import or other non-income taxes. We may recognize additional tax expense, be subject to additional tax liabilities, or incur losses and penalties, due to changes in laws, regulations, administrative practices, principles, assessments by authorities and interpretations related to tax, including tax rules in various jurisdictions. We compute our income tax provision based on enacted tax rates in the countries in which we operate. As tax rates vary among countries, a change in earnings attributable to the various jurisdictions in which we operate could result in an unfavorable change in our overall tax provision. Additionally, changes in the enacted tax rates or adverse outcomes in tax audits, including transfer pricing disputes, could have a material adverse effect on our financial condition and results of operations.

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

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

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

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

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Item 1B—Unresolved Staff Comments

None.

Item 2—Properties

Warehouse Properties

At September 1, 2019, we operated 782 membership warehouses:

	Own Land and Building	Lease Land and/or Building[1]	Total
United States and Puerto Rico	437	106	543
Canada	86	14	100
Mexico	38	1	39
United Kingdom	23	6	29
Japan	13	13	26
Korea	12	4	16
Taiwan	—	13	13
Australia	8	3	11
Spain	2	—	2
Iceland	—	1	1
France	1	—	1
China	—	1	1
Total	620	162	782

(1) 114 of the 162 leases are land-only leases, where Costco owns the building.

The following schedule shows warehouse openings, net of closings and relocations, and expected openings through December 31, 2019:

	United States	Canada	Other International	Total	Total Warehouses in Operation
2015 and prior	480	89	117	686	686
2016	21	2	6	29	715
2017	13	6	7	26	741
2018	13	3	5	21	762
2019	16	—	4	20	782
2020 (expected through 12/31/2019)	3	—	—	3	785
Total	546	100	139	785	

At the end of 2019, our warehouses contained approximately 113.9 million square feet of operating floor space: 79.9 million in the U.S.; 14.0 million in Canada; and 20.0 million in Other International. We operate 24 depots, with approximately 11.0 million square feet, for the distribution of most merchandise shipments to the warehouses. Additionally, we operate various fulfillment, processing, packaging, manufacturing and other facilities to support our business, which includes the production of certain private-label items. Our executive offices are located in Issaquah, Washington, and we maintain 19 regional offices in the U.S., Canada and Other International locations.

Item 3—Legal Proceedings

See discussion of Legal Proceedings in Note 10 to the consolidated financial statements included in Item 8 of this Report.

Item 4—Mine Safety Disclosures

Not applicable.

PART II

Item 5—Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information and Dividend Policy

Our common stock is traded on the NASDAQ Global Select Market under the symbol "COST." On October 3, 2019, we had 9,115 stockholders of record.

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

Issuer Purchases of Equity Securities

The following table sets forth information on our common stock repurchase activity for the fourth quarter of 2019 (dollars in millions, except per share data):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program(1)	Maximum Dollar Value of Shares that May Yet be Purchased under the Program
May 13—June 9, 2019	39,000	$ 246.12	39,000	$ 3,985
June 10—July 7, 2019	36,000	263.30	36,000	3,976
July 8—August 4, 2019	54,000	278.15	54,000	3,961
August 5—September 1, 2019	65,000	275.37	65,000	3,943
Total fourth quarter	194,000	$ 268.08	194,000	

(1) The repurchase program is conducted under a $4,000 authorization approved by our Board of Directors in April 2019, which expires in April 2023. This authorization revoked previously authorized but unused amounts, totaling $2,237.

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Performance Graph

The following graph compares the cumulative total shareholder return (stock price appreciation and the reinvestment of dividends) on an investment of $100 in Costco common stock, S&P 500 Index, and the S&P 500 Retail Index over the five years from August 31, 2014, through September 1, 2019.

chart-06f127ca9abf5974832a02.jpg

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Item 6—Selected Financial Data

The following table sets forth information concerning our consolidated financial condition, operating results, and key operating metrics. This information should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, included in Item 7 of this Report, and our consolidated financial statements and notes thereto, included in Item 8 of this Report.

SELECTED FINANCIAL DATA

(dollars in millions, except per share data)

As of and for the year ended	Sept. 1, 2019 (52 weeks)	Sept. 2, 2018 (52 weeks)	Sept. 3, 2017 (53 weeks)	Aug. 28, 2016 (52 weeks)	Aug. 30, 2015 (52 weeks)
RESULTS OF OPERATIONS					
Net sales	$ 149,351	$ 138,434	$ 126,172	$ 116,073	$ 113,666
Membership fees	3,352	3,142	2,853	2,646	2,533
Gross margin[1] as a percentage of net sales	11.02 %	11.04 %	11.33 %	11.35 %	11.09 %
Selling, general and administrative expenses as a percentage of net sales	10.04 %	10.02 %	10.26 %	10.40 %	10.07 %
Operating income	$ 4,737	$ 4,480	$ 4,111	$ 3,672	$ 3,624
Net income attributable to Costco	3,659	3,134	2,679	2,350	2,377
Net income per diluted common share attributable to Costco	8.26	7.09	6.08	5.33	5.37
Cash dividends declared per common share	2.44	2.14	8.90	1.70	6.51
Changes in comparable sales[2]					
United States	8 %	9 %	4 %	1 %	3 %
Canada	2 %	9 %	5 %	(3 %)	(5 %)
Other International	2 %	11 %	2 %	(3 %)	(3 %)
Total Company	6 %	9 %	4 %	0 %	1 %
Changes in Total Company comparable sales excluding the impact of changes in foreign currency and gasoline prices [3]	6 %	7 %	4 %	4 %	7 %
BALANCE SHEET DATA					
Net property and equipment	$ 20,890	$ 19,681	$ 18,161	$ 17,043	$ 15,401
Total assets	45,400	40,830	36,347	33,163	33,017
Long-term debt, excluding current portion	5,124	6,487	6,573	4,061	4,852
Costco stockholders' equity	15,243	12,799	10,778	12,079	10,617
WAREHOUSE INFORMATION					
Warehouses in Operation					
Beginning of year	762	741	715	686	663
Opened	25	25	28	33	26
Closed due to relocation	(5)	(4)	(2)	(4)	(3)
End of year	782	762	741	715	686
MEMBERSHIP INFORMATION					
Total paid members (000's)	53,900	51,600	49,400	47,600	44,600

(1) Net sales less merchandise costs.

(2) Includes net sales from warehouses and websites operating for more than one year. For 2017, the prior year includes the comparable 53 weeks.

(3) Excluding the impact of the revenue recognition standard for the year ended September 1, 2019. See Note 1 in Item 8.

Item 7—Management's Discussion and Analysis of Financial Conditions and Results of Operations
(amounts in millions, except per share, share, membership fee, and warehouse count data)

Overview

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

Our philosophy is to provide our members with quality goods and services at competitive prices. We do not focus in the short term on maximizing prices charged, but instead seek to maintain what we believe is a perception among our members of our “pricing authority” on quality goods – consistently providing the most competitive values. Our investments in merchandise pricing may include reducing prices on merchandise to drive sales or meet competition and holding prices steady despite cost increases instead of passing the increases on to our members, all negatively impacting gross margin as a percentage of net sales (gross margin percentage). We believe that our gasoline business draws members but it generally has a significantly lower gross margin percentage relative to our non-gasoline business. A higher penetration of gasoline sales will generally lower our gross margin percentage. Rapidly changing gasoline prices may significantly impact our near-term net sales growth. Generally, rising gasoline prices benefit net sales growth which, given the higher sales base, negatively impacts our gross margin percentage but decreases our selling, general and administrative (SG&A) expenses as a percentage of net sales. A decline in gasoline prices has the inverse effect. Additionally, actions in various countries, particularly China and the United States, have created uncertainty with respect to how tariffs will affect the costs of some of our merchandise. The degree of our exposure is dependent on (among other things) the type of goods, rates imposed, and timing of the tariffs. The impact to our net sales and gross margin will be influenced in part by our merchandising and pricing strategies in response to cost increases. While these potential impacts are uncertain, they could have an adverse impact on our results.

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

The membership format is an integral part of our business and has a significant effect on our profitability. This format is designed to reinforce member loyalty and provide continuing fee revenue. The extent to which we achieve growth in our membership base, increase the penetration of our Executive members, and sustain high renewal rates materially influences our profitability. Our paid membership growth rate may be adversely impacted when warehouse openings occur in existing markets as compared to new markets.

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

Our operating model is generally the same across our U.S., Canada, and Other International operating segments (see Note 11 to the consolidated financial statements included in Item 8 of this Report). Certain countries in the Other International segment have relatively higher rates of square footage growth, lower wages and benefits costs as a percentage of country sales, and/or less or no direct membership warehouse competition.

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

Our fiscal year ends on the Sunday closest to August 31. References to 2019 and 2018 relate to the 52-week fiscal years ended September 1, 2019, and September 2, 2018, respectively. References to 2017 relate to the 53-week fiscal year ended September 3, 2017. Certain percentages presented are calculated using actual results prior to rounding. Unless otherwise noted, references to net income relate to net income attributable to Costco.

Highlights for 2019 included:

- We opened 25 new warehouses, including 5 relocations: 16 net new locations in the U.S. and 4 in our Other International segment, including our first warehouse in China, compared to 25 new warehouses, including 4 relocations in 2018;
- Net sales increased 8% to $149,351 driven by a 6% increase in comparable sales and sales at new warehouses opened in 2018 and 2019;
- Membership fee revenue increased 7% to $3,352, primarily due to membership sign-ups at existing and new warehouses and the annual fee increase in the U.S. and Canada in June 2017.
- Gross margin percentage decreased two basis points. Excluding the impact of the new revenue recognition standard on net sales, gross margin as a percentage of adjusted net sales increased eight basis points;
- Selling, general & administrative (SG&A) expenses as a percentage of net sales increased two basis points. Excluding the impact of the new revenue recognition standard on net sales, SG&A as

a percentage of adjusted net sales increased 11 basis points, primarily related to a $123 charge for a product tax assessment;

- Effective March 2019, starting and supervisor wages were increased and paid bonding leave was made available for hourly employees in the U.S. and Canada. The estimated annualized pre-tax cost of these increases is approximately $50-$60;
- The effective tax rate in 2019 was 22.3% compared to 28.4% in 2018. Both years were favorably impacted by the Tax Cuts and Jobs Act (2017 Tax Act) and other net tax benefits;
- Net income increased 17% to $3,659, or $8.26 per diluted share compared to $3,134, or $7.09 per diluted share in 2018; and
- In April 2019, the Board of Directors approved an increase in the quarterly cash dividend from $0.57 to $0.65 per share and authorized a new share repurchase program in the amount of $4,000.

Results of operations

Net Sales

	2019	2018	2017
Net Sales	$ 149,351	$ 138,434	$ 126,172
Changes in net sales:			
U.S.	9 %	9 %	8 %
Canada	3 %	10 %	10 %
Other International	5 %	14 %	8 %
Total Company	8 %	10 %	9 %
Changes in comparable sales:			
U.S.	8 %	9 %	4 %
Canada	2 %	9 %	5 %
Other International	2 %	11 %	2 %
Total Company	6 %	9 %	4 %
Increases in comparable sales excluding the impact of changes in foreign currency and gasoline prices[(1)]:			
U.S.	6 %	7 %	4 %
Canada	5 %	4 %	4 %
Other International	6 %	7 %	4 %
Total Company	6 %	7 %	4 %

(1) Excluding the impact of the revenue recognition standard for the year ended September 1, 2019. See Note 1 in Item 8.

Net Sales

Net sales increased $10,917 or 8% during 2019, primarily due to a 6% increase in comparable sales and sales at new warehouses opened in 2018 and 2019.

Changes in foreign currencies relative to the U.S. dollar negatively impacted net sales by approximately $1,463, or 106 basis points, compared to 2018, attributable to our Canadian and Other International Operations. The revenue recognition standard positively impacted net sales by $1,332, or 96 basis points. Changes in gasoline prices did not have a material impact on net sales.

Comparable Sales

Comparable sales increased 6% during 2019 and were positively impacted by increases in both shopping frequency and average ticket. Comparable sales were negatively impacted by cannibalization (established warehouses losing sales to our newly opened locations).

Membership Fees

	2019	2018	2017
Membership fees	$ 3,352	$ 3,142	$ 2,853
Membership fees increase	7 %	10 %	8 %
Membership fees as a percentage of net sales	2.24 %	2.27 %	2.26 %

The increase in membership fees was primarily due to membership sign-ups at existing and new warehouses and the annual fee increase. Changes in foreign currencies relative to the U.S. dollar negatively impacted membership fees by approximately $30 in 2019. At the end of 2019, our member renewal rates were 91% in the U.S. and Canada and 88% worldwide.

As reported in 2017, we increased our annual membership fees in the U.S. and Canada and in certain of our Other International operations. We account for membership fee revenue on a deferred basis, recognized ratably over the one-year membership period. These fee increases had a positive impact of approximately $178 in 2018 and positively impacted 2019, primarily the first two quarters, by approximately $73.

Gross Margin

	2019	2018	2017
Net sales	$ 149,351	$ 138,434	$ 126,172
Less merchandise costs	132,886	123,152	111,882
Gross margin	$ 16,465	$ 15,282	$ 14,290
Gross margin percentage	11.02 %	11.04 %	11.33 %

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

Total gross margin percentage decreased two basis points compared to 2018. Excluding the impact of the revenue recognition standard on net sales, gross margin as a percentage of adjusted net sales was 11.12%, an increase of eight basis points. This increase was primarily due to a 19 basis point increase in our warehouse ancillary and other businesses, predominantly our gasoline business. This increase was partially offset by decreases of four basis points in our core merchandise categories, four basis points due to an adjustment to our estimate of breakage on rewards earned under our co-branded credit card program and three basis points due to increased spending by members under the Executive Membership 2% reward program. Changes in foreign currencies relative to the U.S. dollar negatively impacted gross margin by approximately $155 in 2019.

The segment gross margin percentage, when expressed as a percentage of the segment's own sales and excluding the impact of changes in gasoline prices on net sales (segment gross margin percentage), increased in our U.S. operations, predominantly in our warehouse ancillary and other businesses, primarily our gasoline business. This increase was partially offset by decreases in our core merchandise categories and the breakage adjustment noted above. The segment gross margin percentage in our Canadian operations decreased predominantly in hardlines and softlines and certain of our warehouse ancillary and other businesses, partially offset by an increase in fresh foods. The segment gross margin percentage in our Other International operations decreased primarily in our core merchandise categories and due to the introduction of the Executive Membership 2% reward program in Korea. This decrease was partially offset by an increase in our gasoline business.

Selling, General and Administrative Expenses

	2019	2018	2017
SG&A expenses	$ 14,994	$ 13,876	$ 12,950
SG&A expenses as a percentage of net sales	10.04 %	10.02 %	10.26 %

SG&A expenses as a percentage of net sales increased two basis points compared to 2018. Excluding the impact of the revenue recognition standard on net sales, SG&A expenses as a percentage of adjusted net sales were 10.13%, an increase of 11 basis points. This increase is largely due to a $123 charge, or eight basis points, recorded in the U.S. related to a product tax assessment. Central operating costs were higher by two basis points and stock compensation expense was higher by one basis point. Operating costs as a percent of adjusted net sales related to warehouses, ancillary, and other businesses, which includes e-commerce and travel, were flat despite the wage increases and bonding leave benefits for U.S. and Canadian hourly employees effective in March 2019. Changes in foreign currencies relative to the U.S. dollar positively impacted SG&A expenses by approximately $124 in 2019.

Preopening

	2019	2018	2017
Preopening expenses	$ 86	$ 68	$ 82
Warehouse openings, including relocations			
United States	18	17	15
Canada	3	3	6
Other International	4	5	7
Total warehouse openings, including relocations	25	25	28

Preopening expenses include costs for startup operations related to new warehouses and relocations, developments in new international markets, new manufacturing and distribution facilities, and expansions at existing warehouses. Preopening expenses vary due to the number of warehouse and facility openings, the timing of the opening relative to our year-end, whether a warehouse is owned or leased, and whether openings are in an existing, new, or international market. In 2019, we opened our first warehouse in China. Subsequent to year end, operations commenced at our new poultry processing plant.

Interest Expense

	2019	2018	2017
Interest expense	$ 150	$ 159	$ 134

Interest expense primarily relates to Senior Notes issued by the Company. Interest expense decreased in 2019 largely due to an increase in capitalized interest associated with our new poultry processing plant.

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Interest Income and Other, Net

	2019	2018	2017
Interest income	$ 126	$ 75	$ 50
Foreign-currency transaction gains (losses), net	27	23	(5)
Other, net	25	23	17
Interest income and other, net	$ 178	$ 121	$ 62

The increase in interest income in 2019 was primarily due to higher interest rates earned on higher average cash and investment balances. Foreign-currency transaction gains (losses), net include the revaluation and settlement of monetary assets and liabilities and mark-to-market adjustments for forward foreign-exchange contracts by our Canadian and Other International operations. See Derivatives and Foreign Currency sections in Item 8, Note 1 of this Report.

Provision for Income Taxes

	2019	2018	2017
Provision for income taxes	$ 1,061	$ 1,263	$ 1,325
Effective tax rate	22.3 %	28.4 %	32.8 %

Our effective tax rate for 2019 was favorably impacted by the reduction in the U.S. federal corporate tax rate in December 2017 from 35% to 21%, which was in effect for all of 2019, and compared to a higher blended rate effective for 2018. Net discrete tax benefits of $221 in 2019 included a benefit of $59 related to the stock-based compensation accounting standard adopted in the first quarter of 2018. This also included a tax benefit of $105 related to U.S. taxation of deemed foreign dividends, offset by losses of foreign tax credits, which impacted the effective tax rate. The tax rate for 2019 was 26.9%, excluding the net discrete tax benefits.

LIQUIDITY AND CAPITAL RESOURCES

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

	2019	2018	2017
Net cash provided by operating activities	$ 6,356	$ 5,774	$ 6,726
Net cash used in investing activities	(2,865)	(2,947)	(2,366)
Net cash used in financing activities	(1,147)	(1,281)	(3,218)

Our primary sources of liquidity are cash flows generated from warehouse operations, cash and cash equivalents, and short-term investments. Cash and cash equivalents and short-term investments were $9,444 and $7,259 at the end of 2019 and 2018, respectively. Of these balances, unsettled credit and debit card receivables represented approximately $1,434 and $1,348 at the end of 2019 and 2018, respectively. These receivables generally settle within four days. Cash and cash equivalents were negatively impacted by a change in exchange rates of $15 and $37 in 2019 and 2018, respectively, and positively impacted by $25 in 2017.

Management believes that our cash position and operating cash flows will be sufficient to meet our liquidity and capital requirements for the foreseeable future. We believe that our U.S. current and projected asset position is sufficient to meet our U.S. liquidity requirements. We no longer consider earnings after 2017 of our non-U.S. consolidated subsidiaries to be indefinitely reinvested.

Cash Flows from Operating Activities

Net cash provided by operating activities totaled $6,356 in 2019, compared to $5,774 in 2018. Our cash flow provided by operations is primarily derived from net sales and membership fees. Cash flow used in operations generally consists of payments to our merchandise suppliers, warehouse operating costs, including payroll and employee benefits, utilities, and credit and debit card processing fees. Cash used in operations also includes payments for income taxes. Changes in our net investment in merchandise inventories (the difference between merchandise inventories and accounts payable) is impacted by several factors, including how fast inventory is sold, payment terms with our suppliers, and the amount of payables paid early to obtain discounts from our suppliers.

Cash Flows from Investing Activities

Net cash used in investing activities totaled $2,865 in 2019, compared to $2,947 in 2018, and primarily related to capital expenditures. Net cash flows from investing activities also includes maturities and purchases of short-term investments.

Capital Expenditures

Our primary requirement for capital is acquiring land, buildings, and equipment for new and remodeled warehouses. Capital is also required for information systems, manufacturing and distribution facilities, initial warehouse operations and working capital. In 2019, we spent $2,998 on capital expenditures, and it is our current intention to spend approximately $3,000 to $3,200 during fiscal 2020. These expenditures are expected to be financed with cash from operations, existing cash and cash equivalents, and short-term investments. We opened 25 new warehouses, including five relocations, in 2019, and plan to open approximately 22 additional new warehouses, including three relocations, in 2020. There can be no assurance that current expectations will be realized and plans are subject to change upon further review of our capital expenditure needs.

Cash Flows from Financing Activities

Net cash used in financing activities totaled $1,147 in 2019, compared to $1,281 in 2018. Cash flows used in financing activities primarily related to the payment of dividends, withholding taxes on stock-based awards, and repurchases of common stock. Dividends totaling $1,038 were paid during 2019, of which $250 related to the dividend declared in August 2018. In August 2019, approximately $200 and $100 of Guaranteed Senior Notes were issued by our Japanese subsidiary at fixed interest rates of 0.28% and 0.42%, respectively.

Stock Repurchase Programs

In April 2019, the Board of Directors authorized a new share repurchase program in the amount of $4,000, which expires in April 2023. This authorization revoked previously authorized but unused amounts, totaling $2,237. During 2019 and 2018, we repurchased 1,097,000 and 1,756,000 shares of common stock, at average prices of $225.16 and $183.13, respectively, totaling approximately $247 and $322, respectively. The remaining amount available to be purchased under our approved plan was $3,943 at the end of 2019. These amounts may differ from the stock repurchase balances in the accompanying consolidated statements of cash flows due to changes in unsettled stock repurchases at the end of each fiscal year. Purchases are made from time-to-time, as conditions warrant, in the open market or in block purchases and pursuant to plans under SEC Rule 10b5-1. Repurchased shares are retired, in accordance with the Washington Business Corporation Act.

Dividends

Cash dividends declared in 2019 totaled $2.44 per share, as compared to $2.14 per share in 2018. In April 2019, the Board of Directors increased our quarterly cash dividend from $0.57 to $0.65 per share. In August 2019, the Board of Directors declared a quarterly cash dividend in the amount of $0.65 per share, which was paid subsequent to the end of 2019.

Bank Credit Facilities and Commercial Paper Programs

We maintain bank credit facilities for working capital and general corporate purposes. At September 1, 2019, we had borrowing capacity under these facilities of $865, including a $400 revolving line of credit, which expires in June 2020. The Company currently has no plans to draw upon this facility. Our international operations maintain $355 of the total borrowing capacity under bank credit facilities, of which $150 is guaranteed by the Company. There were no outstanding short-term borrowings under the bank credit facilities at the end of 2019 and 2018.

The Company has letter of credit facilities, for commercial and standby letters of credit, totaling $219. The outstanding commitments under these facilities at the end of 2019 totaled $145, most of which were standby letters of credit with expiration dates within one year. The bank credit facilities have various expiration dates, most of which are within one year, and we generally intend to renew these facilities. The amount of borrowings available at any time under our bank credit facilities is reduced by the amount of standby and commercial letters of credit outstanding.

Contractual Obligations

At September 1, 2019, our commitments to make future payments under contractual obligations were as follows:

	Payments Due by Fiscal Year				
Contractual obligations	**2020**	**2021 to 2022**	**2023 to 2024**	**2025 and thereafter**	**Total**
Purchase obligations (merchandise)[1]	$ 8,752	$ 4	$ —	$ —	$ 8,756
Long-term debt[2]	1,828	2,594	1,330	1,651	7,403
Operating leases [3]	239	431	374	2,206	3,250
Construction and land obligations	606	8	—	—	614
Capital lease obligations[4]	51	91	78	544	764
Purchase obligations (equipment, services and other)[5]	538	176	33	65	812
Other[6]	18	28	23	96	165
Total	$ 12,032	$ 3,332	$ 1,838	$ 4,562	$ 21,764

(1) Includes only open merchandise purchase orders.

(2) Includes contractual interest payments and excludes deferred issuance costs.

(3) Excludes common area maintenance, taxes, and insurance and have been reduced by $105 related to sub-lease income.

(4) Includes build-to-suit lease obligations and contractual interest payments.

(5) Excludes certain services negotiated at the individual warehouse or regional level that are not significant and generally contain clauses allowing for cancellation without significant penalty.

(6) Includes asset retirement obligations and deferred compensation obligations. The amount excludes $27 of non-current unrecognized tax contingencies and $36 of other obligations due to uncertainty regarding the timing of future cash payments.

Off-Balance Sheet Arrangements

In the opinion of management, we have no off-balance sheet arrangements that have had or are reasonably likely to have a material current or future effect on our financial condition or financial statements, other than operating leases, included in the table above and discussed in Note 1 and Note 5 to the consolidated financial statements included in Item 8 of this Report.

Critical Accounting Estimates

The preparation of our consolidated financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP) requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and on assumptions that we believe to be reasonable, and we continue to review and evaluate these estimates. For further information on significant accounting policies, see discussion in Note 1 to the consolidated financial statements included in Item 8 of this Report.

Insurance/Self-insurance Liabilities

The Company is predominantly self-insured for employee health-care benefits, workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, and inventory loss. Insurance coverage is maintained in certain instances to seek to limit exposures arising from very large losses. We use different risk management mechanisms, including a wholly-owned captive insurance subsidiary, and participate in a reinsurance program. Liabilities associated with the risks that we retain are not discounted and are estimated by using historical claims experience, demographic factors, severity factors, and other actuarial assumptions. The costs of claims are highly unpredictable and can fluctuate as a result of inflation rates, regulatory or legal changes, and unforeseen developments in claims over time. While we believe our estimates are reasonable and provide for a certain degree of coverage to account for these variables, actual claims and costs could differ significantly from recorded liabilities. Historically, adjustments to our estimates have not been material.

Income Taxes

The determination of our provision for income taxes requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. Significant judgment also is required in assessing the timing and amounts of deductible and taxable items and the probability of sustaining uncertain tax positions. The benefits associated with uncertain tax positions are recorded only after determining a more-likely-than-not probability that the positions will withstand challenge from tax authorities. When facts and circumstances change, we reassess these positions and record any changes in the consolidated financial statements as appropriate. The 2017 Tax Act includes various provisions that significantly altered U.S. tax law, many of which impact our business (see Note 8 to the consolidated financial statements for further discussion).

Recent Accounting Pronouncements

See Note 1 to the consolidated financial statements included in Item 8 of this Report for a detailed description of recent accounting pronouncements.

Item 7A—Quantitative and Qualitative Disclosures About Market Risk (amounts in millions)

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

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment holdings that are diversified among various instruments considered to be cash equivalents, as defined in Note 1 to the consolidated financial statements included in Item 8 of this Report, as well as short-term investments in government and agency securities with effective maturities of generally three months to five years at the date of purchase. The primary objective of our investment activities is to preserve principal and secondarily to generate yields. The majority of our short-term investments are in fixed interest-rate securities. These securities are subject to changes in fair value due to interest rate fluctuations.

Our policy limits investments in the U.S. to direct U.S. government and government agency obligations, repurchase agreements collateralized by U.S. government and government agency obligations, U.S. government and government agency money market funds, and insured bank balances. Our wholly-owned captive insurance subsidiary invests in U.S. government and government agency obligations and U.S. government and government agency money market funds. Our Canadian and Other International subsidiaries' investments are primarily in money market funds, bankers' acceptances, and bank certificates of deposit, generally denominated in local currencies.

A 100 basis-point change in interest rates as of the end of 2019 would have had an immaterial incremental change in fair market value. For those investments that are classified as available-for-sale, the unrealized gains or losses related to fluctuations in market volatility and interest rates are reflected within stockholders' equity in accumulated other comprehensive income in the consolidated balance sheets.

The nature and amount of our long-term debt may vary as a result of business requirements, market conditions, and other factors. As of the end of 2019, long-term debt with fixed interest rates was $6,852. Fluctuations in interest rates may affect the fair value of the fixed-rate debt. See Note 4 to the consolidated financial statements included in Item 8 of this Report for more information on our long-term debt.

Foreign Currency Risk

Our foreign subsidiaries conduct certain transactions in non-functional currencies, which exposes us to fluctuations in exchange rates. We manage these fluctuations, in part, through the use of forward foreign-exchange contracts, seeking to economically hedge the impact of these fluctuations on known future expenditures denominated in a non-functional foreign-currency. The contracts are intended primarily to economically hedge exposure to U.S. dollar merchandise inventory expenditures made by our international subsidiaries whose functional currency is other than the U.S. dollar. We seek to mitigate risk with the use of these contracts and do not intend to engage in speculative transactions. For additional information related to the Company's forward foreign-exchange contracts, see Notes 1 and 3 to the consolidated financial statements included in Item 8 of this Report. A hypothetical 10% strengthening of the functional currency compared to the non-functional currency exchange rates at September 1, 2019, would have decreased the fair value of the contracts by $79 and resulted in an unrealized loss in the consolidated statements of income for the same amount.

Commodity Price Risk

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

Item 8—Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors
Costco Wholesale Corporation:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Costco Wholesale Corporation and subsidiaries (the Company) as of September 1, 2019 and September 2, 2018, the related consolidated statements of income, comprehensive income, equity, and cash flows for the 52-week period ended September 1, 2019, the 52-week period ended September 2, 2018 and the 53-week period ended September 3, 2017, and the related notes (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of September 1, 2019 and September 2, 2018, and the results of its operations and its cash flows for the 52-week period ended September 1, 2019, the 52-week period ended September 2, 2018 and the 53-week period ended September 3, 2017, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of September 1, 2019, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated October 10, 2019 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

Critical Audit Matters

The critical audit matters communicated below are matters arising from the current period audit of the consolidated financial statements that were communicated or required to be communicated to the audit committee and that: (1) relate to accounts or disclosures that are material to the consolidated financial statements and (2) involved our especially challenging, subjective, or complex judgments. The communication of critical audit matters does not alter in any way our opinion on the consolidated financial statements, taken as a whole, and we are not, by communicating the critical audit matters below, providing separate opinions on the critical audit matters or on the accounts or disclosures to which they relate.

Evaluation of self-insurance liabilities

As discussed in Note 1 to the consolidated financial statements, the Company estimates its self-insurance liabilities by considering historical claims experience, demographic factors, severity factors, and other actuarial assumptions. The estimated self-insurance liabilities as of September 1, 2019 were $1,222 million.

We identified the evaluation of the Company's self-insurance liabilities as a critical audit matter because of the specialized skills necessary to evaluate the Company's actuarial models and the judgments required to assess the underlying assumptions made by the Company. Key assumptions underlying the Company's actuarial estimates include: reporting and payment patterns used in the projections of the ultimate loss; loss and exposure trends; the selected loss rates and initial expected losses used in the Paid and Incurred Bornhuetter-Ferguson methods; and the selection of the ultimate loss derived from the various methods.

The primary procedures we performed to address this critical audit matter included the following. We tested certain internal controls over the Company's self-insurance process. Such controls included controls over the (a) evaluation of claims information sent to the actuary, (b) development and selection of the key assumptions used in the actuarial calculation, and (c) review of the actuarial report and evaluation of the external actuarial expert's qualifications, competency, and objectivity. We tested the claims data used in the actuarial calculation by selecting a sample and checking key attributes such as date of loss. We involved actuarial professionals with specialized skills and knowledge who assisted in:

- Assessing the actuarial models used by the Company for consistency with generally accepted actuarial standards;
- Evaluating the Company's ability to estimate self-insurance liabilities by comparing its historical estimates with actual loss payments;
- Evaluating the key assumptions underlying the Company's actuarial estimates by developing an independent expectation of the self-insurance liabilities and comparing them to the amounts recorded by the Company; and
- Evaluating the qualifications of the Company's actuaries by assessing their certifications, and determining whether they met the Qualification Standards of the American Academy of Actuaries to render the statements of actuarial opinion implicit in their analyses.

Performance of incremental audit procedures over IT financial reporting processes

As of September 2, 2018, the Company identified a material weakness in internal control related to ineffective information technology general controls (ITGCs) in the areas of user access and program change-management over certain information technology (IT) systems that support the Company's financial reporting processes. Automated and manual business process controls that are dependent on the affected ITGCs were also deemed ineffective because they could have been adversely impacted. While our report dated October 10, 2019 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting as of September 1, 2019, during a portion of the 52-week period ended September 1, 2019, the ITGCs were ineffective and the information or system generated reports produced by the affected financial reporting systems could not be relied upon without further testing. We identified the performance of the necessary incremental audit procedures over the financial information reliant on the impacted IT systems as a critical audit matter. Significant auditor judgment was required to design and execute the incremental audit procedures and to assess the sufficiency of the procedures performed and evidence obtained due to ineffective controls and the complexity of the Company's IT environment.

The primary procedures we performed to address this critical audit matter included the following. We involved IT professionals with specialized skills and knowledge to assist in the identification and design of the incremental procedures. We modified the types of procedures that were performed, which included:

- Testing the underlying records of selected transaction data obtained from the impacted IT systems to support the use of the information in the conduct of the audit; and

- Involving forensic professionals with specialized skills and knowledge in data analysis to perform an evaluation of the journal entry data, including assessing that the entire population of automated and manual transactions has been identified. Forensic professionals also assisted with the identification of certain entries that required additional testing and for all such entries, we agreed the journal entry data to source documents.

We evaluated the collective results of the incremental audit procedures performed to assess the sufficiency of audit evidence obtained related to the information produced by the impacted IT systems.

Evaluation of the impact of the 2017 Tax Act

As discussed in Note 8 to the consolidated financial statements, H.R. 1, the "Tax Cuts and Jobs Act" (2017 Tax Act) contains numerous provisions impacting the computation of the Company's U.S. federal and state corporate income tax provision, including the Global Intangible Low Tax Income (GILTI), Foreign Derived Intangibles Income (FDII) and Foreign Tax Credit (FTC) provisions. For the year ended September 1, 2019, the Company recognized net tax benefits of $123 million related to the 2017 Tax Act.

We identified the evaluation of the Company's implementation of the provisions of the 2017 Tax Act as a critical audit matter. A high degree of judgment was required to interpret the impact of the new tax law on the Company, especially given the complexity of the 2017 Tax Act and related Treasury Regulations. Further, evaluating the Company's application of the GILTI, FDII and FTC provisions of the 2017 Tax Act required complex auditor judgment.

The primary procedures we performed to address this critical audit matter included the following. We tested certain internal controls over the Company's income tax process, including controls over the (a) identification and interpretation of the relevant provisions of the 2017 Tax Act and related Treasury Regulations and (b) calculation of the impact of the GILTI, FDII and FTC provisions. We involved tax professionals with specialized skills and knowledge who assisted in evaluating the Company's interpretation and application of the 2017 Tax Act. They developed an independent assessment of the impact of the GILTI, FDII and FTC provisions based on our understanding and interpretation, and compared it to the net tax benefits the Company recognized related to the 2017 Tax Act.

/s/ KPMG LLP

We have served as the Company's auditor since 2002.

Seattle, Washington
October 10, 2019

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors
Costco Wholesale Corporation:

Opinion on Internal Control Over Financial Reporting

We have audited Costco Wholesale Corporation and subsidiaries' (the Company) internal control over financial reporting as of September 1, 2019, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of September 1, 2019, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of September 1, 2019 and September 2, 2018, the related consolidated statements of income, comprehensive income, equity, and cash flows for the 52-week period ended September 1, 2019, the 52-week period ended September 2, 2018 and the 53-week period ended September 3, 2017, and the related notes (collectively, the consolidated financial statements), and our report dated October 10, 2019 expressed an unqualified opinion on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting (Item 9A). Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

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

Definition and Limitations of Internal Control Over Financial Reporting

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

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

/s/ KPMG LLP

Seattle, Washington
October 10, 2019

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

	September 1, 2019	September 2, 2018
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 8,384	$ 6,055
Short-term investments	1,060	1,204
Receivables, net	1,535	1,669
Merchandise inventories	11,395	11,040
Other current assets	1,111	321
Total current assets	23,485	20,289
PROPERTY AND EQUIPMENT		
Land	6,417	6,193
Buildings and improvements	17,136	16,107
Equipment and fixtures	7,801	7,274
Construction in progress	1,272	1,140
	32,626	30,714
Less accumulated depreciation and amortization	(11,736)	(11,033)
Net property and equipment	20,890	19,681
OTHER ASSETS	1,025	860
TOTAL ASSETS	$ 45,400	$ 40,830
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 11,679	$ 11,237
Accrued salaries and benefits	3,176	2,994
Accrued member rewards	1,180	1,057
Deferred membership fees	1,711	1,624
Current portion of long-term debt	1,699	90
Other current liabilities	3,792	2,924
Total current liabilities	23,237	19,926
LONG-TERM DEBT, excluding current portion	5,124	6,487
OTHER LIABILITIES	1,455	1,314
Total liabilities	29,816	27,727
COMMITMENTS AND CONTINGENCIES		
EQUITY		
Preferred stock $0.01 par value; 100,000,000 shares authorized; no shares issued and outstanding	0	0
Common stock $0.01 par value; 900,000,000 shares authorized; 439,625,000 and 438,189,000 shares issued and outstanding	4	4
Additional paid-in capital	6,417	6,107
Accumulated other comprehensive loss	(1,436)	(1,199)
Retained earnings	10,258	7,887
Total Costco stockholders' equity	15,243	12,799
Noncontrolling interests	341	304
Total equity	15,584	13,103

TOTAL LIABILITIES AND EQUITY	$ 45,400	$ 40,830

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

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

	52 Weeks Ended September 1, 2019	52 Weeks Ended September 2, 2018	53 Weeks Ended September 3, 2017
REVENUE			
Net sales	$ 149,351	$ 138,434	$ 126,172
Membership fees	3,352	3,142	2,853
Total revenue	152,703	141,576	129,025
OPERATING EXPENSES			
Merchandise costs	132,886	123,152	111,882
Selling, general and administrative	14,994	13,876	12,950
Preopening expenses	86	68	82
Operating income	4,737	4,480	4,111
OTHER INCOME (EXPENSE)			
Interest expense	(150)	(159)	(134)
Interest income and other, net	178	121	62
INCOME BEFORE INCOME TAXES	4,765	4,442	4,039
Provision for income taxes	1,061	1,263	1,325
Net income including noncontrolling interests	3,704	3,179	2,714
Net income attributable to noncontrolling interests	(45)	(45)	(35)
NET INCOME ATTRIBUTABLE TO COSTCO	$ 3,659	$ 3,134	$ 2,679
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO:			
Basic	$ 8.32	$ 7.15	$ 6.11
Diluted	$ 8.26	$ 7.09	$ 6.08
Shares used in calculation (000's)			
Basic	439,755	438,515	438,437
Diluted	442,923	441,834	440,937

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

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(amounts in millions)

	52 Weeks Ended September 1, 2019	52 Weeks Ended September 2, 2018	53 Weeks Ended September 3, 2017
NET INCOME INCLUDING NONCONTROLLING INTERESTS	$ 3,704	$ 3,179	$ 2,714
Foreign-currency translation adjustment and other, net	(245)	(192)	98
Comprehensive income	3,459	2,987	2,812
Less: Comprehensive income attributable to noncontrolling interests	37	38	48
COMPREHENSIVE INCOME ATTRIBUTABLE TO COSTCO	$ 3,422	$ 2,949	$ 2,764

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

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF EQUITY
(amounts in millions)

	Common Stock							
	Shares (000's)	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Costco Stockholders' Equity	Noncontrolling Interests	Total Equity
BALANCE AT AUGUST 28, 2016	437,524	$ 2	$ 5,490	$ (1,099)	$ 7,686	$ 12,079	$ 253	$ 12,332
Net income	—	—	—	—	2,679	2,679	35	2,714
Foreign-currency translation adjustment and other, net	—	—	—	85	—	85	13	98
Stock-based compensation	—	—	518	—	—	518	—	518
Release of vested restricted stock units (RSUs), including tax effects	2,673	—	(165)	—	—	(165)	—	(165)
Conversion of convertible notes	5	—	—	—	—	—	—	—
Repurchases of common stock	(2,998)	—	(41)	—	(432)	(473)	—	(473)
Cash dividends declared and other	—	2	(2)	—	(3,945)	(3,945)	—	(3,945)
BALANCE AT SEPTEMBER 3, 2017	437,204	4	5,800	(1,014)	5,988	10,778	301	11,079
Net income	—	—	—	—	3,134	3,134	45	3,179
Foreign-currency translation adjustment and other, net	—	—	—	(185)	—	(185)	(7)	(192)
Stock-based compensation	—	—	547	—	—	547	—	547
Release of vested RSUs, including tax effects	2,741	—	(217)	—	—	(217)	—	(217)
Repurchases of common stock	(1,756)	—	(26)	—	(296)	(322)	—	(322)
Cash dividends declared and other	—	—	3	—	(939)	(936)	(35)	(971)
BALANCE AT SEPTEMBER 2, 2018	438,189	4	6,107	(1,199)	7,887	12,799	304	13,103
Net income	—	—	—	—	3,659	3,659	45	3,704
Foreign-currency translation adjustment and other, net	—	—	—	(237)	—	(237)	(8)	(245)
Stock-based compensation	—	—	598	—	—	598	—	598
Release of vested RSUs, including tax effects	2,533	—	(272)	—	—	(272)	—	(272)
Repurchases of common stock	(1,097)	—	(16)	—	(231)	(247)	—	(247)
Cash dividends declared and other	—	—	—	—	(1,057)	(1,057)	—	(1,057)
	439,625	$ 4	$ 6,417	$ (1,436)	$ 10,258	$ 15,243	$ 341	$ 15,584

BALANCE AT SEPTEMBER 1, 2019								

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

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COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(amounts in millions)

	52 Weeks Ended September 1, 2019	52 Weeks Ended September 2, 2018	53 Weeks Ended September 3, 2017
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income including noncontrolling interests	$ 3,704	$ 3,179	$ 2,714
Adjustments to reconcile net income including noncontrolling interests to net cash provided by operating activities:			
Depreciation and amortization	1,492	1,437	1,370
Stock-based compensation	595	544	514
Other non-cash operating activities, net	9	(6)	(14)
Deferred income taxes	147	(49)	(29)
Changes in operating assets and liabilities:			
Merchandise inventories	(536)	(1,313)	(894)
Accounts payable	322	1,561	2,258
Other operating assets and liabilities, net	623	421	807
Net cash provided by operating activities	6,356	5,774	6,726
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of short-term investments	(1,094)	(1,060)	(1,279)
Maturities and sales of short-term investments	1,231	1,078	1,385
Additions to property and equipment	(2,998)	(2,969)	(2,502)
Other investing activities, net	(4)	4	30
Net cash used in investing activities	(2,865)	(2,947)	(2,366)
CASH FLOWS FROM FINANCING ACTIVITIES			
Change in bank payments outstanding	210	80	(236)
Proceeds from issuance of long-term debt	298	—	3,782
Repayments of long-term debt	(89)	(86)	(2,200)
Tax withholdings on stock-based awards	(272)	(217)	(202)
Repurchases of common stock	(247)	(328)	(469)
Cash dividend payments	(1,038)	(689)	(3,904)
Other financing activities, net	(9)	(41)	11
Net cash used in financing activities	(1,147)	(1,281)	(3,218)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(15)	(37)	25
Net change in cash and cash equivalents	2,329	1,509	1,167
CASH AND CASH EQUIVALENTS BEGINNING OF YEAR	6,055	4,546	3,379
CASH AND CASH EQUIVALENTS END OF YEAR	$ 8,384	$ 6,055	$ 4,546
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest	$ 141	$ 143	$ 131
Income taxes, net	$ 1,187	$ 1,204	$ 1,185
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:			
Cash dividend declared, but not yet paid	$ 286	$ 250	$ —

COSTCO WHOLESALE CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Note 1—Summary of Significant Accounting Policies

Description of Business

Costco Wholesale Corporation (Costco or the Company), a Washington corporation, and its subsidiaries operate membership warehouses based on the concept that offering members low prices on a limited selection of nationally-branded and private-label products in a wide range of merchandise categories will produce high sales volumes and rapid inventory turnover. At September 1, 2019, Costco operated 782 warehouses worldwide: 543 in the United States (U.S.) located in 44 states, Washington, D.C., and Puerto Rico, 100 in Canada, 39 in Mexico, 29 in the United Kingdom (U.K.), 26 in Japan, 16 in Korea, 13 in Taiwan, 11 in Australia, two in Spain, and one each in Iceland, France and China. The Company operates e-commerce websites in the U.S., Canada, Mexico, U.K., Korea, and Taiwan.

Basis of Presentation

The consolidated financial statements include the accounts of Costco, its wholly-owned subsidiaries, and subsidiaries in which it has a controlling interest. The Company reports noncontrolling interests in consolidated entities as a component of equity separate from the Company's equity. All material inter-company transactions between and among the Company and its consolidated subsidiaries have been eliminated in consolidation. The Company's net income excludes income attributable to the noncontrolling interest in Taiwan. During the first quarter of 2018, the Company purchased its former joint-venture partner's remaining equity interest in its Korean operations. Unless otherwise noted, references to net income relate to net income attributable to Costco.

Fiscal Year End

The Company operates on a 52/53 week fiscal year basis with the year ending on the Sunday closest to August 31. References to 2019 and 2018 relate to the 52-week fiscal years ended September 1, 2019, and September 2, 2018, respectively. References to 2017 relate to the 53-week fiscal year ended September 3, 2017.

Use of Estimates

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

Cash and Cash Equivalents

The Company considers as cash and cash equivalents all cash on deposit, highly liquid investments with a maturity of three months or less at the date of purchase, and proceeds due from credit and debit card transactions with settlement terms of up to four days. Credit and debit card receivables were $1,434 and $1,348 at the end of 2019 and 2018, respectively.

The Company provides for the daily replenishment of major bank accounts as payments are presented. Included in accounts payable at the end of 2019 and 2018 are $673 and $463, respectively, representing the excess of outstanding payments over cash on deposit at the banks on which the payments were drawn.

Short-Term Investments

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

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

Fair Value of Financial Instruments

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

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

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

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

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

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

Current financial liabilities have fair values that approximate their carrying values. Long-term financial liabilities include the Company's long-term debt, which are recorded on the balance sheet at issuance price and adjusted for unamortized discounts or premiums and debt issuance costs, and are being amortized to interest expense over the term of the loan. The estimated fair value of the Company's long-term debt is based primarily on reported market values, recently completed market transactions, and estimates based upon interest rates, maturities, and credit.

Receivables, Net

Receivables consist primarily of vendor, reinsurance, credit card incentive, third-party pharmacy and other receivables. Vendor receivables include volume rebates or other discounts. Balances are generally presented on a gross basis, separate from any related payable due. In certain circumstances, these receivables may be settled against the related payable to that vendor, in which case the receivables are presented on a net basis. Reinsurance receivables are held by the Company's wholly-owned captive insurance subsidiary and primarily represent amounts ceded through reinsurance arrangements gross of the amounts assumed under reinsurance, which are presented within other current liabilities in the consolidated balance sheets. Credit card incentive receivables primarily represent amounts earned under the co-branded credit card arrangement in the U.S. Third-party pharmacy receivables generally relate to amounts due from members' insurers. Other receivables primarily consist of amounts due from governmental entities, mostly tax-related items.

Receivables are recorded net of an allowance for doubtful accounts. The allowance is based on historical experience and application of the specific identification method. Write-offs of receivables were immaterial in 2019, 2018, and 2017.

Merchandise Inventories

Merchandise inventories consist of the following:

	2019	2018
United States	$ 8,415	$ 8,081
Canada	1,123	1,189
Other International	1,857	1,770
Merchandise inventories	$ 11,395	$ 11,040

Merchandise inventories are stated at the lower of cost or market. U.S. merchandise inventories are valued by the cost method of accounting, using the last-in, first-out (LIFO) basis. The Company believes the LIFO method more fairly presents the results of operations by more closely matching current costs with current revenues. The Company records an adjustment each quarter, if necessary, for the projected annual effect of inflation or deflation, and these estimates are adjusted to actual results determined at year-end, after actual inflation or deflation rates and inventory levels have been determined. As of September 1, 2019 and September 2, 2018, U.S. merchandise inventories valued at LIFO approximated first-in, first-out (FIFO) after considering the lower of cost or market principle. Canadian and Other International merchandise inventories are predominantly valued using the cost and retail inventory methods, respectively, using the FIFO basis.

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

Property and Equipment

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

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

Repair and maintenance costs are expensed when incurred. Expenditures for remodels, refurbishments and improvements that add to or change the way an asset functions or that extend the useful life are capitalized. Assets removed during the remodel, refurbishment or improvement are retired. Assets classified as held-for-sale at the end of 2019 and 2018 were immaterial.

The Company evaluates long-lived assets for impairment on an annual basis, when relocating or closing a facility, or when events or changes in circumstances may indicate the carrying amount of the asset group, generally an individual warehouse, may not be fully recoverable. For asset groups held and used, including warehouses to be relocated, the carrying value of the asset group is considered recoverable when the estimated future undiscounted cash flows generated from the use and eventual disposition of the asset group exceed the respective carrying value. In the event that the carrying value is not considered recoverable, an impairment loss is recognized for the asset group to be held and used equal to the excess of the carrying value above the estimated fair value of the asset group. For asset groups classified as held-for-sale (disposal group), the carrying value is compared to the disposal group's fair value less costs to sell. The Company estimates fair value by obtaining market appraisals from third party brokers or using other valuation techniques. There were no impairment charges recognized in 2019, 2018 or 2017.

Insurance/Self-insurance Liabilities

The Company is predominantly self-insured for employee health care benefits, workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, and inventory loss. Insurance coverage is maintained in certain instances to limit exposures arising from very large losses. It uses different risk management mechanisms, including a wholly-owned captive insurance subsidiary (the captive) and participates in a reinsurance program. Liabilities associated with the risks that are retained by the Company are not discounted and are estimated, in part, by considering historical claims experience, demographic factors, severity factors, and other actuarial assumptions. The estimated accruals for these liabilities could be significantly affected if future occurrences and claims differ from these assumptions and historical trends. At the end of 2019 and 2018, these insurance liabilities were $1,222 and $1,148 in the aggregate, respectively, and were included in accrued salaries and benefits and other current liabilities in the consolidated balance sheets, classified based on their nature.

The captive receives direct premiums, which are netted against the Company's premium costs in selling, general and administrative expenses, in the consolidated statements of income. The captive participates in a reinsurance program that includes other third-party participants. The reinsurance agreement is one year in duration, and new agreements are entered into by each participant at their discretion at the commencement of the next calendar year. The participant agreements and practices of the reinsurance program limit a participating members' individual risk. Income statement adjustments related to the reinsurance program and related impacts to the consolidated balance sheets are recognized as information becomes known. In the event the Company leaves the reinsurance program, the Company retains its primary obligation to the policyholders for prior activity.

Derivatives

The Company is exposed to foreign-currency exchange-rate fluctuations in the normal course of business. It manages these fluctuations, in part, through the use of forward foreign-exchange contracts, seeking to economically hedge the impact of fluctuations of foreign exchange on known future expenditures denominated in a non-functional foreign-currency. The contracts relate primarily to U.S. dollar merchandise inventory expenditures made by the Company's international subsidiaries with functional currencies other than the U.S. dollar. Currently, these contracts do not qualify for derivative hedge accounting. The Company seeks to mitigate risk with the use of these contracts and does not intend to engage in speculative transactions. Some of these contracts contain credit-risk-related contingent features that require settlement of outstanding

contracts upon certain triggering events. At the end of 2019 and 2018, the aggregate fair value amounts of derivative instruments in a net liability position and the amount needed to settle the instruments immediately if the credit-risk-related contingent features were triggered were immaterial. The aggregate notional amounts of open, unsettled forward foreign-exchange contracts were $704 and $717 at the end of 2019 and 2018, respectively. See Note 3 for information on the fair value of unsettled forward foreign-exchange contracts at the end of 2019 and 2018.

The unrealized gains or losses recognized in interest income and other, net in the accompanying consolidated statements of income relating to the net changes in the fair value of unsettled forward foreign-exchange contracts were immaterial in 2019, 2018, and 2017.

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

Foreign Currency

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

The Company recognizes foreign-currency transaction gains and losses related to revaluing or settling monetary assets and liabilities denominated in currencies other than the functional currency in interest income and other, net in the accompanying consolidated statements of income. Generally, these include the U.S. dollar cash and cash equivalents and the U.S. dollar payables of consolidated subsidiaries revalued to their functional currency. Also included are realized foreign-currency gains or losses from settlements of forward foreign-exchange contracts. These items were immaterial for 2019, 2018, and 2017.

Revenue Recognition

The Company recognizes sales for the amount of consideration collected from the member, which includes gross shipping fees where applicable, and is net of sales taxes collected and remitted to government agencies and returns. The Company reserves for estimated returns based on historical trends in merchandise returns and reduces sales and merchandise costs accordingly. The Company records, on a gross basis, a refund liability and an asset for recovery, which are included in other current liabilities and other current assets, respectively, in the consolidated balance sheets.

Merchandise Sales - The Company offers merchandise in the following core merchandise categories: food and sundries, hardlines, softlines, and fresh foods. The Company also provides expanded products and services through warehouse ancillary and other businesses. The majority of revenue from merchandise sales is recognized at the point of sale. Revenue generated through e-commerce or special orders is recognized upon shipment to the member to the extent there is no installation provided as a part of the contract. For merchandise shipped directly to the member, shipping and handling costs are expensed as incurred as fulfillment costs and included in merchandise costs in the consolidated statements of income. In certain ancillary businesses, revenue is deferred until the member picks up merchandise at the warehouse. Deferred sales are included in other current liabilities in the consolidated balance sheets.

Principal Versus Agent - The Company is the principal for the majority of its transactions and recognizes revenue on a gross basis. The Company is the principal when it has control of the merchandise or service before it is transferred to the member, which generally is established when Costco is primarily responsible

for merchandising decisions, maintains the relationship with the member, including assurance of member service and satisfaction, and has pricing discretion.

Membership Fees - The Company accounts for membership fee revenue, net of refunds, on a deferred basis, ratably over the one-year membership period. Deferred membership fees at the end of 2019 and 2018 were $1,711 and $1,624, respectively.

In certain countries, the Company's Executive members qualify for a 2% reward on qualified purchases (up to a maximum of approximately $1,000 per year), which does not expire and can be redeemed only at Costco warehouses. The Company accounts for this reward as a reduction in sales, net of the estimated impact of non-redemptions (breakage), with the corresponding liability classified as accrued member rewards in the consolidated balance sheets. Estimated breakage is computed based on redemption data. For 2019, 2018 and 2017, the net reduction in sales was $1,537, $1,394, and $1,281 respectively.

Shop Cards - The Company sells and otherwise provides proprietary shop cards that do not expire and are redeemable at the warehouse or online for merchandise or membership. Revenue from shop cards is recognized upon redemption, and estimated breakage is recognized based on redemption data. The Company accounts for outstanding shop card balances as a shop card liability, net of estimated breakage. Previously, the shop cards were branded as cash cards.

Co-Branded Credit Card Program - Citibank, N.A. (“Citi”) became the exclusive issuer of co-branded credit cards to U.S. members in June 2016. The Company receives various forms of consideration, including a royalty on purchases made on the card outside of Costco, a portion of which, after giving rise to estimated breakage, is used to fund the rebate that cardholders receive. The rebates are issued in February and expire on December 31. Breakage is estimated based on redemption data.

Merchandise Costs

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

Vendor Consideration

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

Selling, General and Administrative Expenses

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

Retirement Plans

The Company's 401(k) retirement plan is available to all U.S. employees over the age of 18 who have completed 90 days of employment. The plan allows participants to make wage deferral contributions, a portion of which the Company matches. In addition, the Company provides each eligible participant an annual discretionary contribution. The Company also has a defined contribution plan for Canadian employees and contributes a percentage of each employee's wages. Certain subsidiaries in the Company's Other International operations have defined benefit and defined contribution plans that are not material. Amounts expensed under all plans were $614, $578, and $543 for 2019, 2018, and 2017, respectively, and are predominantly included in selling, general and administrative expenses in the accompanying consolidated statements of income.

Stock-Based Compensation

Restricted stock units (RSUs) granted to employees generally vest over five years and allow for quarterly vesting of the pro-rata number of stock-based awards that would vest on the next anniversary of the grant date in the event of retirement or voluntary termination. Actual forfeitures are recognized as they occur.

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

Stock-based compensation expense is predominantly included in selling, general and administrative expenses in the consolidated statements of income. Certain stock-based compensation costs are capitalized or included in the cost of merchandise. See Note 7 for additional information on the Company’s stock-based compensation plans.

Leases

The Company leases land and/or buildings at warehouses and certain other office and distribution facilities, primarily under operating leases. Operating leases expire at various dates through 2068, with the exception of one lease in the U.K., which expires in 2151. These leases generally contain one or more of the following options, which the Company can exercise at the end of the initial lease term: (a) renewal for a defined number of years at the then-fair market rental rate or rate stipulated in the lease agreement; (b) purchase of the property at the then-fair market value; or (c) right of first refusal in the event of a third-party purchase offer.

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

The Company has capital leases for certain warehouse locations, expiring at various dates through 2059. Capital lease assets are included in land and buildings and improvements in the accompanying consolidated balance sheets. Amortization expense on capital lease assets is recorded as depreciation expense and is included in selling, general and administrative expenses. Capital lease liabilities are recorded at the lesser of the estimated fair market value of the leased property or the net present value of the aggregate future minimum lease payments and are included in other current liabilities and other liabilities in the accompanying consolidated balance sheets. Interest on these obligations is included in interest expense in the consolidated statements of income.

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

The Company's asset retirement obligations (ARO) primarily relate to leasehold improvements that at the end of a lease must be removed. These obligations are generally recorded as a discounted liability with an offsetting asset at the inception of the lease term based upon the estimated fair value of the costs to remove the improvements. These liabilities are accreted over time to the projected future value of the obligation. The ARO assets are depreciated using the same depreciation method as the leasehold improvement assets and are included with buildings and improvements. Estimated ARO liabilities associated with these leases were immaterial at the end of 2019 and 2018, respectively, and are included in other liabilities in the accompanying consolidated balance sheets.

Preopening Expenses

Preopening expenses include costs for startup operations related to new warehouses and relocations, developments in new international markets, new manufacturing and distribution facilities, and expansions at existing warehouses and are expensed as incurred.

Income Taxes

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

The timing and amounts of deductible and taxable items and the probability of sustaining uncertain tax positions requires significant judgment. The benefits of uncertain tax positions are recorded in the Company's consolidated financial statements only after determining a more-likely-than-not probability that the uncertain tax positions will withstand challenge from tax authorities. When facts and circumstances change, the Company reassesses these probabilities and records any changes as appropriate.

Net Income per Common Share Attributable to Costco

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

Stock Repurchase Programs

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

Recent Accounting Pronouncements Adopted

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, providing for changes in the recognition of revenue from contracts with customers. The guidance requires disclosures sufficient to describe the nature, amount, timing, and uncertainty of revenue and cash flows. The Company adopted the standard in the first quarter of 2019, using the modified retrospective approach, and recorded a cumulative effect adjustment of $16 as an increase to retained earnings, which is included in cash dividend declared and other in the consolidated statements of equity.

The standard impacted the presentation and timing of certain revenue transactions. Specifically, the changes included gross presentation of the Company's estimate of merchandise returns reserve and the related recoverable assets, recognizing shop card breakage over the period of redemption, and accelerating the recognition of certain e-commerce and special-order sales. Additionally, the Company's evaluation under the standard of its status as a principal in certain revenue arrangements resulted in the recognition of additional sales on a gross basis.

The effect of the standard on the Company's consolidated balance sheet was an increase to other current liabilities and other current assets of $649 and $698 at adoption and at the end of 2019, respectively, related to the estimate of merchandise returns reserve and the related recoverable assets.

The effect of the adoption of this standard on the Company's consolidated statement of income is as follows:

	As Reported	ASU 2014-09 Effect	Excluding ASU 2014-09 Effect
52 Weeks Ended September 1, 2019			
Net Sales	$ 149,351	$ 1,332	$ 148,019
Merchandise Costs	132,886	1,324	131,562
Gross Margin [(1)]	16,465	8	16,457

(1) Net sales less merchandise costs.

For related disaggregated revenue disclosures, see Note 11.

Recent Accounting Pronouncements Not Yet Adopted

In February 2016, the FASB issued ASU 2016-02, which requires recognition on the balance sheet of rights and obligations created by leases with terms greater than twelve months. The standard is effective for fiscal years and interim periods within those years beginning after December 15, 2018, with early adoption permitted. The Company plans to adopt this guidance at the beginning of its first quarter of fiscal 2020 and utilize the transition option, which allows for a cumulative-effect adjustment in the period of adoption and does not require application of the guidance to comparative periods. The primary effect of adoption will be recording right-of-use assets and corresponding lease obligations for current operating leases. The Company has substantially completed its assessment of the new standard and estimates total assets and liabilities will increase by approximately $2,400 upon adoption. The adoption is not expected to have a material impact to the Company's consolidated statements of income or cash flows. The Company continues to evaluate the related disclosure requirements.

Note 2—Investments

The Company's investments were as follows:

2019:	Cost Basis	Unrealized Gains, Net	Recorded Basis
Available-for-sale:			
Government and agency securities	$ 716	$ 6	$ 722
Held-to-maturity:			
Certificates of deposit	338		338
Total short-term investments	$ 1,054	$ 6	$ 1,060

2018:	Cost Basis	Unrealized Losses, Net	Recorded Basis
Available-for-sale:			
Government and agency securities	$ 912	$ (14)	$ 898
Held-to-maturity:			
Certificates of deposit	306		306
Total short-term investments	$ 1,218	$ (14)	$ 1,204

Gross unrecognized holding gains and losses on available-for-sale securities were not material for the years ended September 1, 2019, and September 2, 2018. At the end of 2019 and 2018, the Company's available-for-sale securities that were in a continuous unrealized-loss position were not material.

There were no sales of available-for-sale securities in 2019. Proceeds from sales of available-for-sale securities were $39 and $202 during 2018, and 2017, respectively. Gross realized gains or losses from sales of available-for-sale securities were not material in 2018 and 2017.

The maturities of available-for-sale and held-to-maturity securities at the end of 2019 are as follows:

	Available-For-Sale		
	Cost Basis	Fair Value	Held-To-Maturity
Due in one year or less	$ 297	$ 297	$ 338
Due after one year through five years	402	407	0
Due after five years	17	18	0
Total	$ 716	$ 722	$ 338

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Note 3—Fair Value Measurement

Assets and Liabilities Measured at Fair Value on a Recurring Basis

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

2019:	Level 1	Level 2
Investment in government and agency securities[1]	$ 0	$ 766
Forward foreign-exchange contracts, in asset position[2]	0	15
Forward foreign-exchange contracts, in (liability) position[2]	0	(4)
Total	$ 0	$ 777

2018:	Level 1	Level 2
Money market mutual funds[3]	$ 9	$ 0
Investment in government and agency securities[1]	0	903
Forward foreign-exchange contracts, in asset position[2]	0	16
Forward foreign-exchange contracts, in (liability) position[2]	0	(2)
Total	$ 9	$ 917

(1) At September 1, 2019, $44 cash and cash equivalents and $722 short-term investments are included in the accompanying consolidated balance sheets. At September 2, 2018, immaterial cash and cash equivalents and $898 short-term investments are included in the accompanying consolidated balance sheets.

(2) The asset and the liability values are included in other current assets and other current liabilities, respectively, in the accompanying consolidated balance sheets.

(3) Included in cash and cash equivalents in the accompanying balance sheet.

During and at the end of both 2019 and 2018, the Company did not hold any Level 3 financial assets or liabilities that were measured at fair value on a recurring basis. There were no transfers in or out of Level 1 or 2 during 2019 and 2018.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Assets and liabilities recognized and disclosed at fair value on a nonrecurring basis include items such as financial assets measured at amortized cost and long-lived nonfinancial assets. These assets are measured at fair value if determined to be impaired. There were no fair value adjustments to these items during 2019 and 2018.

Note 4—Debt

Short-Term Borrowings

The Company maintains various short-term bank credit facilities, with a borrowing capacity of $865 and $857, in 2019 and 2018, respectively. Borrowings on these short-term facilities were immaterial during 2019 and 2018, and there were no outstanding borrowings at the end of 2019 and 2018.

Long-Term Debt

The Company's long-term debt consists primarily of Senior Notes, which have various principal balances, interest rates, and maturity dates as described below. The Company at its option may redeem the Senior Notes at any time, in whole or in part, at a redemption price plus accrued interest. The redemption price is equal to the greater of 100% of the principal amount or the sum of the present value of the remaining scheduled payments of principal and interest to maturity. Additionally, upon certain events, as defined by the terms of the Senior Notes, the holder has the right to require the Company to purchase this security at a price of 101% of the principal amount plus accrued and unpaid interest to the date of the event. Interest on all outstanding long-term debt is payable semi-annually. The estimated fair value of Senior Notes is valued using Level 2 inputs.

Other long-term debt consists of Guaranteed Senior Notes issued by the Company's Japanese subsidiary and are valued using Level 3 inputs. In October 2018, the Company's Japanese subsidiary repaid a Guaranteed Senior Note and in August 2019, issued approximately $200 and $100 of Guaranteed Senior Notes at fixed interest rates of 0.28% and 0.42%, respectively. Interest is payable semi-annually, and principal is due in August 2029 and August 2034, respectively.

At the end of 2019 and 2018, the fair value of the Company's long-term debt, including the current portion, was approximately $6,997 and $6,492, respectively. The carrying value of long-term debt consisted of the following:

	2019	2018
1.70% Senior Notes due December 2019	$ 1,200	$ 1,200
1.75% Senior Notes due February 2020	500	500
2.15% Senior Notes due May 2021	1,000	1,000
2.25% Senior Notes due February 2022	500	500
2.30% Senior Notes due May 2022	800	800
2.75% Senior Notes due May 2024	1,000	1,000
3.00% Senior Notes due May 2027	1,000	1,000
Other long-term debt	852	613
Total long-term debt	6,852	6,613
Less unamortized debt discounts and issuance costs	29	36
Less current portion(1)	1,699	90
Long-term debt, excluding current portion	$ 5,124	$ 6,487

(1) Net of unamortized debt discounts and issuance costs.

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

2020	$ 1,700
2021	1,094
2022	1,300
2023	94
2024	1,113
Thereafter	1,551
Total	$ 6,852

Note 5—Leases

Operating Leases

The aggregate rental expense for 2019, 2018, and 2017 was $268, $265, and $258, respectively. Sub-lease income and contingent rent were not material in 2019, 2018, or 2017.

Capital and Build-to-Suit Leases

Gross assets recorded under capital and build-to-suit leases were $457 and $427 at the end of 2019 and 2018, respectively. These assets are recorded net of accumulated amortization of $106 and $94 at the end of 2019 and 2018, respectively.

At the end of 2019, future minimum payments, net of sub-lease income of $105 for all years combined, under non-cancelable operating leases with terms of at least one year and capital leases were as follows:

	Operating Leases	Capital Leases[1]
2020	$ 239	$ 51
2021	229	53
2022	202	38
2023	193	39
2024	181	39
Thereafter	2,206	544
Total	$ 3,250	764
Less amount representing interest		(343)
Net present value of minimum lease payments		421
Less current installments[2]		(26)
Long-term capital lease obligations less current installments[3]		$ 395

(1) Includes build-to-suit lease obligations.

(2) Included in other current liabilities in the accompanying consolidated balance sheets.

(3) Included in other liabilities in the accompanying consolidated balance sheets.

Note 6—Stockholders' Equity

Dividends

The Company's current quarterly dividend rate is $0.65 per share. In August 2019, the Board of Directors declared a quarterly cash dividend in the amount of $0.65 per share, which was paid subsequent to the end of 2019.

Stock Repurchase Programs

In April 2019, the Board of Directors authorized a new share repurchase program in the amount of $4,000, which expires in April 2023. This authorization revoked previously authorized but unused amounts, totaling $2,237. As of the end of 2019, the remaining amount available for stock repurchases under the approved plan was $3,943. The following table summarizes the Company's stock repurchase activity:

	Shares Repurchased (000's)	Average Price per Share	Total Cost
2019	1,097	$ 225.16	$ 247
2018	1,756	183.13	322
2017	2,998	157.87	473

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

Note 7—Stock-Based Compensation Plans

The Company grants stock-based compensation, primarily to employees and non-employee directors. Grants to all executive officers are performance-based. Through a series of shareholder approvals, there have been amended and restated plans and new provisions implemented by the Company. RSUs are subject to quarterly vesting upon retirement or voluntary termination. Employees who attain at least 25 years of service with the Company receive shares under accelerated vesting provisions on the annual vesting date. On January 24, 2019, shareholders approved the adoption of the 2019 Incentive Plan, which replaced the Seventh Restated 2002 Stock Incentive Plan (Seventh Plan). The 2019 Incentive Plan authorized the issuance of 17,500,000 shares (10,000,000 RSUs) of common stock for future grants, plus the remaining shares that were available for grant under the Seventh Plan on January 24, 2019 and future forfeited shares from grants under the Seventh Plan up to a maximum aggregate of 27,800,000 shares (15,885,000 RSUs). The Company issues new shares of common stock upon vesting of RSUs. Shares for vested RSUs are generally delivered to participants annually, net of shares withheld for taxes.

Summary of Restricted Stock Unit Activity

RSUs granted to employees and to non-employee directors generally vest over five and three years, respectively. Additionally, the terms of the RSUs, including performance-based awards, provide for accelerated vesting for employees and non-employee directors who have attained 25 or more and five or more years of service with the Company, respectively. Recipients are not entitled to vote or receive dividends on non-vested and undelivered shares. At the end of 2019, 15,676,000 shares were available to be granted as RSUs under the 2019 Incentive Plan.

The following awards were outstanding at the end of 2019:

- 6,268,000 time-based RSUs that vest upon continued employment over specified periods of time;
- 228,000 performance-based RSUs, of which 150,000 were granted to executive officers subject to the certification of the attainment of specified performance targets for 2019. This certification occurred in September 2019, at which time a portion vested as a result of the long service of all executive officers. The remaining awards vest upon continued employment over specified periods of time.

The following table summarizes RSU transactions during 2019:

	Number of Units (in 000's)	Weighted-Average Grant Date Fair Value
Outstanding at the end of 2018	7,578	$ 140.85
Granted	2,792	224.00
Vested and delivered	(3,719)	155.65
Forfeited	(155)	164.75
Outstanding at the end of 2019	6,496	$ 167.55

The weighted-average grant date fair value of RSUs granted was $224.00, $156.19, and $144.12 in 2019, 2018, and 2017, respectively. The remaining unrecognized compensation cost related to non-vested RSUs at the end of 2019 was $694 and the weighted-average period of time over which this cost will be recognized is 1.6 years. Included in the outstanding balance at the end of 2019 were approximately 2,194,000 RSUs vested but not yet delivered.

Summary of Stock-Based Compensation

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

	2019	2018	2017
Stock-based compensation expense before income taxes	$ 595	$ 544	$ 514
Less income tax benefit (1)	(128)	(116)	(167)
Stock-based compensation expense, net of income taxes	$ 467	$ 428	$ 347

(1) In 2019 and 2018, the income tax benefit reflects the reduction in the U.S. federal statutory income tax rate from 35% to 21%.

Note 8— Taxes

Income Taxes

Income before income taxes is comprised of the following:

	2019	2018	2017
Domestic	$ 3,591	$ 3,182	$ 2,988
Foreign	1,174	1,260	1,051
Total	$ 4,765	$ 4,442	$ 4,039

The provisions for income taxes are as follows:

	2019	2018	2017
Federal:			
Current	$ 328	$ 636	$ 802
Deferred	222	(35)	7
Total federal	550	601	809
State:			
Current	178	190	161
Deferred	26	22	8
Total state	204	212	169
Foreign:			
Current	405	487	389
Deferred	(98)	(37)	(42)
Total foreign	307	450	347
Total provision for income taxes	$ 1,061	$ 1,263	$ 1,325

In December 2017, the 2017 Tax Act was signed into law. Except for certain provisions, the 2017 Tax Act is effective for tax years beginning on or after January 1, 2018. The Company is a fiscal-year taxpayer, so most provisions became effective for 2019, including limitations on the Company's ability to claim foreign tax credits, repeal of the domestic manufacturing deduction, and limitations on certain business deductions. Provisions with significant impacts that were effective starting in the second quarter of 2018 and throughout 2019 included: a decrease in the U.S. federal income tax rate, remeasurement of certain net deferred tax liabilities, and a transition tax on deemed repatriation of certain foreign earnings. The decrease in the U.S. federal statutory income tax rate to 21.0% was effective for all of 2019 and resulted in a blended rate for the Company of 25.6% for 2018.

The reconciliation between the statutory tax rate and the effective rate is as follows:

	2019		2018		2017	
Federal taxes at statutory rate	$ 1,001	21.0 %	$ 1,136	25.6 %	$ 1,414	35.0 %
State taxes, net	171	3.6	154	3.4	116	2.9
Foreign taxes, net	(1)	0.0	32	0.7	(64)	(1.6)
Employee stock ownership plan (ESOP)	(18)	(0.4)	(14)	(0.3)	(104)	(2.6)
2017 Tax Act	(123)	(2.6)	19	0.4	—	—
Other	31	0.7	(64)	(1.4)	(37)	(0.9)
Total	$ 1,061	22.3 %	$ 1,263	28.4 %	$ 1,325	32.8 %

During 2019, the Company recognized net tax benefits of $123 related to the 2017 Tax Act. This benefit primarily included $105 related to U.S. taxation of deemed foreign dividends, partially offset by losses of current year foreign tax credits. During 2018, the Company recognized a net tax expense of $19 related to the 2017 Tax Act. This expense included $142 for the estimated tax on deemed repatriation of foreign earnings, and $43 for the reduction in foreign tax credits and other immaterial items, largely offset by a tax benefit of $166 for the remeasurement of certain deferred tax liabilities.

In 2019 and 2018, the Company recognized total net tax benefits of $221 and $57, which included a benefit of $59 and $33, respectively, related to the stock-based compensation accounting standard adopted in 2018 in addition to the impacts of the 2017 Tax Act noted above. In 2017, the Company's provision for income taxes was favorably impacted by a net tax benefit of $104, primarily due to the $82 tax benefit recorded in connection with the May 2017 special cash dividends paid by the Company to employees through the Company's 401(k) retirement plan. Dividends on these shares are deductible for U.S. income tax purposes. There was no similar special cash dividend in 2019 or 2018.

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

	2019	2018
Deferred tax assets:		
Equity compensation	$ 74	$ 72
Deferred income/membership fees	180	136
Foreign tax credit carry forward	65	—
Accrued liabilities and reserves	566	484
Total deferred tax assets	885	692
Valuation allowance	(76)	—
Total net deferred tax assets	809	692
Deferred tax liabilities:		
Property and equipment	(677)	(478)
Merchandise inventories	(187)	(175)
Foreign branch deferreds	(69)	—
Other	(21)	(40)
Total deferred tax liabilities	$ (954)	$ (693)
Net deferred tax (liabilities)/assets	$ (145)	$ (1)

The deferred tax accounts at the end of 2019 and 2018 include deferred income tax assets of $398 and $316, respectively, included in other assets; and deferred income tax liabilities of $543 and $317, respectively, included in other liabilities.

In 2019, the Company recorded a valuation allowance of $76 primarily related to foreign tax credits that we believe will not be realized due to limitations on the Company's ability to claim the credits during the carry forward period. The foreign tax credit carry forwards are set to expire beginning in fiscal 2027.

The Company no longer considers fiscal year earnings of our non-U.S. consolidated subsidiaries after 2017 to be indefinitely reinvested and has recorded the estimated incremental foreign withholding (net of available foreign tax credits) on fiscal year earnings and state income taxes payable assuming a hypothetical repatriation to the U.S. The Company continues to consider undistributed earnings of certain non-U.S. consolidated subsidiaries prior to 2018, which totaled $2,924, to be indefinitely reinvested and has not provided for withholding or state taxes.

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits for 2019 and 2018 is as follows:

	2019	2018
Gross unrecognized tax benefit at beginning of year	$ 36	$ 52
Gross increases—current year tax positions	5	6
Gross increases—tax positions in prior years	2	6
Gross decreases—tax positions in prior years	0	(17)
Settlements	(4)	(1)
Lapse of statute of limitations	(12)	(10)
Gross unrecognized tax benefit at end of year	$ 27	$ 36

The gross unrecognized tax benefit includes tax positions for which the ultimate deductibility is highly certain but there is uncertainty about the timing of such deductibility. At the end of 2019 and 2018, these amounts were immaterial. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of these tax positions would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority. The total amount of such unrecognized tax benefits that, if recognized, would favorably affect the effective income tax rate in future periods is $24 and $32 at the end of 2019 and 2018, respectively.

Accrued interest and penalties related to income tax matters are classified as a component of income tax expense. Interest and penalties recognized during 2019 and 2018 and accrued at the end of each respective period were not material.

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

The Company files income tax returns in the United States, various state and local jurisdictions, in Canada, and in several other foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state or local examination for years before fiscal 2014.

Other Taxes

The Company is undergoing multiple examinations for value added, sales-based, payroll, product, import or other non-income taxes in various jurisdictions. In certain cases, the Company has received assessments from the authorities. Subsequent to the end of 2019, the Company received an assessment related to a product tax audit covering multiple years. The Company recorded a charge of $123 in 2019, but plans to protest the assessment. Other possible losses or range of possible losses associated with these matters are either immaterial or an estimate of the possible loss or range of loss cannot be made at this time. If certain matters or a group of matters were to be decided adversely to the Company, it could result in a charge that might be material to the results of an individual fiscal quarter or year.

Note 9—Net Income per Common and Common Equivalent Share

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

	2019	2018	2017
Net income attributable to Costco	$ 3,659	$ 3,134	$ 2,679
Weighted average basic shares	439,755	438,515	438,437
RSUs and other	3,168	3,319	2,500
Weighted average diluted shares	442,923	441,834	440,937

Note 10—Commitments and Contingencies

Legal Proceedings

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

The Company is a defendant in a class action alleging violation of California Wage Order 7-2001 for failing to provide seating to member service assistants who act as greeters in the Company's California warehouses. *Canela v. Costco Wholesale Corp., et al.* (Case No. 5:13-CV-03598, N.D. Cal. filed July 1, 2013). The complaint seeks relief under the California Labor Code, including civil penalties and attorneys' fees. The Company filed an answer denying the material allegations of the complaint. The action has been stayed pending review by the Ninth Circuit of the order certifying a class. In January 2019, an employee brought similar claims for relief concerning Costco employees engaged at member services counters in California. *Rodriguez v. Costco Wholesale Corp.* (Case No. RG19001310, Alameda Superior Court filed Jan. 4, 2019). The Company filed an answer denying the material allegations of the complaint. In December 2018, a depot employee raised similar claims, alleging that depot employees in California did not receive suitable seating or appropriate workplace temperature conditions. *Lane v. Costco Wholesale Corp.* (Dec. 6, 2018 Notice to California Labor and Workforce Development Agency). The Company filed an answer denying the material allegations of the complaint.

In January 2019, a former seasonal employee filed a class action, alleging failure to provide California seasonal employees meal and rest breaks, proper wage statements, and appropriate wages. *Jadan v. Costco Wholesale Corp.* (Case No. 19-CV-340438 Santa Clara Superior Court filed Jan. 3, 2019). The complaint seeks relief under the California Labor Code, including civil penalties and attorneys' fees.

In March 2019, employees filed a class action against the Company alleging claims under California law for failure to pay overtime, to provide meal periods and itemized wage statements, to timely pay wages due to terminating employees, to pay minimum wages, and for unfair business practices. Relief is sought under the California Labor Code, including civil penalties and attorneys' fees. *Nevarez, et ano., v. Costco Wholesale Corp., et al.* (Case No. 2:19-cv-03454 C.D. Cal. Filed Mar. 25, 2019). The Company filed an answer denying the material allegations of the complaint. In May 2019, employees filed a class action against the Company alleging claims under California law for failure to pay overtime, to provide itemized wage statements, to timely pay wages due to terminating employees, to pay minimum wages, and for unfair business practices. *Rough v. Costco Wholesale Corp*. (Case No. 2:19-cv-01340 E.D. Cal. filed May 28, 2019). Relief is sought under the California Labor Code, including civil penalties and attorneys' fees. In June 2019, employees filed a class action against the Company alleging claims under California law for failure to pay overtime, to provide meal and rest periods, itemized wage statements, to timely pay wages due to terminating employees, to pay minimum wages, and for unfair business practices. *Martinez v. Costco Wholesale Corp*., (Case No. 3:19-cv-05624 (N.D. Cal. filed June 11, 2019). The Company filed an answer denying the material allegations of the complaint. In August 2019, Rough filed a companion case in state court seeking penalties under the California Labor Code Private Attorneys General Act. *Rough v. Costco* (Case No. FCS053454, Sonoma County Superior Court, filed August 23, 2019). Relief is sought under the California Labor Code, including civil penalties and attorneys' fees. In September 2019, an employee re-filed a class action against the Company alleging claims under California law for failure to pay wages, to provide meal and rest periods and itemized wage statements, to timely pay wages due to terminating employees, to pay minimum wages, and for unfair business practices. *Mosley v. Costco Wholesale Corp.* (Case No. 2:19-cv-07935, C.D. Cal. filed Sept. 12, 2019). Relief is sought under the California Labor Code, including civil penalties and attorneys' fees.

In December 2017, the United States Judicial Panel on Multidistrict Litigation consolidated numerous cases filed against various defendants by counties, cities, hospitals, Native American tribes, and third-party payors concerning the impacts of opioid abuse. *In re National Prescription Opiate Litigation* (MDL No. 2804) (N.D. Ohio). Included are federal cases that name the Company, including actions filed by counties and cities in Michigan, New Jersey, Oregon, Virginia and South Carolina, a third-party payor in Ohio, and class actions filed in thirty-eight states on behalf of infants born with opioid-related medical conditions. In 2019 similar actions were commenced against the Company in state courts in Utah. Claims against the Company in state courts in New Jersey and Oklahoma have been dismissed. The Company is defending all of these matters.

The Company and its CEO and CFO are defendants in putative class actions brought on behalf of shareholders who acquired Company stock between June 6 and October 25, 2018. *Johnson v. Costco Wholesale Corp., et al.* (W.D. Wash. filed Nov. 5, 2018); *Chen v. Costco Wholesale Corp., et al.* (W.D. Wash. filed Dec. 11, 2018). The complaints allege violations of the federal securities laws stemming from the Company's disclosures concerning internal control over financial reporting. They seek unspecified damages, equitable relief, interest, and costs and attorneys' fees. On January 30, 2019, an order was entered consolidating the actions and a consolidated amended complaint was filed on April 16, 2019. A motion to dismiss the complaint was filed on June 7.

Members of the Board of Directors, one other individual, and the Company are defendants in a shareholder derivative action related to the internal controls and related disclosures identified in the putative class actions, alleging that the individual defendants breached their fiduciary duties. *Wedekind v. Hamilton James, Susan Decker, Kenneth Denman, Richard Galanti, Craig Jelinek, Richard Libenson, John Meisenbach, Charles Munger, Jeffrey Raikes, John Stanton, Mary Agnes Wilderotter, and Costco Wholesale Corp.* (W.D. Wash. filed Dec. 11, 2018). The complaint seeks unspecified damages, disgorgement of compensation, corporate governance changes, and costs and attorneys' fees. Because the complaint is derivative in nature, it does not seek monetary damages from the Company, which is a nominal defendant. By agreement among the parties the action has been stayed pending further proceedings in the class actions. Similar actions were filed in King County Superior Court on February 20, 2019, *Elliott v. Hamilton James, Susan Decker, Kenneth Denman, Richard Galanti, Craig Jelinek, Richard Libenson, John Meisenbach, Charles Munger, Jeffrey Raikes, John Stanton, Mary Agnes Wilderotter, and Costco Wholesale Corp.* (Case No. 19-2-04824-7), and April 16, 2019, *Brad Shuman, et ano. v. Hamilton James, Susan Decker, Kenneth Denman, Richard Galanti, Craig Jelinek, John Meisenbach, Charles Munger, Jeffrey Raikes, John Stanton, Mary Agnes Wilderotter, and Costco Wholesale Corp.* (Case No. 19-2-10460-1). These actions have also been stayed.

In November 2016 and September 2017, the Company received notices of violation from the Connecticut Department of Energy and Environmental Protection regarding hazardous waste practices at its Connecticut warehouses, primarily concerning unsalable pharmaceuticals. The relief to be sought is not known at this time. The Company is seeking to cooperate concerning the resolution of these notices. On February 13, 2019, the Company's affiliate in Spain received notice from the General Directorate on Environment and Sustainability of the Regional Government of Madrid that the Directorate was investigating issues concerning rain, sewage and hydrocarbon drainage related to the Company's warehouse in Getafe. In August the Company was advised that no fines would be sought in this matter.

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

Note 11—Segment Reporting

The Company and its subsidiaries are principally engaged in the operation of membership warehouses in the U.S., Canada, Mexico, U.K., Japan, Korea, Australia, Spain, Iceland, France, and China and through a majority-owned subsidiary in Taiwan. Reportable segments are largely based on management's organization of the operating segments for operational decisions and assessments of financial performance, which considers geographic locations. The material accounting policies of the segments are as described in Note 1. Inter-segment net sales and expenses have been eliminated in computing total revenue and operating income. Certain operating expenses, predominantly stock-based compensation, incurred on behalf of the Company's Canadian and Other International operations, are included in the U.S. operations because those costs generally come under the responsibility of U.S. management.

	United States Operations	Canadian Operations	Other International Operations	Total
2019				
Total revenue	$ 111,751	$ 21,366	$ 19,586	$ 152,703
Operating income	3,063	924	750	4,737
Depreciation and amortization	1,126	143	223	1,492
Additions to property and equipment	2,186	303	509	2,998
Net property and equipment	14,367	2,044	4,479	20,890
Total assets	32,162	4,369	8,869	45,400
2018				
Total revenue	$ 102,286	$ 20,689	$ 18,601	$ 141,576
Operating income	2,787	939	754	4,480
Depreciation and amortization	1,078	135	224	1,437
Additions to property and equipment	2,046	268	655	2,969
Net property and equipment	13,353	1,900	4,428	19,681
Total assets	28,207	4,303	8,320	40,830
2017				
Total revenue	$ 93,889	$ 18,775	$ 16,361	$ 129,025
Operating income	2,644	841	626	4,111
Depreciation and amortization	1,044	124	202	1,370
Additions to property and equipment	1,714	277	511	2,502
Net property and equipment	12,339	1,820	4,002	18,161
Total assets	24,068	4,471	7,808	36,347

Disaggregated Revenue

The following table summarizes net sales by merchandise category:

	2019	2018	2017
Food and Sundries	$ 59,672	$ 56,073	$ 52,362
Hardlines	24,570	22,620	20,583
Fresh Foods	19,948	18,879	17,849
Softlines	16,590	15,387	14,537
Ancillary	28,571	25,475	20,841
Total Net Sales	$ 149,351	$ 138,434	$ 126,172

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Note 12—Quarterly Financial Data (Unaudited)

The two tables that follow reflect the unaudited quarterly results of operations for 2019 and 2018.

	52 Weeks Ended September 1, 2019				
	First Quarter (12 Weeks)	Second Quarter (12 Weeks)	Third Quarter (12 Weeks)	Fourth Quarter (16 Weeks)	Total (52 Weeks)
REVENUE					
Net sales	$ 34,311	$ 34,628	$ 33,964	$ 46,448	$ 149,351
Membership fees	758	768	776	1,050	3,352
Total revenue	35,069	35,396	34,740	47,498	152,703
OPERATING EXPENSES					
Merchandise costs	30,623	30,720	30,233	41,310	132,886
Selling, general and administrative	3,475	3,464	3,371	4,684 (1)	14,994
Preopening expenses	22	9	14	41	86
Operating income	949	1,203	1,122	1,463	4,737
OTHER INCOME (EXPENSE)					
Interest expense	(36)	(34)	(35)	(45)	(150)
Interest income and other, net	22	46	36	74	178
INCOME BEFORE INCOME TAXES	935	1,215	1,123	1,492	4,765
Provision for income taxes	158	314	207	382	1,061
Net income including noncontrolling interests	777	901	916	1,110	3,704
Net income attributable to noncontrolling interests	(10)	(12)	(10)	(13)	(45)
NET INCOME ATTRIBUTABLE TO COSTCO	$ 767	$ 889	$ 906	$ 1,097	$ 3,659
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO:					
Basic	$ 1.75	$ 2.02	$ 2.06	$ 2.49	$ 8.32
Diluted	$ 1.73	$ 2.01	$ 2.05	$ 2.47	$ 8.26
Shares used in calculation (000's)					
Basic	439,157	440,284	439,859	439,727	439,755
Diluted	442,749	442,337	442,642	443,400	442,923
CASH DIVIDENDS DECLARED PER COMMON SHARE	$ 0.57	$ 0.57	$ 0.65	$ 0.65	$ 2.44

(1) Includes a $123 charge for a product tax assessment.

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	52 Weeks Ended September 2, 2018				
	First Quarter (12 Weeks)	Second Quarter (12 Weeks)	Third Quarter (12 Weeks)	Fourth Quarter (16 Weeks)	Total (52 Weeks)
REVENUE					
Net sales	$ 31,117	$ 32,279	$ 31,624	$ 43,414	$ 138,434
Membership fees	692	716	737	997	3,142
Total revenue	31,809	32,995	32,361	44,411	141,576
OPERATING EXPENSES					
Merchandise costs	27,617	28,733	28,131	38,671	123,152
Selling, general and administrative	3,224	3,234	3,155	4,263	13,876
Preopening expenses	17	12	8	31	68
Operating income	951	1,016	1,067	1,446	4,480
OTHER INCOME (EXPENSE)					
Interest expense	(37)	(37)	(37)	(48)	(159)
Interest income and other, net	22	7	41	51	121
INCOME BEFORE INCOME TAXES	936	986	1,071	1,449	4,442
Provision for income taxes	285	273	309	396	1,263
Net income including noncontrolling interests	651	713	762	1,053	3,179
Net income attributable to noncontrolling interests	(11)	(12)	(12)	(10)	(45)
NET INCOME ATTRIBUTABLE TO COSTCO	$ 640	$ 701	$ 750	$ 1,043	$ 3,134
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO:					
Basic	$ 1.46	$ 1.60	$ 1.71	$ 2.38	$ 7.15
Diluted	$ 1.45	$ 1.59	$ 1.70	$ 2.36	$ 7.09
Shares used in calculation (000's)					
Basic	437,965	439,022	438,740	438,379	438,515
Diluted	440,851	441,568	441,715	442,427	441,834
CASH DIVIDENDS DECLARED PER COMMON SHARE	$ 0.50	$ 0.50	$ 0.57	$ 0.57	$ 2.14

Item 9—Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A—Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended) are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and to ensure that information required to be disclosed is accumulated and communicated to management, including our principal executive and financial officers, to allow timely decisions regarding disclosure. The Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), with assistance from other members of management, have reviewed the effectiveness of our disclosure controls and procedures as of September 1, 2019 and, based on their evaluation, have concluded that the disclosure controls and procedures were effective as of such date.

Management's Annual Report on Internal Control Over Financial Reporting

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

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

Under the supervision of and with the participation of our management, we assessed the effectiveness of our internal control over financial reporting as of September 1, 2019, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework (2013).

As disclosed in Part II Item 9A Controls and Procedures in our Annual Report on Form 10-K for the fiscal year ended September 2, 2018, during the fourth quarter of fiscal 2018 we identified a material weakness in internal control related to ineffective information technology general controls (ITGCs) in the areas of user access and program change-management over certain information technology (IT) systems that support the Company’s financial reporting processes.

During 2019, management implemented our previously disclosed remediation plan that included: (i) creating and filling an IT Compliance Oversight function; (ii) developing a training program addressing ITGCs and policies, including educating control owners concerning the principles and requirements of each control, with a focus on those related to user access and change-management over IT systems impacting financial reporting; (iii) developing and maintaining documentation underlying ITGCs to promote knowledge transfer upon personnel and function changes; (iv) developing enhanced risk assessment procedures and controls related to changes in IT systems; (v) implementing an IT management review and testing plan to monitor

ITGCs with a specific focus on systems supporting our financial reporting processes; and (vi) enhanced quarterly reporting on the remediation measures to the Audit Committee of the Board of Directors.

During the fourth quarter of 2019, we completed our testing of the operating effectiveness of the implemented controls and found them to be effective. As a result we have concluded the material weakness has been remediated as of September 1, 2019.

Changes in Internal Control Over Financial Reporting

Except for the changes in connection with our implementation of the remediation plan discussed above, there have been no other changes in our internal control over financial reporting (as defined in Rules 13a-15(f) or 15d-15(f) of the Exchange Act) that occurred during the fourth quarter of 2019 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

/s/ W. CRAIG JELINEK

W. Craig Jelinek
President, Chief Executive Officer and Director

/s/ RICHARD A. GALANTI

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

Item 9B—Other Information

None.

PART III

Item 10—Directors, Executive Officers and Corporate Governance

Information relating to the availability of our code of ethics for senior financial officers and a list of our executive officers appear in Part I, Item 1 of this Report. The information required by this Item concerning our directors and nominees for director is incorporated herein by reference to the sections entitled "Proposal 1: Election of Directors," "Directors," "Committees of the Board" and "Section 16(a) Beneficial Ownership Reporting Compliance" in Costco's Proxy Statement for its 2020 annual meeting of stockholders, which will be filed with the SEC within 120 days of the end of our fiscal year ("Proxy Statement").

Item 11—Executive Compensation

The information required by this Item is incorporated herein by reference to the sections entitled "Compensation of Directors," "Executive Compensation," and "Compensation Discussion and Analysis" in Costco's Proxy Statement.

Item 12—Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item is incorporated herein by reference to the section entitled "Principal Shareholders" and "Equity Compensation Plan Information" in Costco's Proxy Statement.

Item 13—Certain Relationships and Related Transactions, and Director Independence

The information required by this Item is incorporated herein by reference to the sections entitled "Proposal 1: Election of Directors," "Directors," "Committees of the Board," "Shareholder Communications to the Board," "Meeting Attendance," "Report of the Compensation Committee of the Board of Directors," "Certain Relationships and Transactions" and "Report of the Audit Committee" in Costco's Proxy Statement.

Item 14—Principal Accounting Fees and Services

The information required by this Item is incorporated herein by reference to the sections entitled "Independent Public Accountants" in Costco's Proxy Statement.

PART IV

Item 15—Exhibits, Financial Statement Schedules

(a) Documents filed as part of this report are as follows:

1. Financial Statements:

   See the listing of Financial Statements included as a part of this Form 10-K in Item 8 of Part II.

2. Financial Statement Schedules:

   All schedules have been omitted because the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements, including the notes thereto.

(b) Exhibits: The required exhibits are filed as part of this Annual Report on Form 10-K or are incorporated herein by reference.

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference Form	Period Ended	Filing Date
3.1	Articles of Incorporation as amended of Costco Wholesale Corporation		10-Q	2/17/2019	3/13/2019
3.2	Bylaws as amended of Costco Wholesale Corporation		8-K		4/30/2019
4.1	Form of 2.150% Senior Notes due May 18, 2021		8-K		5/16/2017
4.2	Form of 2.300% Senior Notes due May 18, 2022		8-K		5/16/2017
4.3	Form of 2.750% Senior Notes due May 18, 2024		8-K		5/16/2017
4.4	Form of 3.000% Senior Notes due May 18, 2027		8-K		5/16/2017
10.1*	Costco Wholesale Executive Health Plan		10-K	9/2/2012	10/19/2012

10.2*	2019 Incentive Plan		DEF 14		12/17/2019

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference		
			Form	Period Ended	Filing Date
10.3*	Seventh Restated 2002 Stock Incentive Plan		DEF 14A		12/19/2014
10.3.1*	Seventh Restated 2002 Stock Incentive Plan Restricted Stock Unit Award Agreement-U.S. Employee		10-Q	11/22/2015	12/17/2015
10.3.2*	Seventh Restated 2002 Stock Incentive Plan Restricted Stock Unit Award Agreement-Non-U.S. Employee		10-Q	11/22/2015	12/17/2015
10.3.3*	Seventh Restated 2002 Stock Incentive Plan Restricted Stock Unit Award Agreement-Non-Executive Director		10-Q	11/22/2015	12/17/2015
10.3.4	Seventh Restated 2002 Stock Incentive Plan Letter Agreement for 2016 Performance-Based Restricted Stock Units-Executive		10-Q	11/22/2015	12/17/2015
10.4*	Fiscal 2019 Executive Bonus Plan		8-K		10/26/2018
10.5.1*	Executive Employment Agreement, effective January 1, 2017, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/20/2016	12/16/2016
10.5.2*	Extension of the Term of the Executive Employment Agreement, effective January 1, 2019, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/25/2018	12/20/2018
10.6	Form of Indemnification Agreement		14A		12/13/1999
10.7*	Deferred Compensation Plan		10-K	9/1/2013	10/16/2013
10.8.1**	Citibank, N.A. Co-Branded Credit Card Agreement		10-Q/A	5/10/2015	8/31/2015
10.8.2**	First Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	11/22/2015	12/17/2015
10.8.3**	Second Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/14/2016	3/9/2016
10.8.4**	Third Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-K	8/28/2016	10/12/2016

10.8.5**	Fourth Amendment to Citi, N.A. Co-Branded Credit Card Agreement	10-Q	2/18/2018	3/15/2018

Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference		
			Form	Period Ended	Filing Date
10.8.6**	Fifth Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/17/2019	3/13/2019
10.8.7**	Sixth Amendment to Citi, N.A. Co-Branded Credit Card Agreement	x			
21.1	Subsidiaries of the Company	x			
23.1	Consent of Independent Registered Public Accounting Firm	x			
31.1	Rule 13a – 14(a) Certifications	x			
32.1	Section 1350 Certifications	x			
101.INS	XBRL Instance Document	x			
101.SCH	XBRL Taxonomy Extension Schema Document	x			
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	x			
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	x			
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	x			
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	x			

* Management contract, compensatory plan or arrangement.
** Portions of this exhibit have been omitted under a confidential treatment order issued by the Securities and Exchange Commission.

(c) Financial Statement Schedules—None.

Item 16—Form 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

October 10, 2019

COSTCO WHOLESALE CORPORATION
(Registrant)

By /s/ RICHARD A. GALANTI
Richard A. Galanti
Executive Vice President, Chief Financial Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

October 10, 2019

By /s/ W. CRAIG JELINEK W. Craig Jelinek *President, Chief Executive Officer and Director*	By /s/ HAMILTON E. JAMES Hamilton E. James *Chairman of the Board*
By /s/ RICHARD A. GALANTI Richard A. Galanti *Executive Vice President, Chief Financial Officer and Director* *(Principal Financial Officer)*	By /s/ DANIEL M. HINES Daniel M. Hines *Senior Vice President and Corporate Controller* *(Principal Accounting Officer)*
By /s/ SUSAN L. DECKER Susan L. Decker *Director*	By /s/ KENNETH D. DENMAN Kenneth D. Denman *Director*
By /s/ JOHN W. MEISENBACH John W. Meisenbach *Director*	By /s/ CHARLES T. MUNGER Charles T. Munger *Director*
By /s/ JEFFREY S. RAIKES Jeffrey S. Raikes *Director*	By /s/ JOHN W. STANTON John W. Stanton *Director*
By /s/ MARY (MAGGIE) A. WILDEROTTER Mary (Maggie) A. Wilderotter *Director*	

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-K

☒ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended September 2, 2018
or

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number 0-20355

Costco Wholesale Corporation
(Exact name of registrant as specified in its charter)

Washington	**91-1223280**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

999 Lake Drive, Issaquah, WA 98027
(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code: **(425) 313-8100**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Name of each exchange on which registered**
Common Stock, $.01 Par Value	The NASDAQ Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ☒ NO ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ☐ NO ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES ☒ NO ☐

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). YES ☒ NO ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company", and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒	Accelerated filer ☐
Non-accelerated filer ☐	Smaller reporting company ☐
Emerging growth company ☐	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES ☐ NO ☒

The aggregate market value of the voting stock held by non-affiliates of the registrant as of February 18, 2018 was $83,850,253,577.

The number of shares outstanding of the registrant's common stock as of October 18, 2018 was 438,208,376.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company’s Proxy Statement for the Annual Meeting of Shareholders to be held on January 24, 2019, are incorporated by reference into Part III of this Form 10-K.

COSTCO WHOLESALE CORPORATION
ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED SEPTEMBER 2, 2018

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INFORMATION RELATING TO FORWARD LOOKING STATEMENTS

Certain statements contained in this Report constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. They include statements that address activities, events, conditions or developments that we expect or anticipate may occur in the future and may relate to such matters as sales growth, changes in comparable sales, cannibalization of existing locations by new openings, price or fee changes, earnings performance, earnings per share, stock-based compensation expense, warehouse openings and closures, capital spending, the effect of adopting certain accounting standards, future financial reporting, financing, margins, return on invested capital, strategic direction, expense controls, membership renewal rates, shopping frequency, litigation, and the demand for our products and services. Forward-looking statements may also be identified by the words “anticipate,” “believe,” “continue,” “could,” “estimate,” “expect,” “intend,” “may,” “might,” “likely,” “plan,” “potential,” “predict,” “project,” “seek,” “should,” “target,” “will,” “would,” or similar expressions and the negatives of those terms. Such forward-looking statements involve risks and uncertainties that may cause actual events, results, or performance to differ materially from those indicated by such statements, including, without limitation, the factors set forth in the section titled “Item 1A-Risk Factors”, and other factors noted in the section titled “Item 7-Management's Discussion and Analysis of Financial Condition and Results of Operations” and in the consolidated financial statements and related notes in Item 8 of this Report. Forward-looking statements speak only as of the date they are made, and we do not undertake to update these statements, except as required by law.

PART I

Item 1—Business

Costco Wholesale Corporation and its subsidiaries (Costco or the Company) began operations in 1983, in Seattle, Washington. We are principally engaged in the operation of membership warehouses in the United States (U.S.) and Puerto Rico, Canada, United Kingdom (U.K.), Mexico, Japan, Korea, Australia, Spain, France, Iceland, and through a majority-owned subsidiary in Taiwan. Costco operated 762, 741, and 715 warehouses worldwide at September 2, 2018, September 3, 2017, and August 28, 2016, respectively. Our common stock trades on the NASDAQ Global Select Market, under the symbol “COST.”

We report on a 52/53-week fiscal year, consisting of thirteen four-week periods and ending on the Sunday nearest the end of August. The first three quarters consist of three periods each, and the fourth quarter consists of four periods (five weeks in the thirteenth period in a 53-week year). The material seasonal impact in our operations is increased net sales and earnings during the winter holiday season. References to 2018 and 2016 relate to the 52-week fiscal years ended September 2, 2018, and August 28, 2016, respectively. References to 2017 relate to the 53-week fiscal year ended September 3, 2017.

General

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

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

Our average warehouse space is approximately 145,000 square feet, with newer units being slightly larger. Floor plans are designed for economy and efficiency in the use of selling space, the handling of merchandise, and the control of inventory. Because shoppers are attracted principally by the quality of merchandise and low prices, our warehouses are not elaborate. By strictly controlling the entrances and exits and using a membership format, we believe our inventory losses (shrinkage) are well below those of typical retail operations.

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

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

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

We offer merchandise in the following categories:

- **Food and Sundries** (including dry foods, packaged foods, groceries, snack foods, candy, alcoholic and nonalcoholic beverages, and cleaning supplies)

- **Hardlines** (including major appliances, electronics, health and beauty aids, hardware, and garden and patio)

- **Fresh Foods** (including meat, produce, deli, and bakery)

- **Softlines** (including apparel and small appliances)

- **Ancillary** (including gasoline and pharmacy businesses)

Ancillary businesses within or next to our warehouses provide expanded products and services, encouraging members to shop more frequently. These businesses include gas stations, pharmacies, optical dispensing centers, food courts, and hearing-aid centers. The number of warehouses with gas stations vary significantly by country, and we do not operate our gasoline business in Korea or France. We operated 567 gas stations at the end of 2018.

Our e-commerce operations allow us to connect with our members online and provide additional products and services, many not found in our warehouses. We operate e-commerce websites in the U.S., Canada, Mexico, U.K., Korea, and Taiwan. Net sales for e-commerce represented approximately 4% of total net sales in 2018. Additionally, we offer business delivery, travel and various other services online in certain countries.

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

Certain financial information for our segments and geographic areas is included in Note 11 to the consolidated financial statements included in Item 8 of this Report.

Membership

Our members may utilize their memberships at our warehouses worldwide. Gold Star memberships are available to individuals; Business memberships are limited to businesses, including individuals with a business license, retail sales license or comparable evidence. Business members have the ability to add additional cardholders (affiliates), to which the same annual fee applies. Affiliates are not available for Gold Star members. Our annual fee for these memberships is $60 in our U.S. and Canadian operations and varies in other countries. All paid memberships include a free household card.

Our member renewal rate was 90% in the U.S. and Canada and 88% on a worldwide basis at the end of 2018. The majority of members renew within six months following their renewal date. Therefore, our renewal rate is a trailing calculation that captures renewals during the period seven to eighteen months prior to the reporting date.

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

	2018	2017	2016
Gold Star	40,700	38,600	36,800
Business, including affiliates	10,900	10,800	10,800
Total paid members	51,600	49,400	47,600
Household cards	42,700	40,900	39,100
Total cardholders	94,300	90,300	86,700

Paid cardholders (except Business affiliates) are eligible to upgrade to an Executive membership in the U.S. and Canada for an additional annual fee of $60. Executive memberships are also available in Mexico and the U.K., for which the additional annual fee varies. Executive members earn a 2% reward on qualified purchases (up to a maximum reward of $1,000 per year in U.S. and Canada and varies in Mexico and the U.K.), and can be redeemed only at Costco warehouses. This program also offers (except in Mexico), access to additional savings and benefits on various business and consumer services, such as auto and home insurance, the Costco auto purchase program, and check printing services. These services are generally provided by third parties and vary by state and country. Executive members, who represented 37% of paid members at the end of 2018, generally shop more frequently and spend more than other members.

Labor

Our employee count was as follows:

	2018	2017	2016
Full-time employees	143,000	133,000	126,000
Part-time employees	102,000	98,000	92,000
Total employees	245,000	231,000	218,000

Approximately 15,900 employees are union employees. We consider our employee relations to be very good.

Competition

Our industry is highly competitive, based on factors such as price, merchandise quality and selection, location, convenience, distribution strategy, and customer service. We compete on a worldwide basis with global, national, and regional wholesalers and retailers, including supermarkets, supercenters, internet retailers, gasoline stations, hard discounters, department and specialty stores, and operators selling a single category or narrow range of merchandise. Walmart, Target, Kroger, and Amazon.com are among our significant general

merchandise retail competitors. We also compete with warehouse club operations (primarily Walmart's Sam's Club and BJ's Wholesale Club), and nearly every major U.S. and Mexico metropolitan area has multiple club operations.

Intellectual Property

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

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

Available Information

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

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

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Executive Officers of the Registrant

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

Name	Position	Executive Officer Since	Age
W. Craig Jelinek	President and Chief Executive Officer. Mr. Jelinek has been President and Chief Executive Officer since January 2012 and a director since February 2010. He was President and Chief Operating Officer from February 2010 to December 2011. Prior to that he was Executive Vice President, Chief Operating Officer, Merchandising since 2004.	1995	66
Richard A. Galanti	Executive Vice President and Chief Financial Officer. Mr. Galanti has been a director since January 1995.	1993	62
Jim C. Klauer	Executive Vice President, Chief Operating Officer, Northern Division. Mr. Klauer was Senior Vice President, Non Foods and E-commerce merchandise, from 2013 to January 2018.	2018	56
Franz E. Lazarus	Executive Vice President, Administration. Mr. Lazarus was Senior Vice President, Administration-Global Operations, from 2006 to September 2012.	2012	71
Russ D. Miller	Executive Vice President, Chief Operating Officer, Southern Division and Mexico. Mr. Miller was Senior Vice President, Western Canada Region, from 2001 to January 2018.	2018	61
Paul G. Moulton	Executive Vice President, Chief Information Officer. Mr. Moulton was Executive Vice President, Real Estate Development, from 2001 until March 2010.	2001	67
James P. Murphy	Executive Vice President, Chief Operating Officer, International. Mr. Murphy was Senior Vice President, International, from 2004 to October 2010.	2011	65
Joseph P. Portera	Executive Vice President, Chief Operating Officer, Eastern and Canadian Divisions. Mr. Portera has held these positions since 1994 and has been the Chief Diversity Officer since 2010.	1994	66
Timothy L. Rose	Executive Vice President, Ancillary Businesses, Manufacturing, and Business Centers. Mr. Rose was Senior Vice President, Merchandising, Food and Sundries and Private Label, from 1995 to December 2012.	2013	66
Ron M. Vachris	Executive Vice President, Chief Operating Officer, Merchandising. Mr. Vachris was Senior Vice President, Real Estate Development, from August 2015 to June 2016, and Senior Vice President, General Manager, Northwest Region, from 2010 to July 2015.	2016	53

Item 1A—Risk Factors

The risks described below could materially and adversely affect our business, financial condition and results of operations. We could also be affected by additional risks that apply to all companies operating in the U.S. and globally, as well as other risks that are not presently known to us or that we currently consider to be immaterial. These Risk Factors should be carefully reviewed in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7 and our consolidated financial statements and related notes in Item 8 of this Report.

Business and Operating Risks

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

Our financial and operational performance is highly dependent on our U.S. and Canadian operations, which comprised 87% and 83% of net sales and operating income in 2018, respectively. Within the U.S., we are highly dependent on our California operations, which comprised 30% of U.S. net sales in 2018. Our California market, in general, has a larger percentage of higher volume warehouses as compared to our other domestic markets. Any substantial slowing or sustained decline in these operations could materially adversely affect our business and financial results. Declines in financial performance of our U.S. operations, particularly in California, and our Canadian operations could arise from, among other things: slow growth or declines in comparable warehouse sales (comparable sales); negative trends in operating expenses, including increased labor, healthcare and energy costs; failing to meet targets for warehouse openings; cannibalizing existing locations with new warehouses; shifts in sales mix toward lower gross margin products; changes or uncertainties in economic conditions in our markets, including higher levels of unemployment and depressed home values; and failing to consistently provide high quality and innovative new products.

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

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

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

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

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

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

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

Disruptions in our merchandise distribution or processing, packaging, manufacturing, and other facilities could adversely affect sales and member satisfaction.

We depend on the orderly operation of the merchandise receiving and distribution process, primarily through our depots. We also rely upon processing, packaging, manufacturing and other facilities to support our business, which includes the production of certain private-label items. Although we believe that our operations are efficient, disruptions due to fires, tornadoes, hurricanes, earthquakes or other catastrophic events, labor issues or other shipping problems may result in delays in the production and delivery of merchandise to our warehouses, which could adversely affect sales and the satisfaction of our members.

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

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

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

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

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

We identified a material weakness in our internal control related to ineffective information technology general controls which, if not remediated appropriately or timely, could result in loss of investor confidence and adversely impact our stock price.

Internal controls related to the operation of technology systems are critical to maintaining adequate internal control over financial reporting. As disclosed in Part II, Item 9A, during the fourth quarter of fiscal 2018, management identified a material weakness in internal control related to ineffective information technology general controls (ITGCs) in the areas of user access and program change-management over certain information technology (IT) systems that support the Company’s financial reporting processes. As a result, management concluded that our internal control over financial reporting was not effective as of September 2, 2018. We are implementing remedial measures and, while there can be no assurance that our efforts will be successful, we plan to remediate the material weakness prior to the end of fiscal 2019. These measures will result in additional technology and other expenses. If we are unable to remediate the material weakness, or are otherwise unable to maintain effective internal control over financial reporting or disclosure controls and procedures, our ability to record, process and report financial information accurately, and to prepare financial statements within required time periods, could be adversely affected, which could subject us to litigation or investigations requiring management resources and payment of legal and other expenses, negatively affect investor confidence in our financial statements and adversely impact our stock price.

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

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

The use of data by our business and our business associates is regulated at the national and state or local level in all of our operating countries. Privacy and information-security laws and regulations change, and compliance with them may result in cost increases due to, among other things, systems changes and the development of new processes. If we or those with whom we share information fail to comply with these laws and regulations, our reputation could be damaged, possibly resulting in lost future business, and we could be subjected to additional legal risk as a result of non-compliance, including fines of up to 4% of our global revenue in the case of the General Data Protection Regulation (GDPR). We do not maintain cyber-insurance for these risks.

We have security measures and controls to protect personal and business information and continue to make investments to secure access to our information technology network. These measures may be undermined, however, due to the actions of outside parties, employee error, internal or external malfeasance, or otherwise, and, as a result an unauthorized party may obtain access to our data systems and misappropriate business and personal information. Because the techniques used to obtain unauthorized access, disable or degrade

service, or sabotage systems change frequently and may not immediately produce signs of intrusion, we may be unable to anticipate these techniques, timely discover or counter them, or implement adequate preventative measures. Any such breach or unauthorized access could result in significant legal and financial exposure, damage to our reputation, and potentially have an adverse effect on our business and results of operations.

We are subject to payment-related risks.

We accept payments using a variety of methods, including cash and checks, a select variety of credit and debit cards, and our proprietary cash card. As we offer new payment options to our members, we may be subject to additional rules, regulations, compliance requirements, and higher fraud losses. For certain payment methods, we pay interchange and other related card acceptance fees, along with additional transaction processing fees. We rely on third parties to provide payment transaction processing services, including the processing of credit and debit cards, and our proprietary cash card, and it could disrupt our business if these companies become unwilling or unable to provide these services to us. We are also subject to payment card association and network operating rules, including data security rules, certification requirements and rules governing electronic funds transfers, which could change over time. For example, we are subject to Payment Card Industry Data Security Standards (“PCI DSS”), which contain compliance guidelines and standards with regard to our security surrounding the physical and electronic storage, processing and transmission of individual cardholder data. In addition, if our internal systems are breached or compromised, we may be liable for card re-issuance costs, subject to fines and higher transaction fees and lose our ability to accept credit and/or debit card payments from our members, and our business and operating results could be adversely affected.

We might sell products that cause illness or injury to our members, harm to our reputation, and expose us to litigation.

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

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

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

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

Our success depends on the continued contributions of members of our senior management and other key operations, merchandising and administrative personnel. Failure to identify and implement a succession plan for key senior management could negatively impact the business.

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

We may incur property, casualty or other losses not covered by our insurance.

The Company is predominantly self-insured for employee health care benefits, workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, and inventory loss. Insurance coverage is maintained in certain instances to limit the exposure arising from catastrophic events. The types and amounts of insurance may vary from time to time based on our decisions with respect to risk retention and regulatory requirements. Significant claims or events, regulatory changes, a substantial rise in costs of health care or costs to maintain our insurance, or the failure to maintain adequate insurance coverage could have an adverse impact on our financial condition and results of operations.

We are primarily self-insured as it relates to property damage. Although we maintain specific coverages for catastrophic losses, we still bear the risk of losses incurred as a result of any physical damage to, or the destruction of, any warehouses, depots, manufacturing or home office facilities, loss or spoilage of inventory, and business interruption caused by any such events to the extent they are below catastrophic levels of coverage, as well as any losses to the extent they exceed our aggregate limits of applicable coverages. Such losses could materially impact our cash flow and results of operations.

Market and Other External Risks

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

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

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

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

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

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

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

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

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

During 2018, our international operations, including Canada, generated 28% and 38% of our net sales and operating income, respectively. Our international operations have accounted for an increasing portion of our warehouses, and we plan to continue international growth. To prepare our consolidated financial statements, we translate the financial statements of our international operations from local currencies into U.S. dollars using current exchange rates. Future fluctuations in exchange rates that are unfavorable to us may adversely affect the financial performance of our Canadian and Other International operations and have a corresponding adverse period-over-period effect on our results of operations. As we continue to expand internationally, our exposure to fluctuations in foreign exchange rates may increase.

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

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

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

Factors associated with climate change could adversely affect our business.

We use natural gas, diesel fuel, gasoline, and electricity in our distribution and warehouse operations. U.S. and foreign government regulations limiting carbon dioxide and other greenhouse gas emissions may result in increased compliance and merchandise costs, and legislation or regulation affecting energy inputs that could materially affect our profitability. Climate change and extreme weather conditions, such as intense hurricanes, thunderstorms, tornadoes, and snow or ice storms, as well as rising sea levels could affect our ability to procure needed commodities at costs and in quantities we currently experience. We also sell a substantial amount of gasoline, the demand for which could be impacted by concerns about climate change and which could face increased regulation.

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

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

Legal and Regulatory Risks

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

During 2018, we operated 235 warehouses outside of the U.S., and we plan to continue expanding our international operations. Future operating results internationally could be negatively affected by a variety of factors, many similar to those we face in the U.S., certain of which are beyond our control. These factors include political and economic conditions, regulatory constraints, currency regulations, policy changes such as the U.K.'s vote to withdraw from the European Union, commonly known as "Brexit", and other matters in any of the countries or regions in which we operate, now or in the future. Other factors that may impact international operations include foreign trade (including tariffs), monetary and fiscal policies and the laws and regulations of the U.S. and foreign governments, agencies and similar organizations, and risks associated with having major facilities in locations which have been historically less stable than the U.S. Risks inherent in international operations also include, among others, the costs and difficulties of managing international operations, adverse tax consequences, and difficulty in enforcing intellectual property rights.

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

Accounting principles and related pronouncements, implementation guidelines, and interpretations we apply to a wide range of matters that are relevant to our business, including self-insurance liabilities and income taxes, are highly complex and involve subjective assumptions, estimates and judgments by our management. Changes in rules or interpretation or changes in underlying assumptions, estimates or judgments by our management could significantly change our reported or expected financial performance and have a material impact on our consolidated financial statements.

We could be subject to additional income tax liabilities.

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

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

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

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

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

Item 1B—Unresolved Staff Comments

None.

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Item 2—Properties

Warehouse Properties

At September 2, 2018, we operated 762 membership warehouses:

	Own Land and Building	Lease Land and/or Building(1)	Total
United States and Puerto Rico	426	101	527
Canada	86	14	100
Mexico	38	1	39
United Kingdom	22	6	28
Japan	12	14	26
Korea(2)	11	4	15
Taiwan	—	13	13
Australia	7	3	10
Spain	2	—	2
Iceland	—	1	1
France	1	—	1
Total	605	157	762

(1) 106 of the 157 leases are land-only leases, where Costco owns the building.

(2) In fiscal 2018, Costco purchased the remaining equity interest and three formerly leased locations from its former joint-venture partner in Korea.

The following schedule shows warehouse openings, net of closings and relocations, and expected openings through December 31, 2018:

	United States	Canada	Other International	Total	Total Warehouses in Operation
2014 and prior	468	88	107	663	663
2015	12	1	10	23	686
2016	21	2	6	29	715
2017	13	6	7	26	741
2018	13	3	5	21	762
2019 (expected through 12/31/2018)	6	—	1	7	769
Total	533	100	136	769	

At the end of fiscal 2018, our warehouses contained approximately 110.7 million square feet of operating floor space: 77.5 million in the U.S.; 13.9 million in Canada; and 19.3 million in Other International. We operate 24 depots, with approximately 11.0 million square feet, for the consolidation and distribution of most merchandise shipments to the warehouses. Additionally, we operate various processing, packaging, manufacturing and other facilities to support our business, which includes the production of certain private-label items. Our executive offices are located in Issaquah, Washington, and we maintain 18 regional offices in the U.S., Canada and Other International locations.

Item 3—Legal Proceedings

See discussion of Legal Proceedings in Note 10 to the consolidated financial statements included in Item 8 of this Report.

Item 4—Mine Safety Disclosures

Not applicable.

PART II

Item 5—Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market Information and Dividend Policy

Our common stock is traded on the NASDAQ Global Select Market under the symbol "COST." On October 18, 2018, we had 8,829 stockholders of record. The following table shows the quarterly high and low closing prices of our common stock as reported by NASDAQ for each quarter during the last two fiscal years and the quarterly cash dividend declared per share.

	Price Range		Cash Dividends Declared
	High	Low	
2018:			
Fourth Quarter	$ 233.13	$ 195.48	$ 0.570
Third Quarter	197.16	180.84	0.570
Second Quarter	198.91	172.61	0.500
First Quarter	173.42	154.61	0.500
2017:			
Fourth Quarter	$ 182.20	$ 150.44	$ 0.500
Third Quarter	182.45	164.55	7.500 (1)
Second Quarter	172.00	150.11	0.450
First Quarter	163.98	142.24	0.450

(1) Includes a special cash dividend of $7.00 per share.

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

Issuer Purchases of Equity Securities

The following table sets forth information on our common stock repurchase program activity for the fourth quarter of fiscal 2018 (dollars in millions, except per share data):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program(1)	Maximum Dollar Value of Shares that May Yet be Purchased under the Program
May 14—June 10, 2018	96,000	$ 198.61	96,000	$ 2,497
June 11—July 8, 2018	134,000	208.49	134,000	2,469
July 9—August 5, 2018	111,000	216.06	111,000	2,445
August 6—September 2, 2018	78,000	225.20	78,000	2,427
Total fourth quarter	419,000	$ 211.35	419,000	

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

Performance Graph

The following graph compares the cumulative total shareholder return (stock price appreciation plus dividends) on our common stock for the last five years with the cumulative total return of the S&P 500 Index, the S&P 500 Retail Index, and a peer group previously selected by the Company.

The S&P 500 Retail Index is intended to replace the previously selected peer group to allow for a more broad representation of industry performance. The transition to a larger retail index provides a better representation of total retail market performance. For the year ended September 2, 2018, the cumulative total return of the previous peer group is provided pursuant to SEC rules requiring presentation in the year of change, and consists of: Amazon.com Inc.; The Home Depot Inc.; Lowe's Companies; Best Buy Co., Inc.; Staples Inc.; Target Corporation; Kroger Company; and Walmart Stores, Inc. This group will not be presented in future periods.

The information provided is from September 1, 2013, through September 2, 2018. The graph assumes the investment of $100 in Costco common stock, the S&P 500 Index, the S&P 500 Retail Index, and the previously selected peer group on September 1, 2013, and reinvestment of all dividends.

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Item 6—Selected Financial Data

The following table sets forth information concerning our consolidated financial condition, operating results, and key operating metrics. This information should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations, included in Item 7 of this Report, and our consolidated financial statements and notes thereto, included in Item 8 of this Report.

SELECTED FINANCIAL DATA

(dollars in millions, except per share data)

As of and for the year ended	Sept. 2, 2018 (52 weeks)	Sept. 3, 2017 (53 weeks)	Aug. 28, 2016 (52 weeks)	Aug. 30, 2015 (52 weeks)	Aug. 31, 2014 (52 weeks)
RESULTS OF OPERATIONS					
Net sales	$ 138,434	$ 126,172	$ 116,073	$ 113,666	$ 110,212
Membership fees	3,142	2,853	2,646	2,533	2,428
Gross margin[(1)] as a percentage of net sales	11.04 %	11.33 %	11.35 %	11.09 %	10.66 %
Selling, general and administrative expenses as a percentage of net sales	10.02 %	10.26 %	10.40 %	10.07 %	9.89 %
Operating income	$ 4,480	$ 4,111	$ 3,672	$ 3,624	$ 3,220
Net income attributable to Costco	3,134	2,679	2,350	2,377	2,058
Net income per diluted common share attributable to Costco	7.09	6.08	5.33	5.37	4.65
Cash dividends declared per common share	2.14	8.90	1.70	6.51	1.33
Changes in comparable sales[(2)]					
United States	9 %	4 %	1 %	3 %	5 %
Canada	9 %	5 %	(3 %)	(5 %)	2 %
Other International	11 %	2 %	(3 %)	(3 %)	3 %
Total Company	9 %	4 %	0 %	1 %	4 %
Changes in Total Company comparable sales excluding the impact of foreign currency and gasoline prices	7 %	4 %	4 %	7 %	6 %
BALANCE SHEET DATA					
Net property and equipment	$ 19,681	$ 18,161	$ 17,043	$ 15,401	$ 14,830
Total assets	40,830	36,347	33,163	33,017	32,662
Long-term debt, excluding current portion	6,487	6,573	4,061	4,852	5,084
Costco stockholders' equity	12,799	10,778	12,079	10,617	12,303
WAREHOUSE INFORMATION					
Warehouses in Operation					
Beginning of year	741	715	686	663	634
Opened	25	28	33	26	30
Closed due to relocation	(4)	(2)	(4)	(3)	(1)
End of year	762	741	715	686	663
MEMBERSHIP INFORMATION					
Total paid members (000's)	51,600	49,400	47,600	44,600	42,000

(1) Net sales less merchandise costs.

(2) Includes net sales from warehouses and websites operating for more than one year. For fiscal 2017, the prior year includes the comparable 53 weeks.

Item 7—Management's Discussion and Analysis of Financial Conditions and Results of Operations
(amounts in millions, except per share, share, membership fee, and warehouse count data)
Overview

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

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

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

Our membership format is an integral part of our business and has a significant effect on our profitability. This format is designed to reinforce member loyalty and provide continuing fee revenue. The extent to which we achieve growth in our membership base, increase the penetration of our Executive members, and sustain high renewal rates, materially influences our profitability. Our paid membership growth rate may be adversely impacted when warehouse openings occur in existing markets.

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

Our operating model is generally the same across our U.S., Canada, and Other International operating segments (see Note 11 to the consolidated financial statements included in Item 8 of this Report). Certain countries in the Other International segment have relatively higher rates of square footage growth, lower wages and benefits costs as a percentage of country sales, and/or less or no direct membership warehouse competition.

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

Our fiscal year ends on the Sunday closest to August 31. Fiscal year 2018 and 2016 were 52-week fiscal years ending on September 2, 2018 and August 28, 2016, respectively, and 2017 was a 53-week fiscal year ending on September 3, 2017. Certain percentages presented are calculated using actual results prior to rounding. Unless otherwise noted, references to net income relate to net income attributable to Costco.

Highlights for fiscal year 2018 included:

- We opened 25 new warehouses, including 4 relocations, in 2018: 13 net new locations in the U.S., three in Canada, and five in our Other International segment, compared to 28 new warehouses, including 2 relocations in 2017;
- Net sales increased 10% to 138,434 driven by a 9% increase in comparable sales and sales at new warehouses opened in 2017 and 2018, partially offset by one additional week of sales in 2017;
- Membership fee revenue increased 10% to $3,142, primarily due to the annual fee increase in the U.S. and Canada in June 2017, and membership sign-ups at existing and new warehouses;
- Gross margin percentage decreased 29 basis points due to the impact of gasoline price inflation on net sales and a shift in sales penetration to certain lower margin warehouse ancillary businesses from our core merchandise categories;
- Selling, general & administrative (SG&A) expenses as a percentage of net sales decreased 24 basis points, due to the impact of gasoline price inflation and leveraging increased sales;
- The effective tax rate in 2018 was 28.4% and was favorably impacted by the 2017 Tax Act and net tax benefits of $57. The effective tax rate in 2017 was 32.8% and was favorably impacted by net tax benefits of $104;
- Net income increased 17% to $3,134, or $7.09 per diluted share compared to $2,679, or $6.08 per diluted share in 2017; and
- In April 2018, the Board of Directors approved an increase in the quarterly cash dividend from $0.50 to $0.57 per share.

Results of operations

Net Sales

	2018	2017	2016
Net Sales	$ 138,434	$ 126,172	$ 116,073
Changes in net sales:			
U.S.	9 %	8 %	3 %
Canada	10 %	10 %	(2)%
Other International	14 %	8 %	4 %
Total Company	10 %	9 %	2 %
Changes in comparable sales:			
U.S.	9 %	4 %	1 %
Canada	9 %	5 %	(3)%
Other International	11 %	2 %	(3)%
Total Company	9 %	4 %	0 %
Increases in comparable sales excluding the impact of changes in foreign currency and gasoline prices:			
U.S.	7 %	4 %	3 %
Canada	4 %	4 %	8 %
Other International	7 %	4 %	4 %
Total Company	7 %	4 %	4 %

2018 vs. 2017

Net Sales

Net sales increased $12,262 or 10% during 2018, primarily due to a 9% increase in comparable sales and sales at new warehouses opened in 2017 and 2018, partially offset by the impact of one additional week of sales in 2017.

Changes in gasoline prices positively impacted net sales by approximately $2,267, or 180 basis points, due to a 19% increase in the average sales price per gallon. Changes in foreign currencies relative to the U.S. dollar positively impacted net sales by approximately $1,156, or 92 basis points, compared to 2017. The positive impact was driven by both our Canadian and Other International operations.

Comparable Sales

Comparable sales increased 9% during 2018 and were positively impacted by increases in both shopping frequency and the average ticket. The average ticket and comparable sales results were positively impacted by an increase in gasoline prices and exchange rates in foreign currencies relative to the U.S. dollar. Changes in comparable sales includes the negative impact of cannibalization (established warehouses losing sales to our newly opened locations).

2017 vs. 2016

Net Sales

Net sales increased $10,099 or 9% during 2017, primarily due to a 4% increase in comparable sales, new warehouses opened in 2016 and 2017, and the benefit of one additional week of sales in 2017. Changes in gasoline prices positively impacted net sales by approximately $785, or 68 basis points, due to an 8% increase in the average sales price per gallon. Changes in foreign currencies relative to the U.S. dollar negatively impacted net sales by approximately $295, or 25 basis points, compared to 2016. The negative impact was driven by Other International operations, partially offset by positive impacts attributable to our Canadian operations.

Comparable Sales

Comparable sales increased 4% during 2017 and were positively impacted by an increase in shopping frequency and, to a lesser extent, an increased average ticket. The average ticket and comparable sales results were positively impacted by an increase in gasoline prices, offset by decreases in foreign currencies relative to the U.S. dollar. Changes in comparable sales includes the negative impact of cannibalization.

Membership Fees

	2018	2017	2016
Membership fees	$ 3,142	$ 2,853	$ 2,646
Membership fees increase	10 %	8 %	4 %
Membership fees as a percentage of net sales	2.27 %	2.26 %	2.28 %

2018 vs. 2017

The increase in membership fees was primarily due to the annual fee increase and membership sign-ups at existing and new warehouses. These increases were partially offset by the impact of one additional week of membership fees in 2017. At the end of 2018, our member renewal rates were 90% in the U.S. and Canada and 88% worldwide.

As reported in fiscal 2017, we increased our annual membership fees in the U.S. and Canada and in certain of our Other International operations. We account for membership fee revenue on a deferred basis, recognized ratably over the one-year membership period. These fee increases had a positive impact of approximately $178 in fiscal 2018 and will positively impact fiscal 2019, primarily the first two quarters, by approximately $70.

2017 vs. 2016

The increase in membership fees was primarily due to membership sign-ups at existing and new warehouses, an extra week of membership fee revenue, the annual fee increase, and an increased number of upgrades to our higher-fee Executive Membership program. Fee increases had a positive impact on membership fee revenues during 2017 of approximately $23.

Gross Margin

	2018	2017	2016
Net sales	$ 138,434	$ 126,172	$ 116,073
Less merchandise costs	123,152	111,882	102,901
Gross margin	$ 15,282	$ 14,290	$ 13,172
Gross margin percentage	11.04 %	11.33 %	11.35 %

2018 vs. 2017

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

Total gross margin percentage decreased 29 basis points compared to 2017. Excluding the impact of gasoline price inflation on net sales, gross margin as a percentage of adjusted net sales was 11.22%, a decrease of 11 basis points. This decrease was primarily due to a shift in sales penetration to certain lower margin warehouse ancillary and other businesses, which contributed to a 13 basis point decrease in our core merchandise categories, except hardlines which was flat. Gross margin percentage was also negatively impacted by 10 basis points due to a non-recurring legal settlement benefiting 2017 and costs related to our centralized return centers in the U.S. These decreases were partially offset by a 13 basis point increase in our warehouse ancillary and other businesses, predominantly our gasoline business. Changes in foreign currencies relative to the U.S. dollar positively impacted gross margin by approximately $124 in 2018.

The segment gross margin percentage, when expressed as a percentage of the segment's own sales and excluding the impact of changes in gasoline prices on net sales (segment gross margin percentage), decreased in our U.S. operations, predominantly in our core merchandise categories, and as a result of the non-recurring legal settlement in 2017, and the costs related to our centralized return centers mentioned above. The segment gross margin percentage in our Canadian operations increased, due to warehouse ancillary and other businesses, primarily our gasoline business. The segment gross margin percentage in our Other International operations decreased, predominantly in food and sundries and softlines, partially offset by an increase in our gasoline business.

2017 vs. 2016

The gross margin of our core merchandise categories, when expressed as a percentage of core merchandise sales, increased eight basis points due to increases in these categories other than fresh foods.

Total gross margin percentage decreased two basis points compared to 2016. Excluding the impact of gasoline price inflation on net sales, gross margin as a percentage of adjusted net sales was 11.40%, an increase of five basis points. This increase was primarily due to amounts earned under the co-branded credit card arrangement in the U.S. of 15 basis points and a benefit of three basis points from non-recurring legal settlements and other matters. The improvement in terms in our current co-brand agreement as compared to the prior co-brand arrangement led to substantial year over year benefits in fiscal 2017. These increases were partially offset by a six basis point decrease in our core merchandise categories, primarily due to food and sundries as a result of a decrease in sales penetration. The gross margin percentage was also negatively impacted by five basis points due to a LIFO benefit in 2016 and one basis point in warehouse ancillary and other businesses. Changes in foreign currencies relative to the U.S. dollar had an immaterial impact on gross margin in 2017.

Gross margin on a segment basis, when expressed as a percentage of the segment's own sales and excluding the impact of changes in gasoline prices on net sales, increased in our U.S. operations, due to amounts earned under the co-branded credit card arrangement and non-recurring legal settlements and other matters as discussed above. These increases were partially offset by a decrease in core merchandise categories, predominantly food and sundries as a result of a decrease in sales penetration, and a LIFO benefit in 2016. The segment gross margin percentage in our Canadian operations increased, primarily due to increases in warehouse ancillary and other businesses, primarily our pharmacy business, partially offset by a decrease in our core merchandise categories, largely fresh foods. The segment gross margin percentage increased in our Other International operations due to increases across all core merchandise categories, except fresh foods.

Selling, General and Administrative Expenses

	2018	2017	2016
SG&A expenses	$ 13,876	$ 12,950	$ 12,068
SG&A expenses as a percentage of net sales	10.02 %	10.26 %	10.40 %

2018 vs. 2017

SG&A expenses as a percentage of net sales decreased 24 basis points compared to 2017. Excluding the impact of gasoline price inflation on net sales, SG&A expenses as a percentage of adjusted net sales was 10.19%, a decrease of seven basis points. Operating costs related to warehouses, ancillary, and other businesses, which includes e-commerce and travel, were lower by six basis points, predominantly in our U.S. and Other International operations, due to leveraging increased sales. Charges related to certain non-recurring legal and other matters in 2017 positively impacted SG&A expense by two basis points. Stock compensation expense was also lower by one basis point. Central operating costs were higher by two basis points. Changes in foreign currencies relative to the U.S. dollar increased our SG&A expenses by approximately $98 in 2018.

Effective in June 2018, a portion of the savings generated from the Tax Cuts and Jobs Act (the “2017 Tax Act”) were used to increase wages for the majority of our U.S. hourly employees. The impact in fiscal 2018 was two basis points and the estimated annualized pre-tax cost of these increases is approximately $120.

2017 vs. 2016

SG&A expenses as a percentage of net sales decreased 14 basis points compared to 2016. Excluding the impact of gasoline price inflation on net sales, SG&A expenses as a percentage of adjusted net sales was 10.33%, a decrease of seven basis points. Operating costs related to warehouses, ancillary, and other businesses, were lower by nine basis points, primarily due to lower costs associated with the co-branded credit card arrangement in the U.S. of 18 basis points. The improvement in terms in our current co-brand agreement as compared to the prior co-brand arrangement led to substantial year over year benefits in fiscal 2017. This was partially offset by higher payroll and employee benefit expenses of 11 basis points, primarily in our U.S. operations. Central operating costs were higher by one basis point, primarily due to increased costs associated with our information systems modernization, including increased depreciation for projects placed in service, incurred by our U.S. operations. Stock compensation expense was also higher by one basis point.

Preopening

	2018	2017	2016
Preopening expenses	$ 68	$ 82	$ 78
Warehouse openings, including relocations			
United States	17	15	25
Canada	3	6	2
Other International	5	7	6
Total warehouse openings, including relocations	25	28	33

Preopening expenses include costs for startup operations related to new warehouses and relocations, developments in new international markets, new manufacturing and distribution facilities, and expansions at existing warehouses. Preopening expenses vary due to the number of warehouse openings, the timing of the opening relative to our year-end, whether the warehouse is owned or leased, and whether the opening is in an existing, new, or international market. In 2017, we entered into two new international markets, Iceland and France.

Interest Expense

	2018	2017	2016
Interest expense	$ 159	$ 134	$ 133

Interest expense primarily relates to Senior Notes issued by the Company. In May 2017, we issued $3,800 in aggregate principal amount of Senior Notes. In March and June 2017, we repaid $2,200 in total outstanding principal of the 5.5% and 1.125% Senior Notes, respectively.

Interest Income and Other, Net

	2018	2017	2016
Interest income	$ 75	$ 50	$ 41
Foreign-currency transaction gains (losses), net	23	(5)	28
Other, net	23	17	11
Interest income and other, net	$ 121	$ 62	$ 80

2018 vs. 2017

The increase in interest income in 2018 as compared to 2017 was primarily due to higher interest rates earned on higher average cash and investment balances. Foreign-currency transaction gains (losses), net include the revaluation or settlement of monetary assets and liabilities and mark-to-market adjustments for forward foreign-exchange contracts by our Canadian and Other International operations. In 2018, the increase was primarily due to a strengthening U.S. dollar relative to certain foreign currencies on forward foreign-exchange contracts. See Derivatives and Foreign Currency sections in Item 8, Note 1 of this Report.

2017 vs. 2016

Foreign-currency transaction gains (losses), net include the revaluation or settlement of monetary assets and liabilities and mark-to-market adjustments for forward foreign-exchange contracts by our Canadian and Other International operations.

Provision for Income Taxes

	2018	2017	2016
Provision for income taxes	$ 1,263	$ 1,325	$ 1,243
Effective tax rate	28.4 %	32.8 %	34.3 %

Our effective tax rate for 2018 was favorably impacted by the 2017 Tax Act, which included a reduction in the U.S. federal corporate rate from 35% to 21%. Due to the timing of our fiscal year relative to the effective date of the rate change, our U.S. corporate rate for 2018 resulted in a blended rate of 25.6%. Other impacts from the 2017 Tax Act consisted of tax expense of $142 for the estimated tax on deemed repatriation of unremitted earnings and $43 for the reduction in foreign tax credits and other immaterial items, largely offset by a tax benefit of $166 for the provisional remeasurement of certain deferred tax liabilities. In 2018, we also recognized net tax benefits of $76, which was largely driven by the adoption of an accounting standard related to stock-based compensation and other immaterial net benefits.

In 2017, our provision was favorably impacted by net tax benefits of $104, primarily due to a tax benefit recorded in connection with the May 2017 special dividend paid to employees through our 401(k) retirement plan of $82. This dividend was deductible for U.S. income tax purposes.

LIQUIDITY AND CAPITAL RESOURCES

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

	2018	2017	2016
Net cash provided by operating activities	$ 5,774	$ 6,726	$ 3,292
Net cash used in investing activities	(2,947)	(2,366)	(2,345)
Net cash used in financing activities	(1,281)	(3,218)	(2,419)

Our primary sources of liquidity are cash flows generated from warehouse operations, cash and cash equivalents, and short-term investments. Cash and cash equivalents and short-term investments were $7,259 and $5,779 at the end of 2018 and 2017, respectively. Of these balances, approximately $1,348 and $1,255 represented unsettled credit and debit card receivables, respectively. These receivables generally settle within four days. Cash and cash equivalents were negatively impacted by a change in exchange rates of $37 in 2018 and positively impacted by $25 and $50 in 2017 and 2016, respectively.

Management believes that our cash position and operating cash flows will be sufficient to meet our liquidity and capital requirements for the foreseeable future. While we believe that our U.S. current and projected asset position is sufficient to meet our U.S. liquidity requirements, beginning in the second quarter of fiscal 2018, we no longer consider current fiscal year and future earnings of our non-U.S. consolidated subsidiaries to be permanently reinvested. We recorded the estimated incremental foreign withholding (net of available foreign tax credits) and state income taxes payable on current fiscal year earnings assuming a hypothetical repatriation to the U.S. We continue to consider undistributed earnings of certain non-U.S. consolidated subsidiaries prior to fiscal 2018 to be indefinitely reinvested and have not provided for withholding or state taxes.

In fiscal 2018, we recorded a one-time charge of $142 for the estimated tax on deemed repatriation of unremitted earnings under the 2017 Tax Act. The 2017 Tax Act provides for the payment of the federal tax over an eight-year period. Because of the availability of foreign tax credits, the amount payable is $97, of which $89 is classified as long-term and included in other liabilities on our consolidated balance sheet.

Cash Flows from Operating Activities

Net cash provided by operating activities totaled $5,774 in 2018, compared to $6,726 in 2017. Our cash flow provided by operations is primarily derived from net sales and membership fees. Cash flow used in operations

generally consists of payments to our merchandise vendors, warehouse operating costs including payroll and employee benefits, utilities, and credit and debit card processing fees. Cash used in operations also includes payments for income taxes. The decrease in net cash provided by operating activities for 2018 when compared to 2017 was primarily due to accelerated vendor payments of approximately $1,700 made in the last week of fiscal 2016, which positively impacted cash flows in 2017.

Cash Flows from Investing Activities

Net cash used in investing activities totaled $2,947 in 2018, compared to $2,366 in 2017, and primarily related to capital expenditures. Net cash flows from investing activities also includes maturities and purchases of short-term investments.

Capital Expenditures

We opened 21 net new warehouses and relocated 4 warehouses in 2018 and plan to open approximately 20 net new warehouses and relocate up to 4 warehouses in 2019. Our primary requirement for capital is acquiring land, buildings, and equipment for new and remodeled warehouses. Capital is also required for information systems, manufacturing and distribution facilities, initial warehouse operations and working capital. In 2018, we spent $2,969 on capital expenditures, and it is our current intention to spend approximately $2,800 to $3,100 during fiscal 2019. These expenditures are expected to be financed with cash from operations, existing cash and cash equivalents, and short-term investments. There can be no assurance that current expectations will be realized and plans are subject to change upon further review of our capital expenditure needs.

Cash Flows from Financing Activities

Net cash used in financing activities totaled $1,281 in 2018, compared to $3,218 in 2017. The primary uses of cash in 2018 were related to dividend payments and repurchases of common stock. Net cash used in financing activities in 2017 primarily related to dividend payments, predominantly the special dividend paid in May 2017, and the repayments of debt totaling $2,200 representing the aggregate principal balances of the 5.5% and 1.125% Senior Notes.

In May 2017, we issued $3,800 in aggregate principal amount of Senior Notes. The proceeds received were net of a discount and used to pay the special dividend and a portion of the redemption of the 1.125% Senior Notes.

Stock Repurchase Programs

During 2018 and 2017, we repurchased 1,756,000 and 2,998,000 shares of common stock, at average prices of $183.13 and $157.87, totaling approximately $322 and $473, respectively. The remaining amount available to be purchased under our approved plan was $2,427 at the end of 2018. These amounts may differ from the stock repurchase balances in the accompanying consolidated statements of cash flows due to changes in unsettled stock repurchases at the end of each fiscal year. Purchases are made from time-to-time, as conditions warrant, in the open market or in block purchases and pursuant to plans under SEC Rule 10b5-1. Repurchased shares are retired, in accordance with the Washington Business Corporation Act.

Dividends

Cash dividends declared in 2018 totaled $2.14 per share, as compared to $8.90 per share in 2017, which included a special cash dividend of $7.00 per share. In April 2018, our Board of Directors increased our quarterly cash dividend from $0.50 to $0.57 per share. Subsequent to the end of 2018, our Board of Directors declared a quarterly cash dividend in the amount of $0.57 per share, which is payable on November 23, 2018.

Bank Credit Facilities and Commercial Paper Programs

We maintain bank credit facilities for working capital and general corporate purposes. At September 2, 2018, we had borrowing capacity under these facilities of $857, including a $400 revolving line of credit renewed by the U.S., which expires in June 2019. The Company currently has no plans to draw upon this facility. Our international operations maintain $344 of the total borrowing capacity under bank credit facilities, of which $163 is guaranteed by the Company. There were no outstanding short-term borrowings under the bank credit facilities at the end of 2018 and 2017.

The Company has letter of credit facilities, for commercial and standby letters of credit, totaling $220. The outstanding standby letters of credit under these facilities at the end of 2018 totaled $149 and expire within one year. The bank credit facilities and commercial paper programs have various expiration dates, all within one year, and we generally intend to renew these facilities. The amount of borrowings available at any time under our bank credit facilities is reduced by the amount of standby and commercial letters of credit then outstanding.

Contractual Obligations

At September 2, 2018, our commitments to make future payments under contractual obligations were as follows:

	Payments Due by Fiscal Year				
Contractual obligations	**2019**	**2020 to 2021**	**2022 to 2023**	**2024 and thereafter**	**Total**
Purchase obligations (merchandise)[1]	$ 9,029	$ 2	$ —	$ —	$ 9,031
Long-term debt[2]	232	3,029	1,537	2,496	7,294
Operating leases [3]	227	407	358	2,215	3,207
Construction and land obligations	710	12	—	—	722
Capital lease obligations[4]	34	71	72	647	824
Purchase obligations (equipment, services and other)[5]	611	186	67	3	867
Other[6]	19	38	36	141	234
Total	$ 10,862	$ 3,745	$ 2,070	$ 5,502	$ 22,179

(1) Includes only open merchandise purchase orders.

(2) Includes contractual interest payments and excludes deferred issuance costs.

(3) Excludes common area maintenance, taxes, and insurance and have been reduced by $105 related to sub-lease income.

(4) Includes build-to-suit lease obligations and contractual interest payments.

(5) Excludes certain services negotiated at the individual warehouse or regional level that are not significant and generally contain clauses allowing for cancellation without significant penalty.

(6) Includes asset retirement obligations, deferred compensation obligations and current liabilities for unrecognized tax contingencies. The total amount excludes $36 of non-current unrecognized tax contingencies and $30 of other obligations due to uncertainty regarding the timing of future cash payments.

Off-Balance Sheet Arrangements

In the opinion of management, we have no off-balance sheet arrangements that have had, or are reasonably likely to have, a material current or future effect on our financial condition or financial statements other than operating leases, included in the table above and discussed in Note 1 and Note 5 to the consolidated financial statements included in Item 8 of this Report.

Critical Accounting Estimates

The preparation of our consolidated financial statements in accordance with U.S. generally accepted accounting principles (U.S. GAAP) requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. We base our estimates on historical experience and on assumptions that we believe to be reasonable, and we continue to review and evaluate these estimates. For further information on significant accounting policies, see discussion in Note 1 to the consolidated financial statements included in Item 8 of this Report.

Insurance/Self-Insurance Liabilities

The Company is predominantly self-insured for employee health-care benefits, workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, and inventory loss. Insurance coverage is maintained in certain instances to limit the exposure arising from catastrophic events. We use different mechanisms, including a wholly-owned captive insurance subsidiary and participate in a reinsurance program. Liabilities associated with the risks that we retain are not discounted and are estimated by using historical claims experience, demographic factors, severity factors and other actuarial assumptions. The costs of claims are highly unpredictable and can fluctuate as a result of inflation rates, regulatory or legal changes, and unforeseen developments in claims of an extended nature. While we believe our estimates are reasonable and provide for a certain degree of coverage to account for these variables, actual claims and costs could differ significantly from recorded liabilities. Historically, adjustments to our estimates have not been material.

Income Taxes

The determination of our provision for income taxes requires significant judgment, the use of estimates, and the interpretation and application of complex tax laws. Significant judgment also is required in assessing the timing and amounts of deductible and taxable items and the probability of sustaining uncertain tax positions. The benefits associated with uncertain tax positions are recorded only after determining a more-likely-than-not probability that the positions will withstand challenge from tax authorities. When facts and circumstances change, we reassess these positions and record any changes in the consolidated financial statements as appropriate. In December 2017, the 2017 Tax Act was signed into law and our effective tax rate for fiscal 2018 reflects the provisional impact (see Note 8 to our Consolidated Financial Statements).

Recent Accounting Pronouncements

See Note 1 to the consolidated financial statements included in Item 8 of this Report for a detailed description of recent accounting pronouncements.

Item 7A—Quantitative and Qualitative Disclosures About Market Risk (amounts in millions)

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

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates primarily to our investment holdings that are diversified among various instruments considered to be cash equivalents, as defined in Note 1 to the consolidated financial statements included in Item 8 of this Report, as well as short-term investments in government and agency securities with effective maturities of generally three months to five years at the date of purchase. The primary objective of our investment activities is to preserve principal and secondarily to generate yields. The majority of our short-term investments are in fixed interest-rate securities. These securities are subject to changes in fair value due to interest rate fluctuations.

Our policy limits investments in the U.S. to direct U.S. government and government agency obligations, repurchase agreements collateralized by U.S. government and government agency obligations, and U.S. government and government agency money market funds. Our wholly-owned captive insurance subsidiary invests in U.S. government and government agency obligations and U.S. government and government agency money market funds. Our Canadian and Other International subsidiaries' investments are primarily in money market funds, bankers' acceptances, and bank certificates of deposit, generally denominated in local currencies.

A 100 basis-point change in interest rates as of the end of 2018 would have had an immaterial incremental change in fair market value. For those investments that are classified as available-for-sale, the unrealized gains or losses related to fluctuations in market volatility and interest rates are reflected within stockholders' equity in accumulated other comprehensive income in the consolidated balance sheets.

The nature and amount of our long-term debt may vary as a result of business requirements, market conditions, and other factors. As of the end of 2018, long-term debt with fixed interest rates was $6,577. Fluctuations in interest rates may affect the fair value of the fixed-rate debt. See Note 4 to the consolidated financial statements included in Item 8 of this Report for more information on our long-term debt.

Foreign Currency-Exchange Risk

Our foreign subsidiaries conduct certain transactions in their non-functional currencies, which exposes us to fluctuations in exchange rates. We manage these fluctuations, in part, through the use of forward foreign-exchange contracts, seeking to economically hedge the impact of these fluctuations on known future expenditures denominated in a non-functional foreign-currency. The contracts are intended primarily to economically hedge exposure to U.S. dollar merchandise inventory expenditures made by our international subsidiaries whose functional currency is other than the U.S. dollar. We seek to mitigate risk with the use of these contracts and do not intend to engage in speculative transactions. For additional information related to the Company's forward foreign-exchange contracts, see Notes 1 and 3 to the consolidated financial statements included in Item 8 of this Report. A hypothetical 10% strengthening of the functional currency compared to the non-functional currency exchange rates at September 2, 2018, would have decreased the fair value of the contracts by $80 and resulted in an unrealized loss in the consolidated statements of income for the same amount.

Commodity Price Risk

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

Item 8—Financial Statements and Supplementary Data

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors
Costco Wholesale Corporation:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Costco Wholesale Corporation and subsidiaries (the Company) as of September 2, 2018 and September 3, 2017, the related consolidated statements of income, comprehensive income, equity, and cash flows for the 52-week period ended September 2, 2018, the 53-week period ended September 3, 2017 and the 52-week period ended August 28, 2016, and the related notes (collectively, the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of September 2, 2018 and September 3, 2017, and the results of its operations and its cash flows for the 52-week period ended September 2, 2018, the 53-week period ended September 3, 2017 and the 52-week period ended August 28, 2016, in conformity with U.S. generally accepted accounting principles.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the Company's internal control over financial reporting as of September 2, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated October 25, 2018 expressed an adverse opinion on the effectiveness of the Company's internal control over financial reporting.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ KPMG LLP

We have served as the Company's auditor since 2002.

Seattle, Washington
October 25, 2018

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and Board of Directors
Costco Wholesale Corporation:

Opinion on Internal Control Over Financial Reporting

We have audited Costco Wholesale Corporation and subsidiaries' (the Company) internal control over financial reporting as of September 2, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. In our opinion, because of the effect of the material weakness, described below, on the achievement of the objectives of the control criteria, the Company has not maintained effective internal control over financial reporting as of September 2, 2018, based on criteria established in *Internal Control - Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) (PCAOB), the consolidated balance sheets of the Company as of September 2, 2018 and September 3, 2017, and the related consolidated statements of income, comprehensive income, equity, and cash flows for the 52-week period ended September 2, 2018, the 53-week period ended September 3, 2017 and the 52-week period ended August 28, 2016, and the related notes (collectively, the consolidated financial statements), and our report dated October 25, 2018 expressed an unqualified opinion on those consolidated financial statements.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the company's annual or interim financial statements will not be prevented or detected on a timely basis. The following material weakness has been identified and included in management's assessment:

> There were ineffective information technology general controls (ITGCs) in the areas of user access and program change-management over certain information technology (IT) systems that support the Company's financial reporting processes. As a result, business process automated and manual controls that were dependent on the affected ITGCs were ineffective because they could have been adversely impacted. These control deficiencies were a result of: IT control processes lacked sufficient documentation; insufficient knowledge and training of certain individuals with IT expertise; and risk-assessment processes inadequate to identify and assess changes in IT environments and personnel that could impact internal control over financial reporting.

The material weakness was considered in determining the nature, timing, and extent of audit tests applied in our audit of the fiscal year 2018 consolidated financial statements, and this report does not affect our report on those consolidated financial statements.

Basis for Opinion

The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Annual Report on Internal Control Over Financial Reporting (Item 9A). Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit. We are a public accounting firm registered with the PCAOB and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal

control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

Definition and Limitations of Internal Control Over Financial Reporting

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

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

/s/ KPMG LLP

Seattle, Washington
October 25, 2018

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

	September 2, 2018	September 3, 2017
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$ 6,055	$ 4,546
Short-term investments	1,204	1,233
Receivables, net	1,669	1,432
Merchandise inventories	11,040	9,834
Other current assets	321	272
Total current assets	20,289	17,317
PROPERTY AND EQUIPMENT		
Land	6,193	5,690
Buildings and improvements	16,107	15,127
Equipment and fixtures	7,274	6,681
Construction in progress	1,140	843
	30,714	28,341
Less accumulated depreciation and amortization	(11,033)	(10,180)
Net property and equipment	19,681	18,161
OTHER ASSETS	860	869
TOTAL ASSETS	$ 40,830	$ 36,347
LIABILITIES AND EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 11,237	$ 9,608
Accrued salaries and benefits	2,994	2,703
Accrued member rewards	1,057	961
Deferred membership fees	1,624	1,498
Other current liabilities	3,014	2,725
Total current liabilities	19,926	17,495
LONG-TERM DEBT, excluding current portion	6,487	6,573
OTHER LIABILITIES	1,314	1,200
Total liabilities	27,727	25,268
COMMITMENTS AND CONTINGENCIES		
EQUITY		
Preferred stock $0.01 par value; 100,000,000 shares authorized; no shares issued and outstanding	0	0
Common stock $0.01 par value; 900,000,000 shares authorized; 438,189,000 and 437,204,000 shares issued and outstanding	4	4
Additional paid-in capital	6,107	5,800
Accumulated other comprehensive loss	(1,199)	(1,014)
Retained earnings	7,887	5,988
Total Costco stockholders' equity	12,799	10,778
Noncontrolling interests	304	301
Total equity	13,103	11,079
TOTAL LIABILITIES AND EQUITY	$ 40,830	$ 36,347

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

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

	52 Weeks Ended September 2, 2018	53 Weeks Ended September 3, 2017	52 Weeks Ended August 28, 2016
REVENUE			
Net sales	$ 138,434	$ 126,172	$ 116,073
Membership fees	3,142	2,853	2,646
Total revenue	141,576	129,025	118,719
OPERATING EXPENSES			
Merchandise costs	123,152	111,882	102,901
Selling, general and administrative	13,876	12,950	12,068
Preopening expenses	68	82	78
Operating income	4,480	4,111	3,672
OTHER INCOME (EXPENSE)			
Interest expense	(159)	(134)	(133)
Interest income and other, net	121	62	80
INCOME BEFORE INCOME TAXES	4,442	4,039	3,619
Provision for income taxes	1,263	1,325	1,243
Net income including noncontrolling interests	3,179	2,714	2,376
Net income attributable to noncontrolling interests	(45)	(35)	(26)
NET INCOME ATTRIBUTABLE TO COSTCO	$ 3,134	$ 2,679	$ 2,350
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO:			
Basic	$ 7.15	$ 6.11	$ 5.36
Diluted	$ 7.09	$ 6.08	$ 5.33
Shares used in calculation (000's)			
Basic	438,515	438,437	438,585
Diluted	441,834	440,937	441,263
CASH DIVIDENDS DECLARED PER COMMON SHARE	$ 2.14	$ 8.90	$ 1.70

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

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(amounts in millions)

	52 Weeks Ended September 2, 2018	53 Weeks Ended September 3, 2017	52 Weeks Ended August 28, 2016
NET INCOME INCLUDING NONCONTROLLING INTERESTS	$ 3,179	$ 2,714	$ 2,376
Foreign-currency translation adjustment and other, net	(192)	98	26
Comprehensive income	2,987	2,812	2,402
Less: Comprehensive income attributable to noncontrolling interests	38	48	30
COMPREHENSIVE INCOME ATTRIBUTABLE TO COSTCO	$ 2,949	$ 2,764	$ 2,372

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

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COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF EQUITY
(amounts in millions)

	Common Stock Shares (000's)	Common Stock Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Retained Earnings	Total Costco Stockholders' Equity	Noncontrolling Interests	Total Equity
BALANCE AT AUGUST 30, 2015	437,952	$ 2	$ 5,218	$ (1,121)	$ 6,518	$ 10,617	$ 226	$ 10,843
Net income	—	—	—	—	2,350	2,350	26	2,376
Foreign-currency translation adjustment and other, net	—	—	—	22	—	22	4	26
Stock-based compensation	—	—	459	—	—	459	—	459
Stock options exercised, including tax effects	4	—	—	—	—	—	—	—
Release of vested restricted stock units (RSUs), including tax effects	2,749	—	(146)	—	—	(146)	—	(146)
Conversion of convertible notes	3	—	—	—	—	—	—	—
Repurchases of common stock	(3,184)	—	(41)	—	(436)	(477)	—	(477)
Cash dividends declared and other	—	—	—	—	(746)	(746)	(3)	(749)
BALANCE AT AUGUST 28, 2016	437,524	2	5,490	(1,099)	7,686	12,079	253	12,332
Net income	—	—	—	—	2,679	2,679	35	2,714
Foreign-currency translation adjustment and other, net	—	—	—	85	—	85	13	98
Stock-based compensation	—	—	518	—	—	518	—	518
Release of vested RSUs, including tax effects	2,673	—	(165)	—	—	(165)	—	(165)
Conversion of convertible notes	5	—	—	—	—	—	—	—
Repurchases of common stock	(2,998)	—	(41)	—	(432)	(473)	—	(473)
Cash dividends declared and other	—	2	(2)	—	(3,945)	(3,945)	—	(3,945)
BALANCE AT SEPTEMBER 3, 2017	437,204	4	5,800	(1,014)	5,988	10,778	301	11,079
Net income	—	—	—	—	3,134	3,134	45	3,179
Foreign-currency translation adjustment and other, net	—	—	—	(185)	—	(185)	(7)	(192)
Stock-based compensation	—	—	547	—	—	547	—	547
Release of vested RSUs, including tax effects	2,741	—	(217)	—	—	(217)	—	(217)
	(1,756)	—	(26)	—	(296)	(322)	—	(322)

Repurchases of common stock								
Cash dividends declared and other	—	—	3	—	(939)	(936)	(35)	(971)
BALANCE AT SEPTEMBER 2, 2018	438,189	$ 4	$ 6,107	$ (1,199)	$ 7,887	$ 12,799	$ 304	$ 13,103

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

COSTCO WHOLESALE CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(amounts in millions)

	52 Weeks Ended September 2, 2018	53 Weeks Ended September 3, 2017	52 Weeks Ended August 28, 2016
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income including noncontrolling interests	$ 3,179	$ 2,714	$ 2,376
Adjustments to reconcile net income including noncontrolling interests to net cash provided by operating activities:			
Depreciation and amortization	1,437	1,370	1,255
Stock-based compensation	544	514	459
Other non-cash operating activities, net	(6)	(14)	(57)
Deferred income taxes	(49)	(29)	269
Changes in operating assets and liabilities:			
Merchandise inventories	(1,313)	(894)	(25)
Accounts payable	1,561	2,258	(1,532)
Other operating assets and liabilities, net	421	807	547
Net cash provided by operating activities	5,774	6,726	3,292
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchases of short-term investments	(1,060)	(1,279)	(1,432)
Maturities and sales of short-term investments	1,078	1,385	1,709
Additions to property and equipment	(2,969)	(2,502)	(2,649)
Other investing activities, net	4	30	27
Net cash used in investing activities	(2,947)	(2,366)	(2,345)
CASH FLOWS FROM FINANCING ACTIVITIES			
Change in bank checks outstanding	80	(236)	81
Repayments of short-term borrowings	—	—	(106)
Proceeds from short-term borrowings	—	—	106
Proceeds from issuance of long-term debt	—	3,782	185
Repayments of long-term debt	(86)	(2,200)	(1,288)
Tax withholdings on stock-based awards	(217)	(202)	(220)
Repurchases of common stock	(328)	(469)	(486)
Cash dividend payments	(689)	(3,904)	(746)
Other financing activities, net	(41)	11	55
Net cash used in financing activities	(1,281)	(3,218)	(2,419)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS	(37)	25	50
Net change in cash and cash equivalents	1,509	1,167	(1,422)
CASH AND CASH EQUIVALENTS BEGINNING OF YEAR	4,546	3,379	4,801
CASH AND CASH EQUIVALENTS END OF YEAR	$ 6,055	$ 4,546	$ 3,379
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash paid during the year for:			
Interest (reduced by $19, $16, and $19, interest capitalized in 2018, 2017, and 2016, respectively)	$ 143	$ 131	$ 123
Income taxes, net	$ 1,204	$ 1,185	$ 953
SUPPLEMENTAL DISCLOSURE OF NON-CASH INVESTING AND FINANCING ACTIVITIES:			
Property and equipment acquired, but not yet paid	$ 113	$ —	$ —

Cash dividend declared, but not yet paid	$ 250	$ —	$ —

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

COSTCO WHOLESALE CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Note 1—Summary of Significant Accounting Policies

Description of Business

Costco Wholesale Corporation (Costco or the Company), a Washington corporation, and its subsidiaries operate membership warehouses based on the concept that offering members low prices on a limited selection of nationally-branded and private-label products in a wide range of merchandise categories will produce high sales volumes and rapid inventory turnover. At September 2, 2018, Costco operated 762 warehouses worldwide: 527 United States (U.S.) locations (in 44 U.S. states, Washington, D.C., and Puerto Rico), 100 Canada locations, 39 Mexico locations, 28 United Kingdom (U.K.) locations, 26 Japan locations, 15 Korea locations, 13 Taiwan locations, 10 Australia locations, two Spain locations, one Iceland location, and one France location. The Company operates e-commerce websites in the U.S., Canada, Mexico, U.K., Korea, and Taiwan.

Basis of Presentation

The consolidated financial statements include the accounts of Costco Wholesale Corporation, its wholly-owned subsidiaries, and subsidiaries in which it has a controlling interest. The Company reports noncontrolling interests in consolidated entities as a component of equity separate from the Company's equity. All material inter-company transactions between and among the Company and its consolidated subsidiaries have been eliminated in consolidation. The Company's net income excludes income attributable to the noncontrolling interest in Taiwan. During the first quarter of 2018, Costco purchased its former joint-venture partner's remaining equity interest in its Korean operations. Unless otherwise noted, references to net income relate to net income attributable to Costco.

Fiscal Year End

The Company operates on a 52/53 week fiscal year basis with the fiscal year ending on the Sunday closest to August 31. References to 2018 and 2016 relate to the 52-week fiscal years ended September 2, 2018, and August 28, 2016, respectively. References to 2017 relate to the 53-week fiscal year ended September 3, 2017.

Use of Estimates

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

Cash and Cash Equivalents

The Company considers as cash and cash equivalents all cash on deposit, highly liquid investments with a maturity of three months or less at the date of purchase, and proceeds due from credit and debit card transactions with settlement terms of up to four days. Credit and debit card receivables were $1,348 and $1,255 at the end of 2018 and 2017, respectively.

The Company provides for the daily replenishment of major bank accounts as checks are presented. Included in accounts payable at the end of 2018 and 2017 are $463 and $383, respectively, representing the excess of outstanding checks over cash on deposit at the banks on which the checks were drawn.

Short-Term Investments

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

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

Fair Value of Financial Instruments

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

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

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

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

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

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

Current financial liabilities have fair values that approximate their carrying values. Long-term financial liabilities include the Company's long-term debt, which are recorded on the balance sheet at issuance price and adjusted for unamortized discounts or premiums and debt issuance costs, and are being amortized to interest expense over the term of the loan. The estimated fair value of the Company's long-term debt is based primarily on reported market values, recently completed market transactions, and estimates based upon interest rates, maturities, and credit.

Receivables, Net

Receivables consist primarily of vendor, reinsurance, credit card incentive, third-party pharmacy and other receivables. Vendor receivables include coupons, volume rebates or other purchase discounts. Balances are generally presented on a gross basis, separate from any related payable due. In certain circumstances, these receivables may be settled against the related payable to that vendor, in which case the receivables are presented on a net basis. Reinsurance receivables are held by the Company's wholly-owned captive insurance subsidiary and primarily represent amounts ceded through reinsurance arrangements gross of the amounts assumed under reinsurance, which are presented within other current liabilities in the consolidated balance sheets. Credit card incentive receivables primarily represent amounts earned under the co-branded credit card arrangement in the U.S. Third-party pharmacy receivables generally relate to amounts due from members' insurers. Other receivables primarily consist of amounts due from governmental entities, mostly tax-related items.

Receivables are recorded net of an allowance for doubtful accounts. The allowance is based on historical experience and application of the specific identification method. Write-offs of receivables were immaterial for fiscal years 2018, 2017, and 2016.

Merchandise Inventories

Merchandise inventories consist of the following:

	2018	2017
United States	$ 8,081	$ 7,091
Canada	1,189	1,040
Other International	1,770	1,703
Merchandise inventories	$ 11,040	$ 9,834

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

As of September 2, 2018 and September 3, 2017, U.S. merchandise inventories valued at LIFO approximated FIFO after considering the lower of cost or market principle. Due to net deflation, a benefit of $64 was recorded to merchandise costs in 2016.

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

Property and Equipment

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

the asset or the remaining term of the initial lease plus any renewals that are reasonably assured at the date the leasehold improvements are made.

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

Repair and maintenance costs are expensed when incurred. Expenditures for remodels, refurbishments and improvements that add to or change the way an asset functions or that extend the useful life are capitalized. Assets that were removed during the remodel, refurbishment or improvement are retired. Assets classified as held-for-sale at the end of 2018 and 2017 were immaterial.

The Company evaluates long-lived assets for impairment on an annual basis, when relocating or closing a facility, or when events or changes in circumstances may indicate the carrying amount of the asset group, generally an individual warehouse, may not be fully recoverable. For asset groups held and used, including warehouses to be relocated, the carrying value of the asset group is considered recoverable when the estimated future undiscounted cash flows generated from the use and eventual disposition of the asset group exceed the respective carrying value. In the event that the carrying value is not considered recoverable, an impairment loss is recognized for the asset group to be held and used equal to the excess of the carrying value above the estimated fair value of the asset group. For asset groups classified as held-for-sale (disposal group), the carrying value is compared to the disposal group's fair value less costs to sell. The Company estimates fair value by obtaining market appraisals from third party brokers or using other valuation techniques. There were no impairment charges recognized in 2018, 2017 or 2016.

Insurance/Self-Insurance Liabilities

The Company is predominantly self-insured for employee health care benefits, workers' compensation, general liability, property damage, directors' and officers' liability, vehicle liability, and inventory loss. Insurance coverage is maintained in certain instances to limit the exposure arising from catastrophic events. It uses different mechanisms including a wholly-owned captive insurance subsidiary (the captive) and participates in a reinsurance program. Liabilities associated with the risks that are retained by the Company are not discounted and are estimated, in part, by considering historical claims experience, demographic factors, severity factors, and other actuarial assumptions. The estimated accruals for these liabilities could be significantly affected if future occurrences and claims differ from these assumptions and historical trends. At the end of 2018 and 2017, these insurance liabilities were $1,148 and $1,059 in the aggregate, respectively, and were included in accrued salaries and benefits and other current liabilities in the consolidated balance sheets, classified based on their nature.

The captive receives direct premiums, which are netted against the Company's premium costs in selling, general and administrative expenses, in the consolidated statements of income. The captive participates in a reinsurance program that includes other third-party participants. The reinsurance agreement is one year in duration, and new agreements are entered into by each participant at their discretion at the commencement of the next calendar year. The participant agreements and practices of the reinsurance program limit a participating members' individual risk. Income statement adjustments related to the reinsurance program and related impacts to the consolidated balance sheets are recognized as information becomes known. In the event the Company leaves the reinsurance program, the Company retains its primary obligation to the policyholders for prior activity.

Derivatives

The Company is exposed to foreign-currency exchange-rate fluctuations in the normal course of business. It manages these fluctuations, in part, through the use of forward foreign-exchange contracts, seeking to economically hedge the impact of fluctuations of foreign exchange on known future expenditures denominated in a non-functional foreign-currency. The contracts relate primarily to U.S. dollar merchandise inventory expenditures made by the Company’s international subsidiaries with functional currencies other than the U.S. dollar. Currently, these contracts do not qualify for derivative hedge accounting. The Company seeks to mitigate risk with the use of these contracts and does not intend to engage in speculative transactions. Some of these contracts contain credit-risk-related contingent features that require settlement of outstanding contracts upon certain triggering events. At the end of 2018 and 2017, the aggregate fair value amounts of derivative instruments in a net liability position and the amount needed to settle the instruments immediately if the credit-risk-related contingent features were triggered were immaterial. The aggregate notional amounts of open, unsettled forward foreign-exchange contracts were $717 and $637 at the end of 2018 and 2017, respectively. See Note 3 for information on the fair value of unsettled forward foreign-exchange contracts at the end of 2018 and 2017.

The unrealized gains or losses recognized in interest income and other, net in the accompanying consolidated statements of income relating to the net changes in the fair value of unsettled forward foreign-exchange contracts were immaterial in 2018, 2017, and 2016.

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

Foreign Currency

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

The Company recognizes foreign-currency transaction gains and losses related to revaluing or settling monetary assets and liabilities denominated in currencies other than the functional currency in interest income and other, net in the accompanying consolidated statements of income. Generally, these include the U.S. dollar cash and cash equivalents and the U.S. dollar payables of consolidated subsidiaries revalued to their functional currency. Also included are realized foreign-currency gains or losses from settlements of forward foreign-exchange contracts. These items were immaterial for 2018 and 2017 and resulted in net gains of$38 for 2016.

Revenue Recognition

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

Generally, when Costco is the primary obligor, is subject to inventory risk, has latitude in establishing prices and selecting suppliers, can influence product or service specifications, or has several but not all of these indicators, revenue is recorded on a gross basis. It otherwise records the net amounts earned, which is reflected in net sales.

The Company accounts for membership fee revenue, net of refunds, on a deferred basis, ratably over the one-year membership. The Company's Executive members qualify for a 2% reward on qualified purchases

(up to a maximum reward of approximately $1,000 per year), which can be redeemed only at Costco warehouses. The Company accounts for this reward as a reduction in sales. The sales reduction and corresponding liability (classified as accrued member rewards in the consolidated balance sheets) are computed after giving effect to the estimated impact of non-redemptions, based on historical data. The net reduction in sales was $1,394, $1,281, and $1,172 in 2018, 2017, and 2016, respectively.

Merchandise Costs

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

Vendor Consideration

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

Selling, General and Administrative Expenses

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

Retirement Plans

The Company's 401(k) retirement plan is available to all U.S. employees who have completed 90 days of employment. The plan allows participants to make wage deferral contributions, a portion of which the Company matches. In addition, the Company provides each eligible participant an annual discretionary contribution. The Company also has a defined contribution plan for Canadian employees and contributes a percentage of each employee's wages. Certain subsidiaries in the Company's Other International operations have defined benefit and defined contribution plans that are not material. Amounts expensed under all plans were $578, $543, and $489 for 2018, 2017, and 2016, respectively, and are predominantly included in selling, general and administrative expenses in the accompanying consolidated statements of income.

Stock-Based Compensation

Restricted stock units (RSUs) granted to employees generally vest over five years and allow for quarterly vesting of the pro-rata number of stock-based awards that would vest on the next anniversary of the grant date in the event of retirement or voluntary termination. Actual forfeitures are recognized as they occur.

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

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

Leases

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

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

The Company has capital leases for certain warehouse locations, expiring at various dates through 2059. Capital lease assets are included in land and buildings and improvements in the accompanying consolidated balance sheets. Amortization expense on capital lease assets is recorded as depreciation expense and is included in selling, general and administrative expenses. Capital lease liabilities are recorded at the lesser of the estimated fair market value of the leased property or the net present value of the aggregate future minimum lease payments and are included in other current liabilities and other liabilities in the accompanying consolidated balance sheets. Interest on these obligations is included in interest expense in the consolidated statements of income.

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

The Company's asset retirement obligations (ARO) primarily relate to leasehold improvements that at the end of a lease must be removed. These obligations are recorded as a liability with an offsetting asset at the inception of the lease term based upon the estimated fair value of the costs to remove the leasehold improvements. These liabilities are accreted over time to the projected future value of the obligation using the Company's incremental borrowing rate. The ARO assets are depreciated using the same depreciation method as the leasehold improvement assets and are included with buildings and improvements. Estimated ARO liabilities associated with these leases were immaterial at the end of 2018 and 2017, respectively, and are included in other liabilities in the accompanying consolidated balance sheets.

Preopening Expenses

Preopening expenses include costs for startup operations related to new warehouses and relocations, developments in new international markets, new manufacturing and distribution facilities, and expansions at existing warehouses and are expensed as incurred.

Income Taxes

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

The timing and amounts of deductible and taxable items and the probability of sustaining uncertain tax positions requires significant judgment. The benefits of uncertain tax positions are recorded in the Company's consolidated financial statements only after determining a more-likely-than-not probability that the uncertain tax positions will withstand challenge from tax authorities. When facts and circumstances change, the Company reassesses these probabilities and records any changes as appropriate.

Net Income per Common Share Attributable to Costco

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

Stock Repurchase Programs

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

Recent Accounting Pronouncements Adopted

In March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-09 related to the accounting for share-based payment transactions. The guidance relates to income taxes, forfeitures, and minimum statutory tax withholding requirements. The new standard was effective for fiscal years and interim periods within those years beginning after December 15, 2016, with early adoption permitted. The Company adopted this guidance at the beginning of its first quarter of fiscal year 2018. As a result, the Company recognized a net tax benefit in fiscal 2018 of $33 as part of its income tax provision in the accompanying consolidated statements of income, which includes the impact of the lower tax rate from the 2017 Tax Act. Previously, tax benefits associated with the release of employee RSUs were reflected in equity. These amounts are now reflected as cash flows from operations instead of cash flows from financing activities in the consolidated statements of cash flows on a prospective basis. Adoption of this guidance did not have a material impact on the consolidated balance sheets, consolidated statements of cash flows, or related disclosures.

Recent Accounting Pronouncements Not Yet Adopted

In May 2014, the FASB issued ASU 2014-09 providing for changes in the recognition of revenue from contracts with customers. The guidance converges the requirements for reporting revenue and requires disclosures sufficient to describe the nature, amount, timing, and uncertainty of revenue and cash flows arising from these contracts. The new standard is effective for fiscal years and interim periods within those years beginning after December 15, 2017. The Company plans to adopt this guidance at the beginning of its first quarter of fiscal 2019, using the modified retrospective approach through a cumulative effect adjustment to retained earnings. The Company has substantially completed its assessment of the new standard and it does not believe the impacts to be material to the Company's consolidated financial statements. The Company continues to evaluate the disclosure requirements related to the new standard.

In February 2016, the FASB issued ASU 2016-02 which will require recognition on the balance sheet for the rights and obligations created by leases with terms greater than twelve months. The new standard is effective for fiscal years and interim periods within those years beginning after December 15, 2018, with early adoption permitted. The Company plans to adopt this guidance at the beginning of its first quarter of fiscal 2020 and plans to utilize the transition option which does not require application of the guidance to comparative periods in the year of adoption. While the Company continues to evaluate this standard and the effect on related disclosures, the primary effect of adoption will be recording right-of-use assets and corresponding lease obligations for current operating leases. The adoption is expected to have a material impact on the Company's consolidated balance sheets, but not on the consolidated statements of income or cash flows. Additionally, the Company is in the process of reviewing current accounting policies, changes to business processes, systems and controls to support adoption of the new standard, which includes implementing a new lease accounting system.

Note 2—Investments

The Company’s investments were as follows:

2018:	Cost Basis	Unrealized Losses, Net	Recorded Basis
Available-for-sale:			
Government and agency securities	$ 912	$ (14)	$ 898
Held-to-maturity:			
Certificates of deposit	306		306
Total short-term investments	$ 1,218	$ (14)	$ 1,204

2017:	Cost Basis	Unrealized Gains, Net	Recorded Basis
Available-for-sale:			
Government and agency securities	$ 947	$ 0	$ 947
Mortgage-backed securities	1	0	1
Total available-for-sale	948	0	948
Held-to-maturity:			
Certificates of deposit	285		285
Total short-term investments	$ 1,233	$ 0	$ 1,233

Gross unrealized gains and losses on available-for-sale securities were not material in 2018, 2017, and 2016. At the end of 2018 and 2017, the Company's available-for-sale securities that were in a continuous unrealized-loss position were not material. The Company had no available-for-sale securities in a continuous unrealized-loss position in 2016. Gross unrealized gains and losses on cash equivalents were not material at the end of 2018, and there were no gross unrealized gains and losses on cash equivalents at the end of 2017 or 2016.

The proceeds from sales of available-for-sale securities were $39, $202, and $291 during 2018, 2017, and 2016, respectively. Gross realized gains or losses from sales of available-for-sale securities were not material in 2018, 2017, and 2016.

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The maturities of available-for-sale and held-to-maturity securities at the end of 2018 were as follows:

	Available-For-Sale		
	Cost Basis	Fair Value	Held-To-Maturity
Due in one year or less	$ 307	$ 305	$ 306
Due after one year through five years	584	572	0
Due after five years	21	21	0
Total	$ 912	$ 898	$ 306

Note 3—Fair Value Measurement

Assets and Liabilities Measured at Fair Value on a Recurring Basis

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

2018:	Level 1	Level 2
Money market mutual funds[(1)]	$ 9	$ 0
Investment in government and agency securities[(2)]	0	903
Forward foreign-exchange contracts, in asset position[(3)]	0	16
Forward foreign-exchange contracts, in (liability) position[(3)]	0	(2)
Total	$ 9	$ 917

2017:	Level 1	Level 2
Money market mutual funds[(1)]	$ 7	$ 0
Investment in government and agency securities[(2)]	0	947
Investment in mortgage-backed securities	0	1
Forward foreign-exchange contracts, in asset position[(3)]	0	2
Forward foreign-exchange contracts, in (liability) position[(3)]	0	(8)
Total	$ 7	$ 942

(1) Included in cash and cash equivalents in the accompanying consolidated balance sheets.

(2) At September 2, 2018, immaterial cash and cash equivalents and $898 short-term investments are included in the accompanying condensed consolidated balance sheets. At September 3, 2017, there were no securities included in cash and cash equivalents and $947 included in short-term investments in the accompanying condensed consolidated balance sheets.

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

During and at the end of both 2018 and 2017, the Company did not hold any Level 3 financial assets or liabilities that were measured at fair value on a recurring basis. There were no transfers in or out of Level 1 or 2 during 2018 and 2017.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Assets and liabilities recognized and disclosed at fair value on a nonrecurring basis include items such as financial assets measured at amortized cost and long-lived nonfinancial assets. These assets are measured at fair value if determined to be impaired. There were no fair value adjustments to these items during 2018 and 2017.

Note 4—Debt

Short-Term Borrowings

The Company maintains various short-term bank credit facilities with a borrowing capacity of $857 and $833, in 2018 and 2017, respectively. Borrowings on these short-term facilities were immaterial during 2018 and 2017, and there were no outstanding borrowings at the end of 2018 and 2017.

Long-Term Debt

The Company's long-term debt consists primarily of Senior Notes, which have various principal balances, interest rates, and maturity dates as described below. In May 2017, the Company issued $3,800 in aggregate principal amount of Senior Notes, with maturity dates between May 2021 and May 2027. Additionally, in 2017 the Company repaid long-term debt totaling $2,200.

The Company at its option may redeem the Senior Notes at any time, in whole or in part, at a redemption price plus accrued interest. The redemption price is equal to the greater of 100% of the principal amount or the sum of the present value of the remaining scheduled payments of principal and interest to maturity. Additionally, upon certain events, as defined by the terms of the Senior Notes, the holder has the right to require the Company to purchase this security at a price of 101% of the principal amount plus accrued and unpaid interest to the date of the event. Interest on all outstanding long-term debt is payable semi-annually.

The estimated fair value of Senior Notes is valued using Level 2 inputs. Other long-term debt consists of Guaranteed Senior Notes issued by the Company's Japanese subsidiary and are valued using Level 3 inputs. At the end of 2018 and 2017, the fair value of the Company's long-term debt, including the current portion, was approximately $6,492 and $6,753, respectively. The carrying value of long-term debt consisted of the following:

	2018	2017
1.70% Senior Notes due December 2019	$ 1,199	$ 1,198
1.75% Senior Notes due February 2020	499	498
2.15% Senior Notes due May 2021	995	994
2.25% Senior Notes due February 2022	498	497
2.30% Senior Notes due May 2022	794	793
2.75% Senior Notes due May 2024	992	991
3.00% Senior Notes due May 2027	987	986
Other long-term debt	613	702
Total long-term debt	6,577	6,659
Less current portion[1]	90	86
Long-term debt, excluding current portion	$ 6,487	$ 6,573

(1) Included in other current liabilities in the consolidated balance sheets.

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

2019	$ 90
2020	1,700
2021	1,091
2022	1,300
2023	90
Thereafter	2,343
Total	$ 6,614

Note 5—Leases

Operating Leases

The aggregate rental expense for 2018, 2017, and 2016 was $265, $258, and $250, respectively. Sub-lease income and contingent rent were not material in 2018, 2017, or 2016.

Capital and Build-to-Suit Leases

Gross assets recorded under capital and build-to-suit leases were $427 and $404 at the end of 2018 and 2017, respectively. These assets are recorded net of accumulated amortization of $94 and $78 at the end of 2018 and 2017, respectively.

At the end of 2018, future minimum payments, net of sub-lease income of $105 for all years combined, under non-cancelable operating leases with terms of at least one year and capital leases were as follows:

	Operating Leases	Capital Leases(1)
2019	$ 227	$ 34
2020	214	35
2021	193	36
2022	183	36
2023	175	36
Thereafter	2,215	647
Total	$ 3,207	824
Less amount representing interest		(427)
Net present value of minimum lease payments		397
Less current installments(2)		(7)
Long-term capital lease obligations less current installments(3)		$ 390

(1) Includes build-to-suit lease obligations.

(2) Included in other current liabilities in the accompanying consolidated balance sheets.

(3) Included in other liabilities in the accompanying consolidated balance sheets.

Note 6—Stockholders' Equity

Dividends

The Company's current quarterly dividend rate is $0.57 per share. In May 2017, the Company paid a special cash dividend of $7.00 per share. The aggregate payment was approximately $3,100. Subsequent to the end of 2018, the Board of Directors declared a quarterly cash dividend in the amount of $0.57 per share, which is payable on November 23, 2018.

Stock Repurchase Programs

The Company's stock repurchase program is conducted under a $4,000 authorization by the Board of Directors, which expires April 17, 2019. As of the end of 2018, the remaining amount available for stock repurchases under the approved plan was $2,427. The following table summarizes the Company's stock repurchase activity:

	Shares Repurchased (000's)	Average Price per Share	Total Cost
2018	1,756	$ 183.13	$ 322
2017	2,998	157.87	473
2016	3,184	149.90	477

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

Note 7—Stock-Based Compensation Plans

The Company grants stock-based compensation primarily to employees and non-employee directors. RSU grants to all executive officers are performance-based. Through a series of shareholder approvals, there have been amended and restated plans and new provisions implemented by the Company. RSUs are subject to quarterly vesting upon retirement or voluntary termination. Employees who attain certain years of service with the Company receive shares under accelerated vesting provisions on the annual vesting date rather than upon retirement. The Seventh Restated 2002 Stock Incentive Plan (Seventh Plan) is the Company's only stock-based compensation plan with shares available for grant at the end of 2018. Each share issued in respect of stock awards is counted as 1.75 shares toward the limit of shares made available under the Seventh Plan. The Seventh Plan authorized the issuance of 23,500,000 shares (13,429,000 RSUs) of common stock for future grants in addition to the shares authorized under the previous plan. The Company issues new shares of common stock upon vesting of RSUs. Shares for vested RSUs are generally delivered to participants annually, net of statutory withholding taxes.

Summary of Restricted Stock Unit Activity

RSUs granted to employees and to non-employee directors generally vest over five and three years, respectively. Additionally, the terms of the RSUs, including performance-based awards, provide for accelerated vesting for employees and non-employee directors who have attained 25 or more and five or more years of service with the Company, respectively. Recipients are not entitled to vote or receive dividends on non-vested and undelivered shares. At the end of 2018, 8,313,000 shares were available to be granted as RSUs under the Seventh Plan.

The following awards were outstanding at the end of 2018:

- 7,246,000 time-based RSUs that vest upon continued employment over specified periods of time;
- 332,000 performance-based RSUs, of which 205,000 were granted to executive officers subject to the certification of the attainment of specified performance targets for 2018. This certification occurred in October 2018, at which time a portion vested as a result of the long service of all executive officers. The remaining awards vest upon continued employment over specified periods of time.

The following table summarizes RSU transactions during 2018:

	Number of Units (in 000's)	Weighted-Average Grant Date Fair Value
Outstanding at the end of 2017	8,199	$ 128.15
Granted	3,722	156.19
Vested and delivered	(4,088)	129.49
Forfeited	(255)	138.57
Outstanding at the end of 2018	7,578	$ 140.85

The weighted-average grant date fair value of RSUs granted was $156.19, $144.12, and $153.46 in 2018, 2017, and 2016, respectively. The remaining unrecognized compensation cost related to non-vested RSUs at the end of 2018 was $693 and the weighted-average period of time over which this cost will be recognized is 1.6 years. Included in the outstanding balance at the end of 2018 were approximately 2,658,000 RSUs vested but not yet delivered.

Summary of Stock-Based Compensation

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

	2018	2017	2016
Stock-based compensation expense before income taxes	$ 544	$ 514	$ 459
Less income tax benefit [(1)]	(116)	(167)	(150)
Stock-based compensation expense, net of income taxes	$ 428	$ 347	$ 309

(1) In 2018, the income tax benefit reflects the reduction in the U.S. federal statutory income tax rate from 35% to 21%.

Note 8—Income Taxes

Income before income taxes is comprised of the following:

	2018	2017	2016
Domestic	$ 3,182	$ 2,988	$ 2,622
Foreign	1,260	1,051	997
Total	$ 4,442	$ 4,039	$ 3,619

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The provisions for income taxes are as follows:

	2018	2017	2016
Federal:			
Current	$ 636	$ 802	$ 468
Deferred	(35)	7	233
Total federal	601	809	701
State:			
Current	190	161	108
Deferred	22	8	21
Total state	212	169	129
Foreign:			
Current	487	389	398
Deferred	(37)	(42)	15
Total foreign	450	347	413
Total provision for income taxes	$ 1,263	$ 1,325	$ 1,243

In December 2017, the 2017 Tax Act was signed into law. Except for certain provisions, the 2017 Tax Act is effective for tax years beginning on or after January 1, 2018. The Company is a fiscal-year taxpayer, so most provisions will become effective for fiscal 2019, including limitations on the Company's ability to claim foreign tax credits, repeal of the domestic manufacturing deduction, and limitations on certain business deductions. Provisions with significant impacts that were effective starting in the second quarter of fiscal 2018 and throughout the remainder of fiscal 2018 included: a decrease in the U.S. federal income tax rate, remeasurement of certain net deferred tax liabilities, and a transition tax on deemed repatriation of certain foreign earnings. The decrease in the U.S. federal statutory income tax rate to 21.0% resulted in a blended rate for the Company of 25.6% for fiscal 2018.

The reconciliation between the statutory tax rate and the effective rate is as follows:

	2018		2017		2016	
Federal taxes at statutory rate	$ 1,136	25.6 %	$ 1,414	35.0 %	$ 1,267	35.0 %
State taxes, net	154	3.4	116	2.9	91	2.5
Foreign taxes, net	32	0.7	(64)	(1.6)	(21)	(0.6)
Employee stock ownership plan (ESOP)	(14)	(0.3)	(104)	(2.6)	(17)	(0.5)
2017 Tax Act	19	0.4	—	—	—	—
Other	(64)	(1.4)	(37)	(0.9)	(77)	(2.1)
Total	$ 1,263	28.4 %	$ 1,325	32.8 %	$ 1,243	34.3 %

During fiscal 2018, the Company recognized a net tax expense of $19 related to the 2017 Tax Act. This expense included $142 for the estimated tax on deemed repatriation of foreign earnings, and $43 for the reduction in foreign tax credits and other immaterial items, largely offset by a tax benefit of $166 for the provisional remeasurement of certain deferred tax liabilities. These items were predominantly recorded in the second quarter as provisional amounts and reflect the Company's current interpretations and estimates that it believes are reasonable. As the Company continues to evaluate the 2017 Tax Act and available data, it anticipates that adjustments may be made in future periods up to and including the second quarter of fiscal 2019 in accordance with Staff Accounting Bulletin 118.

In fiscal 2018, we also recognized net tax benefits of $76, which was largely driven by the adoption of an accounting standard related to stock-based compensation and other immaterial net benefits. In fiscal

2017, the Company’s provision for income taxes was favorably impacted by a net tax benefit of $104, primarily due to tax benefits recorded in connection with the May 2017 special cash dividends paid by the Company to employees through the Company's 401(k) retirement plan of $82. Dividends on these shares are deductible for U.S. income tax purposes. There was no similar special cash dividend in 2018 or 2016.

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

	2018	2017
Equity compensation	$ 72	$ 109
Deferred income/membership fees	136	167
Accrued liabilities and reserves	484	647
Property and equipment	(478)	(747)
Merchandise inventories	(175)	(252)
Other[(1)]	(40)	18
Net deferred tax (liabilities)/assets	$ (1)	$ (58)

(1) Includes foreign tax credits of $36 for 2017. There were no foreign tax credits in 2018.

The deferred tax accounts at the end of fiscal 2018 and 2017 include deferred income tax assets of $316 and $254, respectively, included in other assets; and deferred income tax liabilities of $317 and $312, respectively, included in other liabilities.

The Company no longer considers current fiscal 2018 and future earnings of our non-U.S. consolidated subsidiaries to be permanently reinvested and has recorded the estimated incremental foreign withholding (net of available foreign tax credits) on current fiscal year earnings and state income taxes payable assuming a hypothetical repatriation to the U.S. The Company continues to consider undistributed earnings of certain non-U.S. consolidated subsidiaries prior to fiscal 2018, which totaled $3,071, to be indefinitely reinvested and has not provided for withholding or state taxes.

A reconciliation of the beginning and ending amount of gross unrecognized tax benefits for 2018 and 2017 is as follows:

	2018	2017
Gross unrecognized tax benefit at beginning of year	$ 52	$ 52
Gross increases—current year tax positions	6	3
Gross increases—tax positions in prior years	6	17
Gross decreases—tax positions in prior years	(17)	0
Settlements	(1)	(11)
Lapse of statute of limitations	(10)	(9)
Gross unrecognized tax benefit at end of year	$ 36	$ 52

The gross unrecognized tax benefit includes tax positions for which the ultimate deductibility is highly certain but there is uncertainty about the timing of such deductibility. At the end of 2018 and 2017, these amounts were immaterial. Because of the impact of deferred tax accounting, other than interest and penalties, the disallowance of these tax positions would not affect the annual effective tax rate but would accelerate the payment of cash to the taxing authority. The total amount of such unrecognized tax benefits that, if recognized, would favorably affect the effective income tax rate in future periods is $32 and $29 at the end of 2018 and 2017, respectively.

Accrued interest and penalties related to income tax matters are classified as a component of income tax expense. Interest and penalties recognized during 2018 and 2017 and accrued at the end of each respective period were not material.

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

The Company files income tax returns in the United States, various state and local jurisdictions, in Canada, and in several other foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state or local examination for years before fiscal 2014. The Company is currently subject to examination in California for fiscal years 2007 to present. No other examinations are believed to be material.

Note 9—Net Income per Common and Common Equivalent Share

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

	2018	2017	2016
Net income attributable to Costco	$ 3,134	$ 2,679	$ 2,350
Weighted average number of common shares used in basic net income per common share	438,515	438,437	438,585
RSUs and other	3,319	2,500	2,678
Weighted average number of common shares and dilutive potential of common stock used in diluted net income per share	441,834	440,937	441,263

Note 10—Commitments and Contingencies

Legal Proceedings

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

The Company is a defendant in a class action alleging violation of California Wage Order 7-2001 for failing to provide seating to member service assistants who act as greeters and exit attendants in the Company's California warehouses. *Canela v. Costco Wholesale Corp., et al.* (Case No. 5:13-cv-03598, N.D. Cal. filed July 1, 2013). The complaint seeks relief under the California Labor Code, including civil penalties and attorneys' fees. The Company filed an answer denying the material allegations of the complaint. The plaintiff has since indicated that exit attendants are no longer a subject of the litigation. The action in the district court

has been stayed pending review by the Ninth Circuit of the order certifying a class. On September 6, 2018, counsel claiming to represent an employee notified the California Labor and Workforce Development agency of an intention to bring similar claims concerning Costco employees engaged at member services counters.

On November 23, 2016, the Company's Canadian subsidiary received from the Ontario Ministry of Health and Long Term Care a request for an inspection and information concerning compliance with the anti-rebate provisions in the Ontario Drug Benefit Act and the Drug Interchangeability and Dispensing Fee Act. The Company is seeking to cooperate with the request. The Ministry has indicated it has reason to believe the Company received payments in violation of these laws and is seeking disgorgement of these sums.

In December 2017, the United States Judicial Panel on Multidistrict Litigation consolidated numerous cases filed against various defendants by counties, cities, hospitals, Native American tribes and third-party payors concerning the impacts of opioid abuse. *In re National Prescription Opiate Litigation* (MDL No. 2804) (N.D. Ohio). Included are federal court cases that name the Company, including actions filed by a number of counties and cities in Michigan, New Jersey and Ohio, and a third-party payor in Ohio. Similar cases that name the Company have been filed in state courts in New Jersey and Oklahoma. The Company is defending these matters.

In November 2016 and September 2017, the Company received notices of violation from the Connecticut Department of Energy and Environmental Protection regarding hazardous waste practices at its Connecticut warehouses, primarily concerning unsalable pharmaceuticals. The Company is seeking to cooperate concerning the resolution of these notices.

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

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Note 11—Segment Reporting

The Company and its subsidiaries are principally engaged in the operation of membership warehouses in the U.S., Canada, Mexico, U.K., Japan, Korea, Australia, Spain, Iceland, and France and through a majority-owned subsidiary in Taiwan. Reportable segments are largely based on management's organization of the operating segments for operational decisions and assessments of financial performance, which considers geographic locations. The material accounting policies of the segments are as described in Note 1. Inter-segment net sales and expenses have been eliminated in computing total revenue and operating income. Certain operating expenses, predominantly stock-based compensation, incurred on behalf of the Company's Canadian and Other International operations, are included in the U.S. operations because those costs generally come under the responsibility of U.S. management.

	United States Operations	Canadian Operations	Other International Operations	Total
2018				
Total revenue	$ 102,286	$ 20,689	$ 18,601	$ 141,576
Operating income	2,787	939	754	4,480
Depreciation and amortization	1,078	135	224	1,437
Additions to property and equipment	2,046	268	655	2,969
Net property and equipment	13,353	1,900	4,428	19,681
Total assets	28,207	4,303	8,320	40,830
2017				
Total revenue	$ 93,889	$ 18,775	$ 16,361	$ 129,025
Operating income	2,644	841	626	4,111
Depreciation and amortization	1,044	124	202	1,370
Additions to property and equipment	1,714	277	511	2,502
Net property and equipment	12,339	1,820	4,002	18,161
Total assets	24,068	4,471	7,808	36,347
2016				
Total revenue	$ 86,579	$ 17,028	$ 15,112	$ 118,719
Operating income	2,326	778	568	3,672
Depreciation and amortization	946	109	200	1,255
Additions to property and equipment	1,823	299	527	2,649
Net property and equipment	11,745	1,628	3,670	17,043
Total assets	22,511	3,480	7,172	33,163

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

	2018	2017	2016
Food and Sundries	41 %	41 %	43 %
Hardlines	16 %	16 %	16 %
Fresh Foods	14 %	14 %	14 %
Softlines	11 %	12 %	12 %
Ancillary	18 %	17 %	15 %

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Note 12—Quarterly Financial Data (Unaudited)

The two tables that follow reflect the unaudited quarterly results of operations for 2018 and 2017.

	52 Weeks Ended September 2, 2018				
	First Quarter (12 Weeks)	Second Quarter (12 Weeks)	Third Quarter (12 Weeks)	Fourth Quarter (16 Weeks)	Total (52 Weeks)
REVENUE					
Net sales	$ 31,117	$ 32,279	$ 31,624	$ 43,414	$ 138,434
Membership fees	692	716	737	997	3,142
Total revenue	31,809	32,995	32,361	44,411	141,576
OPERATING EXPENSES					
Merchandise costs	27,617	28,733	28,131	38,671	123,152
Selling, general and administrative	3,224	3,234	3,155	4,263	13,876
Preopening expenses	17	12	8	31	68
Operating income	951	1,016	1,067	1,446	4,480
OTHER INCOME (EXPENSE)					
Interest expense	(37)	(37)	(37)	(48)	(159)
Interest income and other, net	22	7	41	51	121
INCOME BEFORE INCOME TAXES	936	986	1,071	1,449	4,442
Provision for income taxes	285	273	309	396	1,263
Net income including noncontrolling interests	651	713	762	1,053	3,179
Net income attributable to noncontrolling interests	(11)	(12)	(12)	(10)	(45)
NET INCOME ATTRIBUTABLE TO COSTCO	$ 640	$ 701	$ 750	$ 1,043	$ 3,134
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO:					
Basic	$ 1.46	$ 1.60	$ 1.71	$ 2.38	$ 7.15
Diluted	$ 1.45	$ 1.59	$ 1.70	$ 2.36	$ 7.09
Shares used in calculation (000's)					
Basic	437,965	439,022	438,740	438,379	438,515
Diluted	440,851	441,568	441,715	442,427	441,834
CASH DIVIDENDS DECLARED PER COMMON SHARE	$ 0.50	$ 0.50	$ 0.57	$ 0.57	$ 2.14

	53 Weeks Ended September 3, 2017				
	First Quarter (12 Weeks)	Second Quarter (12 Weeks)	Third Quarter (12 Weeks)	Fourth Quarter (17 Weeks)	Total (53 Weeks)
REVENUE					
Net sales	$ 27,469	$ 29,130	$ 28,216	$ 41,357	$ 126,172
Membership fees	630	636	644	943	2,853
Total revenue	28,099	29,766	28,860	42,300	129,025
OPERATING EXPENSES					
Merchandise costs	24,288	25,927	24,970	36,697	111,882
Selling, general and administrative	2,940	2,980	2,907	4,123	12,950
Preopening expenses	22	15	15	30	82
Operating income	849	844	968	1,450	4,111
OTHER INCOME (EXPENSE)					
Interest expense	(29)	(31)	(21)	(53)	(134)
Interest income and other, net	26	(4)	18	22	62
INCOME BEFORE INCOME TAXES	846	809	965	1,419	4,039
Provision for income taxes	291	288	259 (1)	487	1,325
Net income including noncontrolling interests	555	521	706	932	2,714
Net income attributable to noncontrolling interests	(10)	(6)	(6)	(13)	(35)
NET INCOME ATTRIBUTABLE TO COSTCO	$ 545	$ 515	$ 700	$ 919	$ 2,679
NET INCOME PER COMMON SHARE ATTRIBUTABLE TO COSTCO:					
Basic	$ 1.24	$ 1.17	$ 1.59	$ 2.10	$ 6.11
Diluted	$ 1.24	$ 1.17	$ 1.59	$ 2.08	$ 6.08
Shares used in calculation (000's)					
Basic	438,007	439,127	438,817	437,987	438,437
Diluted	440,525	440,657	441,056	441,036	440,937
CASH DIVIDENDS DECLARED PER COMMON SHARE	$ 0.45	$ 0.45	$ 7.50 (2)	$ 0.50	$ 8.90

(1) Includes an $82 tax benefit recorded in the third quarter in connection with the special cash dividend paid to employees through the Company's 401(k) Retirement Plan.

(2) Includes the special cash dividend of $7.00 per share paid in May 2017.

Item 9—Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A—Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) under the Securities Exchange Act of 1934, as amended) are designed to ensure that information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and to ensure that information required to be disclosed is accumulated and communicated to management, including our principal executive and financial officers, to allow timely decisions regarding disclosure. The Chief Executive Officer (CEO) and the Chief Financial Officer (CFO), with assistance from other members of management, have reviewed the effectiveness of our disclosure controls and procedures as of September 2, 2018 and, based on their evaluation, have concluded that the disclosure controls and procedures were not effective as of such date due to a material weakness in internal control over financial reporting, described below.

Management's Annual Report on Internal Control Over Financial Reporting

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

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

Under the supervision of and with the participation of our management, we assessed the effectiveness of our internal control over financial reporting as of September 2, 2018, using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control—Integrated Framework (2013). A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

We identified a material weakness in internal control related to ineffective information technology general controls (ITGCs) in the areas of user access and program change-management over certain information technology (IT) systems that support the Company’s financial reporting processes. Our business process controls (automated and manual) that are dependent on the affected ITGCs were also deemed ineffective because they could have been adversely impacted. We believe that these control deficiencies were a result of: IT control processes lacking sufficient documentation such that the successful operation of ITGCs was overly dependent upon knowledge and actions of certain individuals with IT expertise, which led to failures resulting from changes in IT personnel; insufficient training of IT personnel on the importance of ITGCs; and risk-assessment processes inadequate to identify and assess changes in IT environments that could impact internal control over financial reporting. The material weakness did not result in any identified misstatements

to the financial statements, and there were no changes to previously released financial results. Based on this material weakness, the Company's management concluded that at September 2, 2018, the Company's internal control over financial reporting was not effective.

The Company's independent registered public accounting firm, KPMG LLP has issued an adverse audit report on the effectiveness of the Company's internal control over financial reporting as of September 2, 2018, which appears in Item 8 of this Form 10-K.

Following identification of the material weakness and prior to filing this Annual Report on Form 10-K, we completed substantive procedures for the year ended September 2, 2018. Based on these procedures, management believes that our consolidated financial statements included in this Form 10-K have been prepared in accordance with U.S. GAAP. Our CEO and CFO have certified that, based on their knowledge, the financial statements, and other financial information included in this Form 10-K, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this Form 10-K. KPMG LLP has issued an unqualified opinion on our financial statements, which is included in Item 8 of this Form 10-K.

Remediation

Management has been implementing and continues to implement measures designed to ensure that control deficiencies contributing to the material weakness are remediated, such that these controls are designed, implemented, and operating effectively. The remediation actions include: (i) creating and filling an IT Compliance Oversight function; (ii) developing a training program addressing ITGCs and policies, including educating control owners concerning the principles and requirements of each control, with a focus on those related to user access and change-management over IT systems impacting financial reporting; (iii) developing and maintaining documentation underlying ITGCs to promote knowledge transfer upon personnel and function changes; (iv) developing enhanced risk assessment procedures and controls related to changes in IT systems; (v) implementing an IT management review and testing plan to monitor ITGCs with a specific focus on systems supporting our financial reporting processes; and (vi) enhanced quarterly reporting on the remediation measures to the Audit Committee of the Board of Directors.

We believe that these actions will remediate the material weakness. The weakness will not be considered remediated, however, until the applicable controls operate for a sufficient period of time and management has concluded, through testing, that these controls are operating effectively. We expect that the remediation of this material weakness will be completed prior to the end of fiscal 2019.

Changes in Internal Control Over Financial Reporting

Except for the material weakness identified during the quarter, as of September 2, 2018, there have been no other changes in our internal control over financial reporting (as defined in Rules 13a-15(f) or 15d-15(f) of the Exchange Act) that occurred during the fourth quarter of fiscal 2018 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

/s/ W. CRAIG JELINEK

W. Craig Jelinek
President, Chief Executive Officer and Director

/s/ RICHARD A. GALANTI

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

Item 9B—Other Information

None.

PART III

Item 10—Directors, Executive Officers and Corporate Governance

Information relating to the availability of our code of ethics for senior financial officers and a list of our executive officers appear in Part I, Item 1 of this Report. The information required by this Item concerning our directors and nominees for director is incorporated herein by reference to the sections entitled “Proposal 1: Election of Directors,” “Directors,” “Committees of the Board” and “Section 16(a) Beneficial Ownership Reporting Compliance” in Costco’s Proxy Statement for its 2019 annual meeting of stockholders, which will be filed with the SEC within 120 days of the end of our fiscal year (“Proxy Statement”).

Item 11—Executive Compensation

The information required by this Item is incorporated herein by reference to the sections entitled “Compensation of Directors,” “Executive Compensation,” and “Compensation Discussion and Analysis” in Costco’s Proxy Statement.

Item 12—Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The information required by this Item is incorporated herein by reference to the section entitled “Principal Shareholders” and “Equity Compensation Plan Information” in Costco’s Proxy Statement.

Item 13—Certain Relationships and Related Transactions, and Director Independence

The information required by this Item is incorporated herein by reference to the sections entitled “Proposal 1: Election of Directors,” “Directors,” “Committees of the Board,” “Shareholder Communications to the Board,” “Meeting Attendance,” “Report of the Compensation Committee of the Board of Directors,” “Certain Relationships and Transactions” and “Report of the Audit Committee” in Costco’s Proxy Statement.

Item 14—Principal Accounting Fees and Services

The information required by this Item is incorporated herein by reference to the sections entitled “Independent Public Accountants” in Costco’s Proxy Statement.

PART IV

Item 15—Exhibits, Financial Statement Schedules

(a) Documents filed as part of this report are as follows:

1. Financial Statements:

See the listing of Financial Statements included as a part of this Form 10-K in Item 8 of Part II.

2. Financial Statement Schedules:

All schedules have been omitted because the required information is not present or is not present in amounts sufficient to require submission of the schedule, or because the information required is included in the consolidated financial statements, including the notes thereto.

(b) Exhibits: The required exhibits are filed as part of this Annual Report on Form 10-K or are incorporated herein by reference.

			Incorporated by Reference		
Exhibit Number	Exhibit Description	Filed Herewith	Form	Period Ending	Filing Date
3.1	Articles of Incorporation as amended of Costco Wholesale Corporation		10-Q	2/15/2015	3/11/2015
3.2	Bylaws as amended of Costco Wholesale Corporation		8-K		11/2/2017
4.1	Form of 2.150% Senior Notes due May 18, 2021		8-K		5/16/2017
4.2	Form of 2.300% Senior Notes due May 18, 2022		8-K		5/16/2017
4.3	Form of 2.750% Senior Notes due May 18, 2024		8-K		5/16/2017
4.4	Form of 3.000% Senior Notes due May 18, 2027		8-K		5/16/2017
10.1*	Costco Wholesale Executive Health Plan		10-K	9/2/2012	10/19/2012
10.2.1*	Fifth Restated 2002 Stock Incentive Plan		10-Q	2/14/2010	3/17/2010
10.2.2*	Sixth Restated 2002 Stock Incentive Plan		8-K		1/31/2012
10.2.3*	Seventh Restated 2002 Stock Incentive Plan		DEF 14A		12/19/2014
10.2.4*	Seventh Restated 2002 Stock Incentive Plan Restricted Stock		10-Q	11/22/2015	12/17/2015

Unit Award Agreement-U.S. Employee

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Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference		
			Form	Period Ending	Filing Date
10.2.5*	Seventh Restated 2002 Stock Incentive Plan Restricted Stock Unit Award Agreement-Non-U.S. Employee		10-Q	11/22/2015	12/17/2015
10.2.6*	Seventh Restated 2002 Stock Incentive Plan Restricted Stock Unit Award Agreement-Non-Executive Director		10-Q	11/22/2015	12/17/2015
10.2.7*	Seventh Restated 2002 Stock Incentive Plan Letter Agreement for 2016 Performance-Based Restricted Stock Units-Executive		10-Q	11/22/2015	12/17/2015
10.3.1*	Executive Employment Agreement, effective January 1, 2017, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/20/2016	12/16/2016
10.3.2*	Letter Dated December 18, 2017, Regarding an Extension of the Term of the Executive Employment Agreement, effective January 1, 2017, between W. Craig Jelinek and Costco Wholesale Corporation		10-Q	11/26/2017	12/21/2017
10.4*	Form of Indemnification Agreement		14A		12/13/1999
10.5*	Deferred Compensation Plan		10-K	9/1/2013	10/16/2013
10.6.1**	Citibank, N.A. Co-Branded Credit Card Agreement		10-Q/A	5/10/2015	8/31/2015
10.6.2**	First Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	11/22/2015	12/17/2015
10.6.3**	Second Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/14/2016	3/9/2016
10.6.4**	Third Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-K	8/28/2016	10/12/2016
10.6.5**	Fourth Amendment to Citi, N.A. Co-Branded Credit Card Agreement		10-Q	2/18/2018	3/15/2018
10.7*	Fiscal 2018 Executive Bonus Plan		8-K		10/31/2017
21.1	Subsidiaries of the Company	x			
23.1	Consent of Independent Registered Public Accounting Firm	x			

31.1	Rule 13a – 14(a) Certifications	x
32.1	Section 1350 Certifications	x

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Exhibit Number	Exhibit Description	Filed Herewith	Incorporated by Reference		
			Form	Period Ending	Filing Date
101.INS	XBRL Instance Document	x			
101.SCH	XBRL Taxonomy Extension Schema Document	x			
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	x			
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	x			
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	x			
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	x			

* Management contract, compensatory plan or arrangement.
** Portions of this exhibit have been omitted under a confidential treatment order issued by the Securities and Exchange Commission.

(c) Financial Statement Schedules—None.

Item 16—Form 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

October 25, 2018

COSTCO WHOLESALE CORPORATION
(Registrant)

By /s/ RICHARD A. GALANTI
Richard A. Galanti
Executive Vice President, Chief Financial Officer and Director

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

October 25, 2018

By /s/ W. CRAIG JELINEK
W. Craig Jelinek
President, Chief Executive Officer and Director

By /s/ HAMILTON E. JAMES
Hamilton E. James
Chairman of the Board

By /s/ RICHARD A. GALANTI
Richard A. Galanti
Executive Vice President, Chief Financial Officer and Director
(Principal Financial Officer)

By /s/ DANIEL M. HINES
Daniel M. Hines
Senior Vice President and Corporate Controller
(Principal Accounting Officer)

By /s/ SUSAN L. DECKER
Susan L. Decker
Director

By /s/ KENNETH D. DENMAN
Kenneth D. Denman
Director

By /s/ JOHN W. MEISENBACH
John W. Meisenbach
Director

By /s/ CHARLES T. MUNGER
Charles T. Munger
Director

By /s/ JEFFREY S. RAIKES
Jeffrey S. Raikes
Director

By /s/ JOHN W. STANTON
John W. Stanton
Director

By /s/ MARY (MAGGIE) A. WILDEROTTER
Mary (Maggie) A. Wilderotter
Director