ALASKA RAILROAD CORPORATION

1992 ANNUAL REPORT

MISSION STATEMENT

The mission of the Alaska Railroad Corporation and its employees is to provide high quality, safe, cost-effective freight, passenger and real estate services for our customers.

TABLE OF CONTENTS

President's Message	1
Year In Review	2
Alaska Railroad Corporate Values:	
Standards For Performance	4
Statistical Review	12
1992 Financials	16

1992 was a year of investment for the Alaska Railroad Corporation, with dividends in the form of improved service and reliability for our customers and training for our employees. Our 1992 capital improvements, one of the largest capital programs in our eight years of state ownership, symbolize our investment for customers.

ROBERT S. HATFIELD, JR.
President and Chief Executive Officer

We invested in our employees through training in the quality process and encouraged them to be a voice for change to make a better railroad.

Safety is the number one priority of our employees. In 1992, we experienced the lowest number of accidents since the state purchased the railroad in 1985. That's something we're proud of, but we know it's not good enough. All of our employees have pledged to make the railroad the safest property in the industry.

In 1992 a group of employees drawn from every segment of the railroad wrote a mission statement; the resulting 27 words direct our focus in everything we do. The statement is our proclamation of dedication to the customer; our golden rule by which we measure everything we do.

The mission of the Alaska Railroad Corporation and its employees is to provide high quality, safe, cost-effective freight, passenger and real estate services for our customers.

The railroad's 1992 revenue totaled $68 million which was slightly less than 1991. In addition, there were several one-time or new expenses that resulted in a net income of $2.3 million or some 50 percent less than the previous year. Those expenses included payments for an early retirement incentive program and postretirement medical benefits.

In mid-year, the company moved into its new headquarters in Anchorage. It's a classic design, built in the style reminiscent of a turn-of-the-century, Pacific Northwest railroad depot. It helped streamline some of our functions and instilled a sense of renewal and greater pride among employees.

Our total quality process adopted two years ago also has boosted employee pride. Every employee on the property has learned that their ideas are important and welcomed. The process has kindled a team spirit among employees as they see results. Some of those results are reflected in our greatly improved on-time performance for general freight, gravel and petroleum shipments.

In 1992, the Alaska Railroad once again experienced an increase in passenger ridership. During the year nearly 500,000 people rode our trains. Alaska is becoming a premier travel destination; and for many, the highlight is a trip on the Alaska Railroad.

Capital investment in 1992 was $12.2 million. Improvements included laying 40,000 feet of new rail, 14,696 new cross ties, the purchase of two yard locomotives and acquisition of 27 side-dump cars . All help improve the quality of service to our customers.

We also continued exploring our real estate investment opportunities in 1992. Our interest in the Comfort Inn Heritage Suites is proving to be a sound investment. The hotel opened in May and enjoyed a profitable summer. Fall occupancy rates were well above average for most hotels in Anchorage.

The Ship Creek redevelopment is a tremendously exciting project. The master developer, LoPatin & Company, has put the opening of a Ship Creek visitors center on track. The center will feature an Omnimax theater and a hologram theater which will make the center one of the most popular drawing cards for tourists in Anchorage. LoPatin also made surprisingly fast progress on the second project in the development: a world trade center and office complex.

Our investment for our customers and our employees means we're serious about offering the highest quality freight, passenger and real estate services. After all, all we have to offer is service. Good service is what customers expect and that's what we want to deliver.

Robert S. Hatfield

ROBERT S. HATFIELD, JR.
President and Chief Executive Officer

The Alaska Railroad Corporation held its own in 1992 to show a profit in a declining oil economy and a year in which we incurred a number of new or one-time expenses. The railroad sought new markets for freight services, aggressively marketed passenger services and expanded the real estate arm of the company.

Revenue totalled $68 million for the year and expenses were $65.7 million. The railroad's net income totaled $2.3 million, a decrease of nearly 50 percent over 1991. New or one-time costs accounting for the decrease were:

- $800,000 for postretirement medical benefits and $200,000 for previously incurred postretirement medical benefits and
- nearly $1 million in incentive payments for an early retirement program

Since land values bottomed out in 1989, they have made a slow, steady recovery in railbelt communities. During 1992, the railroad had 65 real estate appraisals performed. Based on the appraisals, leases were adjusted which increased real estate revenues. Anchorage property experienced the highest increases. Real estate leases and permits generated $4 million in revenue in 1992.

LoPatin & Company took over management of the Ship Creek redevelopment for master planning and development of projects. Corporations approached for sponsorship of a visitors center, called the Northern Crossroads Discovery Center, were enthusiastic about its chances for success. The emphasis for 1992 was planning the Discovery Center, but by the year's end, progress was made on planning a world trade center and office complex as well. Construction of the Discovery Center is scheduled for spring of 1994. The trade center is scheduled for construction later in 1994.

The railroad's interest in the Comfort Inn Heritage Suites on Ship Creek proved to be a wise investment. During the first six months of operation, the hotel has consistently exceeded expectations and reservations for 1993 are very strong.

In 1992 passenger services continued its aggressive marketing and once again ridership was up. Passengers for the year totalled 473,240. Passenger revenue totalled $8.5 million, an increase of about 3 percent over 1991.

Since 1991 passenger services have made substantial contributions to corporate overhead. If the trend continues, passenger services revenue may cover fully allocated expenses in 1993 or 1994.

In anticipation of a strengthening economy, the railroad focused on an aggressive capital program in 1992. Capital investment was among the highest in the corporation's history. The $12.2 million spent was more than 50 percent greater than the 1991 capital program. Projects included:

- 40,000 feet of new rail laid
- 14,696 new cross ties installed
- surfaced (raised, aligned, and tamped) 163.5 miles of track
- relaid and upgraded Honolulu, Gold Creek and Willow sidings, a yard track in Anchorage and two yard tracks in Fairbanks

Two 1,500-horsepower switch engines were purchased in 1992 to free road engines for heavier work and to improve customer service.

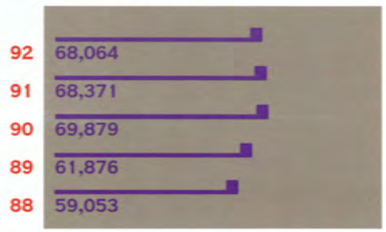
Twenty-seven 100-ton side air-dump cars were purchased to haul track maintenance materials but also can be used in freight service to haul natural resources such as gravel.

During May, executive and administrative employees in Anchorage moved into a new headquarters building. The single location improves efficiency and customer service.

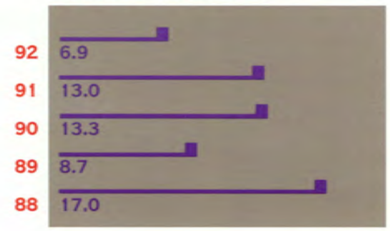
- purchased two 1,500-horsepower switch engines that have enhanced the operations in the Anchorage rail yard and
- purchased 27, 100-ton, air side-dumps for hauling gravel and other material for track maintenance.

Since state ownership began in 1985, the corporation has invested about $72.5 million in capital improvements and equipment without subsidy from the state. At the close of 1992, the railroad's net income during the eight years of state ownership totalled $29.3 million, representing an 11 percent annual return on the state's original investment of $33.2 million.

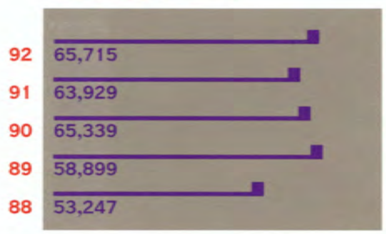
REVENUE (IN THOUSANDS)



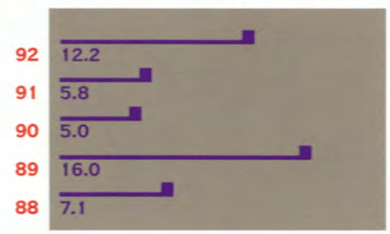
RETURN ON ORIGINAL INVESTMENT (PERCENT)



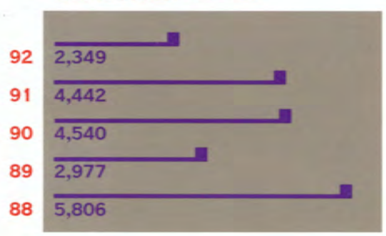
EXPENSES (IN THOUSANDS)



CAPITAL INVESTMENTS (IN MILLIONS)



NET INCOME (IN THOUSANDS)



ALASKA RAILROAD CORPORATE VALUES: STANDARDS FOR PERFORMANCE

The Alaska Railroad Corporation has developed a set of corporate guidelines against which we monitor our progress and document our performance as we continue to grow in the quality process. These guidelines are written as values statements and were developed by a team of employees from every facet of our business. Our values statements reflect the philosophy of Alaska Railroad employees toward our work and the service we provide customers. These short statements speak volumes about what we value and how we want to be seen as a company. Our values define the guiding principles, beliefs and code of conduct of our employees.

Below are our values statements along with a symbol for each that embodies that value. On the following pages we feature several of our nearly 650 employees who share their ideas regarding our values and how they shape their work and their relationships with customers, whether internal or external.

ALASKA RAILROAD VALUES STATEMENTS

Service to our customers is our ultimate goal.

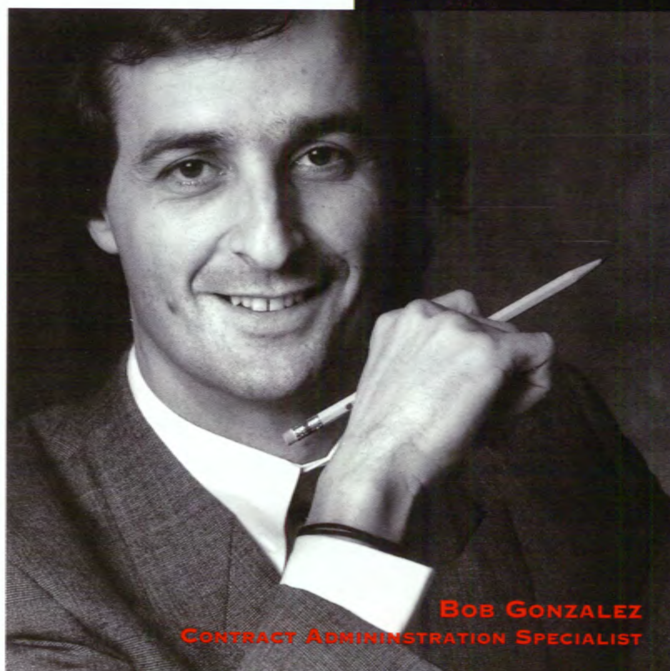
Safety is the essence of all we do.

Pride and integrity must be visible.

Quality is the measure of our work.

Teamwork is essential.

"Service to our customers means they get what they want, on time, with the project schedule maintained and within budget. My primary customers are internal, especially from the Operations Division. I try to keep one thing in mind: They have to maintain the line and keep the track open and we provide that supply line."



BOB GONZALEZ
CONTRACT ADMINISTRATION SPECIALIST

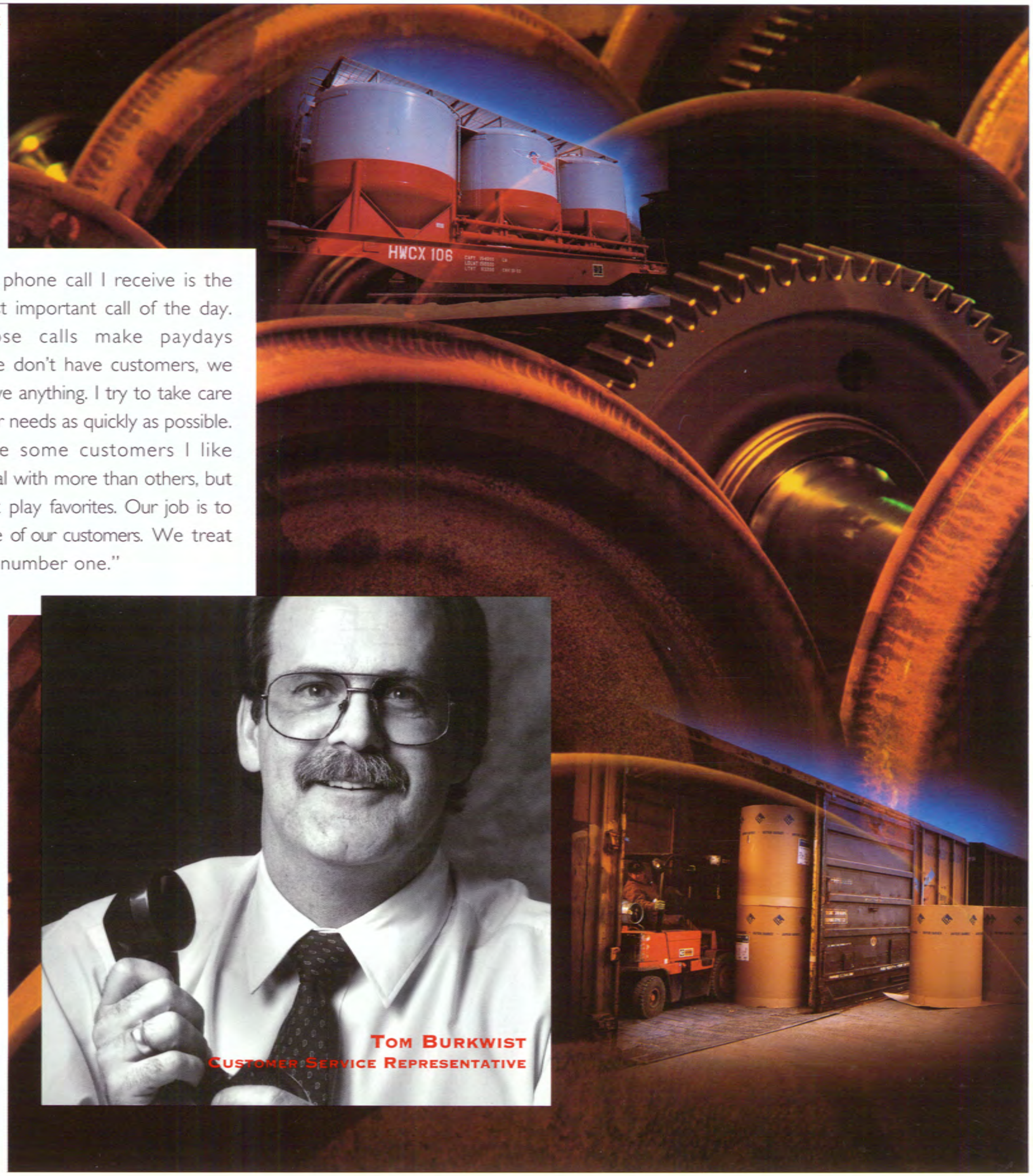
PETROLEUM . *Shipments of petroleum products accounted for more than 35 percent of freight revenue in 1992, generating more than $19 million. More than 400 million gallons of heating oil, aviation and diesel fuels, lubricants and other petroleum products were transported on the Alaska Railroad in 1992.*

COAL . *Since 1917, coal has been a staple of the Alaska Railroad's freight revenue. Nearly 1.4 million tons of coal were hauled during 1992, generating about $12 million in revenue. About half the coal was shipped to customers in Interior Alaska and the remainder was exported to Korea for electric power generation.*

LEE WATNE
MAINTENANCE MECHANICAL LEADER

GRAVEL . *Gravel and gravel products from the Matanuska-Susitna Valley are transported by the railroad to Anchorage for use in local road and building construction projects. Gravel shipments in 1992 were up nearly 15 percent over 1991 and generated nearly $4 million in revenue.*

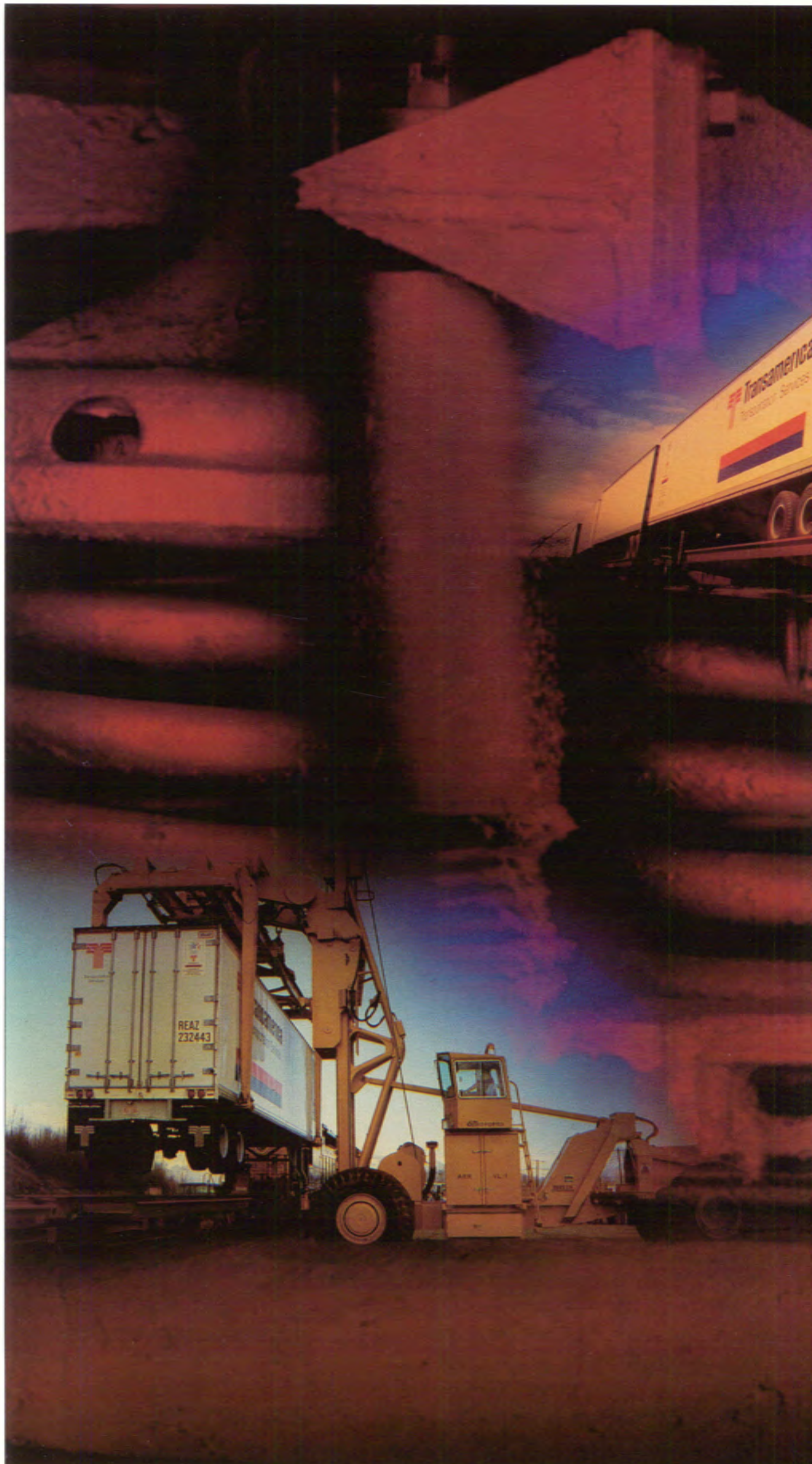
"To me, integrity means doing the best possible job every time. It means being honest about everything, working honestly without taking shortcuts and always taking the safest course. When I look at a job the first thing I look for is simplicity; simplicity and reliability go hand in hand. Everybody on the Alaska Railroad is our customer, but ultimately it's the person who receives the freight. We're here to make the plant work so we can move freight."

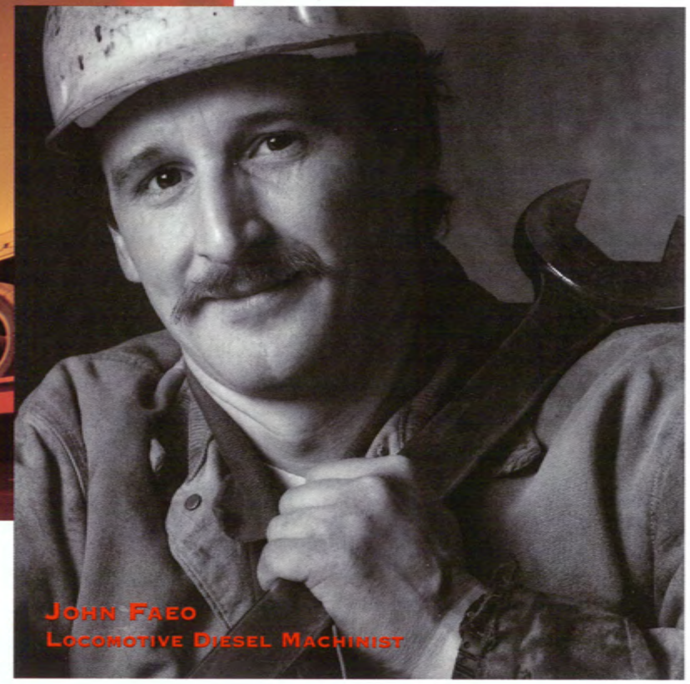


"Each phone call I receive is the most important call of the day. Those calls make paydays possible. If we don't have customers, we don't have anything. I try to take care of their needs as quickly as possible. I have some customers I like to deal with more than others, but I don't play favorites. Our job is to take care of our customers. We treat each one as number one."

Tom Burkwist
Customer Service Representative

INTERLINE . *Everything from heavy equipment to animal feed is hauled by the Alaska Railroad in freight cars from other railroads. Known as interline traffic, the cars enter and leave the state through the Port of Whittier, accounting for more than 15 percent of the 1992 freight revenue or about $8 million.*

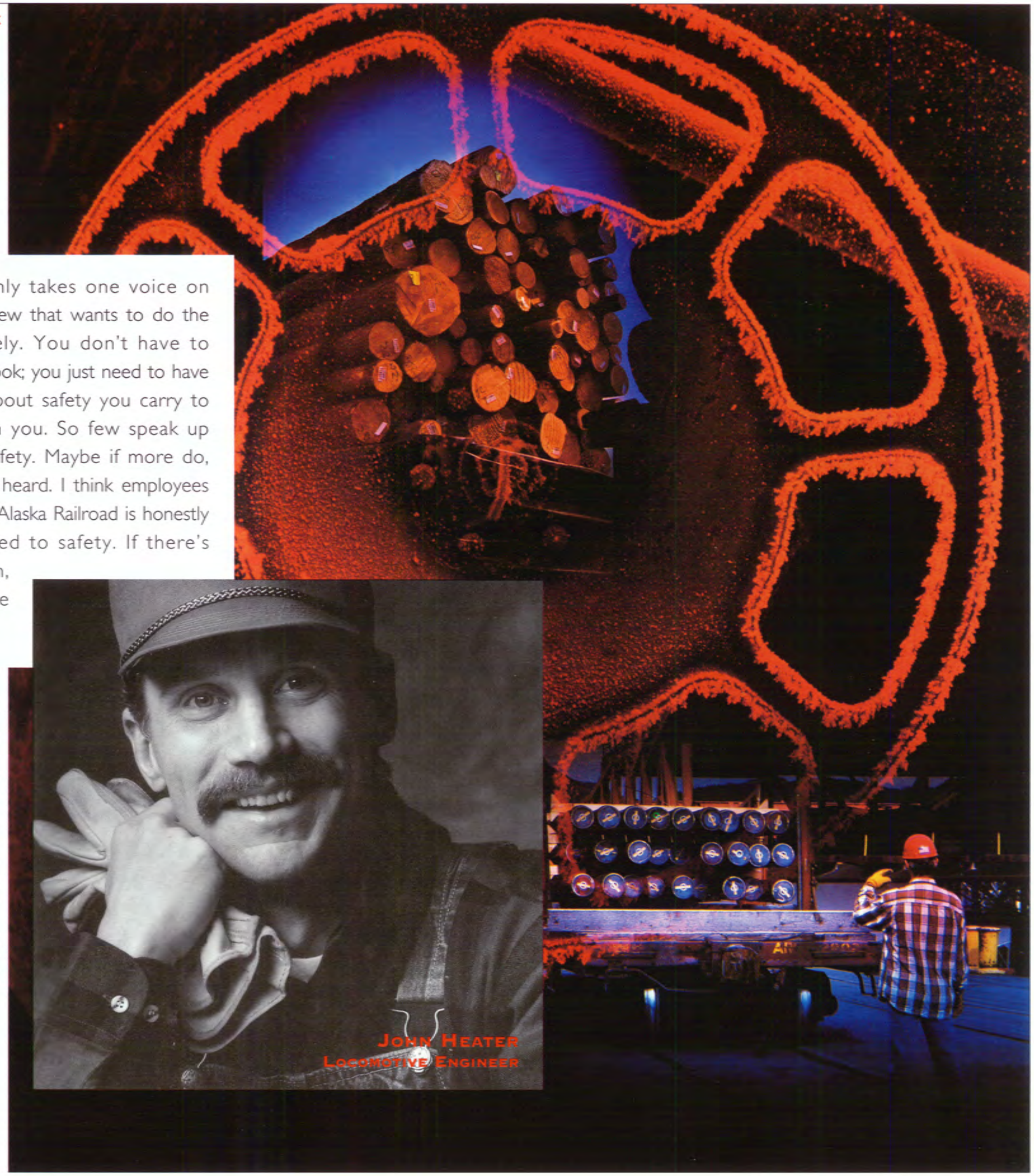



JOHN FAEO
LOCOMOTIVE DIESEL MACHINIST

"I'm proud I work for the Alaska Railroad. It has put bread on my table for 19 years. I'm proud that I am one of a few who can operate every machine here because of a thorough apprenticeship program. We were taught how to do everything from sweeping the floor to remanufacturing a part, and as a result we have a lot of pride in our work. We also have respect for our elders who trained us. They taught us to do the job right the first time."

TOFC . *Intermodal service, trailers or containers moved by several modes of transportation, such as trains, trucks and barges, makes up more than 10 percent of total freight revenue. During 1992, intermodal freight accounted for nearly $6 million in revenue.*

"Safety only takes one voice on every crew that wants to do the job safely. You don't have to quote the rule book; you just need to have an attitude about safety you carry to work with you. So few speak up about safety. Maybe if more do, we'll be heard. I think employees feel the Alaska Railroad is honestly committed to safety. If there's a problem, everyone takes time to solve it."



JOHN HEATER
LOCOMOTIVE ENGINEER

PIPE/MISCELLANEOUS . *During 1992, pipe tonnage for the state's oil industry increased 27 percent over the previous year and accounted for more than $1 million in revenue. Miscellaneous freight, including cement, other building commodities and Japan-bound logs, accounted for more than $1.5 million in revenue for 1992.*

"The employees of the Alaska Railroad are the most hard-working, cooperative, congenial group I've ever worked with. They come in early and they stay late. They are genuinely concerned about what customers think and they care about what customers want. The cooperation and teamwork between departments makes it easy to work here. And there's a lot of goodwill. The cooperation and goodwill go a long way toward making this a good place to work."

IDA PUTMAN
SECRETARY, MARKETING & SALES

PASSENGER SERVICE . *The only full-service railroad in the U.S., the Alaska Railroad provides passenger service year round. In 1992, passenger service accounted for nearly $8.5 million in revenue, an increase of about 3 percent over the previous year. Ridership totalled 473,240.*

REAL ESTATE . *In 1992, real estate leases and permits generated more than $4 million in revenue. The Comfort Inn Heritage Suites at Ship Creek, of which the Alaska Railroad is a 40 percent partner, opened in time for the summer tourist season in Anchorage. Other plans for developing more of the Ship Creek area were unveiled by LoPatin & Company, master developer for Ship Creek.*

GWEN BURNO
LEASING SPECIALIST

"Having a quality Real Estate Department means that when a potential lessee makes an inquiry, information about our property is readily available and everyone has an equal chance of obtaining that information. Quality is responding immediately to requests as they come in. I like to get the work done, close the file and move on to the next project. I don't like to have files open. I like to keep frustrations down by closing a job. Then it's win/win for both parties."

Table Of Contents

Chairman's Message	13
Board Of Directors	13
Management's Statement	14
Report Of Independent Auditors	15
Balance Sheets	16
Statements Of Income	17
Statements Of Cash Flows	18
Notes To The Financials	19
Officers	Inside Back Cover

Statistical Review

CARLOADS

92	70,524
91	69,780
90	80,827
89	70,590
88	66,786

PASSENGER RIDERSHIP

92	473,240
91	471,217
90	436,964
89	366,370
88	360,668

FREIGHT CAR MILES, LOADED (IN THOUSANDS)

92	15,222
91	14,836
90	15,706
89	15,127
88	13,821

PASSENGER REVENUE (IN THOUSANDS)

92	8,460
91	8,173
90	6,973
89	6,026
88	5,600

FREIGHT TRAIN MILES (IN THOUSANDS)

92	596
91	553
90	567
89	603
88	574

REVENUE TON MILES (IN MILLIONS)

92	1,108
91	1,055
90	1,104
89	1,051
88	1,008

INTERMODAL LOADINGS

92	11,638
91	12,095
90	12,542
89	19,166
88	15,510

REVENUE TONS (IN THOUSANDS)

92	5,445
91	5,122
90	5,908
89	4,908
88	4,869

The Alaska Railroad represents more than 70 years of service to the state of Alaska. Our success is based on service to our customers. In our brief history as a state-owned railroad, our mission of quality service has never wavered. From the miner shipping his grubstake to Ferry to the petroleum companies moving pipe to Fairbanks and beyond, it's our years of experience and reliability that make this service possible.

The 1992 Alaska Railroad Board of Directors (left to right): seated, Loren H. Lounsbury and Robert S. Hatfield, Jr. Standing: Frank X. Chapados, Dale R. Lindsey, Frank G. Turpin and Michael W. Olson. Not shown: Glenn A. Olds.

From Seward to Fairbanks, trains are a familiar sight to the people along the railbelt. We have become the symbol of safe, dependable transportation for commercial traffic and passenger service.

In the eight years of state ownership, the railroad has adjusted to Alaska's topsy-turvy economy and has been a profitable enterprise. Along the way the railroad has helped other industries maintain their economic vitality. We take our role seriously in the economic development of Alaska because we are tied to so many of the businesses and industries of Alaska and beyond. We know that when we work as a team our state can grow and prosper.

The Alaska Railroad was chartered by the state to operate as a business. That directive has unleashed creativity and innovation to expand our revenue base. We have been successful in enhancing the public's equity in the corporation and we've done it without additional financial involvement by the state.

Part of what has helped us maintain our financial stability is our real estate. It has sustained us through lean times and will provide some exciting opportunities in the future. The Ship Creek redevelopment project in Anchorage is an example of what will become a major drawing card not only for visitors to our state, but businesses from throughout the world who become part of the proposed World Trade Center. We are ready to work with other railbelt communities in initiating similar projects.

Our people are central to the railroad's success. Up and down the line you see employees proud of the quality services they and the railroad provide our customers.

It has been more than 70 years since Alaskans first heard the whistle of a locomotive. From the first day Alaskans expected and received quality transportation and real estate services. We strive to maintain that legacy.

Loren H. Lounsbury

LOREN H. LOUNSBURY
Chairman, Board Of Directors

1992 ALASKA RAILROAD BOARD OF DIRECTORS

FRANK G. TURPIN
Commissioner, Alaska Department of Transportation and Public Facilities

MICHAEL W. OLSON
Conductor, Alaska Railroad Corporation

ROBERT S. HATFIELD, JR.
President and Chief Executive Officer
Alaska Railroad Corporation

LOREN H. LOUNSBURY
Chairman, International Management Group

FRANK X. CHAPADOS
Retired Business Owner

DALE R. LINDSEY
President, Harbor Enterprises, Inc.

GLENN A. OLDS
Commissioner, Alaska Department of Commerce and Economic Development

Management is responsible for the preparation, integrity and objectivity of the Corporation's financial statements and other financial information appearing in this report. The financial statements are prepared in conformity with generally accepted accounting principles and, in the judgment of management, present fairly and consistently the Corporation's financial position and the results of operations.

The Corporation has established and maintained an internal control structure, including accounting controls and written policies and procedures, which is designed to provide reasonable assurance that assets are safeguarded and that transactions are properly authorized by management and recorded in conformance with generally accepted accounting principles. The concept of reasonable assurance recognizes that the cost of a system of internal accounting control should not exceed the benefits derived and also recognizes that the evaluation of these factors necessarily requires estimates and judgments by management.

In 1992, management and administrative employees were consolidated in a new headquarters building leased by the Corporation in Anchorage. This single location improves the Railroad's efficiency and service to customers.

Net income for 1992 was reduced by $2 million because of two events involving retirees. In October, 33 employees elected to participate in an early retirement program which resulted in one-time incentives and pay-outs of about $1 million. The program will reduce future year costs. A change in the accounting procedures for postretirement medical benefits for all employees, required by the Financial Accounting Standards Board, also totaled about $1 million.

The Alaska Railroad Board of Directors pursues its oversight responsibilities for the financial statements and corporate conduct through its Audit Committee. The committee meets regularly with members of management and independent accountants to discuss the adequacy of the Alaska Railroad's internal controls and financial statements.

The Corporation's financial statements are audited by Ernst & Young, independent certified public accountants, who are appointed by the Board of Directors. Their audit is conducted in accordance with generally accepted auditing standards which include a study and evaluation of the Corporation's system of internal accounting controls. The report of the independent auditors is on page 15.

John O'Meara

JOHN O'MEARA
Vice President, Finance

We have audited the accompanying balance sheets of Alaska Railroad Corporation as of December 31, 1992 and 1991, and the related statements of income, equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Alaska Railroad Corporation as of December 31, 1992 and 1991, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

As discussed in Note 8 to the financial statements, in 1992 the Company changed its method of accounting for postretirement benefit costs.

Ernst & Young

Anchorage, Alaska
February 8, 1993

	1992	(In Thousands)	1991
ASSETS			
Current assets:			
Cash and cash equivalents *(Note 3)*	$ 1,492		$ 5,434
Temporary investments	543		500
Accounts receivable, less allowance for bad debts of $329,000 in 1992 and $327,000 in 1991	9,057		8,281
Operating materials and supplies	3,753		3,240
Other current assets	560		323
Total current assets	15,405		17,778
Property and equipment *(Note 4)*:			
Road	52,715		45,609
Equipment	41,206		35,943
Road materials and supplies	1,784		1,837
Construction in progress	665		256
	96,370		83,645
Less accumulated depreciation and amortization	(29,729)		(24,572)
	66,641		59,073
Land *(Note 5)*	13,850		13,850
	80,491		72,923
Other assets:			
Restricted lease proceeds *(Note 4)*	221		220
Restricted assets—Wishbone Hill *(Note 6)*	10,861		9,798
	11,082		10,018
TOTAL ASSETS	$ 106,978		$ 100,719
LIABILITIES AND EQUITY			
Current liabilities:			
Accounts payable	$ 2,064		$ 2,655
Payroll liabilities	5,064		4,712
Notes payable *(Note 7)*	3,000		6,000
Other accrued liabilities	492		541
Deferred revenues	428		298
Environmental claims	900		1,800
Current portion of capital lease obligations *(Note 4)*	1,637		1,368
Current portion of long-term debt *(Note 7)*	4,047		1,677
TOTAL CURRENT LIABILITIES	17,632		19,051
Deferred revenue, Wishbone Hill *(Note 6)*	10,861		9,798
Long-term debt, less current portion *(Note 7)*	12,947		8,188
Capital lease obligations, less current portion *(Note 4)*	1,089		2,578
Accrued postretirement benefits	996		–
Equity:			
Contributed capital	34,174		34,174
Retained earnings	29,279		26,930
TOTAL EQUITY	63,453		61,104
TOTAL LIABILITIES AND EQUITY	$106,978		$100,719

See accompanying notes.

STATEMENTS OF INCOME

	1992	(In Thousands)	1991
OPERATING REVENUE:			
Freight *(Note 9)*	$ 52,208		$ 51,935
Passenger	8,460		8,174
Other	3,181		3,919
	63,849		64,028
OPERATING EXPENSE:			
Transportation	21,317		20,559
Ways and structures	12,865		12,525
Equipment	11,756		10,296
General and administrative	13,005		13,735
Depreciation and amortization	5,157		4,697
	64,100		61,812
Income (loss) from operations	(251)		2,216
OTHER INCOME (EXPENSE):			
Real estate, less direct expenses of **$426,000** in **1992** and $388,000 in 1991	3,616		3,591
Interest income	173		364
Interest expense	(1,189)		(1,729)
	2,600		2,226
NET INCOME	$ 2,349		$ 4,442

STATEMENTS OF EQUITY

	Contributed Capital *(In Thousands)*
Balance at December 31, 1990	$ 34,174
Net income for the year ended December 31, 1991	–
Balance at December 31, 1991	34,174
Net income for the year ended December 31, 1992	–
Balance at December 31, 1992	$ 34,174

	Retained Earnings *(In Thousands)*
Balance at December 31, 1990	$ 22,488
Net income for the year ended December 31, 1991	4,442
Balance at December 31, 1991	26,930
Net income for the year ended December 31, 1992	2,349
Balance at December 31, 1992	$ 29,279

See accompanying notes.

	1992	(In Thousands)	1991
OPERATING ACTIVITIES			
Net income	$ 2,349		$ 4,442
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	5,157		4,697
Increase (decrease) in accrued environmental claims	(900)		1,800
Loss on disposal of equipment	–		168
Changes in operating assets and liabilities:			
(Increase) decrease in accounts receivable	(776)		1,683
Increase in operating materials and supplies	(513)		(272)
Increase in other current assets and restricted lease proceeds	(238)		(135)
(Decrease) in accounts payable and payroll liabilities	(239)		(33)
(Decrease) in other accrued liabilities	(49)		(876)
Increase (decrease) in deferred revenues	130		(280)
Increase in accrued postretirement benefits	996		–
Net cash provided by operating activities	5,917		11,194
INVESTING ACTIVITIES			
Increase in temporary investments, net	(43)		(500)
Increase in road and equipment	(12,157)		(5,777)
Decrease in road materials and supplies	53		814
(Increase) decrease in construction in progress	(409)		2,013
Net cash used in investing activities	(12,556)		(3,450)
FINANCING ACTIVITIES			
Proceeds from short-term debt	3,000		6,000
Payments on short-term debt	(6,000)		(3,000)
Proceeds from long-term debt	10,455		–
Payments on long-term debt	(3,326)		(2,752)
Payments on capital lease obligations	(1,432)		(4,904)
Net cash provided (used) by financing activities	2,697		(4,656)
(Decrease) increase in cash and cash equivalents	(3,942)		3,088
Cash and cash equivalents at beginning of year	5,434		2,346
Cash and cash equivalents at end of year	$ 1,492		$ 5,434

See accompanying notes.

1. ORGANIZATION 'OPERATIONS

Congress authorized construction of the Alaska Railroad (Railroad) in 1914 and operations began in 1923. The federal government operated the Railroad until its sale to the State of Alaska in January 1985. The sale of the Railroad to the State of Alaska was authorized under the Alaska Railroad Transfer Act of 1982 (ARTA), which was signed into law on January 14, 1983. The Alaska Railroad Corporation (ARRC) is a public corporation created by the State of Alaska Legislature to own and operate the Railroad and manage the Railroad's rail, industrial, port, and other properties. The ARRC commenced operations on January 6, 1985, and adopted the accounting policies of a commercial enterprise.

The ARRC operates 525 route miles, providing both freight and passenger services. The ARRC serves the Alaska cities of Anchorage and Fairbanks as well as the ports of Whittier, Seward, and Anchorage; Denali National Park; and military installations. Vessel and rail barge connections are provided from Seattle, Washington, and Prince Rupert, British Columbia.

2. SIGNIFICANT ACCOUNTING POLICIES

Materials and Supplies Inventories

Operating materials and supplies are carried at the lower of cost (average cost) or market. Road materials and supplies include rail, ties, ballast, and other track materials, and because these items are generally capitalized when placed into service, they are included in property and equipment at cost.

Property and Equipment

Property and equipment are stated at cost. Depreciation and amortization are computed on a straight-line basis over the estimated useful lives of the related assets.

Capitalized Interest

The ARRC capitalizes interest costs as part of the cost of constructing major facilities and equipment. Interest costs of $63,000 and $84,000 were capitalized in 1992 and 1991, respectively.

Income Taxes

As a public corporation, the ARRC is exempt from federal and state income taxes.

Reclassification

Certain amounts included in the 1991 financial statements have been reclassified to conform to the 1992 presentation.

3. CASH, CASH EQUIVALENTS, AND TEMPORARY INVESTMENTS

For purposes of the statements of cash flows, cash and cash equivalents include time deposits, money market accounts, and repurchase agreements with original maturities of three months or less. Temporary investments are carried at cost which approximates market value.

Cash and cash equivalents are summarized at December 31, 1992 as follows:

	Carrying Amount	Bank Statement Balance
	(In Thousands)	
Checking accounts and repurchase agreements	$ (719)	$ 908
Money market accounts	2,211	2,211
Total cash and cash equivalents	$ 1,492	$ 3,119
Collateralized by U.S. Government obligations	155	155
Insured by FDIC	200	200
Uninsured and uncollateralized	1,137	2,764
Total cash and cash equivalents	$ 1,492	$ 3,119

Temporary investments include bonds issued by U.S. Government Agencies, which had a market value of $552,000 at December 31, 1992.

4. LEASES

The ARRC leases its headquarters building under an operating lease expiring July 1, 2012, plus three renewal options of four to five years. The lease agreement includes escalations based upon the consumer price index at five-year intervals beginning with year six of the lease term. Rental expense on the building, which ARRC occupied in May 1992 was $568,000 for 1992.

The ARRC leases certain locomotives, freight cars, vehicles, and other property under capital leases. Future minimum lease payments as of December 31, 1992, are summarized as follows (in thousands):

	Capital Leases	Operating Leases
Year ending December 31,		
1993	$ 1,807	$ 785
1994	917	785
1995	139	785
1996	48	785
1997	25	785
Thereafter	2	11,382
Total minimum lease payments	2,938	$ 15,307
Less interest	212	
Present value of net minimum lease payments (including $1,637 classified as current)	$ 2,726	

During 1992, the ARRC acquired equipment worth approximately $212,000 under capital lease agreements. The total cost of equipment held under capital leases was $10,246,000 and $10,034,000 at December 31, 1992 and 1991, respectively. The related accumulated amortization was $4,391,000 and $3,663,000 at December 31, 1992 and 1991, respectively. Amortization expense is included in depreciation expense in the statement of income.

A lease for freight cars requires that $221,000 be kept on deposit with a financial institution for the term of the lease agreement.

5. LAND

Certain parcels of land are leased to various parties under agreements which are cancelable upon 90 days notice by the lessee. The lease terms vary from 2 to 55 years. Annual rental income on these leases was approximately $4,042,000 in 1992 and $3,979,000 in 1991.

6. WISHBONE HILL

The ARRC received $9 million from the State of Alaska in 1990 for the purchase of locomotives and coal hopper cars for the Wishbone Hill Coal project. Any remaining funds, along with interest earned on the $9 million while in the possession of the ARRC, may be used to purchase other equipment and improvements related to the project. This contribution from the State is accounted for as deferred revenue, which will be amortized over the life of the project. Since 1991, the $9 million has been invested in U.S. Government securities. At December 31, 1992, these investments had a carrying value, including accrued interest, of $10,861,000 at cost and a market value of $10,861,000. According to the current agreement, ARRC is to refund the $9,000,000 plus interest earned during the holding period if the Wishbone Hill Coal Project is canceled.

7. LONG-TERM DEBT

Long-term debt at December 31, 1992 consists of the following (in thousands):

Note payable, secured by equipment, due in monthly payments of $100,000, plus interest, through May 15, 1997. Interest is accrued at 69% of the prime rate, which was 4.14% at December 31, 1992. This note requires maintenance of a current ratio of at least .9, a net worth of at least $30 million, and a debt service coverage ratio of at least 1.25. The ARRC is not in compliance with the current ratio covenant at December 31, 1992; however, the bank has granted a one-time waiver of the covenant through December 31, 1993.	$ 5,300
Note payable, secured by equipment, due in semi-annual principal payments of $203,397, plus interest, through April 1, 2004. Interest accrued at 9% through September 1991 and thereafter at the two-year treasury note rate, which was 3.86% at December 31, 1992.	$ 4,678
Note payable, secured by various assets, due in monthly payments ranging from $118,696 to $119,076, including interest, through July 1, 1995. Interest is accrued at 8%. This note requires maintenance of a net worth of at least $30 million and a debt service ratio of at least 1.25.	$ 3,165
Note payable, secured by equipment, due in quarterly payments of $115,500, plus interest, through December 17, 1996. Interest is accrued at 68% of the prime rate, which was 4.08% at December 31, 1992.	$ 1,849
Note payable, secured by computer equipment, due in monthly payments of $43,069, including interest, through May 1, 1995. Interest is accrued at 6.36%.	$ 1,158
Other notes payable, secured by equipment, with varying maturities through 1997 with interest from 4.47% to 7.82%. One note requires maintenance of a current ratio of at least .9, a net worth of at least $30 million, and a debt service coverage ratio of at least 1.25. The ARRC is not in compliance with the current ratio covenant at December 31, 1992; however, the bank has granted a one- time waiver of the covenant through December 31, 1993.	$ 844
	16,994
Less current portion	4,047
	$12,947

Long-term debt maturities are as follows (in thousands):

Year ending December 31,	1993	$ 4,047
	1994	4,151
	1995	3,015
	1996	2,159
	1997	977
	Thereafter	2,645
		$16,994

The ARRC has arrangements for short-term operating borrowing up to $10 million with two banks at December 31, 1992. The amount outstanding on the first line is $3 million at December 31, 1992 with interest at 4.81%. There were no amounts outstanding at December 31, 1992 on the second line. In addition, the ARRC has available a line of credit of up to $10 million for the purpose of financing self-insurance claims (see Note 11). There is no outstanding balance on the self-insurance line at December 31, 1992.

8. Employee Benefits

The ARRC has a defined benefit pension plan (the Plan) that covers all nonrepresented permanent employees who have not remained in the Civil Service Retirement System (CSRS) and permanent employees who are members of collective bargaining units which have bargained to become covered by this plan. Benefits under this plan are generally based upon the employee's years of service and final average compensation. The ARRC's funding policy is to contribute to the Plan for each year the amount equal to the net periodic pension cost. Contributions are made continually throughout the year.

The funded status of the pension plan at December 31, 1992 and 1991 is as follows:

	1992	1991
	(In Thousands)	
Actuarial present value of benefit obligations:		
Accumulated benefit obligation—vested	$ (5,442)	$ (4,109)
Accumulated benefit obligation—nonvested	(1,467)	(324)
	$ (6,909)	$ (4,433)
Projected benefit obligation for service rendered to date	$ (8,497)	$ (6,367)
Plan assets at fair value	10,771	8,620
Projected benefit obligation less than plan assets	2,274	2,253
Prior service cost	298	–
Unrecognized net transition obligation	547	608
Unrecognized net gain	(3,025)	(3,009)
Pension prepayment (liability)	$ 94	$ (148)

Net pension costs at December 31, 1992 and 1991 are included in the following components:

	1992	1991
	(In Thousands)	
Service cost—benefits earned during the period	$ 238	$ 255
Interest cost on projected benefit obligation	621	475
Return on plan assets	(735)	(1,347)
Net amortization and deferral	(55)	780
Net periodic pension costs	$ 69	$ 163

Actuarial assumptions used in 1992 and 1991 to develop net periodic pension costs were:

	1992	1991
Assumed discount rate	8.0%	8.0%
Assumed salary increase rate	5.5%	5.5%
Expected long-term rate of investment return	8.0%	8.0%

Assets of the ARRC's pension plan are invested in fixed income securities and common stocks.

Federal employees who transferred to the ARRC will continue participation in the CSRS. The contribution required of the ARRC is 7 percent of the transferred employees' base pay. Pension expense related to the CSRS is $910,348 and $980,380 for 1992 and 1991, respectively.

In addition to the Railroad's defined benefit pension plan, the Railroad sponsors a defined benefit health care plan that provides postretirement medical benefits to employees receiving retirement under the corporate retirement plan, and retired CSRS employees who do not qualify for the federal medical insurance. The plan is contributory, with retiree contributions adjusted annually, and contains other cost-sharing features such as deductibles and coinsurance. The accounting for the plan anticipates future cost-sharing changes to the written plan that are consistent with the Railroad's expressed intent to increase the retiree contribution rate by the amount of that year's premium increase. The Railroad's policy is to fund the cost of medical benefits in amounts determined at the discretion of the management. At December 31, 1992, the ARRC has not designated any assets for the funding of these benefit costs.

In 1992, the Railroad adopted FASB Statement No. 106, Employer's Accounting for Postretirement Benefits Other Than Pensions. The effect of adopting the new rules increased 1992 net periodic postretirement benefit cost and decreased 1992 net income by $964,000. Postretirement benefit cost for 1991, which was recorded on a cash basis, has not been restated.

The following table presents the plan's funded status reconciled with amounts (in thousands) recognized in the Railroad's balance sheet at December 31, 1992:

Accumulated postretirement benefit obligation:		
Retirees	$	912
Fully eligible active plan participants		418
Other active employees		2,538
Total accumulated postretirement benefit obligation		3,868
Unrecognized transition obligation		(3,675)
Accrued postretirement benefit cost	$	193

Net periodic postretirement benefit cost includes the following components:		
Service cost	$	510
Interest cost		348
Amortization of transition obligation over 20 years		193
Net periodic postretirement benefit cost	$	1,051

The weighted-average annual assumed rate of increase in the per capita cost of covered benefits (i.e., health care cost trend rate) is 14% for 1993 (15% for 1992) and is assumed to decrease 1% per year to 6% in 2001 and after. The health care cost trend rate assumption has a significant effect on the amounts reported. For example, increasing the assumed health care cost trend rates by one percentage point in each year would increase the accumulated postretirement benefit obligation as of December 31, 1992 by $800,000 and the aggregate service and interest components of net periodic postretirement benefit cost for 1992 by $210,000.

The weighted-average discount rate used in determining the accumulated postretirement benefit obligation was 8% at December 31, 1992.

9. Major Customers

Two ARRC customers accounted for 36 percent and 11 percent of freight revenue for the year ended December 31, 1992. In 1991, two customers accounted for 33 percent and 11 percent of freight revenue.

10. Contingencies

In 1990 an action was commenced against the ARRC and several of its present and former officers, alleging that in 1986 the ARRC made a verbal agreement with the plaintiff for very favorable wharfage and transportation rates. The complaint seeks up to $74 million in damages. In 1991, the U.S. District Court granted ARRC's motion to dismiss. The plaintiff appealed this decision to the 9th Circuit Court of Appeals. ARRC believes that the suit is without merit and intends to vigorously litigate the asserted claims, if the 9th Circuit Court reinstates the case on appeal.

During 1991, ARRC was named as a potentially responsible party in a lawsuit brought by the U.S. Environmental Protection Agency (EPA) to recover money spent to date and to be spent in the future cleaning up a superfund site at the Anchorage Terminal Reserve. ARRC believes the contamination occurred prior to the transfer of the Railroad from the federal government to the State of Alaska and will be covered under a pre-transfer pollution agreement between the federal government and the State of Alaska.

On February 6, 1992, the EPA fined ARRC a total of $1.8 million for alleged violations of the Resource Conservation and Recovery Act in relation to storing hazardous wastes at the Anchorage rail yard. An estimate of the ultimate liability cannot be made until all facts underlying these fines are gathered and negotiations are conducted with the EPA. The entire amount of the fines was accrued in the 1991 financial statements. During 1992, ARRC reduced the amount accrued and the related general and administrative expense by $900,000 based on a settlement offer made by EPA representatives. Although a final agreement has not been made, ARRC believes the remaining accrual of $900,000 is the maximum liability it will incur for these violations.

The ARRC is a defendant in various legal proceedings related to the conduct of its business. Provision has been made in the financial statements for possible losses from litigation. In the opinion of management, the outcome of this litigation will not have a material effect on the financial position of the ARRC.

11. Insurance

The ARRC is self-insured to certain limits for employee health benefits, personal property and casualty damage. The ARRC is also self-insured against workers' compensation claims. The ARRC employs a full time "Risk Manager" who monitors all cases involving ARRC liability.

12. Investment in Partnership

Effective August 22, 1991, ARRC entered into a general partnership agreement to develop and operate a hotel complex in the Ship Creek area. ARRC entered into a 35-year lease with the partnership for the ground on which the hotel is located for $1 per year. In return for this ARRC received its 40% investment in the partnership, which is accounted for on the equity method. During the construction phase of the project, the ARRC responded to a partnership cash call of approximately $500,000, which was included in accounts receivable at December 31, 1991. All cash call moneys were returned to the partners and at December 31, 1992 the ARRC had no cash investment in the partnership. The ARRC is jointly and severally liable as a partner on a deed of trust loan for $3.9 million, secured by the hotel construction which is due December 31, 1993, and on a $500,000 line of credit which is renewable annually.

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