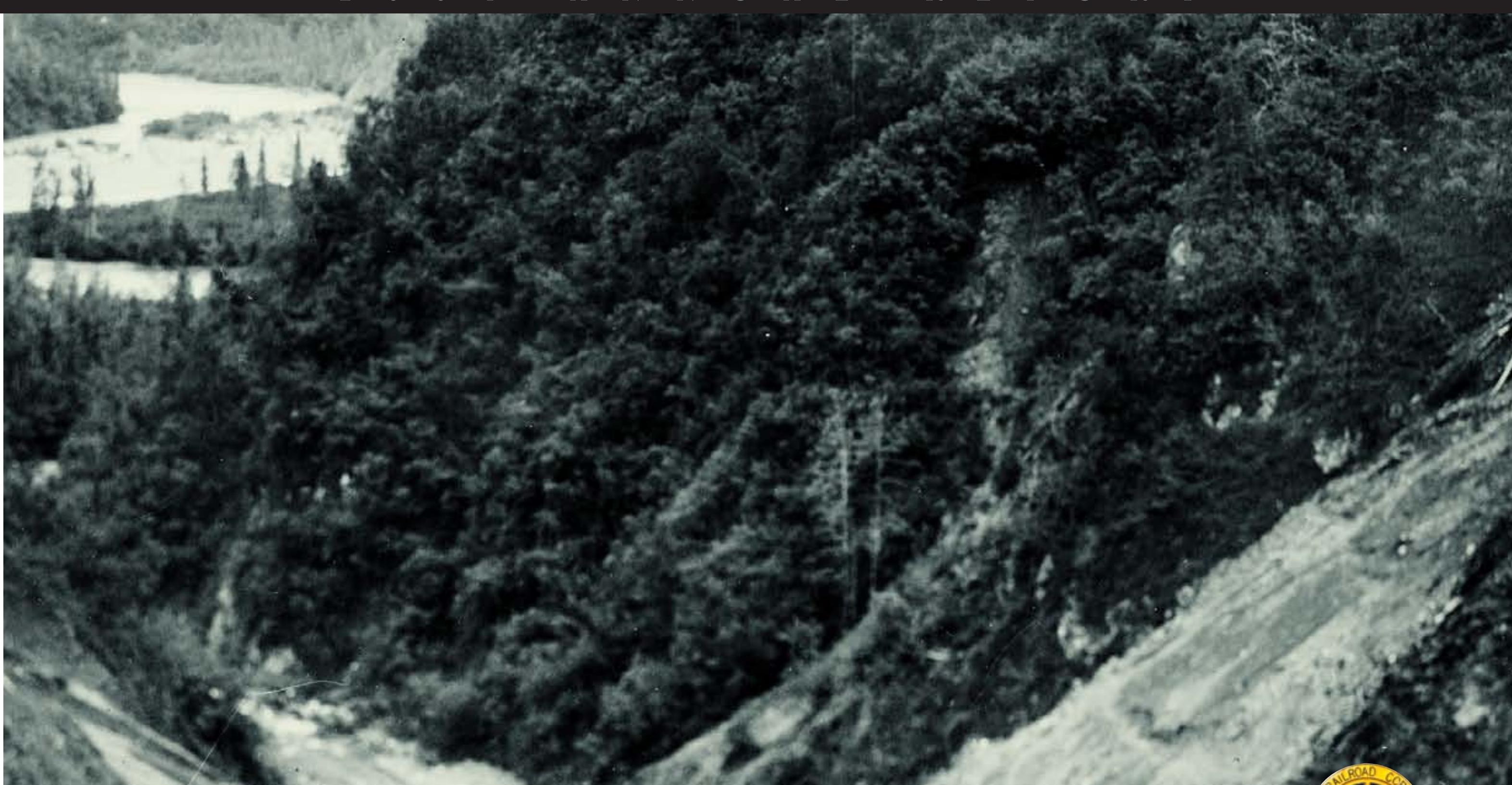
THE ALASKA RAILROAD CORPORATION

A VISION ETCHED IN STEEL

2004 ANNUAL REPORT



FINANCIAL SECTION

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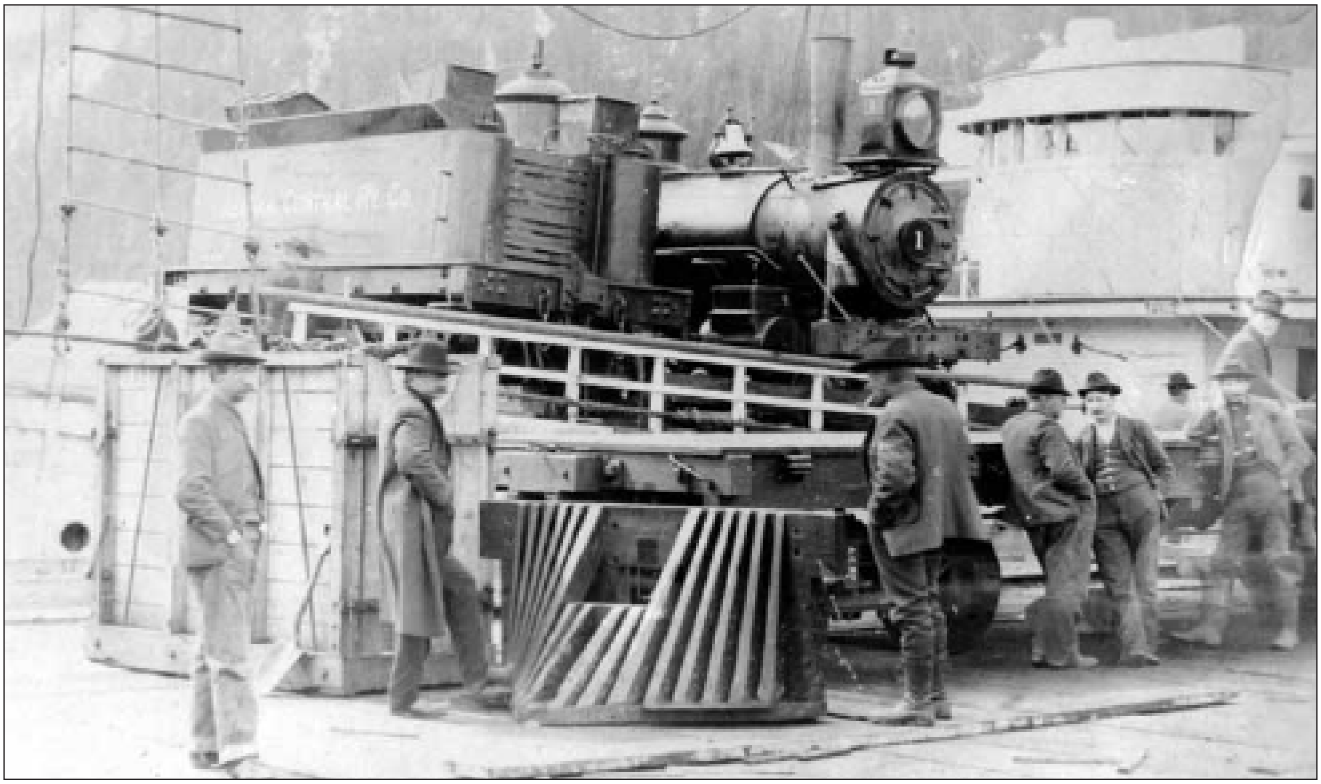

Engine No.1 arrives in Seward in 1904. The "dinky" engine was originally purchased by the Alaska Central Railroad which became property of the Alaska Railroad in 1915.

March 4, 2005

In accordance with Alaska Statute (AS) 42.40.260, it is our pleasure to present the financial section of the Alaska Railroad Corporation's (ARRC) Annual Report for the fiscal year ending December 31, 2004.

The financial section of the Annual Report is presented in three parts:

- Management's Discussion and Analysis (MD&A) – provides an introduction, overview, and analysis of the basic financial statements
- The independent auditor's report on the basic financial statements
- The basic financial statements and accompanying notes

Whether an ARRC customer, creditor, or other resident of the State of Alaska, we hope you find this section of the Annual Report useful.

Sincerely,

Bill O'Leary, CPA
Vice President Finance and
Chief Financial Officer

Wendy Richerson, CPA
Controller

ALASKA RAILROAD CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS

December 31, 2004 and 2003

This section of the Alaska Railroad Corporation's (ARRC's) annual financial report presents our discussion and analysis of the ARRC's financial performance during the fiscal years that ended on December 31, 2004 and 2003. Please read it in conjunction with the ARRC's financial statements, which follow this section.

Financial Highlights

- The ARRC's total fund equity increased 10% over the course of this year's operations and 15% over the course of 2003 operations.
- During the year, the ARRC's operating revenues exceeded operating expenses by $10.1 million, yielding an operating ratio of .91. Last year, operating revenues exceeded operating expenses by $12.1 million and yielded an operating ratio of 0.89.
- The total operating costs of the ARRC's programs were $105.9 million, an increase of 4% compared to last year. Total operating costs were $102.2 million, an increase of 11% during 2003.
- Expenditures on capital assets totaled $102.3 million during the year ended December 31, 2004, an increase of 26% compared to last year. Expenditures on capital assets totaled $81.4 million during the year ended December 31, 2003, an increase of 23% compared to last year.
- Federal grant funding was used for $61.9 million, or 61%, of the 2004 capital expenditures. In 2003, federal grant funding was $63 million, or 77%, of capital expenditures. These amounts were recorded as deferred revenue in the regulatory liabilities section of the balance sheet. Revenue associated with capital grants is recognized when the assets are depreciated. Grant revenue for capital assets equals grant depreciation expense in operations and real estate. More detailed information can be found in note 8.

Overview of the Financial Statements

The ARRC is a component unit of the State of Alaska and operates like a stand-alone business. The ARRC is subject to the jurisdiction of the Surface Transportation Board (STB) and the ARRC's rates for services are established by its board of directors and designed to recover the cost of providing the service. The financial statements report information about the ARRC using accounting methods similar to those used by private-sector companies. This annual report consists of two parts – *management's discussion and analysis* (this section) and the *basic financial statements*. The basic financial statements consists of three statements that present information about the ARRC's overall financial status:

- Balance sheet – the balance sheets report assets, liabilities, and fund equity of the ARRC. Assets and liabilities are segregated into current and noncurrent; that is, assets and liabilities that are expected to be received or liquidated within one year (current), and those that are not expected to be received or liquidated within one year (noncurrent). Fund equity, the difference between the ARRC's assets and its liabilities, is one way to measure the ARRC's financial health. Over time, increases or decreases in the ARRC's fund equity are an indicator of whether its financial health is improving or deteriorating, respectively.
- Statement of revenues, expenses, and changes in fund equity – this statement reflects revenues earned from services and expenses incurred to operate the ARRC, as well as the activities of the ARRC not considered to be operations. All of the current year's revenues and expenses are accounted for in this statement regardless of when cash is received or paid. This statement replaces the previously reported statement of income.
- Statement of cash flows – this statement reports activities of the ARRC as they affect cash balances.

The financial statements also include notes that explain some of the information in the financial statements and provide more detailed data.

Financial Analysis of the Alaska Railroad Corporation

Fund equity – ARRC's fund equity increased 9.5% between fiscal years 2003 and 2004 – increasing to approximately $150.3 million. ARRC's fund equity increased 15% between fiscal years 2002 and 2003 – increasing to approximately $137.2 million:

		2004	2003	2002
Assets:				
Current assets	$	55,243	60,348	44,983
Capital assets		459,290	378,792	320,052
Other noncurrent assets		1,043	982	1,603
Total assets	$	515,576	440,122	366,638
Liabilities:				
Current liabilities	$	24,566	26,129	18,376
Long-term debt outstanding, less current installments		27,446	17,874	16,466
Other liabilities		3,036	3,397	6,302
Regulatory liabilities:				
Postretirement and pension		17,984	13,495	14,599
Deferred grant revenue		292,294	242,014	191,468
Total liabilities	$	365,326	302,909	247,211
Fund equity:				
Invested in capital assets, net of related debt	$	136,500	116,728	110,003
Restricted for reinvestment in infrastructure		13,750	20,485	9,424
Total fund equity	$	150,250	137,213	119,427

Capital assets – Capital assets, net of accumulated depreciation, increased $80.5 million in 2004 and $58.7 million in 2003. During 2004 and 2003, the ARRC continued an extensive capital improvement plan, including track refurbishing, straightening of curves in the track to allow faster train speed, and building new passenger depots. The majority of capital assets are funded through federal grants.

Regulatory liabilities – The Surface Transportation Board regulates the ARRC's operations and has specific accounting requirements. The ARRC's board of directors establishes rates for services that are designed to recover the cost of providing the services. The ARRC records regulatory liabilities as required by Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulations*. A description of each of the regulatory liabilities follows:

- Deferred grant revenue relates to capital assets funded with federal grants. Deferred grant revenue increased $50.3 million in 2004 and $50.5 million in 2003. This increase reflects the increased amount of capital assets constructed with grant funding. This deferred grant revenue will be recognized as operating income as the related capital assets are depreciated.

- The postretirement and pension liability increased $4.5 million during 2004, primarily due to poor market performance during 2004. The postretirement and pension liability decreased $1.1 million during 2003, primarily due to good market performance during 2003.

Changes in fund equity – The ARRC's total revenues increased 1% and totaled $129.5 million in 2004. The ARRC's total revenues increased 22% and totaled $128.7 million in 2003. Approximately 67% and 66% of the ARRC's revenue comes from freight revenue during 2004 and 2003, respectively, and 13% and 11% of the revenue comes from passenger services during 2004 and 2003, respectively. The majority of the remaining income is related to real estate activities and federal grant revenue. Generally, federal grant revenue is recognized as the capital assets funded by the grants are depreciated.

ARRC's total expenses including real estate expenses of $7,066 in 2004, $11,137 in 2003 and $3,477 in 2002, decreased less than 1% from 2003 to 2004 and increased 18% from 2002 to 2003 (in thousands):

		2004	2003	2002
Operating revenue:				
Freight	$	86,516	85,228	76,021
Passenger		16,923	14,174	13,980
Other		116	245	544
Total transportation revenue		103,555	99,647	90,545
Grant revenue		12,488	14,665	3,905
Total		116,043	114,312	94,450
Operating expense:				
Transportation		28,124	25,498	22,839
Passenger services		3,559	3,563	2,672
Markets, sales, and service		14,364	16,639	16,737
Passenger operations		4,343	2,824	3,368
Mechanical		15,316	14,346	13,019
Maintenance		24,224	24,767	22,197
Engineering and signals		2,098	1,945	1,535
Health, safety, and environment		1,822	1,522	1,285
General and administrative		12,084	11,095	8,692
Total		105,934	102,199	92,344
Operating income		10,109	12,113	2,106
Nonoperating revenues (expenses):				
Real estate income, net of expenses		5,980	2,873	7,831
Investment income (loss)		371	385	(28)
Interest expense		(1,083)	(837)	(1,000)
Net income		15,377	14,534	8,909
Other changes in fund equity		(2,340)	3,252	(3,252)
Change in fund equity	$	13,037	17,786	5,657

Several events occurred during 2004 that significantly impacted the change in fund equity:

- The Federal Railroad Administration approval of ARRC's indirect cost rate agreements allowed ARRC to allocate eligible general and administrative expenses to federal grant projects. A total of $1.2 million was allocated to capital projects during 2004, reducing general and administrative expenses. The overall indirect cost recovery was $240,000 less than 2003.
- Total transportation revenue was $3.9 million greater than 2003. The revenue increases resulted from strong passenger ridership, increased local and export coal shipments, solid petroleum shipments and trailer on flat car (TOFC) service.
- Market conditions led to pension investments being inadequate to cover the accumulated pension benefit obligation. This was the primary reason for the $2.3 million additional minimum pension liability recorded as an "other change in fund equity" during 2004.

Several events occurred during 2003 that significantly impacted the change in fund equity:

- The Federal Railroad Administration approval of ARRC's indirect cost rate agreements allowed ARRC to allocate eligible general and administrative expenses to federal grant projects. A total of $1.5 million was allocated to capital projects during 2003, reducing general and administrative expenses. The overall indirect cost recovery was $900,000 less than 2002.
- Total transportation revenue was $9.1 million greater than 2002. These revenues increased as a result of the return of export coal shipments, a large Alaska DOT construction project that generated unbudgeted gravel shipments and additional petroleum shipments.
- During 2003, ARRC accrued expenses relating to possible environmental impacts attributable to ARRC. More detailed information about the accrued expenses is presented in note 14 to the financial statements.
- Market conditions led to pension investments being adequate to cover the accumulated pension benefit obligation. This was the primary reason for the decrease in the $3.3 million additional minimum pension liability recorded as an "other change in fund equity" during 2003.

Capital Asset and Debt Administration

Capital Assets

At the end of 2004, the ARRC had invested $459.3 million in a broad range of capital assets including land, road and roadway structures, equipment, and leasehold improvements. This amount represents a net increase (including additions and deductions) of $80.5 million, or 21%, over last year. Federal grants have funded $290.9 million of the assets, net of accumulated depreciation (in thousands):

		2004	2003	2002
Land and improvements	$	19,587	18,991	17,644
Road materials and supplies		10,197	3,724	3,491
Road and roadway structures		177,760	160,982	80,393
Equipment		93,427	71,306	62,283
Leasehold improvements		1,393	1,529	1,668
Construction in progress		156,926	122,260	154,573
Total capital assets, net of accumulated depreciation	$	459,290	378,792	320,052

The ARRC's fiscal year 2005 capital budget approved spending another $70.4 million for capital projects, principally for continued track straightening and depot construction and improvements. The ARRC intends to use federal grant funding to provide $54.6 million of the capital additions. The remaining capital projects will be funded out of current year earnings and cash flow. More detailed information about the ARRC's capital assets is presented in note 4 to the financial statements.

Long-Term Debt

At year-end the ARRC had $30.5 million in long-term notes outstanding – an increase of 52% from last year. During 2004 the ARRC refinanced twelve locomotives and issued $13.3 million in new debt for eight locomotives. More detailed information about the ARRC's long-term liabilities is presented in note 6 to the financial statements.

Next Year's Budget

Freight and passenger revenues are projected at $85 million and $19.1 million, respectively. Management will continue initiatives to reduce operating expenses that were implemented during 2004. As a result, the ARRC's fund equity is expected to increase $11.1 million or 7.4% by the close of 2005.

Contacting the ARRC's Financial Management

This financial report is designed to provide residents of the State of Alaska and our customers and creditors with a general overview of the ARRC's finances and to demonstrate accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Alaska Railroad Corporation, P.O. Box 107500, Anchorage, Alaska 99510-7500, or visit us on the Internet at www.alaskarailroad.com.

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Alaska Railroad Corporation:

We have audited the accompanying balance sheets of the Alaska Railroad Corporation, a component unit of the State of Alaska, as of and for the years ended December 31, 2004 and 2003, and the related statements of revenues, expenses and changes in fund equity, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. 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 the Alaska Railroad Corporation as of December 31, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 4, 2005 on our consideration of the Alaska Railroad Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 1 through 6 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

March 4, 2005

ALASKA RAILROAD CORPORATION
BALANCE SHEETS

December 31, 2004 and 2003

(In thousands)

Assets		2004	2003
Current assets:			
Cash and cash equivalents (note 3)	$	10,222	26,092
Accounts receivable, net of allowance for doubtful accounts of $165 in 2004 and $136 in 2003		12,372	9,382
Grants receivable (note 8)		17,160	6,162
Materials and supplies		6,280	5,760
Restricted assets (note 3)		1,909	10,652
Prepaid expenses and other current assets		6,391	2,300
Under recovery of vehicle and equipment allocated costs (note (2k))		909	—
Total current assets		55,243	60,348
Capital assets (note 4):			
Land and improvements (note 11)		19,587	18,991
Road materials and supplies		10,197	3,724
Road and roadway structures		257,429	228,231
Equipment		159,000	127,703
Leasehold improvements (note 11)		1,848	1,848
Accumulated depreciation and amortization		(145,697)	(123,965)
Construction in progress		156,926	122,260
Total capital assets, net		459,290	378,792
Restricted assets (note 3)		920	831
Other assets		123	151
	$	515,576	440,122
Liabilities and Fund Equity			
Current liabilities:			
Current portion of long-term debt (notes 5 and 6)	$	3,050	2,176
Accounts payable and accrued liabilities (notes 5, 13, and 14)		6,730	10,092
Payroll liabilities		9,410	8,435
Over recovery of vehicle and equipment allocated costs (note (2k))		—	1,509
Unearned revenues (note 11)		5,376	3,917
Total current liabilities		24,566	26,129
Long-term debt, less current portion (notes 5 and 6)		27,446	17,874
Environmental remediation reserve (notes 5, 13, and 14)		2,371	2,567
State of Alaska advances (notes 3, 5, and 8)		665	830
Regulatory liabilities:			
Accrued postretirement and pension benefits (notes 5 and 7)		17,984	13,495
Deferred grant revenue (notes 5 and 8)		292,294	242,014
Total liabilities		365,326	302,909
Fund equity (notes 7 and 9):			
Investment in capital assets, net of related debt and deferred grant revenue (note 4)		136,500	116,728
Restricted for reinvestment in infrastructure (notes 2(a) and 3)		13,750	20,485
Total fund equity		150,250	137,213
Commitments and contingencies (notes 6, 7, 10, 12, 13, and 14)			
	$	515,576	440,122

See accompanying notes to basic financial statements.

ALASKA RAILROAD CORPORATION
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND EQUITY

Years ended December 31, 2004 and 2003

(In thousands)

		2004	2003
Operating revenues:			
Freight (note 10)	$	86,516	85,228
Passenger		16,923	14,174
Other		116	245
		103,555	99,647
Grant revenue (note 8)		12,488	14,665
		116,043	114,312
Operating expenses (note 8):			
Transportation		28,124	25,498
Passenger services		3,559	3,563
Markets, sales, and service		14,364	16,639
Passenger operations		4,343	2,824
Mechanical		15,316	14,346
Maintenance		24,224	24,767
Engineering and signals		2,098	1,945
Health, safety, and environment		1,822	1,522
General and administrative, net of indirect cost recovery of $1,219 in 2004 and $1,459 in 2003		12,084	11,095
		105,934	102,199
Operating income		10,109	12,113
Nonoperating revenues (expenses):			
Real estate income, less direct expenses of $7,066 in 2004 and $11,137 in 2003 (notes 8 and 11)		5,980	2,873
Investment income		371	385
Interest expense		(1,083)	(837)
Total nonoperating revenues		5,268	2,421
Net income (note 2(a))		15,377	14,534
Other change in fund equity:			
Reduction (additional) minimum pension liability (note 7)		(2,340)	3,252
Change in fund equity		13,037	17,786
Fund equity, beginning of year		137,213	119,427
Fund equity, end of year	$	150,250	137,213

See accompanying notes to basic financial statements.

ALASKA RAILROAD CORPORATION

STATEMENTS OF CASH FLOWS

Years ended December 31, 2004 and 2003

(In thousands)

		2004	2003
Cash flows from operating activities:			
Receipts from customers	$	100,871	99,492
Operating grants received		2,173	2,636
Payments to suppliers		(49,079)	(29,051)
Payments to employees		(45,807)	(44,217)
Net cash provided by operating activities		8,158	28,860
Cash flows from capital and related financing activities:			
Principal payments on long-term debt		(2,854)	(2,540)
Interest payments on long-term debt		(1,083)	(837)
Proceeds from long-term debt		13,300	4,009
Purchases of capital assets		(102,293)	(81,399)
Proceeds from sales of capital assets		71	345
Increase in deferred revenues, net of advances		49,432	51,520
Net cash used in capital and related financing activities		(43,427)	(28,902)
Cash flows from investing activities:			
Real estate income received, net of direct expenses		10,374	7,429
Proceeds from sale of investments		—	652
Interest received on investments		282	201
Purchase of restricted investments		—	(786)
Proceeds from sale of restricted investments		8,743	—
Net cash provided by investing activities		19,399	7,496
Net increase in cash and cash equivalents		(15,870)	7,454
Cash and cash equivalents at beginning of year		26,092	18,638
Cash and cash equivalents at end of year	$	10,222	26,092
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	10,109	12,113
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization		18,483	18,536
Grant revenue on capital assets		(10,315)	(12,029)
Gain on disposal of capital assets		(20)	(155)
Changes in assets and liabilities:			
Increase in materials and supplies		(520)	(461)
Increase in accounts receivable		(2,664)	—
Increase in prepaid expenses and other assets		(4,063)	(655)
Increase (decrease) in accounts payable and accrued liabilities		(3,362)	4,762
Increase (decrease) in over recovery of vehicle and equipment allocated costs		(2,418)	1,509
Increase in payroll liabilities		975	1,104
Increase (decrease) in environmental reserve		(196)	1,988
Increase in accrued postretirement and pension benefits		2,149	2,148
Total adjustments		(1,951)	16,747
Net cash provided by operating activities	$	8,158	28,860
Supplemental disclosure of noncash activity:			
Depreciation included in real estate activity	$	3,261	3,933
Reduction (additional) minimum pension liability recognized		(2,340)	3,252

See accompanying notes to basic financial statements.

(1) Organization and Operations

The United States Congress authorized construction of the Alaska Railroad (ARR) 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 ARR to the State of Alaska was authorized under the Alaska Railroad Transfer Act of 1982, which was signed into law on January 14, 1983. The State of Alaska legislature created the Alaska Railroad Corporation (ARRC), a component unit of the State of Alaska, 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.

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

(2) Summary of Significant Accounting Policies

In preparing the financial statements in accordance with accounting principles generally accepted in the United States of America, management is required to make a number of estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities as of the date of the financial statements and revenue and expenses for the reporting period. Actual results could differ from these estimates. The more significant accounting and reporting policies and estimates applied in the preparation of the accompanying financial statements are discussed below.

(a) Basis of Accounting

As a component unit of the State of Alaska and for the purpose of preparing financial statements in accordance with accounting principles generally accepted in the United States of America, the ARRC is subject to the accounting requirements as set forth by the Governmental Accounting Standards Board (GASB).

The ARRC is an enterprise fund of the State of Alaska. Accordingly, the financial activities of the ARRC are reported using the economic resources measurement focus and the accrual basis of accounting, whereby revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

The ARRC has elected to apply all applicable private-sector standards of accounting and financial reporting issued by the Financial Accounting Standards Board (FASB) that do not conflict with or contradict GASB pronouncements, under the option allowed by GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting.*

The ARRC is subject to the jurisdiction of the Surface Transportation Board (STB) and the ARRC's rates for services are established by the board of directors and designed to recover the cost of providing the service. Accordingly, the ARRC has implemented the provisions of FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation.*

The ARRC's board of directors has adopted a resolution requiring a measure of net income in the statement of revenues, expenses and changes in fund equity. This statement replaces the previously reported statement of income. The ARRC's board of directors has also adopted a resolution restricting fund equity for reinvestment in infrastructure.

(b) *Cash and Cash Equivalents*

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.

(c) *Materials and Supplies*

Materials and supplies inventories are carried at the lower of average cost or market. Road materials and supplies include rail, ties, ballast, and other track materials. These items will generally be capitalized when placed into service, and accordingly are included in operating property and equipment.

(d) *Capital Assets*

Capital assets are stated at cost. Costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized. Depreciation and amortization is computed on the straight-line basis over the estimated useful lives of the related assets, ranging from 3 to 32 years.

(e) *Restricted Assets and Investments*

The ARRC's marketable equity and debt securities are reported at fair value on the balance sheet. Unrealized gains and losses are reported as a component of investment income. Fair values are based on quoted market prices.

(f) *Regulatory Liabilities*

The ARRC's rates for services are established by the board of directors and are designed to recover the cost of providing the service. For purposes of establishing rates, the ARRC defers the recognition of grant revenues relating to capital assets funded with federal grants, and amortizes the deferred amounts over the life of the related capital assets. Additionally, costs relating to pension and postretirement benefits are calculated in accordance with FASB Statements No. 87, *Employers' Accounting for Pensions*, and No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. Accordingly, the ARRC has recorded regulatory liabilities in the aggregate amount of $310,278,000 and $255,509,000 at December 31, 2004 and 2003, respectively. Regulatory liabilities at December 31, 2004 and 2003 include $2,340,000 and $0 of additional minimum pension liability, respectively. This additional minimum pension reduction (liability) was included as an other change in fund equity during the years ended December 31, 2004 and 2003.

(g) *Operations*

The ARRC considers all revenues and expenses related to the transportation of freight and passengers, including general and administrative costs, to be operating revenues and expenses. Revenues and expenses associated with leasing and permitting ARRC property are not considered a part of the ARRC's primary operations and are reported as nonoperating activities.

(h) *Grants*

Grants are recognized as earned when all eligibility requirements have been met, however, recognition of revenue for grants expended for capital assets is deferred and recognized over the period in which the asset is depreciated as described in note 2(f). Grant funds received but not yet expended are recorded as advance grant funding.

(i) Income Taxes

As a corporation owned by the State of Alaska, the ARRC is exempt from Federal and State income taxes.

(j) Environmental Remediation Costs

The ARRC accrues for losses associated with environmental remediation obligations when such losses are probable and reasonably estimable. Costs of future expenditures for environmental remediation liabilities are not discounted to their present value.

(k) Vehicle and Equipment Allocated Costs

The ARRC's vehicle and equipment costs for maintenance, fuel, depreciation, and leases are recorded in the vehicle and equipment cost pool. These costs are recovered through various responsibility centers through a fixed charge rate based on usage of vehicles and equipment. Any over or under recovery of actual vehicle and equipment costs is applied against fixed charge rates in subsequent years. Accordingly, the ARRC has recorded an under recovery of $909,000 at December 31, 2004, and an over recovery of $1,509,000 at December 31, 2003.

(l) Fair Value of Financial Instruments

Fair values of financial instruments, as defined under FASB Statement No. 107, *Disclosures About Fair Value of Financial Instruments*, are estimated by the ARRC's management. Fair values of restricted assets and investments are based on quoted market prices. Fair values for accounts receivable are estimated using cash flows in comparison to assets with similar estimated average lives but bearing current market interest rates. Fair values of long-term debt are based on the discounted value of contractual cash flows and interest rates being offered for similar debt. The fair values of financial instruments do not differ significantly from their carrying amounts.

(m) Reclassifications

Certain reclassifications not affecting net income have been made to the 2003 financial statements to conform with current presentation.

(3) Deposits and Investments

At December 31, 2004, the ARRC's carrying amount of cash and cash equivalents was $10,222,000 and the bank balance was $14,189,000. Of the bank balance, $100,000 was covered by federal depository insurance; $4,715,000 was collateralized with securities held by the pledging financial institution's trust department or agent, but not in the ARRC's name; $226,000 was uncollateralized; and $9,148,000 represents money market funds held by the ARRC's agent in the ARRC's name.

At December 31, 2003, the ARRC's carrying amount of cash and cash equivalents was $26,092,000 and the bank balance was $28,953,000. Of the bank balance, $100,000 was covered by federal depository insurance; $5,856,000 was collateralized with securities held by the pledging financial institution's trust department or agent, but not in the ARRC's name; $501,000 was uncollateralized; and $22,496,000 represents money market funds held by the ARRC's agent in the ARRC's name.

All restricted assets and investments are insured or registered, or held by the ARRC's agent in the ARRC's name. The ARRC's investment policy allows for investments in U.S. Treasury and Agency obligations, state and local government obligations, corporate bonds, certificates of deposit, bankers acceptances, commercial paper, asset backed securities, and money market funds.

(a) ***Restricted Assets***

The market value of restricted assets consists of the following at December 31, 2004 and 2003 (in thousands):

Description of security		2004	2003
Money market accounts	$	1,909	10,652
Equity mutual funds		920	831
Total	$	2,829	11,483

These investments are restricted by the terms of grant or other agreements or by the ARRC's board of directors and are summarized as follows at December 31, 2004 and 2003 (in thousands):

Description of restriction		2004	2003
Capital assets as authorized by the State of Alaska	$	477	570
Capital assets as authorized by the Department of Natural Resources		192	265
Advance grant funding, Taxpayer Relief Act		550	3,231
Advance grant funding, other federal grants		644	776
Postretirement benefits		920	831
Locomotive purchase		46	5,810
Total	$	2,829	11,483

During 2004, the ARRC's board of directors restricted $13,750,000 of fund equity for reinvestment in infrastructure.

The ARRC received $9,000,000 from the State of Alaska in 1990 for the purchase of locomotives and coal hopper cars for the Wishbone Hill Coal project. An agreement reached in 2000 reduced the amount to $5,489,000 authorized for the purchase of equipment. Interest earned on these funds is remitted to the State of Alaska. The unspent balance and interest thereon is reported as restricted assets and State of Alaska advances.

The ARRC also received funding in 1990 from the State of Alaska Department of Natural Resources. These funds are being managed by the ARRC in anticipation of future capital projects. If no capital projects are undertaken, the funds, including accrued interest, will be returned to the Department of

Natural Resources. The unspent balance and interest thereon is reported as restricted assets and State of Alaska advances.

As part of the 1997 Taxpayer Relief Act passed by the U.S. Congress, states without Amtrak service are due a benefit in lieu of the tax benefits received through Amtrak subsidies over the years. The ARRC received Alaska's $23,230,000 share of this benefit. The amount received, along with investment income earned thereon, is required to be spent on passenger service improvements or capital expenses related to State owned rail operations. The unspent portion of the amount received and related investment income is reported as advance grant funding (note 8).

ARRC has received grants from various federal agencies. The amounts received in excess of the amounts spent on the grant programs are reported as advance grant funding (note 8).

The ARRC's board of directors has restricted investments in anticipation of funding future postretirement benefits (note 7).

The ARRC's board of directors has restricted cash for the purchase of locomotives.

(4) Capital Assets

During 2002 the ARRC received approval of their indirect cost rate agreement from their federal cognizant agency. This agreement allows ARRC to allocate certain general and administrative expenses to grant projects. Indirect costs allocated to capital projects under this agreement totaled $1,219,000 and $1,459,000 during the years ended December 31, 2004 and 2003, respectively.

The following summarizes activity in the capital assets accounts during the years ended December 31, 2004 and 2003 (in thousands):

	Balance at December 31, 2003	Additions	Reclassifications	Reductions	Balance at December 31, 2004
Capital assets not being depreciated:					
Land	$ 18,991	—	596	—	19,587
Road materials and supplies	3,724	6,473	—	—	10,197
Construction in progress	122,260	95,820	(61,154)	—	156,926
Total capital assets not being depreciated	144,975	102,293	(60,558)	—	186,710
Capital assets being depreciated:					
Road and roadway structures	228,231	—	29,252	(54)	257,429
Equipment	127,703	—	31,306	(9)	159,000
Leasehold improvements	1,848	—	—	—	1,848
Total capital assets being depreciated	357,782	—	60,558	(63)	418,277
Less accumulated depreciation for:					
Road and roadway structures	67,249	12,485	(53)	(12)	79,669
Equipment	56,397	9,123	53	—	65,573
Leasehold improvements	319	136	—	—	455
Total accumulated depreciation	123,965	21,744	—	(12)	145,697
Capital assets being depreciated, net	233,817	(21,744)	60,558	(51)	272,580
Net capital assets	$ 378,792	80,549	—	(51)	459,290

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	Balance at December 31, 2002	Additions	Reclassifications	Reductions	Balance at December 31, 2003
Capital assets not being depreciated:					
Land	$ 17,644	—	1,347	—	18,991
Road materials and supplies	3,491	233	—	—	3,724
Construction in progress	154,573	81,166	(113,479)	—	122,260
Total capital assets not being depreciated	175,708	81,399	(112,132)	—	144,975
Capital assets being depreciated:					
Road and roadway structures	134,000	—	94,244	(13)	228,231
Equipment	110,050	—	17,888	(235)	127,703
Leasehold improvements	1,848	—	—	—	1,848
Total capital assets being depreciated	245,898	—	112,132	(248)	357,782
Less accumulated depreciation for:					
Road and roadway structures	53,607	13,646	—	(4)	67,249
Equipment	47,767	8,684	—	(54)	56,397
Leasehold improvements	180	139	—	—	319
Total accumulated depreciation	101,554	22,469	—	(58)	123,965
Capital assets being depreciated, net	144,344	(22,469)	112,132	(190)	233,817
Net capital assets	$ 320,052	58,930	—	(190)	378,792

Depreciation expense was charged to the following departments during the years ending December 31 (in thousands):

	2004		2003	
	Grant Funded Depreciation	Non-Grant Funded Depreciation	Grant Funded Depreciation	Non-Grant Funded Depreciation
Transportation	$ 400	41	1,078	63
Passenger services	1,159	437	888	319
Markets, sales, and service	94	587	94	596
Passenger operations	139	6	—	73
Mechanical	1,276	2,482	1,046	2,166
Maintenance	4,421	6,182	5,655	5,574
Engineering and signals	207	808	114	491
Health, safety and environment	—	86	—	57
General and administrative	9	149	9	174
Real estate	2,610	651	3,145	927
	$ 10,315	11,429	12,029	10,440

Fund equity invested in capital assets, net of related debt and deferred grant revenue, is as follows at December 31, 2004 and 2003 (in thousands):

	2004	2003
Net capital assets	$ 459,290	378,792
Long-term debt (note 6)	(30,496)	(20,050)
Deferred grant revenue (note 8)	(292,294)	(242,014)
	$ 136,500	116,728

(5) Long-Term Liabilities

Long-term liability activity is summarized as follows during the years ended December 31, 2004 and 2003 (in thousands):

	Balance at December 31, 2003	Additions	Reductions	Balance at December 31, 2004	Due within one year
Long-term debt	$ 20,050	13,300	(2,854)	30,496	3,050
Environmental remediation reserve	6,291	400	(2,008)	4,683	2,312
State of Alaska advances	830	3	(168)	665	—
Regulatory liabilities:					
Accrued postretirement and pension benefits	13,495	4,489	—	17,984	—
Deferred grant revenue	242,014	60,595	(10,315)	292,294	—
Total long-term liabilities	$ 282,680	78,787	(15,345)	346,122	5,362

	Balance at December 31, 2002	Additions	Reductions	Balance at December 31, 2003	Due within one year
Long-term debt	$ 18,581	4,009	(2,540)	20,050	2,176
Environmental remediation reserve	1,314	4,977	—	6,291	3,724
Advance grant funding	4,782	57,321	(62,103)	—	—
State of Alaska advances	941	—	(111)	830	—
Regulatory liabilities:					
Accrued postretirement and pension benefits	14,599	3,070	(4,174)	13,495	—
Deferred grant revenue	191,468	62,575	(12,029)	242,014	—
Total long-term liabilities	$ 231,685	131,952	(80,957)	282,680	5,900

(6) Long-Term Debt

Long-term debt at December 31, 2004 and 2003 consists of the following (in thousands):

		2004	2003
Note payable, secured by equipment, due in monthly payments of $156,934, including interest at 3.79%, matures March 2014.	$	14,579	15,954
Note payable, secured by equipment, due in monthly payments of $97,249, including interest at 3.83%, matures March 2019.		12,800	—
Note payable, secured by equipment, due in monthly payments of $44,226, including interest at 2.55%, matures July 2008.		1,816	2,293
Note payable, secured by equipment, due in monthly payments of $27,557, including interest at 3.35%, matures April 2008.		1,042	1,332
Note payable, secured by vehicles and equipment, due in monthly payments of $18,415, including variable interest at 56% of prime rate, adjusted monthly, matures April 2006.		259	471
		30,496	20,050
Less current portion		3,050	2,176
	$	27,446	17,874

Annual payments on debt are scheduled as follows at December 31, 2004 (in thousands):

		Principal	Interest
Year ending December 31:			
2005	$	3,050	1,083
2006		2,978	977
2007		3,041	871
2008		2,705	764
2009		2,378	672
2010 – 2014		11,774	1,930
2015 - 2019		4,570	389
	$	30,496	6,686

The ARRC has arrangements for three short-term unsecured lines of credit. The general purpose line of credit allows borrowing up to $10,000,000 at a rate of 55% of the prime rate of a major bank. The self-insurance line of credit allows borrowing up to $10,000,000 at a rate of 55% of the prime rate of a major bank. The nonrevolving equipment line of credit allows borrowing up to $5,000,000, limited to $1,000,000 annually, at a rate of 56% of the prime rate of a major bank. None of the lines of credit had an outstanding balance as of December 31, 2004 or 2003.

Chapter 71, SLA 2003 authorized the ARRC to issue up to $17,000,000,000 in revenue bonds to finance the construction of a natural gas pipeline and related facilities, subject to an agreement with a third party to pay the debt service and other costs of the bonds. To date, no bonds have been issued.

Chapter 46, SLA 2004 authorized the ARRC to issue up to $500,000,000 in revenue bonds, subject to an agreement with a third party to pay the debt service and other related bond costs, to finance the cost of extending its rail line to Fort Greely, Alaska. To date, no bonds have been issued.

(7) Employee Benefits

Accrued benefits under employee benefit plans are calculated under the provisions of FASB Statement No. 87, *Employers' Accounting for Pensions*, and FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, and are reported as regulatory liabilities in the balance sheets. Periodic benefit costs related to these plans are included in operating expenses. The change in the minimum pension liability is reported as an other change in fund equity, decreasing fund equity $2,340,000 during 2004 and increasing fund equity $3,252,000 during 2003.

(a) Defined Benefit Plan

The ARRC has a defined benefit pension plan (Plan) covering all regular represented and nonrepresented employees who are not covered by the Civil Service Retirement System. Benefits under this Plan are based upon the employee's years of service and final average compensation. The ARRC's funding policy is to contribute each year an amount equal to the net periodic pension cost. Employees contribute an amount equal to 9% of compensation. Contributions are made continuously throughout the year. Plan assets are comprised of fixed income securities and common stocks.

The following table sets forth the Plan's funded status at December 31 (in thousands):

		2004	2003
Change in benefit obligation:			
Benefit obligation at beginning of year	$	44,757	37,541
Service cost		2,196	1,792
Interest cost		2,885	2,471
Participant contributions		2,946	2,728
Actuarial (gain) loss		4,711	1,236
Benefits paid		(1,042)	(1,011)
Benefit obligation at end of year		56,453	44,757
Change in plan assets:			
Fair value of plan assets at beginning of year		43,568	32,236
Actual return on plan assets		4,280	7,978
Employer contributions		1,533	1,637
Participant contributions		2,946	2,728
Benefits paid		(1,042)	(1,011)
Fair value of plan assets at end of year		51,285	43,568
Funded status		(5,168)	(1,189)
Unrecognized net actuarial loss		4,550	495
Unrecognized prior service cost		618	694
Other change in fund equity:			
Adjustment to recognize minimum liability		(2,340)	—
Accrued benefit cost	$	(2,340)	—

The following table sets forth the Plan's weighted average assumptions used in determining the actuarial present value of the projected benefit obligation at December 31:

	2004	2003
Discount rate	6.00%	6.50%
Expected return on plan assets	8.00%	8.00%
Rate of compensation increase	4.00%	4.00%

Components of net pension costs are as follows (in thousands):

		2004	2003
Service cost	$	2,196	1,792
Interest cost		2,885	2,471
Expected return on plan assets		(3,623)	(2,719)
Amortization of prior service costs		75	75
Recognized net actuarial gain		—	18
Net periodic benefit cost	$	1,533	1,637

(b) Postretirement Benefits Other Than Pension

The ARRC sponsors a defined benefit health care plan (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. ARRC's policy is to pre-fund the cost of medical benefits in amounts determined at the discretion of management. At December 31, 2004 and 2003, the ARRC has designated assets with a market value of $920,000 and $831,000, respectively, for the funding of these benefits (note 3).

The ARRC accounts for postretirement health care by accruing these benefits over the period in which active employees become eligible for such postretirement benefits. The following table sets forth the Plan's funded status at December 31 (in thousands):

		2004	2003
Change in benefit obligation:			
Benefit obligation at beginning of year	$	14,092	14,299
Service cost		1,720	1,709
Interest cost		774	751
Actuarial (gain) loss		(514)	(2,380)
Benefits paid		(306)	(287)
Benefit obligation at end of year	$	15,766	14,092
Funded status	$	(15,766)	(14,092)
Unamortized prior service costs		(138)	(166)
Unrecognized net actuarial loss		260	763
Accrued benefit cost	$	(15,644)	(13,495)

The components of net periodic cost for these postretirement benefits are as follows (in thousands):

		2004	2003
Service costs	$	1,720	1,709
Interest costs		774	751
Recognized prior service costs		(27)	(27)
Recognized net actuarial gains		(11)	—
Net periodic cost	$	2,456	2,433

For measuring the 2004 expected postretirement benefit obligation, a 8.8% annual rate of increase in the per capita claims cost was utilized. This rate was assumed to decrease by 1.1% per year over a 3-year period to an ultimate rate of 5.50% in 2007.

For measuring the 2003 expected postretirement benefit obligation, a 9.9% annual rate of increase in the per capita claims cost was utilized. This rate was assumed to decrease by 1.1% per year over a 3-year period to an ultimate rate of 5.50% in 2007.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects (in thousands):

		2004		2003	
		One percentage point increase	One percentage point decrease	One percentage point increase	One percentage point decrease
Effect on total service and interest cost components	$	806	(594)	746	(552)
Effect on postretirement benefit obligation		4,263	(3,194)	3,746	(2,819)

(c) *Civil Service Retirement System*

Federal employees who transferred to the ARRC continue to participate in the Civil Service Retirement System (CSRS), a multi-employer defined benefit plan. ARRC is required to contribute 7% of the transferred employees' base pay. Benefit expense related to CSRS was $474,000 and $495,000 for the years ended December 31, 2004 and 2003, respectively.

(d) Defined Contribution Plan

The ARRC sponsors a defined contribution plan (Plan) under section 401(k) of the IRS Code for employees. All regular employees are eligible to contribute to the Plan. Under the terms of certain collective bargaining agreements, representing 46% of employees, the ARRC will match a portion of employee contributions. The maximum amount of matching required under the agreements is 66% of employee contributions for the first 9% of salary. Benefit expense related to the Plan was $331,800 and $78,000 for the years ended December 31, 2004 and 2003, respectively.

During 2004, the ARRC implemented a Section 457 deferred compensation plan under section 457(b) of the IRS Code for non-represented employees.

(8) Grants

The ARRC has spent grant funding on a variety of operating property and equipment. Generally, grant revenue will be recognized equal to depreciation on these assets each year. The original cost of assets constructed with grant funding as of December 31 consists of the following (in thousands):

		2004	2003
Road and roadway structures	15 – 32 year life	$ 140,075	116,759
Equipment	5 – 25 year life	36,964	33,482
Construction in process		147,452	111,006
		$ 324,491	261,247

Deferred grant revenue consists of grant funding received in advance (receivable from grantor). Deferred items relating to grants consist of the net book value of assets constructed with grant funding. Deferred grant balances as of December 31 consist of the following (in thousands):

	2004		2003	
	Advance grant funding (receivable)	Deferred grant revenue	Advance grant funding (receivable)	Deferred grant revenue
Federal Railroad Administration:				
Net book value of assets constructed	$ —	101,664	—	93,875
Construction in process	—	89,257	—	68,412
Grant funding received in advance	—	—	—	—
Amount receivable from grantor	(6,584)	—	(1,659)	—
Taxpayer Relief Act:				
Net book value of assets purchased and constructed	—	13,475	—	12,307
Construction in process	—	9,407	—	8,921
Nondepreciable asset	—	(1,303)	—	(1,303)
Grant funding received in advance	—	—	—	—
Investment earnings on funding	278	—	2,895	—
Federal Transit Administration:				
Net book value of assets purchased and constructed	—	23,578	—	17,187
Construction in process	—	46,550	—	33,716
Amount receivable from grantor	(10,224)	—	(5,834)	—
Federal Emergency Management Agency:				
Net book value of assets constructed	—	1,430	—	—
Construction in process	—	257	—	1,566
Amount receivable from grantor	(315)	—	(1,556)	—
Department of Interior:				
Grant funding received in advance	593	—	775	—
Accrued derailment expense (note 14)	(593)	—	(775)	—
Department of Agriculture:				
Net book value of assets constructed	—	1,127	—	1,300
Construction in process	—	—	—	—
U.S. Fish and Wildlife:				
Construction in process	—	180	—	—
Amount receivable from grantor	(180)	—	—	—
Department of Homeland Security:				
Net book value of assets constructed	—	437	—	—
State of Alaska Wishbone Hill Coal Project:				
Net book value of assets purchased	—	4,333	—	4,591
Construction in process	—	1,378	—	1,260
Amount receivable from grantor	(28)	—	(8)	—
Municipality of Anchorage Ship Creek Economic Development:				
Net book value of assets constructed	(107)	174	—	182
Alaska State Fair:				
Construction in process	—	298	—	—
State of Alaska Other:				
Net book value of asssets constructed	—	5	—	—
Construction in process	—	47	—	—
	$ (17,160)	292,294	(6,162)	242,014

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The ARRC recognized the following grant revenue during the years ended December 31 (in thousands):

		2004	2003
Federal Railroad Administration:			
Depreciation on assets constructed	$	6,553	9,034
Taxpayer Relief Act:			
Depreciation on assets purchased and constructed		984	1,245
Grant funded project planning expense		—	1,303
Federal Transit Administration:			
Depreciation on assets purchased and constructed		2,213	1,139
Grant funded maintenance expense		4,700	4,422
Federal Emergency Management Agency:			
Depreciation on assets constructed		126	9
Grant funded disaster recovery expense		82	1
Department of Agriculture:			
Depreciation on assets constructed		172	321
Grant funded project expense		—	55
Department of Interior:			
Grant funding of accrued derailment expense (note 14)		182	249
Derailment expense paid in current year		(182)	(249)
Municipality of Anchorage Ship Creek Economic Development:			
Depreciation on assets constructed		10	10
State of Alaska Wishbone Hill Coal Project:			
Depreciation on assets purchased		257	271
		15,097	17,810
Less grant revenue included in real estate nonoperating revenues		(2,609)	(3,145)
	$	12,488	14,665

(9) Fund Equity

Fund equity consists of the following major items as of December 31 (in thousands):

	Investment by the State of Alaska	Cumulative net income	Cumulative other changes in fund equity	Total fund equity
Balance at December 31, 2002	$ 34,174	88,505	(3,252)	119,427
Net income	—	14,534	—	14,534
Other changes in fund equity	—	—	3,252	3,252
Total changes in fund equity				17,786
Balance at December 31, 2003	34,174	103,039	—	137,213
Net income	—	15,377	—	15,377
Other changes in fund equity	—	—	(2,340)	(2,340)
Total changes in fund equity				13,037
Balance at December 31, 2004	$ 34,174	118,416	(2,340)	150,250

(10) Major Customer

One ARRC customer accounted for 48% of freight revenue in 2004 and 2003.

(11) Land

The ARRC leases a significant portion of its land to various parties under long-term agreements. Rental income on these leases, which is included in Real Estate income, was $9,093,000 and $8,557,000 in 2004 and 2003, respectively. The following table summarizes future minimum lease payments as of December 31, 2004 (in thousands):

	Amount
Year ending December 31:	
2005	$ 8,075
2006	7,981
2007	7,683
2008	7,555
2009	7,423
Thereafter	150,894
	$ 189,611

The ARRC has $1,393,000 in rent credits outstanding on these leases at December 31, 2004. The assets provided by tenants in exchange for the rent credits are included in property and equipment and are depreciated over their useful lives. The balance of the rent credits is included in unearned revenue.

(12) Operating Leases and Agreements

The ARRC leases its headquarters, certain operating equipment, and barge services under operating leases and agreements. Payments under the leases and agreements totaled $11,330,000 and $11,855,000 in 2004 and 2003, respectively. Future minimum lease payments as of December 31, 2004 are summarized as follows (in thousands):

		Amount
Year ending December 31:		
2005	$	11,623
2006		11,298
2007		10,694
2008		10,404
2009		10,393
Thereafter		13,089
	$	67,501

(13) Insurance

The ARRC is self-insured to certain limits for employee health benefits, personal injury, property and casualty damage claims and establishes reserves for the estimated losses of such claims. The ARRC is also self-insured against workers' compensation claims. The ARRC carries commercial insurance policies limiting ARRC's exposure for health benefits to $6.3 million, for casualty/liability to $50 million and for property to $65 million at December 31, 2004. Self-insurance activity is summarized as follows during the years ended December 31, 2004 and 2003 (in thousands):

		Balance at December 31, 2003	Incurred claims	Claim payments	Balance at December 31, 2004
Employee health benefits	$	1,275	4,585	(4,522)	1,338
Casualty and liability		3,180	866	(1,592)	2,454
Workers' compensation		1,022	1,261	(1,280)	1,003
	$	5,477	6,712	(7,394)	4,795

		Balance at December 31, 2002	Incurred claims	Claim payments	Balance at December 31, 2003
Employee health benefits	$	1,322	4,064	(4,111)	1,275
Casualty and liability		1,389	2,523	(732)	3,180
Workers' compensation		782	1,778	(1,538)	1,022
	$	3,493	8,365	(6,381)	5,477

(14) Commitments and Contingencies

During 2004, the ARRC commenced investigation of the nature and extent of certain environmental conditions at the Anchorage Terminal Reserve (the Site), which includes the Anchorage rail yard and properties the ARRC owns and leases to third parties. The work is being done under a consent order negotiated with the U.S. EPA. Management has accrued a reasonable estimate of its obligations, as the current owner of the Site, for the activities required under the order. However, it is not possible at this time to reasonably estimate the ARRC's ultimate liability associated with the Site because the extent of environmental impacts attributable to the ARRC, the allocation of liability to other potentially responsible parties, the potential cleanup alternatives and the concurrence of regulatory authorities have not yet advanced to the stage where reasonable estimates of liability can be made. The ARRC management believes most, if not all, contamination would have occurred prior to the transfer of the ARRC from the federal government to the State of Alaska or as a result of actions by third party tenants. If this is the case, the liability for contamination that occurred prior to the transfer ultimately may be imposed on the federal government under terms of the transfer act (as originally enacted and as recently amended) and a 1990 agreement between the federal government and the ARRC. The ARRC also will seek cost recovery and contribution from third-party former and current tenants for contamination as a result of their actions on leased portions of the Site. The eventual disposition of such cost-recovery and contribution claims and the ultimate realization of any judgments or allocations awards, however, cannot be predicted with certainty at this time. If other responsible parties do not contribute or pay their fair share of the liability, or if remedial requirements are more stringent than currently anticipated, the ARRC will revise its estimate. It is the opinion of ARRC's management that the ultimate outcome will not have a material adverse impact on the ARRC's financial position, but may have significant impact on the change in fund equity in a given year.

During 1999, a derailment at Gold Creek resulted in fuel spills along the ARRC tracks. The ARRC is responsible for the remediation, restoration and monitoring of environmental contamination at this site. The ARRC has accrued its best estimate of its remaining obligation with respect to the site, which were $593,000 and $775,000 at December 31, 2004 and 2003, respectively. The amount expected to be paid within the next year, $91,000 and $490,000 at December 31, 2004 and 2003, respectively, is included in accounts payable and accrued liabilities. The remaining amount is expected to be incurred through 2020 and is reported as environmental remediation reserve. ARRC received grants to cover the costs associated with the Gold Creek derailment and the 1999/2000 winter storm disaster. The grants are expected to cover ARRC's remaining obligation. The aggregate undiscounted amount has been recorded since it represents management's best estimate of the cost, but the payments are not considered to be fixed and reliably determinable. The estimate of costs and their timing of payment could change as a result of changes to the remediation plan, changes in technology available to treat the site and unforeseen circumstances existing at the site. It is not possible to estimate the amount losses may exceed amounts accrued at this time as a result of these factors.

Approximately 73% of the ARRC's labor force is subject to one of five collective bargaining agreements. None of these agreements is currently being renegotiated.

The ARRC has certain other contingent liabilities resulting from lawsuits, environmental issues, contract disputes and claims incident to the ordinary course of business. Provision has been made in the financial statements for probable losses, if any, from such contingencies. In the opinion of management, the resolution of such contingencies will not have a material effect on the financial position of the ARRC.

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