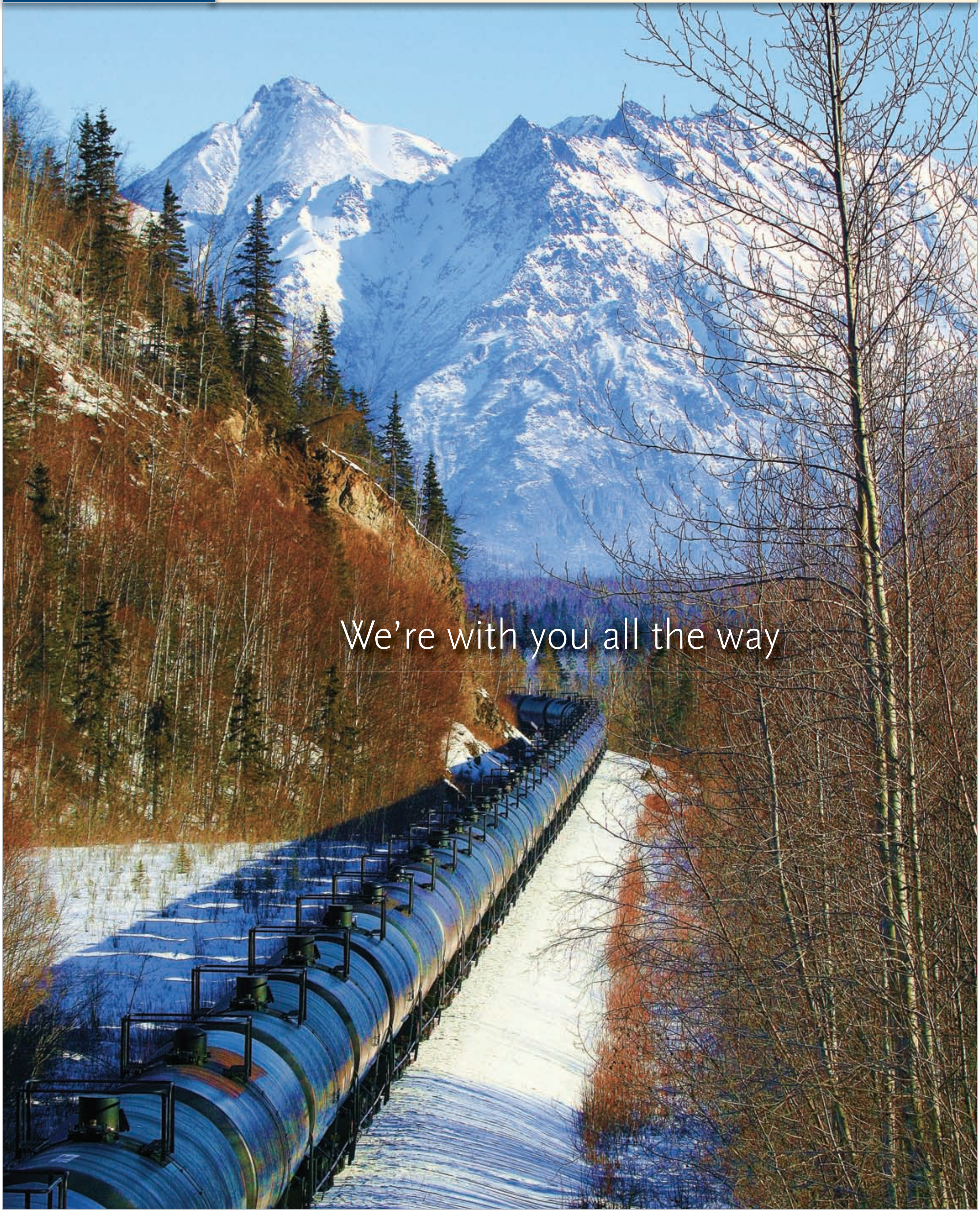
2011 Alaska Railroad Corporation Annual Report



We're with you all the way

2011

Cover photo: A freight train heads south toward Anchorage just after crossing the Knik River Bridge. On its way from Fairbanks loaded with jet fuel from Flint Hills Resources, this train is bound for Ted Stevens Anchorage International Airport. Petroleum products accounted for 29.7 percent of freight revenue in 2011. Photo by Dave Blazejewski.

TABLE OF CONTENTS

2011

Alaska Railroad Corporation Annual Report

We're with you all the way

Since I became chair of the Alaska Railroad Corporation board of directors last year, I have come to appreciate the effort and dedication it takes to keep the Alaska Railroad running. My background in logistics and business strategy gives me a unique perspective on the crucial role that excellent customer service plays in earning and keeping a client's business. The team at the Alaska Railroad works hard to provide that service.

A fresh and energized commitment to customer service was a defining theme in 2011. Whether we're working with our leaseholders, shippers, or passengers, it is important to everyone at the Alaska Railroad that our customers know they are the top priority. A principal addition that epitomizes this philosophy is the company-wide adoption of a new motto: "We're with you all the way." From the moment you contact the Alaska Railroad, your needs will be handled with the utmost attention to quality service, solid value and an understanding of the market and our competition. It's an ethic we're embracing internally to empower every employee to do whatever is required to ensure our customers know how much we value their business.

For example, our Real Estate Department instituted several measures in 2011 to work more productively with Alaska Railroad leaseholders. These included updating long-term lease agreements, investing in lease land to increase its business value, and instituting better communications protocols to keep customers informed and connected. Our efforts boil down to being a better business partner in the economic development of railbelt communities.

The emphasis on customer service throughout the corporation has certainly contributed to an exciting trend in our fiscal performance, and in many cases serving customer needs has advanced economic activity. Assets grew by more than $38.7 million to total $926.9 million by year's end. While 2011's net income of $13.4 million was on par with 2010, the railroad generated $185.7 million in gross revenue, a $13.3 million increase over 2010. The performance in gross revenue is in large part attributable to our freight department's agile and market-savvy response to a decline of some of our legacy lines of business.

Linda Leary

Board Chair

The Alaska Railroad expanded our hopper fleet and employed modern technologies to accommodate growth in our customer's coal exports to world markets. With a competitive approach to service, we met the demand for increased barge-rail (interline) transport of commodities via Lower 48 and Canadian lines of commerce. This included oilfield pipe and supplies for customers seeking to capitalize on oil and gas development opportunities. These diversification efforts enabled the railroad to recover from traditional business-line losses, and then some.

With such truly remarkable gains in operations, service and financial performance, I thoroughly enjoyed my railroad board service this past year. Progress was almost inevitable given the combined expertise of fellow board members Susan Bell, John Binkley, Jack Burton, Jon Cook, Marc Luiken and Bill Sheffield. I thank my colleagues for their unfailing commitment as we worked with our local officials, governor, state legislators and congressional delegation on policy and capital funding issues important to the Alaska Railroad, and to our foremost customers – the people of Alaska.

Continuing as board chair in 2012, I look forward to building on our 2011 accomplishments. In the world of transportation and logistics, seamless service from one mode to the next is essential to meeting customer expectations, and that remains our goal. Our customer service pledge extends to all Alaskans: "We're with YOU all the way."

Respectfully,

Linda Leary

Board of Directors

Linda Leary
Susan Bell
John Binkley
Jack Burton
Jon Cook
Marc Luiken
Bill Sheffield

Management Team

President & CEO
Chris Aadnesen

Engineering & Maintenance
VP Tom Brooks

General Counsel / Legal
VP Bill Hupprich

Real Estate & Facilities
VP Jim Kubitz

Corporate & Gov't Affairs
VP Wendy Lindskoog

CFO / Finance
VP Bill O'Leary

Technology, Info & Telecom
VP Eileen Reilly

Mechanical & Transportation
VP Patrick Shake

Business Development
VP Dale Wade

Board of Directors

Susan Bell

Director

John Binkley

Director

Jack Burton

Director

Jon Cook

Director

Marc Luiken

Director

Bill Sheffield

Vice Chair

Return to Table of Contents

2011

My career in railroading has spanned from Texas to Mexico to Europe and back, and now I find myself in Alaska where one key characteristic truly stands out - teamwork. Working together our team authored a comprehensive strategic plan that guides proactive planning and response to challenges and opportunities for our company. We are focusing on core strategic initiatives that address sound fiscal stewardship, customer and community relations, capital investments and funding, technology advancement, operational safety, and economic development. The plan reflects our corporate mission with an emphasis on safety, profitability and excellent service to our customers, both external and internal.

Our customer service pledge, "We're with you all the way," blended well with our efforts to pull together as a united railroad team in 2011. Of significant note has been our success in completing agreements with three of our five unions and laying the groundwork for agreement on a fourth contract which is still being negotiated. These four unions, the American Train Dispatchers Association (ATDA), Transportation Communications International Union (TCU – carmen/rail car mechanics), the United Transportation Union (UTU – train crews), and the International Brotherhood of Teamsters (IBT – locomotive and heavy equipment mechanics), represent more than a third of our total employees.

Solid performance on many fronts provides important momentum heading into 2012. Strong 2011 financial results are detailed in the accompanying audited financial statements. These statements now show key customer growth and marked improvement in our operational efficiency were able to offset significantly higher fuel costs and tepid market returns.

Though not highlighted in the audit, these operational improvements had tremendous impact on our bottom line. For example, in 2011 we ran fewer, longer freight trains while shipping more freight than in 2010. In railroad parlance this is a hallmark of greater efficiency through reduced fuel cost, wear and tear on equipment and expended crew time.

Our multi-year effort to replace old jointed rail with continuously welded rail (CWR) is nearly complete, enabling trains to move faster across the entire route. Other operational improvements have greatly reduced time lost to unplanned locomotive or track repairs, snow removal and other maintenance issues, enhancing customer service. Our "slow orders" metric, a measure of delays to a train during the course of its journey, has improved for several years, from 22 minutes lost per day in 2009 to just nine minutes per day, on average, in 2011. We're making the trip between Anchorage and Fairbanks in less than 12 hours more often than ever – saving time and money. We did this 47 percent of the time in 2009, and by 2011, we completed 80 percent of these trips in less than 12 hours.

2011 was also marked by continued progress on two major extensions of railroad infrastructure – one on the north end and one in southcentral Alaska. With support from the military and Federal Railroad Administration, the 80-mile Northern Rail Extension

Chris Aadnesen

President/CEO

We're with you all the way

celebrated a 2011 ground-breaking ceremony and fully-funded construction budget for Phase 1, a bridge over the Tanana River. Meanwhile, the partnership with Matanuska-Susitna Borough yielded progress on the 32-mile Port MacKenzie Rail Extension, which began final design, permitting and land acquisition in 2011. Building new infrastructure will help meet current and future customer needs, and underscores our responsibility to promote Alaska's current and future economic well-being. Both projects continue to require close teamwork and effective coordination with local, state, and national policymakers.

While operating and capital improvements are certainly sources of pride, a strong relationship with fellow Alaskans is just as meaningful. It happens each day at almost every level of our organization. We are exceptionally pleased to have received major awards from three organizations recognizing good corporate citizenship. The Anchorage Chamber of Commerce presented the Alaska Railroad with its Gold Pan Award for Community Service by a Large Organization in recognition of our contributions in education, in-kind donations to nonprofits, volunteered expertise and environmental commitment. Green Star, Inc. presented its inaugural Super Nova Award to recognize the Alaska Railroad as one of an elite few businesses that set the standard for environmentally and fiscally sound operations. And, the Alaskans for Litter Prevention and Recycling presented the Alaska Railroad with its Contributor of the Year Award for continued support of backhaul recycling services, particularly for small communities without recycling capabilities.

Anchorage Chamber

Green Star Inc.

ALPAR

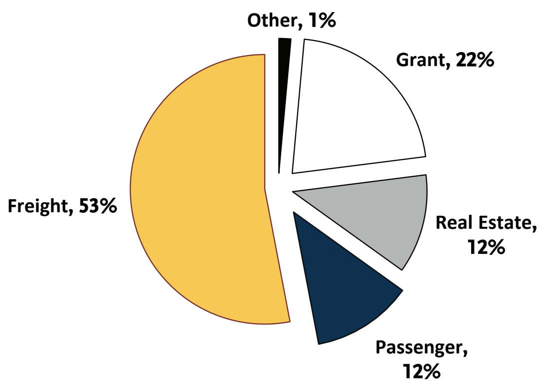
One area of continuing focus is safety. 2011 safety statistics show we took a small step backward when measuring personal injury occurrences. Railroading is not a forgiving business. But I am pleased to report that our injury severity measurement improved. Our strategic safety initiative provides a blueprint to implement department Safety Action Plans. A focused, concentrated effort by each of our employees will help us improve.

Collectively, our 2011 accomplishments provide a strong and positive foundation for future work on our strategic initiatives that will enhance our efficiency and service. We look forward to meeting the challenges of 2012 with the coordinated effort of our community partners, our board of directors and an excellent workforce.

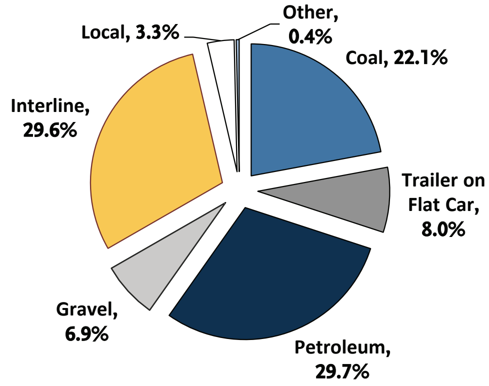
Best regards,

Chris Aadnesen

2011 Revenue



2011 Freight Revenue

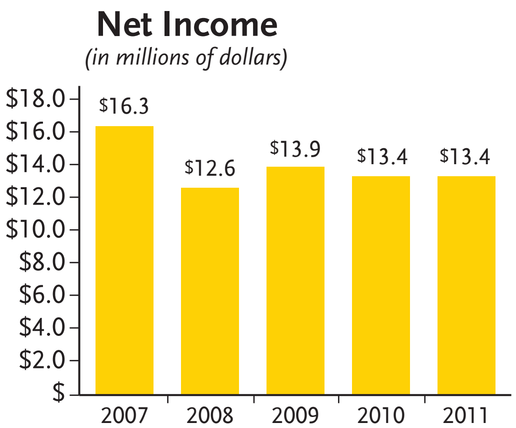


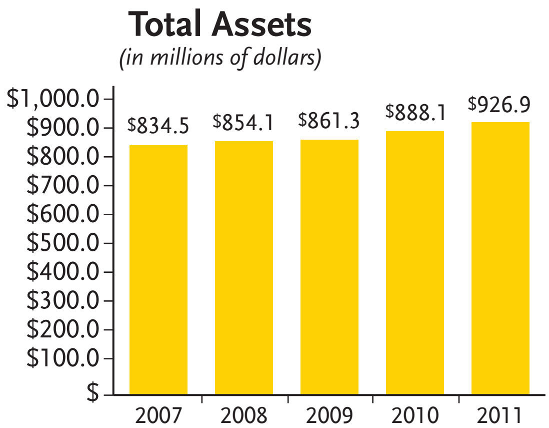
Return to Table of Contents

FINANCIAL HIGHLIGHTS

Earnings (in thousands):	2011	2010
Operating Revenue:		
Freight	$ 98,045	$ 87,019
Passenger	22,382	20,783
Other	1,154	772
Grant	39,892	40,225
Total Operating Revenue	161,473	148,799
Operating Expenses	156,524	143,247
Operating Income	4,949	5,552
Non-operating Revenue (Expenses):		
Net Real Estate Income	8,548	9,378
Gain (Loss) on Sale of Capital Assets	1,391	–
Investment Income	110	78
Interest Expense, Net of Grant Revenue	(1,562)	(1,561)
Net Income	13,436	13,447

Balance Sheet (in thousands):		
Assets:		
Current Assets	$ 111,098	$ 97,910
Non-current Assets	798,121	761,002
Restricted Assets	12,131	27,087
Regulatory Assets	5,486	2,101
Other Assets	18	18
Total Assets	926,854	888,118
Liabilities:		
Current Liabilities	54,645	43,863
Non-current Liabilities	626,949	611,626
Total Liabilities	681,594	655,489
Fund Equity	245,260	232,629
Total Liabilities & Fund Equity	926,854	888,118
Operating Ratio	0.97	0.96





The Alaska Railroad Corporation has not received any bona-fide offers of a sale arrangement within the calendar year of 2011, nor is the Corporation aware of any potential sales that require analysis under AS 42.40.260.

Maintenance of Way head Bruce Gough and his team beat back substantial snow loads each year to keep the tracks clear for Alaska Railroad trains. Photo by Judy Patrick.

The hard work of Maintenance of Way crews contributes to steadily improving metrics related to the amount of time it takes to move trains along the Alaska Railroad route. Since 2009, Alaska Railroad trains have made the trip from Anchorage to Fairbanks in under 12 hours more frequently than ever, from 47 percent of the time in 2009 to 80 percent in 2011. Photo by Judy Patrick.

Trailer on Flat Car business, featured in this photo by Judy Patrick, accounted for 8 percent of the Alaska Railroad's 2011 freight revenue.

Return to Table of Contents

March 28, 2012

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, 2011.

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

Return to Table of Contents

December 31, 2011 and 2010

This section of the Alaska Railroad Corporation's (ARRC's) annual financial report presents the discussion and analysis of the ARRC's financial performance during the fiscal years that ended on December 31, 2011 and 2010. Please read it in conjunction with the ARRC's financial statements, which follow this section.

Financial Highlights

- The ARRC's total fund equity increased 5% during the course of this year's operations and increased 9% over the course of 2010 operations.
- During 2011, the ARRC's operating revenues exceeded operating expenses by $5.0 million, yielding an operating ratio of 0.97. Last year, operating revenues exceeded operating expenses by $5.6 million and yielded an operating ratio of 0.96.
- The total 2011 operating costs of the ARRC's programs were $156.5 million, an increase of 9% compared to last year. The total 2010 operating costs of the ARRC's programs were $143.2 million, an increase of 2% compared to 2009.
- Expenditures on capital assets totaled $87.9 million during 2011, an increase of 20% compared to last year. Expenditures on capital assets totaled $73.1 million during 2010, a decrease of 9% compared to 2009.
- Federal grant funding was used for $40.3 million, or 46%, of the 2011 capital expenditures. Federal grant funding was used for $36.3 million, or 50%, of the 2010 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 to the financial statements.

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 consist 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

December 31, 2011 and 2010

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.

- 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 5% between fiscal years 2010 and 2011 to approximately $245.3 million. ARRC's fund equity increased 9% between fiscal years 2009 and 2010 to approximately $232.6 million.

(in thousands)		2011	2010	2009
Assets:				
Current assets	$	111,098	97,910	73,928
Capital assets		798,121	761,002	741,154
Other noncurrent assets		17,635	29,206	46,173
Total assets	$	926,854	888,118	861,255
Liabilities:				
Current liabilities	$	54,645	43,863	40,768
Notes payable outstanding, less current installments		24,328	24,028	24,537
Revenue bonds payable, net of unamortized premiums and deferred amounts		124,426	135,133	145,315
Other liabilities		1,391	1,434	1,484
Payable from restricted assets		99	757	619
Regulatory liabilities:				
Pension		7,107	2,933	6,258
Deferred grant revenue		469,598	447,341	428,501
Total liabilities	$	681,594	655,489	647,482
Fund equity:				
Invested in capital assets, net of related debt	$	175,546	166,416	174,564
Restricted for reinvestment in infrastructure		69,714	66,213	39,209
Total fund equity	$	245,260	232,629	213,773

Capital assets – Capital assets, net of accumulated depreciation increased $37.1 million in 2011 and $19.8 million in 2010. During 2011 and 2010, the ARRC continued an extensive capital improvement plan, including bridge replacements, siding extensions, track refurbishing, straightening of curves, and welding rail to allow faster train speed and reduce wear. Also during this time period, ARRC continued developing a positive train control system, and acquired right of way in anticipation of future rail realignments.

December 31, 2011 and 2010

Long-term debt – Notes payable increased $0.3 million and decreased $0.5 million in 2011 and 2010, respectively. During 2011, ARRC issued a new long-term loan of $4.6 million to partially fund the acquisition of 110 freight cars. During 2010, ARRC refinanced 12 locomotives to provide security interest in a new long-term loan of $2.8 million to fund tenant improvements in Anchorage and fund a property acquisition in Whittier.

Regulatory assets and liabilities – The STB 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 assets and liabilities as required by provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 980, *Regulated Operations*, formerly, FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*.

A description of each of the regulatory assets and liabilities is as follows:

- Deferred grant revenue relates to capital assets funded with federal grants. Deferred grant revenue increased $22.3 million in 2011 and $18.8 million in 2010. This increase reflects the amount of capital assets constructed with grant funding. Generally deferred grant revenue will be recognized as income as the related capital assets are depreciated.
- The postretirement benefits asset increased $3.4 million and the accrued pension benefit liability increased $4.2 million during 2011, due primarily to market performance of the assets invested. The postretirement benefits asset increased $2.1 million and the pension benefit liability increased $745,000 during 2010 primarily due to the change in asset valuation methods and market performance of the assets invested.

Revenue – The ARRC's total revenues increased 8% and totaled $185.7 million in 2011. The ARRC's total revenues increased less than 1% and totaled $172.4 million in 2010. Approximately 53% and 50% of the ARRC's revenue comes from freight revenue during 2011 and 2010, respectively, and 12% and 12% of the revenue comes from passenger services during 2011 and 2010, 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.

Real estate expenses were $11.8 million in 2011, $11.5 million in 2010, and $13.1 million in 2009, an increase of 3% from 2010 to 2011 and a decrease of 12% from 2009 to 2010. The slight increase in real estate expense is due to higher facilities operating costs.

December 31, 2011 and 2010

(in thousands)		2011	2010	2009
Operating revenue:				
Freight	$	98,045	87,019	87,630
Passenger		22,382	20,783	21,455
Other		1,154	772	704
Total transportation revenue		121,581	108,574	109,789
Grant revenue		39,892	40,225	36,515
Total		161,473	148,799	146,304
Operating expense:				
Transportation		47,257	41,591	40,716
Passenger		9,832	9,486	9,606
Business development		18,925	16,916	16,941
Mechanical		22,270	21,432	21,700
Maintenance		34,761	31,553	31,254
Facilities		10,383	9,383	7,453
Engineering services		1,392	1,451	1,129
Signals		3,021	2,856	2,719
General and administrative		8,683	8,579	9,166
Total		156,524	143,247	140,684
Operating income		4,949	5,552	5,620
Nonoperating revenues (expenses):				
Real estate and facilities income, net of expenses		8,548	9,378	9,365
Gain on sale of capital assets		1,391	—	517
Investment income		110	78	115
Interest expense, net of grant revenue		(1,562)	(1,561)	(1,715)
Net income		13,436	13,447	13,902
Other changes in fund equity		(805)	5,409	20,140
Change in fund equity	$	12,631	18,856	34,042

Several events occurred during 2011 that significantly impacted the change in fund equity:

- ARRC's indirect cost rate agreements allowed ARRC to allocate eligible general and administrative expenses to capital projects. A total of $2.1 million was allocated to capital projects during 2011, reducing general and administrative expenses. The overall indirect cost recovery was $50,000 less than 2010.

Return to Table of Contents

December 31, 2011 and 2010

- Total transportation revenue was $12.6 million greater than 2010. The increase in transportation revenue is attributed to fuel surcharges related to increased fuel costs and the global recovery, which impacted freight shipments and passenger services.
- ARRC used $397,000 of federal grant funding to acquire right of way in anticipation of future rail realignments.
- ARRC received $1.3 million from the sale of capital assets for right of way relating to a State of Alaska highway project.
- During 2011, ARRC entered into an agreement with one customer under the Internal Revenue Code (IRC) §45G. Under the agreement, ARRC received $4.8 million for qualified track maintenance expense and gave the customer a shipping credit of $2.7 million.
- ARRC records costs and accrued benefits under its defined benefit and postretirement plans. The other changes in fund equity of $0.8 million represent the change from the prior year in the unfunded actuarial accrued liability of the defined benefit pension and postretirement plans.

Several events occurred during 2010 that significantly impacted the change in fund equity:

- ARRC's indirect cost rate agreements allowed ARRC to allocate eligible general and administrative expenses to capital projects. A total of $2.2 million was allocated to capital projects during 2010, reducing general and administrative expenses. The overall indirect cost recovery was $160,000 less than 2009.
- Total transportation revenue was $1.2 million less than 2009. The decrease in transportation revenue is attributed to the overall global recession, which significantly reduced freight shipments and passenger services.
- ARRC used $472,000 of federal grant funding to acquire right of way in anticipation of future rail realignments.
- During 2010, ARRC entered into an agreement with one customer under the IRC §45G. Under the agreement, ARRC received $4.8 million for qualified track maintenance expense and gave the customer a shipping credit of $2.7 million.
- ARRC records costs and accrued benefits under its defined benefit and postretirement plans. The other changes in fund equity of $5.4 million represent the change from the prior year in the unfunded actuarial accrued liability of the defined benefit pension and postretirement plans.

December 31, 2011 and 2010

Capital Asset and Debt Administration

Capital Assets

At the end of 2011, the ARRC had invested $798.1 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 $37.1 million, or 5%, over last year. Grants have funded $433.1 million of the assets, net of accumulated depreciation.

(in thousands)		2011	2010	2009
Land and improvements	$	29,719	29,288	26,292
Road materials and supplies		7,575	6,684	8,959
Road and roadway structures		566,700	558,876	489,152
Equipment		146,146	146,372	144,017
Leasehold improvements		251	415	542
Quarry improvements		3,675	3,801	3,801
Construction in progress		44,055	15,566	68,391
Total capital assets, net of accumulated depreciation	$	798,121	761,002	741,154

The ARRC's fiscal year 2012 capital budget approved spending another $55.4 million for capital projects, principally for continued track and bridge rehabilitation and other infrastructure improvements. The ARRC intends to use federal grant funding to provide $21.2 million of the capital additions. The remaining capital projects will be funded out of the FTA Capital Receipts Bonds, Series 2007, 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 the end of 2011, the ARRC had $28.4 million in notes payable outstanding, an increase of 4% from 2010, and $135.1 million in revenue bonds payable outstanding, a decrease of 7%. At the end of 2010, the ARRC had $27.3 million in notes payable outstanding, a decrease of less than 1% from 2009, and $145.3 million in revenue bonds payable outstanding, a decrease of 6%. Bond issuance costs from FTA Capital Grants Receipts, Series 2007 of $1.2 million and Series 2006 of $1.4 million are being amortized over the life of the bonds. More detailed information about the ARRC's long-term debt is presented in note 6 to the financial statements.

Bond Rating

In July 2006, Standard & Poor's Ratings Services and Fitch Ratings assigned "A+" and "A" ratings, respectively, to the approximately $76.4 million of Capital Grant Receipts Bonds, Series 2006 (FTA Section 5307 Urbanized Area Formula Funds and Section 5309 Fixed Guideway Modernization Formula Funds). These ratings were used to determine the ARRC's financial strength for the bond issuance insured under a policy issued by Financial Guaranty Insurance Company.

In August 2007, Standard & Poor's Ratings Services, Fitch Ratings, and Moody's Investor Services assigned "A+", "A" and "A1" ratings to the approximately $88.6 million of Capital Grant Receipts Bonds, Series 2007 (FTA Section 5307 Urbanized Area Formula Funds and Section 5309 Fixed Guideway Modernization Formula

December 31, 2011 and 2010

Funds). These ratings were used to determine the ARRC's financial strength for the bond issuance insured under a policy issued by Financial Guaranty Insurance Company.

On April 16, 2010, Moody's Investors Service raised its underlying unenhanced rating assigned to ARRC's Capital Grant Receipts Bonds to "Aa3" as a result of the recalibration by Moody's Investors Service of its municipal rating scale to align it with the scales used by Moody's Investors Service in assessing the creditworthiness of other types of issuers. On September 12, 2011, Moody's Investors Service lowered its underlying unenhanced rating assigned to ARRC's Capital Grant Receipts Bonds to "A1" with a stable outlook as a result of a reassessment of such bonds in comparison with similar bonds to which Federal Transit Administration grants are pledged and the relatively low additional bonds test applicable to ARRC's Capital Grant Receipts Bonds. Moody's Investors Service no longer rates FGIC. On September 30, 2008, FGIC entered into a Reinsurance Agreement with MBIA Insurance Corporation (Reinsurance Agreement) pursuant to which certain of FGIC's policyholders may receive the benefit of MBIA's reinsurance by presenting claims directly to MBIA under their FGIC-issued policies. ARRC's Capital Grant Receipts Bonds are included in the list of bonds covered by the Reinsurance Agreement. Based on the Reinsurance Agreement, Moody's Investors Service assigned an enhanced rating of "Aa3" to ARRC's Capital Grant Receipts Bonds.

Fitch Ratings no longer rates Financial Guaranty Insurance Company and, accordingly, has assigned only an underlying, unenhanced rating to ARRC's Capital Grant Receipts Bonds. Fitch Ratings affirmed an "A" rating and stable outlook on ARRC's Capital Grant Receipts Bonds in September 2010. In March 2011, Fitch Ratings changed the outlook on all grant receipts bonds payable solely from and secured solely by Federal Transit Administration (FTA) formula funds, including ARRC's Capital Grant Receipts Bonds, from stable to negative, citing growing uncertainty in federal transportation policy, less predictable funding levels and a pending expiration of a majority of federal motor fuel taxes. Fitch Ratings affirmed this negative outlook on March 6, 2012. More detailed information about ARRC's bond funded activities is presented in note 6 to the financial statements.

Next Year's Budget

Freight and passenger revenues are budgeted at $105.5 million and $24.9 million, respectively. As a result, the ARRC's fund equity is expected to increase $15.4 million or 6% by the close of 2012.

Contacting the ARRC's Financial Management

This financial report is designed to provide residents of the State of Alaska and 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, 907-265-2300 or visit the website at www.alaskarailroad.com.

KPMG LLP
Suite 600
701 West Eighth Avenue
Anchorage, AK 99501

Independent Auditors' Report

The Board of Directors
Alaska Railroad Corporation:

We have audited the accompanying balance sheets of the Alaska Railroad Corporation (the Corporation), a component unit of the State of Alaska, as of December 31, 2011 and 2010, 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. An audit includes 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 also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 28, 2012 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, 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.

Return to Table of Contents

The management's discussion and analysis on pages 1 through 7 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. 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 28, 2012

BALANCE SHEETS

December 31, 2011 and 2010

(In thousands)

Assets		2011	2010
Current assets:			
Cash and cash equivalents (note 3)	$	48,523	33,488
Accounts receivable, net of allowance for doubtful accounts of $370 in 2011 and $452 in 2010		19,039	21,573
Grants receivable (note 8)		12,184	11,676
Materials and supplies		9,828	9,223
Prepaid expenses and other current assets		1,229	1,064
Under recovery of vehicle and equipment allocated costs (note 2(k))		416	785
Restricted assets (note 3)		19,879	20,101
Total current assets		111,098	97,910
Capital assets (notes 4 and 8):			
Land and improvements and quarry improvements (note 11)		33,833	33,402
Road materials and supplies		7,575	6,684
Road and roadway structures		839,892	797,677
Equipment (note 6)		294,549	279,317
Leasehold improvements (note 11)		1,650	1,650
Accumulated depreciation, depletion and amortization		(423,433)	(373,294)
Construction in progress		44,055	15,566
Total capital assets, net		798,121	761,002
Restricted assets (note 3)		12,131	27,087
Regulatory asset:			
Postretirement benefits (notes 5 and 7)		5,486	2,101
Other assets		18	18
	$	926,854	888,118
Liabilities and Fund Equity			
Current liabilities:			
Current portion of notes payable (notes 5 and 6)	$	4,051	3,309
Accounts payable and accrued liabilities (notes 5, 13, and 16)		21,568	13,184
Current portion of payable from restricted assets (note 5)		936	—
Environmental remediation reserve (notes 5 and 15)		801	1,059
Interest payable		2,672	2,852
Payroll liabilities		10,660	9,563
Unearned revenues (note 11)		3,322	3,701
Current portion of revenue bonds payable (notes 5 and 6)		10,635	10,195
Total current liabilities		54,645	43,863
Notes payable, less current portion (notes 5 and 6)		24,328	24,028
Revenue bonds payable (net of unamortized premiums and deferred amounts), less current portion (notes 5 and 6)		124,426	135,133
Environmental remediation reserve (notes 5 and 15)		1,218	1,257
State of Alaska advances (notes 3, 5, and 8)		173	177
Payable from restricted assets (note 5)		99	757
Regulatory liabilities:			
Accrued pension benefits (notes 5 and 7)		7,107	2,933
Deferred grant revenue (notes 5 and 8)		469,598	447,341
Total liabilities		681,594	655,489
Fund equity (note 9):			
Investment in capital assets, net of related debt and deferred grant revenue (note 4)		175,546	166,416
Restricted for reinvestment in infrastructure (notes 2(a) and 2(l))		69,714	66,213
Total fund equity		245,260	232,629
Commitments and contingencies (notes 5, 7, 10, 12, 13, 15 and 16)			
	$	926,854	888,118

See accompanying notes to financial statements.

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND EQUITY

Years ended December 31, 2011 and 2010

(In thousands)

		2011	2010
Operating revenues:			
Freight (note 10)	$	98,045	87,019
Passenger		22,382	20,783
Other		1,154	772
		121,581	108,574
Grant revenue (note 8)		39,892	40,225
		161,473	148,799
Operating expenses:			
Transportation		47,257	41,591
Passenger		9,832	9,486
Business development		18,925	16,916
Mechanical		22,270	21,432
Maintenance		34,761	31,553
Facilities		10,383	9,383
Engineering services		1,392	1,451
Signals		3,021	2,856
General and administrative, net of indirect cost recovery of $2,123 in 2011 and $2,169 in 2010		8,683	8,579
		156,524	143,247
Operating income		4,949	5,552
Nonoperating revenues (expenses):			
Real estate and facilities income, less direct expenses of $11,817 in 2011 and $11,494 in 2010 (notes 6, 8 and 11)		8,548	9,378
Gain on sale of capital assets		1,391	—
Investment income		110	78
Interest expense, net of grant revenue of $2,361 in 2011 and $2,603 in 2010 (note 8)		(1,562)	(1,561)
Total nonoperating revenues		8,487	7,895
Net income (note 2(a))		13,436	13,447
Other change in fund equity:			
Change in pension and postretirement funding status (note 7)		(805)	5,409
Change in fund equity		12,631	18,856
Fund equity, beginning of year		232,629	213,773
Fund equity, end of year	$	245,260	232,629

See accompanying notes to financial statements.

STATEMENTS OF CASH FLOWS

Years ended December 31, 2011 and 2010

(In thousands)

		2011	2010
Cash flows from operating activities:			
Receipts from customers	$	124,241	106,178
Operating grants received		8,326	7,479
Payments to suppliers		(48,663)	(40,720)
Payments to employees		(58,663)	(56,130)
Net cash provided by operating activities		25,241	16,807
Cash flows from capital and related financing activities:			
Principal payments on long-term debt		(14,001)	(12,846)
Interest payments on long-term debt		(7,504)	(8,328)
Grant received for interest expense		2,201	2,191
Proceeds from long-term debt		4,600	2,800
Purchases and construction of capital assets		(78,570)	(65,041)
Proceeds from sales of capital assets		1,690	31
Increase in deferred revenues, net of advances		53,647	45,454
Net cash used by capital and related financing activities		(37,937)	(35,739)
Cash flows from investing activities:			
Real estate income and related cash flows		19,986	20,423
Real estate direct expenses paid		(8,682)	(7,730)
Purchase of restricted investments		(17,991)	(17,828)
Proceeds from sale of restricted investments		33,448	37,595
Interest received		970	1,693
Net cash provided by investing activities		27,731	34,153
Net increase in cash and cash equivalents		15,035	15,221
Cash and cash equivalents at beginning of year		33,488	18,267
Cash and cash equivalents at end of year	$	48,523	33,488
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	4,949	5,552
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization		48,085	47,223
Bond issuance cost amortization		176	176
Gain on disposal of capital assets		126	—
Grant revenue on capital assets		(31,742)	(32,922)
Changes in operating assets and liabilities:			
Materials and supplies		(605)	452
Accounts receivable		2,534	(2,397)
Prepaid expenses and other assets		(165)	124
Accounts payable and accrued liabilities		911	(676)
Interest payable		(180)	167
Over (under) recovery of vehicle and equipment allocated costs		369	(906)
Payroll liabilities		1,097	68
Environmental reserve		(297)	(37)
Accrued postretirement and pension benefits		(17)	(17)
Total adjustments		20,292	11,255
Net cash provided by operating activities	$	25,241	16,807
Supplemental disclosure of noncash, investing, capital and related financing activity:			
Depreciation included in real estate activity	$	3,135	3,764
Notes payable refinanced		—	13,874
Construction of capital assets using accounts payable		7,473	3,625

See accompanying notes to financial statements.

December 31, 2011 and 2010

(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 685 track 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 follows the provisions of FASB Accounting Standards Codification (ASC) 980, *Regulated Operations*, formerly, FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*.

(Continued)

December 31, 2011 and 2010

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. 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 capital assets.

(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 are computed on the straight-line basis over the estimated useful lives of the related assets, ranging from 3 to 32 years.

(e) Restricted Assets

The ARRC's restricted assets consist of money market accounts, investments in commercial paper, U.S. Treasury notes, and guaranteed investment contracts (GICs). Money market accounts, investments in commercial paper and U.S. Treasury notes are reported at cost. GICs are reported at amortized cost because they cannot be negotiated or transferred to a third party.

(f) Regulatory Assets and 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 depreciable capital assets funded with federal grants, and amortizes the deferred amounts over the life of the related capital assets. Additionally, ARRC records the funded status of its defined pension and postretirement plans as regulatory assets and liabilities.

(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.

(Continued)

December 31, 2011 and 2010

(h) Grants

Grants are recognized as earned when all eligibility requirements have been met; however, recognition of revenue for grants expended for depreciable capital assets is deferred and recognized over the period in which the asset is depreciated as described in note 2(f).

(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, including legal fees, associated with environmental remediation obligations based on obligating events as defined under GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. 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 cost is applied against fixed charge rates in subsequent years. Accordingly, the ARRC has recorded under recoveries of $416,000 and $785,000 as of December 31, 2011 and 2010, respectively.

(l) Equity

As of December 31, 2011 and 2010, the ARRC's board of directors has restricted $69,714,000 and $66,213,000, respectively, of fund equity for reinvestment in infrastructure.

(m) Reclassifications

Certain reclassifications not affecting net income have been made to the 2010 financial statements to conform to the current presentation.

(n) Subsequent Events

The ARRC has evaluated subsequent events from the balance sheet date through March 28, 2012, the date at which the financial statements were available to be issued, and determined there are no other items requiring disclosure.

(Continued)

December 31, 2011 and 2010

(3) Deposits and Investments

The carrying value and maturities of the investments consist of the following at December 31, 2011 and 2010:

(in thousands)

Investment Type	Maturities		2011	2010
Commercial Paper	1/5/2012	$	1,016	1,016
Guaranteed Investment Contract	6/30/2012		10,418	25,313
U.S. Treasury Notes	1/15/2011		—	3,238
	Total investments		11,434	29,567
Money Market			20,576	17,621
	Total	$	32,010	47,188

These investments are restricted by the terms of grant or other agreements or by the ARRC's board of directors and the fair value is summarized as follows at December 31, 2011 and 2010:

(in thousands)

Description of Restriction		2011	2010
Capital assets as authorized by the Department of Natural Resources	$	177	177
Advance grant funding, other federal grants		461	460
Project Fund			
Guaranteed Investment Contract (GIC)		10,418	25,313
Money Market		45	107
Debt Service Reserve			
U.S. Treasury Notes		—	3,238
Money Market		19,879	16,863
Forward Sale Agreement:			
2006A Reserve Account		440	440
2006B Reserve Account		590	590
	$	32,010	47,188

(a) *Custodial Credit Risk*

In the case of deposits, custodial credit is the risk that in the event of a bank failure, the ARRC's deposits may not be returned to it. For an investment, custodial credit risk is a risk that, in the event of the failure of the counterparty, the ARRC will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The ARRC's Investment Policy requires that all investments be collateralized and/or insured.

(Continued)

December 31, 2011 and 2010

At December 31, 2011, the ARRC's carrying amount of cash and cash equivalents was $48,523,000 and the bank balance was $49,347,000. Of the bank balance, $4,079,000 was covered by federal depository insurance, and $45,518,000 represents money market funds held by the ARRC's agent in the ARRC's name.

At December 31, 2010, the ARRC's carrying amount of cash and cash equivalents was $33,488,000 and the bank balance was $34,423,000. Of the bank balance, $5,400,000 was covered by federal depository insurance, and $29,273,000 represents money market funds held by the ARRC's agent in the ARRC's name

(b) Interest Rate Risk

The ARRC's Investment Policy limits investment maturities to five years or less as a means of managing its exposure to fair value losses arising from increasing interest rates. The ARRC uses the specific identification method to report maturities of investments.

(c) Credit Risk

The ARRC's Investment Policy authorizes the ARRC to invest 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.

(d) Concentration of Credit Risk

The ARRC Investment Policy places no limit on the amount the ARRC may invest in any one issuer.

(e) Foreign Currency Risk

Foreign currency risk arises when changes in foreign exchange rates will adversely affect the fair value of an investment. ARRC does not have a policy to limit foreign currency risk associated with investment funds. ARRC does not have exposure to foreign currency risk in its investment funds at December 31, 2011 and 2010.

(4) Capital Assets

During 2002, the ARRC received initial approval from its federal cognizant agency, which was updated in 2005, of its indirect cost rate agreement. In compliance with Federal Transit Authority (FTA) Circular 5010.1C, ARRC will continue to update its indirect cost rate proposal but will retain it onsite and make it available for review during its annual financial audit. This agreement allows ARRC to allocate certain general and administrative expenses to grant projects. Indirect costs allocated to capital projects under this agreement totaled $2,123,000 and $2,169,000 during the years ended December 31, 2011 and 2010, respectively.

(Continued)

December 31, 2011 and 2010

The following tables summarize activity in the capital assets accounts during the years ended December 31, 2011 and 2010:

(in thousands)		Balance at December 31, 2010	Additions	Reductions	Reclasses	Balance at December 31, 2011
Capital assets not being depreciated:						
Land and improvements	$	29,288	433	(2)	—	29,719
Road materials and supplies		6,684	891	—	—	7,575
Construction in progress		15,566	87,873	(59,384)	—	44,055
Total capital assets not being depreciated		51,538	89,197	(59,386)	—	81,349
Capital assets being depreciated:						
Road and roadway structures		797,677	42,215	—	—	839,892
Equipment		279,317	16,736	(1,504)	—	294,549
Leasehold improvements		1,650	—	—	—	1,650
Total capital assets being depreciated		1,078,644	58,951	(1,504)	—	1,136,091
Capital assets being depleted:						
Quarry improvements		4,114	—	—	—	4,114
Less accumulated depreciation for:						
Road and roadway structures		238,801	34,391	—	—	273,192
Equipment		132,945	16,665	(1,207)	—	148,403
Leasehold improvements		1,235	164	—	—	1,399
Total accumulated depreciation		372,981	51,220	(1,207)	—	422,994
Less accumulated depletion for:						
Quarry improvements		313	126	—	—	439
Capital assets being depreciated and depleted, net		709,464	7,605	(297)	—	716,772
Net capital assets	$	761,002	96,802	(59,683)	—	798,121

(Continued)

Return to Table of Contents

December 31, 2011 and 2010

(in thousands)	Balance at December 31, 2009	Additions	Reductions	Reclasses	Balance at December 31, 2010
Capital assets not being depreciated:					
Land and improvements	$ 26,292	2,996	—	—	29,288
Road materials and supplies	8,959	—	(2,275)	—	6,684
Construction in progress	68,391	73,140	(125,965)	—	15,566
Total capital assets not being depreciated	103,642	76,136	(128,240)	—	51,538
Capital assets being depreciated:					
Road and roadway structures	693,482	104,195	—	—	797,677
Equipment	261,091	18,775	(549)	—	279,317
Leasehold improvements	1,650	—	—	—	1,650
Total capital assets being depreciated	956,223	122,970	(549)	—	1,078,644
Capital assets being depleted:					
Quarry improvements	4,114	—	—	—	4,114
Less accumulated depreciation for:					
Road and roadway structures	204,330	34,471	—	—	238,801
Equipment	117,074	16,389	(518)	—	132,945
Leasehold improvements	1,108	127	—	—	1,235
Total accumulated depreciation	322,512	50,987	(518)	—	372,981
Less accumulated depletion for:					
Quarry improvements	313	—	—	—	313
Capital assets being depreciated and depleted, net	637,512	71,983	(31)	—	709,464
Net capital assets	$ 741,154	148,119	(128,271)	—	761,002

(Continued)

December 31, 2011 and 2010

Depreciation was charged to the following departments during the years ending December 31, 2011 and 2010:

(in thousands)	2011		2010	
	Grant Funded Depreciation	Non-Grant Funded Depreciation	Grant Funded Depreciation	Non-Grant Funded Depreciation
Transportation	$ 3,399	838	4,977	739
Passenger	880	537	1,343	526
Business development	118	1,331	118	1,177
Mechanical	3,299	5,607	3,096	5,661
Maintenance	17,639	5,737	15,600	5,597
Facilities	3,529	972	3,207	944
Engineering services	2	18	—	27
Signals	1,079	267	1,078	—
General and administrative	472	2,361	503	2,630
Real estate and facilities	1,325	1,810	2,226	1,538
	$ 31,742	19,478	32,148	18,839

Fund equity invested in capital assets, net of related debt and deferred grant revenue is as follows at December 31, 2011 and 2010:

(in thousands)	2011	2010
Net capital assets (note 4)	$ 798,121	761,002
Notes payable (note 6)	(28,379)	(27,337)
Outstanding balance of revenue bonds, less unexpended bond proceeds (note 6)	(124,598)	(119,908)
Deferred grant revenue (note 8)	(469,598)	(447,341)
	$ 175,546	166,416

(Continued)

Return to Table of Contents

December 31, 2011 and 2010

(5) Long-Term Liabilities

Long-term liability activity is summarized as follows during the years ended December 31, 2011 and 2010:

(in thousands)	Balance at December 31, 2010	Additions	Reductions	Balance at December 31, 2011	Due within one year
Long-term debt:					
Notes payable	$ 27,337	4,600	(3,558)	28,379	4,051
Revenue bonds payable	145,328	—	(10,267)	135,061	10,635
Environmental remediation reserve	2,316	653	(950)	2,019	801
Other claims	150	201	(5)	346	346
State of Alaska advances	177	—	(4)	173	—
Payable from restricted assets	757	279	—	1,036	936
Regulatory liabilities:					
Accrued pension benefits	2,933	4,174	—	7,107	—
Deferred grant revenue	447,341	54,155	(31,898)	469,598	—
Total long-term liabilities	$ 626,339	64,062	(46,682)	643,719	16,769

(in thousands)	Balance at December 31, 2009	Additions	Reductions	Balance at December 31, 2010	Due within one year
Long-term debt:					
Notes payable	$ 27,435	16,674	(16,772)	27,337	3,309
Revenue bonds payable	155,100	13	(9,785)	145,328	10,195
Environmental remediation reserve	2,353	929	(966)	2,316	1,059
Other claims	1,274	72	(1,196)	150	150
State of Alaska advances	181	—	(4)	177	—
Payable from restricted assets	619	138	—	757	—
Regulatory liabilities:					
Accrued pension and postretirement benefits	6,258	745	(4,070)	2,933	—
Deferred grant revenue	428,501	51,145	(32,305)	447,341	—
Total long-term liabilities	$ 621,721	69,716	(65,098)	626,339	14,713

The ARRC has arrangements for three short-term unsecured lines of credit. The general purpose lines of credit allow borrowing up to $20,000,000 at a rate of 68% of London Interbank Offered Rate (LIBOR) plus 2.25%. The self-insurance line of credit allows borrowing up to $10,000,000 at a rate of 68% of LIBOR plus 2.25%. None of the lines of credit had an outstanding balance at December 31, 2011 or 2010.

(Continued)

December 31, 2011 and 2010

(6) Long-Term Debt

Long-term debt at December 31, 2011 and 2010 consists of the following:

(in thousands)		2011	2010
Notes payable:			
Note payable, secured by equipment, due in monthly payments of $285,842 including interest at 3.73%, matures March 2019	$	13,817	16,674
Note payable, secured by equipment, due in monthly payments of $60,553 including interest at 2.89%, matures July 2018		4,351	—
Note payable, secured by real estate revenue, due in monthly payments of $36,211, including interest at 5.40%, matures June 2026		4,363	4,556
Note payable, secured by real estate revenue, due in monthly payments of $48,539, including interest at 5.40%, matures June 2026		5,848	6,107
		28,379	27,337
Less current portion		4,051	3,309
	$	24,328	24,028
Revenue bonds:			
Revenue Bonds – Series 2006 and 2007, (interest at 3.625% – 5.25%) interest payable semi annually February 1 and August 1, secured by 5307 and 5309 FTA Formula Funds, matures August 2021, including premiums of $5,199,000 and unamortized issuance costs of $1,697,000 for the year ended December 31, 2011	$	135,061	145,328
Less current portion		10,635	10,195
	$	124,426	135,133

(Continued)

Return to Table of Contents

December 31, 2011 and 2010

Annual payments on debt are scheduled as follows at December 31, 2011:

(in thousands)		Notes Payable		Revenue Bonds Payable		
		Principal	Interest	Principal	Interest	Total
Year ending December 31:						
2012	$	4,051	1,122	10,635	6,301	22,109
2013		4,208	966	11,120	5,820	22,114
2014		2,816	824	11,620	5,319	20,579
2015		2,583	724	12,095	4,841	20,243
2016		2,685	622	12,680	4,257	20,244
2017 – 2021		7,982	1,771	73,409	11,283	94,445
2022 – 2026		4,054	522	—	—	4,576
		28,379	6,551	131,559	37,821	204,310
Current portion of principal		(4,051)		(10,635)		(14,686)
Unamortized premium		—		5,199		5,199
Unamortized issuance cost		—		(1,697)		(1,697)
Total long-term portion	$	24,328		124,426		193,126

Federal Transit Program – Corporation Participation in Section 5307 Formula Program and Section 5309 Formula Program

In July 2006, Standard & Poor's Ratings Services and Fitch Ratings assigned "A+" and "A" ratings, respectively, to the approximately $76.4 million of Capital Grant Receipts Bonds, Series 2006 (FTA Section 5307 Urbanized Area Formula Funds and Section 5309 Fixed Guideway Modernization Formula Funds). (These ratings were used to determine the ARRC's financial strength for the bond issuance insured under a policy issued by Financial Guaranty Insurance Company.) Bond issuance costs of $1.4 million and bond premium of $3.4 will be amortized over the life of the bonds.

In August 2007, Standard & Poor's Ratings Services, Fitch Ratings, and Moody's Investor Services assigned "A+", "A" and "A1" ratings to the approximately $88.6 million of Capital Grant Receipts Bonds, Series 2007 (FTA Section 5307 Urbanized Area Formula Funds and Section 5309 Fixed Guideway Modernization Formula Funds). (These ratings were used to determine the ARRC's financial strength for the bond issuance insured under a policy issued by Financial Guaranty Insurance Company.) Bond issuance costs of $1.2 million and bond premium of $2.4 will be amortized over the life of the bonds.

On April 16, 2010, Moody's Investors Service raised its underlying unenhanced rating assigned to ARRC's Capital Grant Receipts Bonds to "Aa3" as a result of the recalibration by Moody's Investors Service of its municipal rating scale to align it with the scales used by Moody's Investors Service in assessing the creditworthiness of other types of issuers. On September 12, 2011, Moody's Investors Service lowered its underlying unenhanced rating assigned to ARRC's Capital Grant Receipts Bonds to "A1" with a stable outlook as a result of a reassessment of such bonds in comparison with similar bonds to which Federal Transit Administration grants are pledged and the relatively low additional bonds test applicable to ARRC's Capital Grant Receipts Bonds. Moody's Investors Service no longer rates FGIC. On September 30, 2008, FGIC entered into a Reinsurance Agreement with MBIA Insurance Corporation (Reinsurance Agreement) pursuant to which certain of FGIC's policyholders may receive the benefit of

(Continued)

December 31, 2011 and 2010

MBIA's reinsurance by presenting claims directly to MBIA under their FGIC-issued policies. ARRC's Capital Grant Receipts Bonds are included in the list of bonds covered by the Reinsurance Agreement. Based on the Reinsurance Agreement, Moody's Investors Service assigned an enhanced rating of "Aa3" to ARRC's Capital Grant Receipts Bonds.

Fitch Ratings no longer rates Financial Guaranty Insurance Company and, accordingly, has assigned only an underlying, unenhanced rating to ARRC's Capital Grant Receipts Bonds. Fitch Ratings affirmed an "A" rating and stable outlook on ARRC's Capital Grant Receipts Bonds in September 2010. In March 2011, Fitch Ratings changed the outlook on all grant receipts bonds payable solely from and secured solely by Federal Transit Administration (FTA) formula funds, including ARRC's Capital Grant Receipts Bonds, from stable to negative, citing growing uncertainty in federal transportation policy, less predictable funding levels and a pending expiration of a majority of federal motor fuel taxes. Fitch Ratings affirmed this negative outlook on March 6, 2012.

Current law:

The following table sets forth the authorized funding allocation of the Federal Transit Administration (FTA) Section 5307 Formula Program Funds and Section 5309 Formula Program Funds to ARRC in Federal Fiscal Years (FFY) 2011 and 2012:

(in thousands) FFY		Section 5307 Formula Program	Section 5309 Formula Program	Total
2011	$	18,397,519	17,387,576	35,785,095
2012*		17,897,519	16,977,877	34,875,396

*FFY 2012 estimates are reasonable estimates based on formula programs contained in the Continuing Appropriations Surface Transportation Extensions Act, 2011 (Public Law 111-322).

Recent developments:

On March 14, 2012, the United States Senate passed the Surface Transportation Reauthorization Bill, Senate Bill 1813 (Senate Bill 1813) which repeals current law which counts 60% of ARRC's passenger track miles that are "attributable" to Anchorage for purposes of calculating ARRC's allocation of Section 5307 Urbanized Area Formula Funds and Section 5309 Fixed Guideway Modernization Formula Funds (Formula Funds). Under the current law, all other FTA passenger rail systems are permitted to count 100% of their attributable miles.

Senate Bill 1813 delegates to the FTA the responsibility for determining how many attributable miles to allocate to each FTA passenger rail system for purposes of calculating the amount of Formula Funds for that system. At the request of the Senate Banking Committee (which has jurisdiction over the FTA) the FTA provided information to the Senate Banking Committee which indicates how the FTA proposes to allocate the Formula Funds among the various transit agencies throughout the United States. Based on information available to ARRC, ARRC estimates that if Senate Bill 1813 were enacted into law, the FTA would reduce ARRC's Formula Funds from $36,000,000 annually to approximately $2,000,000 to

(Continued)

Return to Table of Contents

December 31, 2011 and 2010

$10,000,000 annually. This would occur by eliminating all "attributable" miles for ARRC while allowing all other systems to use 100% of their attributable miles.

The United States House of Representatives is considering a bill, H.R. 7, titled "The American Energy and Infrastructure Jobs Act of 2012" which does not change current law provisions applicable to the Formula Funds allocable to ARRC.

However, if the House of Representatives were to enact a transportation bill which included the provisions of Senate Bill 1813 that adversely affect ARRC and such bill was signed into law by the President of the United States, and if the FTA exercises its discretion with respect to ARRC in the manner indicated by FTA, ARRC will receive approximately $2,000,000 to $10,000,000 in Formula Funds annually, which is less than the annual debt service on the ARRC Capital Grant Receipts Bonds.

Accordingly, there would be insufficient FTA Formula Funds to pay the debt service on the ARRC Capital Grant Receipts Bonds. ARRC can make no prediction as to whether the House of Representatives will enact a transportation bill in the current form of Senate Bill 1813 and, if such a bill were enacted by the House, whether the President would sign it into law. Further, in the event that the current form of Senate Bill 1813 becomes law, ARRC can make no prediction as to whether the FTA will actually exercise its discretion to reduce ARRC's Formula Funds.

Other related activity:

The ARRC expended $23.1 million during 2011 and $23.7 million during 2010 of the bond proceeds on eligible capital costs related to the capital improvement program.

The following table sets forth the interest capitalized during the years ended December 31, 2011 and 2010:

(in thousands)		2011	2010
Interest expense	$	3,581	3,815
Less interest income		860	1,615
Interest capitalized	$	2,721	2,200

Section 509 of the Trust Indenture requires five year arbitrage certificates to be filed with the trustee for the Capital Grant Receipts Bonds, Series 2006 and Series 2007, as of December 31, 2010 and December 31, 2011, respectively. There was no rebate amount due on the Series 2006, as of December 31, 2011. The Series 2007 rebate of $936,000 was paid in February 2012.

State of Alaska Authorizations

Chapter 65, SLA 2007, authorized the ARRC to issue up to $2.9 billion in revenue bonds to finance all or a portion of the Kenai gasification project and Port MacKenzie rail spur project, 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.

(Continued)

December 31, 2011 and 2010

Chapter 28, SLA 2006, authorized the ARRC to issue up to $165 million in revenue bonds to finance rail transportation projects that qualify for federal financial participation and associated costs. To date, $165 million in bonds have been issued with a premium of $5.8 million.

Chapter 46, SLA 2004, authorized the ARRC to issue up to $500 million 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.

Chapter 71, SLA 2003, authorized the ARRC to issue up to $17 billion 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 77, SLA 1994, authorized the ARRC to issue up to $55 million in revenue bonds to finance the construction and acquisition of the Alaska Discovery Center for the Ship Creek Project in Anchorage. To date, no bonds have been issued.

(7) Employee Benefits

The ARRC's board of directors has established a method of accounting for pension and postretirement cost, which is designed to recover the full costs of these benefits. As a result, the unfunded or overfunded actuarial accrued liabilities associated with these benefits are reported as regulatory assets or liabilities in the balance sheets. Periodic benefit costs related to these plans are included in operating expenses and capital additions. Pension costs and accrued benefits under the defined benefit pension and postretirement plans (Plans) are calculated under the provisions of GASB Statements No. 27, *Accounting for Pensions by State and Local Government Employers*, and No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

The overfunded actuarial accrued liability of the postretirement plan, which is the difference between the actuarial value of the assets and the actuarial accrued liability of the plans, is reported as a regulatory asset of $5,486,000 and $2,101,000 at December 31, 2011 and 2010, respectively. The unfunded actuarial accrued liability of the pension plan, is reported as a regulatory liability of $7,107,000 and $2,933,000 at December 31, 2011 and 2010, respectively. The change in pension and postretirement funding status presented as other changes in fund equity of a decrease of $805,000 and an increase of $5,409,000 in 2011 and 2010, respectively, represents the change in the unfunded actuarial accrued liability for both plans.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to

(Continued)

Return to Table of Contents

reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

(a) Alaska Railroad Corporation Pension Plan

The ARRC has a defined benefit pension plan (Plan) covering all regular represented and non represented 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 annual required contribution (ARC). Employees contribute an amount equal to 9% of eligible compensation. Contributions are made continuously throughout the year. Plan assets consist of fixed income securities, common stocks, real estate investment trusts, and real estate separate accounts.

Assumptions used to determine annual pension cost (APC) and related information for the years ended December 31, 2011 and 2010 are as follows:

	2011	2010
Actuarial assumptions compounded annually:		
Inflation rate	2.80%	2.80%
Discount rate	7.50	7.50
Investment return for funding purposes	7.50	7.50
Expected investment return	7.50	7.50
Investment return on employee accounts	4.50	4.50
Projected salary increase	4.00	4.00
Cost of living allowance	1.40	1.40

All valuations are as of January 1st of each year. The actuarial cost method used was the projected unit credit. The unfunded accrued liability is amortized over an open 30-year period as a level dollar amount.

(Continued)

December 31, 2011 and 2010

The following table presents activity of the Plan's assets during the years ended December 31, 2011 and 2010:

(in thousands)

		2011	2010
Income:			
Contributions received:			
Employee	$	3,965	3,773
Employer		3,014	2,254
Investment earnings		241	10,525
Total income		7,220	16,552
Disbursements:			
Benefit payments		2,639	2,475
Administrative and investment consulting expenses		441	573
Total disbursements		3,080	3,048
Net income		4,140	13,504
Fair value of assets at beginning of year		89,024	75,520
Fair value of assets at end of year	$	93,164	89,024

The following table reconciles the Plan's fair value of the assets to the actuarial value of the assets based on valuation dates of January 1st of each year and presents the funding status at December 31, 2011, 2010 and 2009:

(in thousands)

		2011	2010	2009
Fair value of assets at end of year	$	93,164	89,024	75,520
Unamortized actuarial losses		3,860	588	6,905
Actuarial value of assets at the end of year		97,024	89,612	82,425
Actuarial accrued liability (AAL)		104,131	92,545	84,614
Unfunded AAL (UAAL)	$	7,107	2,933	2,189
Funded ratio (actuarial value of plan assets/AAL)		93.2%	96.8%	97.4%
Covered payroll (active plan members)	$	43,773	45,048	47,426
UAAL as a percentage of covered payroll		16.2%	6.5%	4.6%

(Continued)

Return to Table of Contents

The ARC of $3,014,000 and $2,254,000 and the associated expenses of $2,434,000 and $1,816,000 were included in the accompanying financial statements for the years ended December 31, 2011 and 2010, respectively. The ARRC's APC, which is the periodic cost of the plan, the percentage of APC contributed to the plan, and the net pension obligation for 2011 and the two preceding years were as follows:

(in thousands)

		2011	2010	2009
Annual pension cost	$	3,014	2,254	1,857
Contributed		100%	100%	100%
Net pension obligation	$	—	—	—

(b) *Alaska Railroad Postretirement Health Care Trust*

The ARRC sponsors a retiree health care plan (Plan) that provides postretirement medical benefits to employees receiving retirement under the pension plan and retired CSRS employees who do not qualify for the federal medical insurance, and who move directly from active coverage to retiree coverage. The Plan is contributory with retiree contributions adjusted annually, and contains other cost-sharing features such as deductibles and coinsurance.

Assumptions used to determine annual postemployment benefit cost and related information for the years ended December 31, 2011 and 2010 are as follows:

	2011	2010
Discount rate	7.50%	7.50%
Investment return for funding purposes	7.50	7.50
Expected investment return	7.50	7.50
Health cost trend (grading down):		
Medical	9.4 to 4.5	9.9 to 4.5
Prescription	9.4 to 4.5	9.9 to 4.5

All valuations are as of January 1st of each year. The actuarial cost method used was the projected unit credit. The unfunded accrued liability is amortized over an open 30-year period as a level dollar amount.

The ARRC has incorporated the impact of the Patient Protection and Affordable Care Act (PPACA) or "Health Care Reform", as currently enacted, in calculating its actuarial accrued liability.

(Continued)

December 31, 2011 and 2010

The following table represents activity of the Plan's assets during the years ended December 31, 2011 and 2010:

(in thousands)

		2011	2010
Income:			
Contributions received – employer	$	1,665	2,099
Investment earnings		(157)	3,663
Total income		1,508	5,762
Disbursements:			
Benefit payments		363	352
Administrative and investment consulting expenses		57	45
Total disbursements		420	397
Net income		1,088	5,365
Fair value of assets at beginning of year		31,495	26,130
Fair value of assets at the end of year	$	32,583	31,495

The following table reconciles the Plan's fair value of the assets to the actuarial value of the assets based on valuation dates of January 1st of each year and presents the funding status at December 31, 2011, 2010 and 2009:

(in thousands)

		2011	2010	2009
Fair value of assets at end of year	$	32,583	31,495	26,130
Unamortized actuarial (gains) losses		1,078	(580)	1,400
Actuarial value of assets at end of year		33,661	30,915	27,530
Actuarial accrued liability (AAL)		26,490	27,113	31,600
Unfunded (overfunded) AAL	$	(7,171)	(3,802)	4,070
Funded ratio (actuarial value of plan assets/AAL)		127.1%	114.0%	87.1%
Covered payroll (active plan members)	$	43,773	45,048	47,426
UAAL as a percentage of covered payroll		(16.4)%	(8.4)%	8.6%

(Continued)

Return to Table of Contents

December 31, 2011 and 2010

The ARC of $1,665,000 and $2,099,000 and the associated expenses of $1,345,000 and $1,676,000 were included in the accompanying financial statements for the years ended December 31, 2011 and 2010, respectively. The periodic cost of ARRC's annual other postemployment benefit (OPEB), the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for 2011 and the two preceding years were as follows:

(in thousands)

	2011	2010	2009
Annual OPEB cost	$ 1,649	2,083	2,393
Annual OPEB cost contributed	101%	101%	218%
Net OPEB obligation	$ 1,685	1,702	1,718

(c) Civil Service Retirement System (CSRS)

Federal employees who transferred to the ARRC continue to participate in the CSRS, a multi-employer defined benefit plan. ARRC is required to contribute 7% of the transferred employees' eligible compensation. Benefit expense related to CSRS was $179,000 and $212,000 for the years ended December 31, 2011 and 2010, respectively.

(d) Alaska Railroad Corporation 401(k) Tax Deferred Savings Plan

The ARRC sponsors a defined contribution plan (Plan) under Section 401(k) of the Internal Revenue Code (IRC) for employees. All regular employees are eligible to contribute to the Plan. Under the terms of certain collective bargaining agreements, representing 55% 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 $537,000 and $528,000 for the years ended December 31, 2011 and 2010, respectively.

(e) Alaska Railroad Corporation 457 Deferred Compensation Plan

ARRC sponsors a Section 457 deferred compensation plan under Section 457(b) of the IRC for non represented employees. There are no benefit expenses related to the Plan for the years ended December 31, 2011 and 2010, respectively.

(Continued)

December 31, 2011 and 2010

(8) Grants

The ARRC has spent grant funding on a variety of operating property, right of way acquisition and equipment. Generally, grant revenue will be recognized equal to depreciation on these assets each year.

The original cost of assets constructed or acquired with grant funding as of December 31, 2011 and 2010 consists of the following:

(in thousands)

			2011	2010
Land and improvements		$	7,938	7,541
Road and roadway structures	15 – 32 year life		482,280	469,757
Equipment	5 – 25 year life		104,380	99,810
Construction in process			28,492	5,726
		$	623,090	582,834

The original cost of assets constructed or acquired with Capital Grant Receipts Bonds, Series 2006 and 2007 funding at December 31, 2011 and 2010 consists of the following:

(in thousands)

			2011	2010
Road and roadway structures	15 – 32 year life	$	149,462	128,154
Equipment	5 – 25 year life		18,960	18,960
Construction in process			9,332	7,514
		$	177,754	154,628

(Continued)

Return to Table of Contents

December 31, 2011 and 2010

The ARRC recognized the following grant revenue during the years ended December 31, 2011 and 2010:

(in thousands)

		2011	2010
Alaska State Fair:			
Depreciation on assets constructed	$	12	12
FTA Formula Funds relating to Capital Grant Receipts Bonds, Series 2006 and 2007:			
Depreciation on assets purchased and constructed		5,913	5,079
Grant funded principal, interest and issuance costs		2,518	2,759
Department of Agriculture:			
Depreciation on assets constructed		182	182
Department of Interior:			
Grant funding of accrued derailment expense		1	30
Derailment expense paid in current year		(1)	(30)
Federal Emergency Management Agency:			
Depreciation on assets constructed		388	255
Federal Railroad Administration:			
Depreciation on assets constructed		13,539	16,443
Right of way acquisition		37	511
Federal Transit Administration:			
Depreciation on assets purchased and constructed		9,963	8,382
Grant funded maintenance and transit security expense		8,922	9,660
Right of way acquisition		359	(39)
Homeland Security:			
Depreciation on assets purchased and constructed		102	93
Grant funded transit security expense		—	15
Municipality of Anchorage Ship Creek Economic Development:			
Depreciation on assets constructed		10	10
Rasmuson Foundation:			
Depreciation on assets purchased		80	80
State of Alaska:			
Depreciation on assets purchased and constructed		531	404
Taxpayer Relief Act:			
Depreciation on assets purchased and constructed		939	1,178
US Environmental Protection Agency			
Depreciation on assets constructed		53	—
US Fish and Wildlife:			
Depreciation on assets constructed		30	30
		43,578	45,054
Less grant revenue included in real estate nonoperating revenues		(1,325)	(2,226)
Less grant revenue reported as a reduction of interest expense		(2,361)	(2,603)
	$	39,892	40,225

(Continued)

December 31, 2011 and 2010

(9) Fund Equity

Fund equity consists of the following major items as of December 31, 2011 and 2010:

(in thousands)		Investment by the State of Alaska	Cumulative net income	Cumulative other changes in fund equity	Total fund equity
Balance at December 31, 2009	$	34,174	184,137	(4,538)	213,773
Net income		—	13,447	—	13,447
Other changes in fund equity		—	—	5,409	5,409
Total changes in fund equity					18,856
Balance at December 31, 2010		34,174	197,584	871	232,629
Net income		—	13,436	—	13,436
Other changes in fund equity		—	—	(805)	(805)
Total changes in fund equity					12,631
Balance at December 31, 2011	$	34,174	211,020	66	245,260

(10) Concentrations

Two ARRC customers accounted for 52% and 51% of freight revenue in 2011 and 2010, respectively. During 2011 and 2010, ARRC entered into agreements with one of the customers under the Internal Revenue Code §45G. Under the agreements, ARRC received $4.8 and $4.8 million for qualified track maintenance expenses and gave the customer a shipping credit of $2.7 and $2.7 million in 2011 and 2010, respectively. The qualified track maintenance expenses and the shipping credit are recorded as reductions in operating expenses.

A significant portion of ARRC's funding comes from the Federal government in the form of grants. Federal grant funding was used for 46% and 50% of capital expenditures in 2011 and 2010, respectively.

(Continued)

Return to Table of Contents

December 31, 2011 and 2010

(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 $12,751,000 and $12,948,000 in 2011 and 2010, respectively. The following table summarizes future minimum lease payments as of December 31, 2011:

(in thousands)		Amount
Year ending December 31:		
2012	$	11,385
2013		10,967
2014		10,348
2015		9,935
2016		9,773
Thereafter		136,394
	$	188,802

The ARRC has $780,000 in rent credits outstanding on these leases at December 31, 2011. 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 certain operating equipment and barge services under operating leases and agreements. Payments under the leases and agreements totaled $10,076,000 and $10,536,000 in 2011 and 2010, respectively. Future minimum lease payments as of December 31, 2011 are summarized as follows:

(in thousands)		Amount
Year ending December 31:		
2012	$	9,906
2013		8,403
2014		8,203
2015		8,112
2016		1,248
Thereafter		—
	$	35,872

(13) Insurance

The ARRC is self-insured to certain limits for employee health benefits, personal injury, property and casualty damage claims, and workers' compensation claims, and establishes reserves for the estimated losses of such claims. The ARRC uses third-party administrators that process claims based on the provisions of the employee health plan, or for on-the-job injuries, in compliance with the State of Alaska

(Continued)

December 31, 2011 and 2010

Workers' Compensation Act. ARRC's commercial insurance policies with self-insured retention limits are summarized as follows at December 31, 2011 and 2010:

(in thousands)		2011	2010
Casualty/liability	$	75,000	50,000
Property damage		65,000	65,000
Casualty/liability retention		5,000	5,000
Property damage retention		10,000	10,000

Self-insurance activity is summarized as follows during the years ended December 31, 2011 and 2010:

(in thousands)		Balance at December 31, 2010	Incurred claims	Claim payments	Balance at December 31, 2011
Employee health benefits	$	2,068	9,299	(10,037)	1,330
Workers' compensation		1,867	1,734	(2,002)	1,599
	$	3,935	11,033	(12,039)	2,929

(in thousands)		Balance at December 31, 2009	Incurred claims	Claim payments	Balance at December 31, 2010
Employee health benefits	$	1,995	10,414	(10,341)	2,068
Workers' compensation		1,575	1,714	(1,422)	1,867
	$	3,570	12,128	(11,763)	3,935

(Continued)

Return to Table of Contents

December 31, 2011 and 2010

(14) Fair Value of Financial Instruments

At December 31, 2011 and 2010, the fair values of cash and cash equivalents, net receivables, accounts payable and accrued liabilities, including payroll and interest payable, approximate their carrying value due to the short-term nature of these financial instruments.

The carrying amounts and estimated fair values of ARRC's restricted assets, notes payable and revenue bonds payable are summarized as follows for the years ended December 31, 2011 and 2010:

(in thousands)

		2011		2010	
		Carrying amount	**Fair value**	**Carrying amount**	**Fair value**
Financial assets:					
Restricted assets	$	32,010	32,010	47,188	47,188
Financial liabilities:					
Notes payable	$	28,379	28,379	27,337	27,337
Revenue bonds payable		135,061	145,588	145,328	153,668

Restricted assets, which consist of investments in GICs, commercial paper and money market accounts, are measured using quoted market prices at the reporting date multiplied by the quantity held for investments traded in an active market (money market funds and commercial paper) or using contractual cash flows discounted using current market rates for investments with comparable terms for those investments that are not traded in an active market (GIC).

The estimated fair value of notes payable is measured using contractual cash flows discounted using quoted interest rates adjusted for ARRC's credit standing and interest rates currently offered to the ARRC for similar debt instruments of comparable maturities by the ARRC's bankers.

The estimated fair value of revenue bonds payable is measured using contractual cash flows discounted using bond yields quoted from brokered markets and other long-term debt offered to the ARRC.

(Continued)

December 31, 2011 and 2010

(15) Environmental Remediation Reserve

The ARRC has accrued certain environmental pollution remediation liabilities for its properties. The accrual for the Anchorage Terminal Reserve is based on an ongoing investigation described below. As to all other locations, ARRC has estimated the liability for pollution remediation by estimating a reasonable range of potential outlays and multiplying those outlays by the probability of occurrence, reduced by the allocation of liability to other potentially responsible parties where applicable. The liabilities associated with these sites could change over time due to changes in costs of goods and services, changes in remediation technology, or changes in laws and regulations governing the remediation efforts.

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 an administrative settlement agreement negotiated with the United States Environmental Protection Agency (EPA). Management completed a remedial investigation in 2010 and a feasibility study was a completed in 2011. ARRC has also reflected an anticipated settlement with the United States for a share of costs to date based on the United States' ownership of the Site before 1985. Payment on this settlement was received on February 17, 2010. ARRC is waiting for EPA to determine what, if any, future remediation is required for the Site and what parties will be required to perform the work. This will be subject to negotiations with third parties in addition to ARRC. ARRC has accrued a reasonable estimate of its potential obligation for such future work by estimating a reasonable range of potential outlays and multiplying those outlays by the probability of occurring, reduced by the allocation of liability to other potentially responsible parties. 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.

(16) Commitments and Contingencies

Approximately 76% of the ARRC's labor force is subject to one of five collective bargaining agreements. The labor agreement with the United Transportation Union (UTU) expired in September 2008 and a new agreement was ratified in January 2012. The labor agreement with American Train Dispatchers Department (ATDD) expired June 2009 and a new agreement was ratified in November 2011. The labor agreement with the Carmen's Division of Transportation Communication International Union (TCU) expired January 2010 and a new agreement was ratified in September 2011. The labor agreement with the Alaska Railroad Workers (ARW) expired August 2010 and a new agreement was ratified in September 2010. The labor agreement with the International Association of Machinists and Aerospace Workers (IAM) expired December 2010. Coincident with the IAM negotiations, the International Brotherhood of Teamsters Local 959 (IBT) made a bid to decertify and replace the IAM as the representative union. Effective March 2011, IBT replaced IAM as the representative union. Negotiations began with the IBT in 2011 and continue in 2012.

The ARRC has certain other contingent liabilities resulting from lawsuits, 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.

ALASKA RAILROAD CORPORATION

Mailing Address: P.O. Box 107500, Anchorage, Alaska 99510-7500

OFFICES	PHYSICAL ADDRESS	TELEPHONE	FAX
Anchorage, Alaska			
Headquarters Offices	327 W. Ship Creek Avenue	(907) 265-2300	(907) 265-2312
Reservations and Information	411 W. 1st Avenue	(907) 265-2494	(907) 265-2509
Anchorage Operations Center	825 Whitney Road	(907) 265-2434	(907) 265-2643
Fairbanks, Alaska			
Passenger Depot	1745 Johansen Expressway	(907) 458-6025	(907) 458-6068
Freight Customer Service	1888 Fox Avenue	(907) 458-6022	(907) 458-6034
Freight House	230 Jack Lindsey Lane	(907) 458-6048	(907) 458-6061
Seward, Alaska			
913 Port Avenue, P.O. Box 95, Seward, Alaska 99664		(907) 224-5550	(907) 265-2660
Seattle, Washington			
5615 W. Marginal Way S.W., Seattle, Washington 98106		(206) 767-1100	(206) 767-1112
Toll-free Numbers			
Corporate Information		1-800-321-6518	
Freight Marketing/Customer Service		1-800-321-6518	
Passenger Service		1-800-544-0552	
Seattle Office		1-800-843-2772	

The Alaska Railroad Corporation has not received any bona-fide offers of a sale arrangement within the calendar year of 2011, nor is the Corporation aware of any potential sales that require analysis under AS 42.40.260.

ALASKARAILROAD.COM

Return to Table of Contents

facebook.com/alaskarailroad twitter.com/akrr