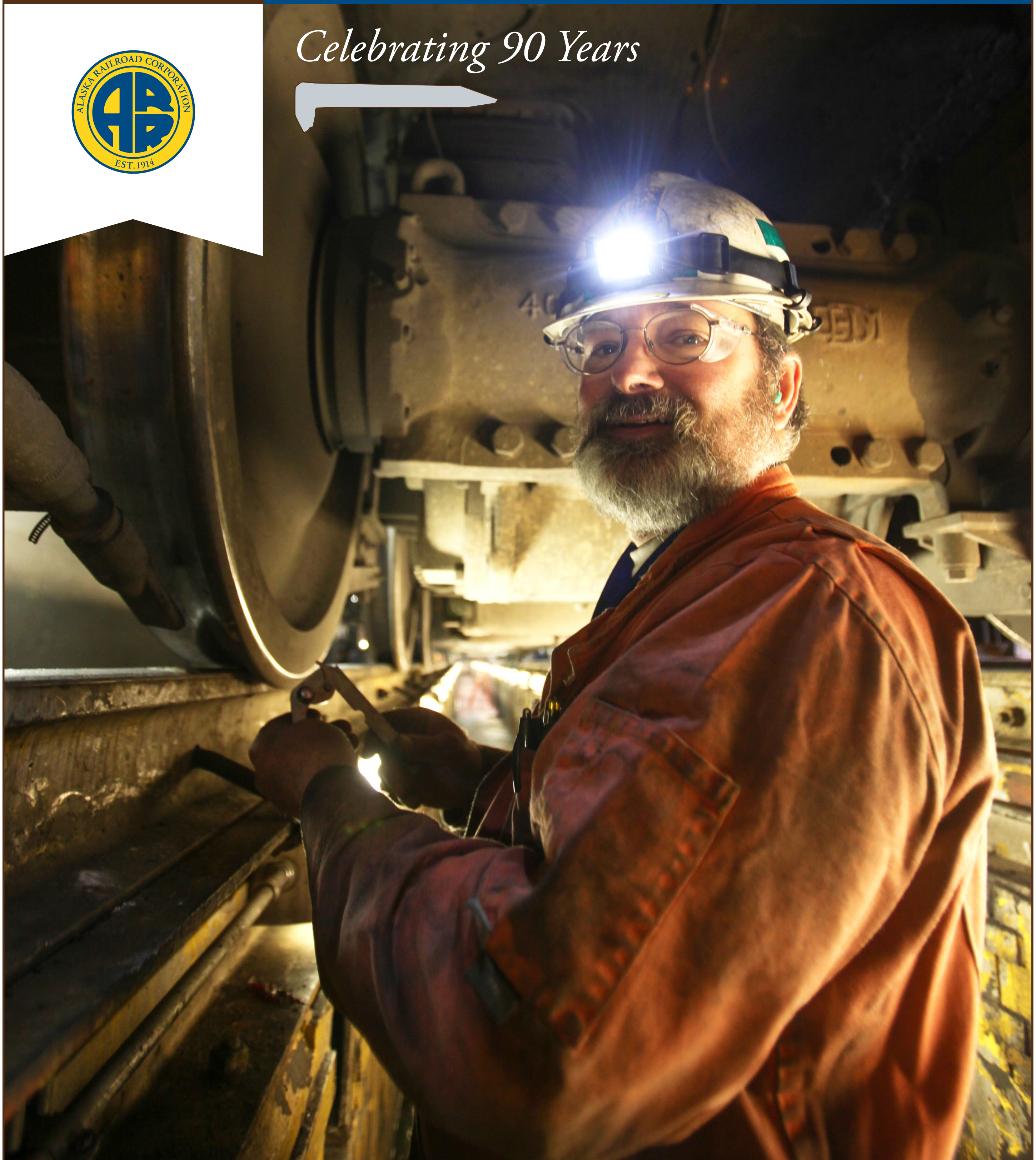
ALASKA RAILROAD CORPORATION

2013 ANNUAL REPORT

Celebrating 90 Years



Alaska Railroad Mission

Operate safely and profitably, foster economic development and provide high-quality service.

2013

Alaska Railroad employees are working smarter and safer.

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2013 YEAR IN Leadership

Board of Directors

Board Chair
Linda Leary

Director
John Binkley

Commissioner
Susan Bell

Director
Jon Cook

Director
Jack Burton

Vice Chair
Bill Sheffield

Commissioner
Pat Kemp

On July 15, 1923, President Warren G. Harding drove a ceremonial spike in Nenana, thus concluding a decade-long mega project to build the Alaska Railroad. Mid-year, we paid tribute to the ingenuity that brought this pivotal asset to fruition. A 90th anniversary commemoration offered perspective at a time when the Alaska Railroad Corporation (ARRC) grapples with its own mega projects, a whopping regulatory mandate, and formidable financial dilemmas. Then and now, such super-sized challenges called for exceptional problem solving. Railroaders answered the call throughout 2013.

Mega Projects and Mandates

For the first time in seven decades, two major capital projects are expanding our rail route. Along the southern half, ground broke and construction got underway on about two-thirds of the 32-mile spur connecting Port MacKenzie to the main line near Houston. To the north, Phase One of the Northern Rail Extension (NRE) moved into the home stretch, on budget and on schedule. Measuring 3,300 feet, the NRE bridge over the Tanana River at Salcha will be Alaska's longest bridge when it is completed in 2014.

Our third mega project is the federally-mandated Positive Train Control (PTC) system to prevent train accidents caused by human error. Recent progress has come by way of state capital funds appropriated in 2013 (and requested in future years) to help buy costly and still-developing technology. The deadline to implement PTC is December 31, 2015. However, like most railroads nationwide, ARRC is more likely to meet the deadline only if it is extended to 2018. The penalty for failing to install PTC ranges from daily fines to curtailing or ending passenger service.

Above and beyond new infrastructure via mega projects, the railroad realistically needs to spend tens of millions of dollars per year to maintain and modernize existing track, bridges and facilities. ARRC net income is a vital part of annual capital spending, particularly since federal funding for our regular capital program is shrinking. We saw a 20% drop in Federal Transit Administration (FTA) grants that had, for the past decade, been a reliable source for critical infrastructure investments. In 2012, a new federal surface transportation funding bill (MAP-21) reduced ARRC's allocation of FTA formula funds, while more than doubling the local match requirement.

Fewer capital dollars is the result of reduced commercial activity. Two important freight business lines —refined petroleum and export coal — continued to decline in 2013, leaving a substantial gap in operations revenue. 2013 was the first full year's impact from the North Pole refinery's 2012 decision to shut down all but one of its three petroleum refining units. A soft global market curtailed export coal shipments by a third.

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REVIEW

Railroaders Rally in Response

In response, employees across the company rallied to offset the fiscal damage. Working in focused teams, railroaders developed new initiatives to lower expenses, boost efficiency and generate new business opportunities. As a result, we achieved a $14.3 million net income — nearly triple the original budget of $4.9 million.

Some revenue growth came from oilfield shipments bound for the North Slope, which drove an increase in rail-barge and trailer/container business. And our award-winning team approach to customer care drew praise and attracted new complex transportation projects, such as moving massive generators for the Matanuska Electric Association's Eklutna power plant in early fall 2013. We saw an 18% increase in passenger train ridership. Real estate revenues grew by 7% thanks to an uptick in dock activity, land use permits, and a full year of lease revenue from the Historic Freight Shed. Recent real estate developments in Seward have solid potential. A revamped ARRC Seward Master Plan provides a blueprint for growth, and renewed land negotiations can facilitate Seward waterfront re-development.

The quest for new revenues and business opportunities was coupled with dogged cost control company wide. The biggest savings came from $4.7 million less spent on utilities and fuel than the prior year. Locomotive idle reduction policies and savvy train operating practices boosted fuel efficiency. We initiated a new facility energy monitoring and management program that reduced electricity consumption in the Anchorage railcar mechanical shop by 40%. Such proven measures can be duplicated in other high-demand facilities moving forward.

Cost-conscious railroaders reduced material-and-supply spending by $1.7 million. Personnel reductions early in the year translated to $2.3 million less in wages and benefits compared to 2012. In conjunction with a 54-position (7.3%) workforce reduction in spring, we restructured the company to elicit greater efficiency from our leadership and rank-and-file. This comes on the heels of a 52-position cut in 2012 and nearly 200 positions eliminated in 2009/2010. The railroad is lean. Every employee is called upon to work harder, smarter, safer. The proof is in the numbers.

Safety in Numbers

Comparing 2013 to 2012, employee injuries numbered 40% fewer, and safety incidents were down by 21%. ARRC's annual performance audit focused on our safety management system, including safety program oversight, policies, tools and practices. Conducted by a third party expert, the analysis provided unprecedented insight into all aspects that impact safety — from communications,

Management Team

President/CEO
Bill O'Leary

Finance
CFO Barbara Amy

Operations
COO Doug Engebretson

Engineering & Maintenance
VP Clark Hopp

General Counsel / Legal
VP Bill Hupprich

Corporate Planning
& Real Estate
VP Jim Kubitz

Business Management
& Corporate Affairs
VP Wendy Lindskoog

Advanced Train Control Systems
& Technology
VP Eileen Reilly

Marketing & Customer Service
VP Dale Wade

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(Photos by Stephenie Wheeler)

Mat-Su Borough and railroad officials, Governor Parnell and legislators break ground at the project site in June 2013.

metrics, and action planning, to company culture, employee engagement and work environment. Thanks to this in-depth evaluation, we are developing a more comprehensive safety management system.

The railroad's commitment to safety extends beyond internal stakeholders to our neighbors and communities. In summer 2013, we initiated a Rail Safety Public Awareness Campaign supported largely by ARRC in-kind contributions and a grant from Operation Lifesaver Inc. (OLI), a national/international organization that promotes rail safety. The campaign spread such messages as "Always Expect a Train" and "Stay Off! Stay Away! Stay Alive" through newspaper ads, trail signs, locomotive decals, public bus advertising signs, presentations and giveaways at public gatherings, bike commuting event flyers, and public service announcements (PSA) broadcast on radio, voiced at baseball games and shown on monitors in the lobby of Division of Motor Vehicle office statewide. Many campaign elements can be reused and expanded in future years.

Service and Stewardship

While our people worked more safely and efficiently in 2013, so too did our assets. By operating longer trains, we adjusted our Anchorage-Fairbanks freight service from 7 to 5 days per week. Train productivity (tonnage per train) increased by 7% as trains lengthened by 12% on average. In fact, crews assembled a record-breaking 2-mile-long train in late April, demonstrating that lower cost doesn't have to sacrifice service.

Excellent customer service is important to keeping and growing business. In 2013, customer service ratings indicated railroaders regularly met and exceeded the expectations of freight and passenger

(Photos by Judy Patrick)

A rail barge unloads in Whittier and a fuel train loads at the North Pole refinery. Barge business increased while fuel hauling declined in 2013.


(Photo by Judy Patrick)

(Photo by Dennis Bouwens)

Fuel conservation improved thanks to experienced engineer train handling techniques and keeping locomotives inside to reduce idling in winter.

customers. The Alaska Railroad passenger train Tour Guide Program was at full strength this year, with 24 high school students hired to engage and tend to passengers traveling aboard daily summer trains. This popular program is well worth the investment, as evidenced by passenger customer survey scores that averaged 4.76 on a scale from 1 to 5. Likewise, many travel writers gave our passenger services a resounding thumbs up. For example, in 2013 a *World Property Channel* writer ranked our Anchorage-Seward *Coastal Classic* train as the second in his top 10 train rides in the world!

In terms of service, safety and stewardship, a strong 2013 translates to positive momentum. And we need it, because there is no shortage of super-sized challenges to address in 2014. Flint Hills Resources Alaska has announced it will cease North Pole refinery operations by mid-year, effectively eliminating our Fairbanks-to-Anchorage fuel-hauling business and delivering an annual $11 million blow to revenue. MAP-21 expires this year, meaning we will likely face another difficult fight to keep our FTA formula funds, putting about $28 million at risk of additional reduction or even elimination. The PTC project still needs another $70 million to complete, and diminished progress could spell the end of passenger rail service for the Alaska Railroad.

In 1914, the U.S. Congress agreed to invest $35 million to build a railroad in the far-flung territory of Alaska. In 1985, the State of Alaska spent a similar amount to buy the railroad from the federal government. In 2013 the value of the Alaska Railroad's total assets surpassed $1 billion (with a "b") — an impressive milestone demonstrating tremendous returns on a smart and pivotal investment — then and now.

Bill O'Leary, President & CEO

Linda Leary, Chair


(Photo by Judy Patrick)

Mandatory hearing protection has reduced hearing loss incidence.

(Photo by Dwight West)

Locomotive decals are part of a summer public rail safety campaign.

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2013 Financial HIGHLIGHTS

Earnings *(in thousands)*:

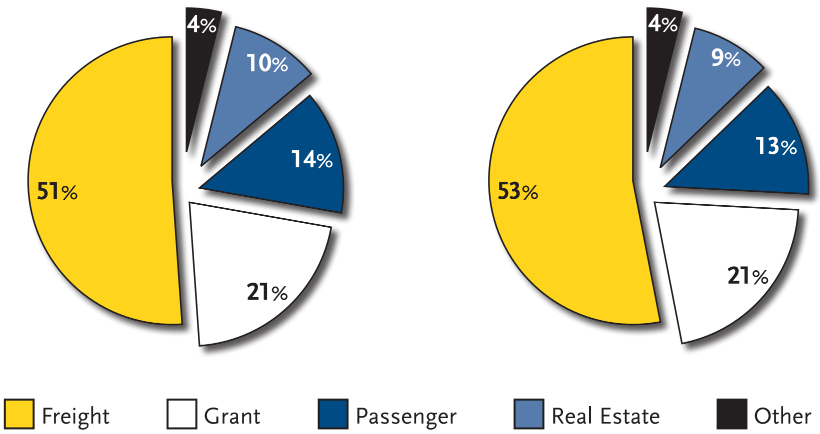
	2013	2012
Operating revenues:		
Freight	$ 96,575	$ 100,022
Passenger	25,650	24,027
Other	3,242	4,059
Grant	40,111	40,341
Total operating revenue	165,578	168,449
Operating expenses:	160,725	164,651
Operating income	4,853	3,798
Non-operating revenue (expenses):		
Net real estate income	10,929	10,104
Gain (loss) on sale of capital assets	6	—
Investment income	31	87
Interest expense, net of grant revenue	(1,502)	(1,474)
Net income	14,317	12,515
Other changes in net position	8,372	(2,108)
Change in net position	22,689	10,407
Net position, beginning of year	255,542	245,135
Net position, end of year	278,231	255,542
Operating Ratio:	0.97	0.98

Statements of Net Position *(in thousands)*:

	2013	2012
Assets:		
Current assets	$ 113,716	$ 104,860
Capital assets	911,367	875,284
Restricted assets	982	992
Other assets	26	18
Regulatory assets	11,989	8,738
Total assets	1,038,080	989,892
Liabilities:		
Current liabilities	49,642	50,933
Other liabilities	124,249	135,326
Total liabilities	173,891	186,259
Deferred inflows:		
Accrued pension benefits	5,661	10,781
Unearned grant revenue	580,297	537,310
Total liabilities and deferred inflows	759,849	734,350
Net position:	278,231	255,542
Total liabilities, deferred inflows & net position	1,038,080	989,892

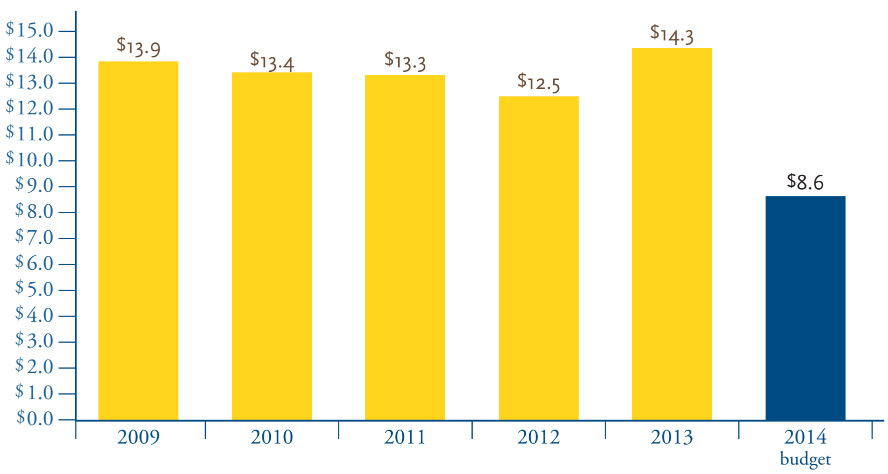
REVENUE

2013   2012



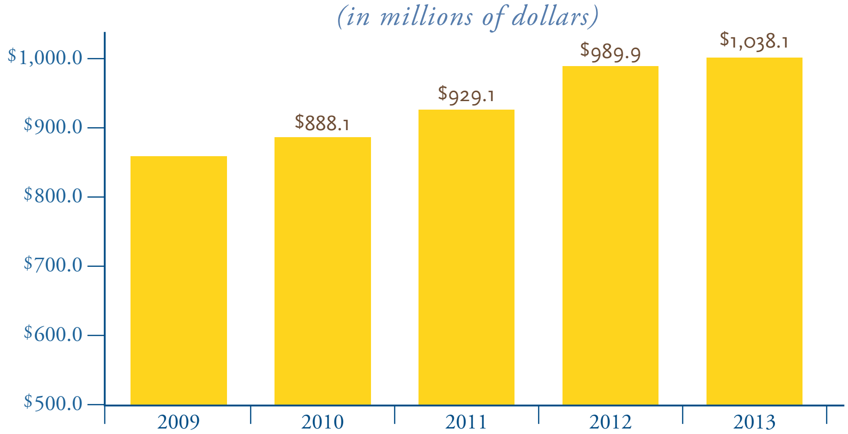
NET INCOME

(in millions of dollars)



TOTAL ASSETS

(in millions of dollars)



Sale Statement
The Alaska Railroad Corporation has not received any bona-fide offers of a sale arrangement within the calendar year of 2013, nor is the Corporation aware of any potential sales that require analysis under AS 42.40.260.

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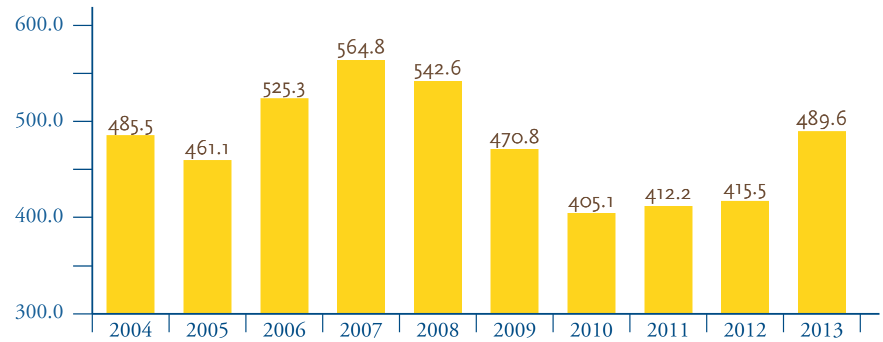
10-YEAR OPERATING TRENDS

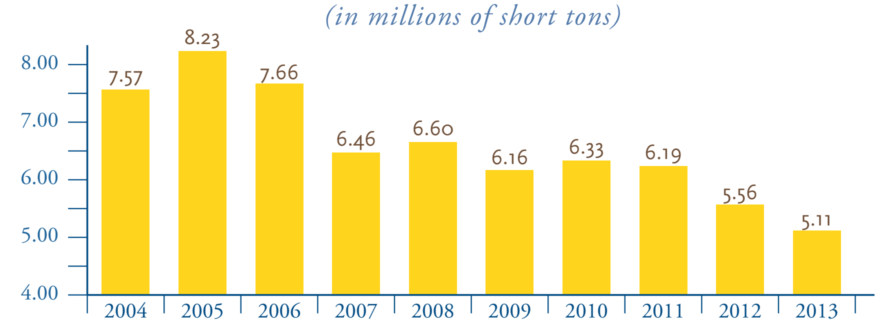
PASSENGER RIDERSHIP

(in thousands of passengers)



FREIGHT TONNAGE

(in millions of short tons)



Headquarters Mailing Address:

P.O. Box 107500
Anchorage, AK 99510-7500

Toll Free Phone Numbers:

Corporate Information:
1-800-321-6518

Freight Marketing/Customer Service:
1-800-321-6518

Passenger Customer Service:
1-800-544-0552

Seattle Office: 1-800-843-2772

ARRC Offices	Physical Location	Telephone	Fax
Anchorage, Alaska (99501)			
Headquarters Offices	327 W. Ship Creek Avenue	(907) 265-2300	(907) 265-2312
Reservations & Depot	411 W. 1st Avenue	(907) 265-2494	(907) 265-2509
Operations Center	825 Whitney Road	(907) 265-2434	(907) 265-2643
Fairbanks, Alaska (99701)			
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 (99664)			
Dock Operations / Terminal	913 Port Avenue (99664)	(907) 224-5550	(907) 265-2660
Seattle, Washington (98106)			
Barge Operations Office	1001 Klickitat Ave, Ste 200B	(206) 767-1100	(206) 767-1112

Online: facebook.com/alaskarailroad www.AlaskaRailroad.com twitter.com/akrr

TRANSMITTAL LETTER

March 27, 2014

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, 2013.

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,

Barbara Amy
Chief Financial Officer

Wendy Richerson, CPA
Controller

December 31, 2013 and 2012

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 years that ended on December 31, 2013 and 2012. Please read it in conjunction with the ARRC's financial statements, which follow this section.

Financial Highlights

The ARRC's total net position increased 9% during the course of this year's operations and increased 4% over the course of 2012 operations.

- During 2013, the ARRC's operating revenues exceeded operating expenses by $4.9 million, yielding an operating ratio of 0.97. Last year, operating revenues exceeded operating expenses by $3.8 million and yielded an operating ratio of 0.98.
- The total 2013 operating costs of the ARRC's programs were $160.7 million, a decrease of 2% compared to last year. The total 2012 operating costs of the ARRC's programs were $164.7 million, an increase of 2% compared to the prior year.
- Expenditures on capital assets totaled $90.2 million during 2013, a decrease of 28% compared to last year. Expenditures on capital assets totaled $125.6 million during 2012, an increase of 43% compared to the prior year.
- Grant funding was used for $67.7 million, or 75%, of the 2013 capital expenditures. Grant funding was used for $90.1 million, or 72%, of the 2012 capital expenditures. These amounts were recorded as unearned revenue in the regulatory liabilities section of the statement of net position. 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 notes 4 and 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:

- Statement of net position – the statement of net position reports assets, liabilities, and net position 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). Net position, 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 net position are an indicator of whether its financial health is improving or deteriorating, respectively.
- Statement of revenues, expenses, and changes in net position – this statement reflects revenues earned from services and expenses incurred to operate the ARRC, as well as the activities of the ARRC not considered to

be operations. All of the current year's revenues and expenses are accounted for in this statement regardless of when cash is received or paid.

- 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

Net position – ARRC's net position increased 9% between fiscal years 2012 and 2013 to approximately $278.2 million. ARRC's net position increased 4% between fiscal years 2011 and 2012 to approximately $255.5 million.

		2013	2012	2011
			(in thousands)	
Assets:				
Current assets	$	113,716	104,860	111,098
Capital assets		911,367	875,284	798,122
Other noncurrent assets		12,997	9,748	19,320
Total assets		1,038,080	989,892	928,540
Liabilities:				
Current liabilities		49,642	50,933	54,615
Notes payable outstanding, less current installments		19,137	19,049	24,328
Revenue bonds payable, less current portion, net of unamortized premiums		102,347	114,137	125,535
Other liabilities		2,660	2,035	2,646
Payable from restricted assets		105	105	100
Deferred inflows:				
Regulatory liabilities:				
Pension		5,661	10,781	7,107
Unearned grant revenue		580,297	537,310	469,077
Total liabilities and deferred inflows		759,849	734,350	683,408
Net position:				
Net invested in capital assets		194,689	188,937	174,959
Restricted for reinvestment in infrastructure		83,542	66,605	70,173
Total net position	$	278,231	255,542	245,132

Capital assets – Capital assets, net of accumulated depreciation increased $36.1 million in 2013 and $77.2 million in 2012. During 2013 and 2012, the ARRC continued an extensive capital improvement plan, including a new bridge, bridge rehabilitations, siding extensions, track refurbishing, and welding rail to allow faster train speed and reduce wear. Also during this time period, ARRC continued developing the federally mandated positive train control system and acquired right of way in anticipation of future rail realignments.

Long-term debt – Notes payable decreased $88,000 and $5.3 million in 2013 and 2012, respectively. During 2013, ARRC refinanced a long-term loan of $9.4 million and issued a new long-term loan of $1.9 million to fund the acquisition of real property. During 2012, ARRC refinanced two long-term loans of $4.0 million and $5.3 million.

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 allowed by Governmental Accounting Standards Board (GASB) Codification Section Re. 10, *Regulated Operations*. A description of each of the regulatory assets and liabilities is as follows:

- Unearned grant revenue relates to capital assets funded with federal grants. Unearned grant revenue increased $43.0 million in 2013 and $68.2 million in 2012. This increase reflects the amount of capital assets constructed with grant funding, partially offset by grant revenue recognized as the related capital assets are depreciated.
- The postretirement benefits asset increased $3.3 million and the accrued pension benefit liability decreased $5.1 million during 2013, due primarily to investment earnings. The postretirement benefits asset increased $1.6 million and the accrued pension benefit liability increased $3.7 million during 2012, due primarily to the increase in the actuarial accrued liability.

December 31, 2013 and 2012

Change in net position – ARRC's 2013 net income of $14.3 million and other changes in net position of $8.4 million combined to increase overall net position by $22.7 million, a 118% increase from fiscal year 2012's change in net position. ARRC's 2012 net income of $12.5 million was partially offset by other changes in net position of ($2.1 million), netting to increase overall net position by $10.4 million, a 17% decrease from fiscal year 2011's change in net position.

		2013	2012	2011
			(in thousands)	
Operating revenue:				
Freight	$	96,575	100,022	98,045
Passenger		25,650	24,027	22,382
Other		3,242	4,059	4,965
Total transportation revenue		125,467	128,108	125,392
Grant revenue		40,111	40,341	40,873
Total		165,578	168,449	166,265
Operating expense:				
Transportation		38,578	43,883	44,432
Passenger		9,311	9,755	8,796
Marketing and customer service		21,165	20,735	18,472
Mechanical		25,110	26,276	25,484
Engineering		40,394	40,348	38,494
Facilities		15,327	15,953	16,023
General and administrative		10,840	7,701	9,484
Total		160,725	164,651	161,185
Operating income		4,853	3,798	5,080
Nonoperating revenues (expenses):				
Corporate planning and real estate, net of expenses		10,929	10,104	8,292
Gain on sale of capital assets		6	—	1,391
Investment income		31	87	110
Interest expense, net of grant revenue		(1,502)	(1,474)	(1,562)
Net income		14,317	12,515	13,311
Other changes in net position		8,372	(2,108)	(805)
Change in net position	$	22,689	10,407	12,506

Operating Revenue – The ARRC's total revenues decreased less than 1% and totaled $188.7 million in 2013. The ARRC's total revenues increased 2% and totaled $189.7 million in 2012. Approximately 51% and 53% of the ARRC's revenue comes from freight revenue during 2013 and 2012, respectively, and 14% and 13% of the revenue comes from passenger services during 2013 and 2012, respectively. The majority of the remaining income relates to real estate activities and federal grant revenue. Generally, federal grant revenue is recognized as the capital assets funded by the grants are depreciated.

December 31, 2013 and 2012

Total transportation revenue for 2013 was $2.6 million less than 2012. The decrease in transportation revenue is attributed to weakening global coal markets and less petroleum shipments.

Total transportation revenue for 2012 was $3.6 million greater than 2011. The increase in transportation revenue is attributed to fuel surcharges related to increased fuel costs and the global recovery, which impacted freight shipments, passenger services, and other operating revenues.

Operating expenses were $160.7 million in 2013, $164.7 million in 2012 and $161.2 million in 2011, a decrease of $4.0 million or 2% from 2012 to 2013 and an increase of $3.5 million or 2% from 2011 to 2012.

Real estate expenses were $7.6 million in 2013, $7.2 million in 2012, and $8.3 million in 2011, an increase of 5% from 2012 to 2013 and a decrease of 13% from 2011 to 2012.

Other change in net position – ARRC records costs and accrued benefits under its defined benefit and postretirement plans. The other changes in net position of an increase of $8.4 million and decrease of $2.1 million during 2013 and 2012, respectively, represent the changes in the overfunded or unfunded actuarial accrued liability of the defined benefit pension and postretirement plans.

Capital Asset and Debt Administration

Capital Assets

At the end of 2013, the ARRC had invested $911.4 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 $36.1 million, or 4%, over last year. Grants have funded $541.6 million and $479.4 million of the assets, net of accumulated depreciation, at the end of 2013 and 2012, respectively.

		2013	2012 (in thousands)	2011
Land and improvements	$	31,671	30,424	29,719
Road materials and supplies		6,904	9,947	7,575
Road and roadway structures		537,818	549,345	566,700
Equipment		145,414	152,683	146,146
Leasehold improvements		515	122	251
Quarry improvements		3,534	3,534	3,675
Construction in progress		185,511	129,229	44,055
Total capital assets, net of accumulated depreciation	$	911,367	875,284	798,121

The ARRC's fiscal year 2014 capital budget approved spending another $26.0 million for capital projects, principally for continued track and bridge rehabilitation, planned replacement of vehicles and equipment, other infrastructure improvements, and continuing the development of federally mandated Positive Train Control. The ARRC intends to use federal grant funding to provide $7.4 million to provide the capital additions. The remaining capital projects will be funded out of current year earnings and cash flow and approximately $3.5 million State of Alaska funding. More detailed information about the ARRC's capital assets is presented in note 4 to the financial statements.

(Continued)

December 31, 2013 and 2012

Long-Term Debt

At the end of 2013, the ARRC had $22.0 million in notes payable outstanding, a decrease of 6% from 2012, and $113.9 million in revenue bonds payable outstanding, a decrease of 9%. At the end of 2012, the ARRC had $23.4 million in notes payable outstanding, a decrease of 17% from 2011, and $125.7 million in revenue bonds payable outstanding, a decrease of 8%. 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 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.

The ratings and outlooks have changed multiple times since the original ratings in 2006 and 2007. The most current ratings:

> On November 14, 2012, Moody's Investors Service lowered the ratings assigned to the bonds to "A3" from "A2" and revised the outlook on the bonds from stable to negative.
>
> On September 5, 2013, Fitch Ratings affirmed their "BBB" rating and stable outlook.
>
> On October 1, 2013, Standard & Poor's Rating Service affirmed its "A+" underlying and unenhanced rating to the bonds and affirmed their stable outlook on the bonds.

More detailed information about ARRC's bond-funded activities is presented in note 6 to the financial statements.

(Continued)

December 31, 2013 and 2012

Next Year's Budget

The 2014 budgets for freight and passenger revenues are $94.8 million and $25.2 million, respectively. As a result, the ARRC's net position is expected to increase $8.6 million or less than 1% by the close of 2014.

Subsequent to the adoption of the 2014 budget, one customer that accounted for 23% of budgeted freight revenue announced a significant change to its operations. The ARRC has not yet determined the impact of this change on the 2014 budget.

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.

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

Independent Auditors' Report

The Board of Directors
Alaska Railroad Corporation:

Report on the Financial Statements

We have audited the accompanying financial statements of the Alaska Railroad Corporation, a component unit of the State of Alaska, which comprise the statements of net position as of December 31, 2013 and 2012, and the related statements of revenues, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Alaska Railroad Corporation as of December 31, 2013 and 2012, and the changes in financial position and cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG

Emphasis of Matter

As discussed in note 2 to the financial statements, the Alaska Railroad Corporation adopted the provisions of Governmental Accounting Standards Board Statement No. 65, *Items Previously Reported as Assets and Liabilities,* retroactive to January 1, 2012. Our opinion is not modified with respect to this matter.

Other Matter

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 1–7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 27, 2014 on our consideration of the Alaska Railroad Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Alaska Railroad Corporation's internal control over financial reporting and compliance.

KPMG LLP

March 27, 2014

STATEMENTS OF NET POSITION

December 31, 2013 and 2012

(In thousands)

		2013	2012
Assets:			
Current assets:			
Cash and cash equivalents (note 3)	$	41,136	31,468
Accounts receivable, net of allowance for doubtful accounts of $346 in 2013 and $275 in 2012		16,388	18,251
Grants receivable		24,737	24,320
Materials and supplies		10,327	9,941
Prepaid expenses and other current assets		1,487	1,217
Under recovery of vehicle and equipment allocated costs (note 2(k))		209	—
Restricted assets (note 3)		19,432	19,663
Total current assets		113,716	104,860
Capital assets (notes 4 and 8):			
Land and improvements and quarry improvements (note 11)		35,785	34,538
Road materials and supplies		6,904	9,947
Road and roadway structures		853,205	831,288
Equipment (note 6)		352,243	342,614
Leasehold improvements (note 11)		2,172	1,650
Accumulated depreciation, depletion and amortization		(524,453)	(473,982)
Construction in progress		185,511	129,229
Total capital assets, net		911,367	875,284
Restricted assets (note 3)		982	992
Other assets		26	18
Regulatory asset:			
Postretirement benefits (note 7)		11,989	8,738
Total assets	$	1,038,080	989,892
Liabilities:			
Current liabilities:			
Current portion of notes payable (notes 5 and 6)	$	2,869	4,384
Accounts payable and accrued liabilities (notes 5 and 13)		18,227	19,396
Payroll liabilities		10,403	9,584
Environmental remediation reserve (notes 5 and 15)		624	366
Interest payable		2,280	2,460
Over recovery of vehicle and equipment allocated costs (note 2(k))		—	357
Unearned revenues		3,619	3,266
Current portion of revenue bonds payable (notes 5 and 6)		11,620	11,120
Total current liabilities		49,642	50,933
Notes payable, less current portion (notes 5 and 6)		19,137	19,049
Revenue bonds payable (net of unamortized premiums), less current portion (notes 5 and 6)		102,347	114,137
Environmental remediation reserve (notes 5 and 15)		1,849	1,019
State of Alaska advances (notes 3 and 5)		162	167
Payable from restricted assets (note 5)		105	105
Accrued postretirement benefits (note 7)		649	849
Total liabilities		173,891	186,259
Deferred inflows:			
Regulatory liabilities:			
Accrued pension benefits (note 7)		5,661	10,781
Unearned grant revenue (note 8)		580,297	537,310
Total deferred inflows		585,958	548,091
Total liabilities and deferred inflows		759,849	734,350
Net position (note 9):			
Net investment in capital assets (note 4)		195,097	189,285
Restricted for reinvestment in infrastructure (notes 2(a) and 2(l))		83,134	66,257
Total net position		278,231	255,542
Commitments and contingencies (notes 5, 7, 12, 13, and 15)			
Total liabilities, deferred inflows, and net position	$	1,038,080	989,892

See accompanying notes to financial statements.

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION

December 31, 2013 and 2012

(In thousands)

		2013	2012
Operating revenues:			
Freight (note 10)	$	96,575	100,022
Passenger		25,650	24,027
Other		3,242	4,059
		125,467	128,108
Grant revenue (note 8)		40,111	40,341
		165,578	168,449
Operating expenses:			
Transportation		38,578	43,883
Passenger		9,311	9,755
Marketing and customer service		21,165	20,735
Mechanical		25,110	26,276
Engineering		40,394	40,348
Facilities		15,327	15,953
General and administrative, net of indirect cost recovery of $2,011 in 2013 and $2,102 in 2012		10,840	7,701
		160,725	164,651
Operating income		4,853	3,798
Nonoperating revenues (expenses):			
Corporate planning and real estate income, less direct expenses of $7,583 in 2013 and $7,195 in 2012 (notes 6 and 11)		10,929	10,104
Gain on sale of capital assets		6	—
Investment income		31	87
Interest expense, net of grant revenue of $4,617 in 2013 and $3,833 in 2012 (note 6)		(1,502)	(1,474)
Total nonoperating revenues		9,464	8,717
Net income (note 2(a))		14,317	12,515
Other change in net position:			
Change in pension and postretirement funding status (note 7)		8,372	(2,108)
Change in net position		22,689	10,407
Net position, beginning of year		255,542	245,135
Net position, end of year	$	278,231	255,542

See accompanying notes to financial statements.

STATEMENTS OF CASH FLOW

December 31, 2013 and 2012

(In thousands)

		2013	2012
Cash flows from operating activities:			
Receipts from customers	$	127,330	128,896
Operating grants received		9,486	9,891
Payments to suppliers		(48,957)	(54,105)
Payments to employees		(59,643)	(65,110)
Net cash provided by operating activities		28,216	19,572
Cash flows from capital and related financing activities:			
Principal payments on long-term debt		(14,711)	(15,913)
Interest payments on long-term debt		(6,299)	(6,953)
Grant received for interest expense		5,376	3,099
Purchases and construction of capital assets		(88,720)	(126,571)
Proceeds from sales of capital assets		85	138
Increase in unearned revenues, net of advances		72,485	87,329
Net cash used in capital and related financing activities		(31,784)	(58,871)
Cash flows from investing activities:			
Real estate income and related cash flows		18,865	17,246
Real estate direct expenses paid		(5,901)	(5,577)
Purchase of restricted investments		—	(16,689)
Proceeds from sale of restricted investments		241	27,113
Interest received		31	151
Net cash provided by investing activities		13,236	22,244
Net increase (decrease) in cash and cash equivalents		9,668	(17,055)
Cash and cash equivalents at beginning of year		31,468	48,523
Cash and cash equivalents at end of year	$	41,136	31,468
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	4,853	3,798
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization		49,909	48,965
Bond issuance cost amortization		54	54
Grant revenue on capital assets		(30,679)	(30,504)
Changes in operating assets and liabilities:			
Materials and supplies		(386)	(113)
Accounts receivable		1,863	788
Prepaid expenses and other assets		(278)	12
Accounts payable and accrued liabilities		1,738	(2,114)
Over (under) recovery of vehicle and equipment allocated costs		(566)	773
Payroll liabilities		819	(1,076)
Environmental reserve		1,088	(174)
Accrued postretirement and pension benefits		(199)	(837)
Net cash provided by operating activities	$	28,216	19,572
Supplemental schedule of noncash investing and capital and related financing activities:			
Depreciation included in real estate activity	$	1,682	1,587
Change in construction of capital assets not yet paid		2,907	54
Capital assets acquired through issuance of note		1,940	—

See accompanying notes to financial statements.

December 31, 2013 and 2012

(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 683 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 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 GASB Codification Section Re. 10, *Regulated Operations*.

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 net position. The ARRC's board of directors has also adopted a resolution restricting net position for reinvestment in infrastructure.

(Continued)

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(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

Money market accounts, investments in commercial paper and U.S. Treasury notes are reported at cost.

(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 grants, and amortizes the unearned amounts over the life of the related capital assets. Additionally, ARRC records the funded status of its defined benefit 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.

(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 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.

(Continued)

December 31, 2013 and 2012

(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 overrecovery or underrecovery of actual vehicle and equipment cost is applied against fixed charge rates in subsequent years. Accordingly, the ARRC has recorded an underrecovery of $209,000 and an overrecovery of $357,000 as of December 31, 2013 and 2012, respectively.

(l) Net Position

As of December 31, 2013 and 2012, the ARRC's board of directors has restricted $83,134,000 and $66,257,000, respectively, of net position for reinvestment in infrastructure.

(m) Reclassifications

Certain reclassifications not affecting net income have been made to the 2012 financial statements to conform to the current presentation.

(n) Recently Issued Accounting Pronouncements

In June 2012, the GASB issued GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* (Statement 68), an amendment of GASB Statement No. 27. This Statement requires that an employer recognize its obligation for pensions net of the amount of the pensions plan's fiduciary net position that is available to satisfy that obligation as well as additional note disclosures regarding the obligation. The new standard is effective for financial statements for periods beginning after June 15, 2014. The ARRC is currently evaluating the impact that the adoption of Statement 68 will have on its financial statements.

(Continued)

December 31, 2013 and 2012

(o) *Change in Accounting Principle*

In March 2012, the GASB issued GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities* (Statement 65). Statement 65 established accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The ARRC adopted the provisions of Statement 65 during 2013, retroactive to January 1, 2012. The adoption of Statement 65 resulted in the write-off of certain debt issuance costs and unearned grant revenue, and also resulted in the reclassification of regulatory liabilities to deferred inflows. The effects adopting Statement 65 in ARRC's financial statements for the year ended December 31, 2012 were as follows:

	Year ended December 31, 2012		
	As previously reported	**Effect of adoption of Statement No. 65**	**As restated**
		(in thousands)	
Statement of net position:			
Total assets	$ 989,892	528	990,420
Deferred outflows	—	—	—
Total assets and deferred outflows	989,892	528	990,420
Total liabilities	(734,236)	547,449	(186,787)
Deferred inflows	—	(548,091)	(548,091)
Total liabilities and deferred inflows	(734,236)	(642)	(734,878)
Total net position	255,656	(114)	255,542
Statement of revenues, expenses and changes in net position:			
Operating income	3,817	(19)	3,798
Nonoperating revenues	8,687	30	8,717
Other change in net position	(2,108)	—	(2,108)
Changes in net position	10,396	11	10,407
Net position, beginning of year	245,260	(125)	245,135
Net position, end of year	$ 255,656	(114)	255,542

(Continued)

December 31, 2013 and 2012

(3) Deposits and Investments

Restricted assets consist entirely of money market funds and are reported on the statements of net position as follows at December 31, 2013 and 2012:

		2013	2012
		(in thousands)	
Restricted assets – current	$	19,432	19,663
Restricted assets – long-term		982	992
	$	20,414	20,655

These assets are restricted by the terms of grant or other agreements or by the ARRC's board of directors and are summarized as follows at December 31, 2013 and 2012:

Description of restriction		2013	2012
		(in thousands)	
Capital assets as authorized by the Department of Natural Resources	$	162	173
Advance grant funding		461	460
Debt service reserve		19,432	19,663
Arbitrage rebate reserve		104	104
Debt service reserve 2012A and 2012B		255	255
	$	20,414	20,655

(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.

At December 31, 2013, the ARRC's carrying amount of cash and cash equivalents was $41,136,000 and the bank balance was $41,693,000. Of the bank balance, $250,000 was covered by federal depository insurance, and $38,845,000 represents money market funds held by the ARRC's agent in the ARRC's name.

At December 31, 2012, the ARRC's carrying amount of cash and cash equivalents was $31,468,000 and the bank balance was $32,575,000. Of the bank balance, $250,000 was covered by federal depository insurance, and $30,320,000 represents money market funds held by the ARRC's agent in the ARRC's name.

(Continued)

(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, 2013 and 2012.

(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 Administration (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-funded capital assets. Indirect costs allocated to capital assets under this agreement totaled $2,011,000 and $2,102,000 during the years ended December 31, 2013 and 2012, respectively.

(Continued)

December 31, 2013 and 2012

The following tables summarize activity in the capital assets accounts during the years ended December 31, 2013 and 2012:

		Balance at December 31, 2012	Increases	Decreases	Balance at December 31, 2013
			(In thousands)		
Capital assets not being depreciated:					
Land and improvements	$	30,424	1,247	—	31,671
Road materials and supplies		9,947	—	(3,043)	6,904
Construction in progress		129,229	90,195	(33,913)	185,511
Total capital assets not being depreciated		169,600	91,442	(36,956)	224,086
Capital assets being depreciated:					
Road and roadway structures		831,288	21,917	—	853,205
Equipment		342,614	10,749	(1,120)	352,243
Leasehold improvements		1,650	522	—	2,172
Total capital assets being depreciated		1,175,552	33,188	(1,120)	1,207,620
Capital assets being depleted:					
Quarry improvements		4,114	—	—	4,114
Less accumulated depreciation for:					
Road and roadway structures		281,943	33,444	—	315,387
Equipment		189,931	18,018	(1,120)	206,829
Leasehold improvements		1,528	129	—	1,657
Total accumulated depreciation		473,402	51,591	(1,120)	523,873
Less accumulated depletion for:					
Quarry improvements		580	—	—	580
Capital assets being depreciated and depleted, net		705,684	(18,403)	—	687,281
Net capital assets	$	875,284	73,039	(36,956)	911,367

(Continued)

December 31, 2013 and 2012

	Balance at December 31, 2011	Increases	Decreases	Balance at December 31, 2012
	(In thousands)			
Capital assets not being depreciated:				
Land and improvements	$ 29,719	705	—	30,424
Road materials and supplies	7,575	9,204	(6,832)	9,947
Construction in progress	44,055	125,554	(40,380)	129,229
Total capital assets not being depreciated	81,349	135,463	(47,212)	169,600
Capital assets being depreciated:				
Road and roadway structures	801,917	29,371	—	831,288
Equipment	332,524	10,303	(213)	342,614
Leasehold improvements	1,650	—	—	1,650
Total capital assets being depreciated	1,136,091	39,674	(213)	1,175,552
Capital assets being depleted:				
Quarry improvements	4,114	—	—	4,114
Less accumulated depreciation for:				
Road and roadway structures	247,736	34,207	—	281,943
Equipment	173,859	16,246	(174)	189,931
Leasehold improvements	1,399	129	—	1,528
Total accumulated depreciation	422,994	50,582	(174)	473,402
Less accumulated depletion for:				
Quarry improvements	439	141	—	580
Capital assets being depreciated and depleted, net	716,772	(11,049)	(39)	705,684
Net capital assets	$ 798,121	124,414	(47,251)	875,284

(Continued)

December 31, 2013 and 2012

Depreciation was charged to the following departments during the years ended December 31, 2013 and 2012:

		2013		2012	
		Grant funded depreciation	Nongrant funded depreciation	Grant funded depreciation	Nongrant funded depreciation
		(in thousands)			
Transportation	$	2,762	534	2,773	618
Passenger		35	405	35	419
Marketing and customer service		—	846	—	1,010
Mechanical		3,652	6,242	3,680	6,066
Engineering		19,727	5,667	19,247	5,510
Facilities		4,246	2,784	4,353	2,992
General and administrative		257	2,752	416	1,876
Corporate planning and real estate		235	1,447	235	1,352
	$	30,914	20,677	30,739	19,843

Net investment in capital assets is as follows at December 31, 2013 and 2012:

		2013	2012
		(in thousands)	
Net capital assets (note 4)	$	911,367	875,284
Notes payable (note 6)		(22,006)	(23,433)
Outstanding balance of revenue bonds (note 6)		(113,967)	(125,256)
Unearned grant revenue (note 8)		(580,297)	(537,310)
	$	195,097	189,285

(Continued)

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December 31, 2013 and 2012

(5) Long-Term Liabilities

Long-term liability activity is summarized as follows during the years ended December 31, 2013 and 2012:

		Balance at December 31, 2012	Additions	Reductions (in thousands)	Balance at December 31, 2013	Due within one year
Long-term debt:						
Notes payable	$	23,433	1,940	(3,367)	22,006	2,869
Revenue bonds payable		120,925	—	(11,120)	109,805	11,620
Plus (less) deferred amounts:						
Issuance of premiums		4,860	—	(231)	4,629	—
Unamortized insurance costs		(529)	—	62	(467)	—
Total revenue bonds payable		125,256	—	(11,289)	113,967	11,620
Environmental remediation reserve		1,385	1,455	(367)	2,473	624
Other claims		240	385	(200)	425	295
State of Alaska advances		167	—	(5)	162	—
Payable from restricted assets		105	—	—	105	—
Total long-term liabilities	$	150,586	3,780	(15,228)	139,138	15,408

		Balance at December 31, 2011	Additions	Reductions (in thousands)	Balance at December 31, 2012	Due within one year
Long-term debt:						
Notes payable	$	28,379	—	(4,946)	23,433	4,384
Revenue bonds payable		131,560	—	(10,635)	120,925	11,120
Plus (less) deferred amounts:						
Issuance of premiums		5,199	—	(339)	4,860	—
Unamortized insurance costs		(589)	—	60	(529)	—
Total revenue bonds payable		136,170	—	(10,914)	125,256	11,120
Environmental remediation reserve		2,019	937	(1,571)	1,385	366
Other claims		346	120	(226)	240	240
State of Alaska advances		173	—	(6)	167	—
Payable from restricted assets		1,036	—	(931)	105	—
Total long-term liabilities	$	168,123	1,057	(18,594)	150,586	16,110

(Continued)

The ARRC has arrangements for two 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, 2013 or 2012.

ARRC also has an irrevocable letter of credit in the amount of $430,800.

(6) Long-Term Debt

Long-term debt at December 31, 2013 and 2012 consists of the following:

		2013	2012
		(in thousands)	
Notes payable:			
Note payable, secured by equipment, due in monthly payments of $60,553 including interest at 2.89%, matures July 2018	$	3,116	3,743
Note payable, secured by real estate revenue, due in monthly payments of $36,210, including interest at 3.95%, matures August 2023		3,486	3,776
Note payable, secured by real estate revenue, due in monthly payments of $48,538, including interest at 3.95%, matures August 2023		4,672	5,062
Note payable, secured by equipment, due in monthly payments of $136,842, including interest at 1.71%, matures August 2019		8,862	—
Note payable to State of Alaska, unsecured, due in annual payments (varies), including interest at 3.00%, matures September 2023		1,870	—
Matured amounts		—	10,852
		22,006	23,433
Less current portion		2,869	4,384
	$	19,137	19,049
Revenue bonds:			
Revenue Bonds – Series 2006 and 2007, interest at 3.625% – 5.25% payable semi-annually February 1 and August 1, secured by 5307 and 5309 FTA Formula Funds, matures August 2021	$	113,967	125,257
Less current portion		11,620	11,120
	$	102,347	114,137

(Continued)

Annual payments on debt are scheduled as follows at December 31, 2013:

	Notes payable		Revenue bonds payable		
	Principal	Interest	Principal	Interest	Total
			(in thousands)		
Year ending December 31:					
2014	$ 2,869	587	11,620	5,319	20,395
2015	2,942	513	12,095	4,841	20,391
2016	3,088	438	12,680	4,257	20,463
2017	3,168	357	13,305	3,635	20,465
2018	2,947	276	13,950	2,989	20,162
2019–2023	6,992	570	46,155	4,659	58,376
2024–2028	—	—	—	—	—
	22,006	$ 2,741	109,805	$ 25,700	160,252
Current portion of principal	(2,869)		(11,620)		(14,489)
Unamortized premium	—		4,629		4,629
Unamortized issuance cost	—		(467)		(467)
Total long-term portion	$ 19,137		102,347		149,925

Federal Transit Program – Corporation Participation in Section 5307 Formula Program and Section 5309/5337 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 (FGIC).

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 FGIC.

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)

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 FGIC 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 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.

On July 6, 2012, the President signed into law Public Law 112-141, titled "Moving Ahead for Progress in the 21st Century Act" or "MAP-21", commonly known as the multi-year surface transportation reauthorization bill, which reduced ARRC's FTA formula funding by approximately 21% or $7.3 million.

On September 12, 2012, Fitch Ratings lowered the ratings assigned to the bonds to "BBB" from "A" and revised the outlook on the bonds to stable from negative. On September 28, 2012, Standard & Poor's Rating Service affirmed its "A+" underlying and unenhanced rating to the bonds and affirmed the stable outlook on the bonds. On November 14, 2012, Moody's Investors Service lowered the ratings assigned to the bonds to "A3" from "A2" and revised the outlook on the bonds from stable to negative.

On September 5, 2013, Fitch Ratings affirmed their "BBB" rating and stable outlook. On October 1, 2013, Standard & Poor's Rating Service affirmed its "A+" underlying and unenhanced rating to the bonds and affirmed the stable outlook on the bonds.

The following table sets forth the authorized funding allocation of the FTA Section 5307 Formula Program Funds and Section 5309 or 5337 Formula Program Funds to ARRC in Federal Fiscal Years (FFY) 2012 and 2013 and estimated apportionments for FFY 2014:

FFY		Section 5307 formula program	Section 5309 or Section 5337 formula program	Total
2012	$	18,064,178	16,405,108	34,469,286
2013		9,546,554	18,275,576	27,822,130
2014 Estimated apportionments		9,597,624	18,426,377	28,024,001

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, 2012 and December 31, 2013, respectively. There was no rebate amount due on the Series 2006 or Series 2007 as of December 31, 2013. The Series 2007 rebate of $936,000 was paid in February 2012.

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December 31, 2013 and 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.

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 unfunded or overfunded actuarial accrued liabilities associated with pension and postretirement benefits are reported as regulatory assets or liabilities in the statements of net position. 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*.

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December 31, 2013 and 2012

The overfunded actuarial accrued liability (AAL) of the postretirement plan, which is the difference between the actuarial value of the assets and the actuarial accrued liability of the plan, is reported as regulatory assets. The unfunded AAL of the pension plan is reported as a regulatory liability. The change in pension and postretirement funding status is presented as other changes in net position and represents the change in the overfunded or unfunded actuarial accrued liability for both plans. The following table presents the regulatory assets and liabilities and other changes in net position for both plans at December 31, 2013, 2012, and 2011:

		2013	2012	2011
			(in thousands)	
Regulatory asset:				
Overfunded postretirement AAL	$	11,989	8,738	7,171
Regulatory liability:				
Unfunded pension AAL	$	5,661	10,781	7,107
Other change in net position:				
Change in pension and postretirement funding status	$	8,372	(2,108)	805

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 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 nonrepresented employees who are not covered by the Civil Service Retirement System (CSRS). 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.

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Assumptions used to determine annual pension cost (APC) and related information for the years ended December 31, 2013 and 2012 are as follows:

	2013	2012
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 actuarial accrued liability is amortized over an open 30-year period as a level dollar amount.

The following table presents activity of the Plan's assets during the years ended December 31, 2013 and 2012:

	2013	2012
	(in thousands)	
Income:		
Contributions received:		
Employee	$ 4,062	4,172
Employer	3,957	3,647
Investment earnings	19,576	14,440
Total income	27,595	22,259
Disbursements:		
Benefit payments	3,405	3,107
Administrative and investment consulting expenses	468	356
Total disbursements	3,873	3,463
Net income	23,722	18,796
Fair value of assets at beginning of year	111,960	93,164
Fair value of assets at end of year	$ 135,682	111,960

(Continued)

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, 2013, 2012, and 2011:

		2013	2012 (in thousands)	2011
Fair value of assets at end of year	$	135,682	111,960	93,164
Unamortized actuarial (gains) losses		(11,510)	(5,376)	3,860
Actuarial value of assets at the end of year		124,172	106,584	97,024
Actuarial accrued liability (AAL)		129,833	117,365	104,131
Unfunded (UAAL)	$	5,661	10,781	7,107
Funded ratio (actuarial value of plan assets/AAL)		96.0%	91.0%	93.0%
Covered payroll (active plan members)	$	48,661	48,134	43,773
UAAL as a percentage of covered payroll		12.0%	22.0%	16.0%

The ARC of $3,957,000 and $3,647,000 and the associated expenses of $3,490,000 and $3,082,000 were included in the accompanying financial statements for the years ended December 31, 2013 and 2012, 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 2013 and the two preceding years were as follows:

		2013	2012 (in thousands)	2011
Annual pension cost	$	3,957	3,647	3,014
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.

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December 31, 2013 and 2012

Assumptions used to determine annual postemployment benefit cost and related information for the years ended December 31, 2013 and 2012 are as follows:

	2013	2012
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	8.9 to 4.5	8.9 to 4.5
Prescription	8.9 to 4.5	8.9 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 actuarial accrued liability is amortized over an open 6-year period as a level dollar amount. The ARRC has incorporated the impact of the Patient Protection and Affordable Care Act or "Health Care Reform," as currently enacted, in calculating its actuarial accrued liability.

The following table represents activity of the Plan's assets during the years ended December 31, 2013 and 2012:

	2013	2012
	(in thousands)	
Income:		
Contributions received – employer	$ —	20
Investment earnings	6,755	4,997
Total income	6,755	5,017
Disbursements:		
Benefit payments	123	217
Administrative and investment consulting expenses	210	82
Total disbursements	333	299
Net income	6,422	4,718
Fair value of assets at beginning of year	37,301	32,583
Fair value of assets at the end of year	$ 43,723	37,301

(Continued)

December 31, 2013 and 2012

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, 2013, 2012, and 2011:

		2013	2012	2011
			(in thousands)	
Fair value of assets at end of year	$	43,723	37,301	32,583
Unamortized actuarial (gains) losses		(4,016)	(1,847)	1,078
Actuarial value of assets at the end of year		39,707	35,454	33,661
Actuarial accrued liability (AAL)		27,718	26,716	26,490
Overfunded AAL	$	(11,989)	(8,738)	(7,171)
Funded ratio (actuarial value of plan assets/AAL)		143.0%	133.0%	127.0%
Covered payroll (active plan members)	$	48,661	48,134	43,773
UAAL as a percentage of covered payroll		(25.0)%	(18.0)%	(16.0)%

The following table shows the components of the ARRC's net other postemployment benefit (OPEB) cost for the year. Changes in the ARRC's net OPEB obligation to the plan, and the percentage of annual OPEB cost contributed to the plan during the years ended December 31, 2013, 2012, and 2011:

		2013	2012	2011
			(in thousands)	
Annual required contribution (ARC)	$	—	20	1,665
Interest on net OPEB obligation		108	126	128
Adjustment to the ARC		(308)	(359)	(145)
Annual OPEB cost		(200)	(213)	1,648
Contributions made		—	(623)	(1,665)
Decrease in the net OPEB obligation		(200)	(836)	(17)
Net OPEB obligation at beginning of year		849	1,685	1,702
Net OPEB obligation at the end of year	$	649	849	1,685
Annual OPEB cost contributed		—%	(9)%	101%

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(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 $111,000 and $152,000 for the years ended December 31, 2013 and 2012, 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 $548,000 and $558,000 for the years ended December 31, 2013 and 2012, 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 nonrepresented employees. There are no benefit expenses related to the Plan for the years ended December 31, 2013 and 2012.

(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, 2013 and 2012 consists of the following:

			2013	2012
			(in thousands)	
Land and improvements		$	8,322	8,140
Road and roadway structures	15–32 year life		468,382	457,389
Equipment	5–25 year life		139,053	138,731
Construction in process			165,069	108,820
		$	780,826	713,080

(Continued)

December 31, 2013 and 2012

The original cost of assets constructed or acquired with Capital Grant Receipts Bonds, Series 2006 and 2007, consists of the following:

			Total (in thousands)
Road and roadway structures	15–32 year life	$	163,779
Equipment	5–25 year life		18,960
Construction in process			—
		$	182,739

(9) Net Position

Net position consists of the following major items as of December 31, 2013 and 2012:

	Investment by the State of Alaska	Cumulative net income	Cumulative other changes in net position	Total net position
	(in thousands)			
Balance at January 1, 2012	$ 34,174	210,892	69	245,135
Net income	—	12,515	—	12,515
Other changes in net position	—	—	(2,108)	(2,108)
Total changes in net position				10,407
Balance at December 31, 2012	34,174	223,407	(2,039)	255,542
Net income	—	14,317	—	14,317
Other changes in net position	—	—	8,372	8,372
Total changes in net position				22,689
Balance at December 31, 2013	$ 34,174	237,724	6,333	278,231

(10) Concentrations

Two ARRC customers accounted for 36% and 38% of freight revenue in 2013 and 2012, respectively. During 2013 and 2012, ARRC entered into agreements with one of the customers under the Internal Revenue Code §45G. Under the agreements, ARRC received $4.8 million for qualified track maintenance expenses and gave the customer a shipping credit of $2.7 million in 2013 and 2012. The qualified track maintenance expenses and the shipping credit are recorded as net reductions in operating expenses.

(Continued)

Subsequent to year-end, one freight customer that accounted for 22% and 20% of freight revenue in 2013 and 2012, respectively, announced it was significantly altering its operations.

A significant portion of ARRC's funding comes from the federal government in the form of grants. Federal grant funding was used for 75% and 72% of capital expenditures in 2013 and 2012, respectively.

(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 $15,198,862 and $14,132,000 in 2013 and 2012, respectively. The following table summarizes future minimum lease payments as of December 31, 2013:

		Amount (in thousands)
Year ending December 31:		
2014	$	12,851
2015		12,305
2016		11,766
2017		11,587
2018		10,725
Thereafter		127,176
	$	186,410

(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 $9,849,000 and $10,152,000 in 2013 and 2012, respectively. Future minimum lease payments as of December 31, 2013 are summarized as follows:

		Amount (in thousands)
Year ending December 31:		
2014	$	9,649
2015		8,685
2016		1,437
2017		137
2018		54
Thereafter		—
	$	19,962

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(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 Workers' Compensation Act. ARRC's commercial insurance policies with self-insured retention limits are summarized as follows at December 31, 2013 and 2012:

		2013	2012
		(in thousands)	
Casualty/liability	$	75,000	75,000
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, 2013, 2012, and 2011:

		Balance at December 31, 2012	Incurred claims	Claim payments	Balance at December 31, 2013
			(in thousands)		
Employee health benefits	$	1,367	11,709	(11,672)	1,404
Workers' compensation		1,691	2,669	(1,852)	2,508
	$	3,058	14,378	(13,524)	3,912

		Balance at December 31, 2011	Incurred claims	Claim payments	Balance at December 31, 2012
			(in thousands)		
Employee health benefits	$	1,330	11,292	(11,255)	1,367
Workers' compensation		1,599	2,025	(1,933)	1,691
	$	2,929	13,317	(13,188)	3,058

		Balance at December 31, 2010	Incurred claims	Claim payments	Balance at December 31, 2011
			(in thousands)		
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

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(14) Environmental Remediation Reserve

The ARRC has accrued certain environmental pollution remediation liabilities for its properties. 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.

(15) Commitments and Contingencies

Approximately 76% of the ARRC's labor force is subject to one of five collective bargaining agreements. The representative unions are United Transportation Union (UTU), International Brotherhood of Teamsters Local 959 (IBT), American Train Dispatchers Association (ATDA), Carmen's Division of Transportation Communication International Union (TCU) and the Alaska Railroad Workers (ARW). The labor agreement with the ARW expired October 2013. Negotiations with ARW began on September 4, 2013 and continue in 2014. The TCU labor agreement expires September 2014. All other labor agreements expire in 2015 or later.

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.

(16) Related Party Transactions

During the year ended December 31, 2013, the ARRC issued a $1,940,000 note payable to the State of Alaska, Department of Transportation and Public Facilities in exchange for real property.

The State of Alaska awarded ARRC appropriations for two capital improvement projects totaling $103,100,000. The ARRC has incurred $60,769,000 of costs under these appropriations, which are included in accounts receivable and construction in progress as of December 31, 2013. Consistent with other grants, revenue from these appropriations will be deferred and recognized over the life of the related capital assets.