ALASKA

2005

THE ALASKA RAILROAD CORPORATION ANNUAL REPORT
FINANCIAL SECTION

FINANCIAL SECTION

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March 21, 2006

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, 2005.

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

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

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

Sincerely,

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

Wendy Richerson, CPA
Controller

ALASKA RAILROAD CORPORATION

Management's Discussion and Analysis

December 31, 2005 and 2004

This section of the Alaska Railroad Corporation's (ARRC's) annual financial report presents our discussion and analysis of the ARRC's financial performance during the fiscal years that ended on December 31, 2005 and 2004. Please read it in conjunction with the ARRC's financial statements, which follow this section.

Financial Highlights

- The ARRC's total fund equity increased 14% over the course of this year's operations and 10% over the course of 2004 operations.
- During the year, the ARRC's operating revenues exceeded operating expenses by $6.8 million, yielding an operating ratio of 0.95. Last year, operating revenues exceeded operating expenses by $10.1 million and yielded an operating ratio of 0.91.
- The total operating costs of the ARRC's programs were $122.8 million, an increase of 16% compared to last year. Total operating costs were $105.9 million, an increase of 4% during 2004.
- Expenditures on capital assets totaled $90.5 million during the year ended December 31, 2005, a decrease of 12% compared to last year. Expenditures on capital assets totaled $102.3 million during the year ended December 31, 2004, an increase of 26% compared to last year
- Federal grant funding was used for $64.8 million, or 72%, of the 2005 capital expenditures. In 2004 federal grant funding was $61.9 million, or 61%, of capital expenditures. These amounts were recorded as deferred revenue in the regulatory liabilities section of the balance sheet. Revenue associated with capital grants is recognized when the assets are depreciated. Grant revenue for capital assets equals grant depreciation expense in operations and real estate. More detailed information can be found in note 8.

Overview of the Financial Statements

The ARRC is a component unit of the State of Alaska and operates like a stand-alone business. The ARRC is subject to the jurisdiction of the Surface Transportation Board (STB) and the ARRC's rates for services are established by its board of directors and designed to recover the cost of providing the service. The financial statements report information about the ARRC using accounting methods similar to those used by private-sector companies. This annual report consists of two parts – *management's discussion and analysis* (this section) and the *basic financial statements*. The basic financial statements 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 considered to be operations. All of the current year's revenues and expenses are accounted for in this statement regardless of when cash is received or paid. This statement replaces the previously reported statement of income.

- Statement of cash flows – this statement reports activities of the ARRC as they affect cash balances.

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

Financial Analysis of the Alaska Railroad Corporation

Fund equity – ARRC's fund equity increased 14% between fiscal years 2004 and 2005 – increasing to approximately $171.2 million. ARRC's fund equity increased 10% between fiscal years 2003 and 2004 – increasing to approximately $150.3 million.

		2005	2004	2003
Assets:				
Current assets	$	48,005	55,243	60,348
Capital assets		525,851	459,290	378,792
Other noncurrent assets		103	1,043	982
Total assets	$	573,959	515,576	440,122
Liabilities:				
Current liabilities	$	27,449	24,566	26,129
Long-term debt outstanding, less current installments		24,468	27,446	17,874
Other liabilities		1,193	3,036	3,397
Regulatory liabilities:				
Postretirement and pension		4,279	17,984	13,495
Deferred grant revenue		345,391	292,294	242,014
Total liabilities	$	402,780	365,326	302,909
Fund equity:				
Invested in capital assets, net of related debt	$	153,014	136,500	116,728
Restricted for reinvestment in infrastructure		18,165	13,750	20,485
Total fund equity	$	171,179	150,250	137,213

Capital assets – Capital assets, net of accumulated depreciation, increased $66.6 million in 2005 and $80.5 million in 2004. During 2005 and 2004, the ARRC continued an extensive capital improvement plan, including track refurbishing, straightening of curves in the track to allow faster train speed, and building new passenger depots. The majority of capital assets are funded through federal grants.

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

- Deferred grant revenue relates to capital assets funded with federal grants. Deferred grant revenue increased $53.1 million in 2005 and $50.3 million in 2004. This increase reflects the increased 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 net postretirement and pension liability decreased $13.7 million during 2005, primarily due to a strong market performance of the assets invested in the pension funds, changes in the assumptions used to calculate the liabilities and a $7.7 million postretirement contribution. The postretirement and pension liability increased $4.5 million during 2004, primarily due to poor market performance during 2004.

Changes in fund equity – The ARRC's total revenues increased 11% and totaled $144.0 million in 2005. The ARRC's total revenues increased 1% and totaled $129.5 million in 2004. Approximately 66% and 67% of the ARRC's revenue comes from freight revenue during 2005 and 2004, respectively, and 14% and 13% of the revenue comes from passenger services during 2005 and 2004, respectively. The majority of the remaining income is related to real estate activities and federal grant revenue. Generally, federal grant revenue is recognized as the capital assets funded by the grants are depreciated.

ARRC's total expenses including real estate expenses of $7,404,000 in 2005, $7,066,000 in 2004, and $11,137,000 in 2003, increased less than 5% from 2004 to 2005 and decreased less than 1% from 2003 to 2004 (in thousands):

	2005	2004	2003
Operating revenue:			
Freight	$ 94,485	86,516	85,228
Passenger	19,472	16,923	14,174
Other	573	116	245
Total transportation revenue	114,530	103,555	99,647
Grant revenue	15,115	12,488	14,665
Total	129,645	116,043	114,312
Operating expense:			
Transportation	34,270	28,124	25,498
Passenger services	4,304	3,559	3,563
Markets, sales, and service	17,153	14,364	16,639
Passenger operations	5,187	4,343	2,824
Mechanical	16,877	15,316	14,346
Maintenance	28,095	24,224	24,767
Engineering and signals	2,510	2,098	1,945
Health, safety, and environment	1,884	1,822	1,522
General and administrative	12,561	12,084	11,095
Total	122,841	105,934	102,199
Operating income	6,804	10,109	12,113
Nonoperating revenues (expenses):			
Real estate income, net of expenses	6,506	5,980	2,873
Investment income	430	371	385
Interest expense	(1,085)	(1,083)	(837)
Net income	12,655	15,377	14,534
Other changes in fund equity	8,274	(2,340)	3,252
Change in fund equity	$ 20,929	13,037	17,786

Several events occurred during 2005 that significantly impacted the change in fund equity:

- The Federal Railroad Administration approval of ARRC's indirect cost rate agreements allowed ARRC to allocate eligible general and administrative expenses to federal grant projects. A total of $1.4 million was allocated to capital projects during 2005, reducing general and administrative expenses. The overall indirect cost recovery was $149,000 more than 2004.

- Total transportation revenue was $11 million greater than 2004. The revenue increases resulted from strong passenger ridership, solid petroleum shipments, increased gravel shipments, increased interline activity and trailer on flat car (TOFC) service.
- In 2005, ARRC changed methods for recording costs and accrued benefits under its defined benefit and postretirement plans to be 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 change and a $7.7 million postretirement contribution resulted in a decrease of $13.7 million in the net postretirement and pension liabilities. The ARRC's annual required contribution of $668,000 and $2,268,000 for its defined benefit and postretirement plans, respectively, was made during the year and is included in the accompanying financial statements. The other changes in fund equity of $8.3 million and ($2.3) million represents the change from the prior year in the unfunded accrued actuarial liability of the defined benefit and post retirement plans at December 31, 2005 and 2004, respectively.

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

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

Capital Asset and Debt Administration

Capital Assets

At the end of 2005, the ARRC had invested $525.9 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 $66.6 million, or 14%, over last year. Federal grants have funded $345.4 million of the assets, net of accumulated depreciation (in thousands):

	2005	2004	2003
Land and improvements	$ 19,598	19,587	18,991
Road materials and supplies	12,311	10,197	3,724
Road and roadway structures	189,013	177,760	160,982
Equipment	90,510	93,427	71,306
Leasehold improvements	1,064	1,393	1,529
Construction in progress	213,355	156,926	122,260
Total capital assets, net of accumulated depreciation	$ 525,851	459,290	378,792

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

Long-Term Debt

At year-end the ARRC had $27.4 million in long-term notes outstanding, a decrease of 10% from last year. More detailed information about the ARRC's long-term liabilities is presented in note 6 to the financial statements.

Next Year's Budget

Freight and passenger revenues are projected at $89.7 million and $20.8 million, respectively. Management will continue initiatives to reduce operating expenses that were implemented during 2004. As a result, the ARRC's fund equity is expected to increase $7.4 million or 4% by the close of 2006.

Contacting the ARRC's Financial Management

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

Independent Auditors' Report

The Board of Directors
Alaska Railroad Corporation:

We have audited the accompanying balance sheets of the Alaska Railroad Corporation, a component unit of the State of Alaska, as of and for the years ended December 31, 2005 and 2004, and the related statements of revenues, expenses and changes in fund equity, and cash flows for the years then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Corporation's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Alaska Railroad Corporation as of December 31, 2005 and 2004, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 21, 2006 on our consideration of the Alaska Railroad Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 2 through 7 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

March 21, 2006

ALASKA RAILROAD CORPORATION

Balance Sheets

December 31, 2005 and 2004

(In thousands)

Assets		2005	2004
Current assets:			
Cash and cash equivalents (note 3)	$	2,078	10,222
Accounts receivable, net of allowance for doubtful accounts of $137 in 2005 and $165 in 2004		13,888	12,372
Grants receivable (note 8)		20,131	17,160
Materials and supplies		7,728	6,280
Restricted assets (note 3)		1,241	1,909
Prepaid expenses and other current assets		2,137	6,391
Under recovery of vehicle and equipment allocated costs (note (2k))		802	909
Total current assets		48,005	55,243
Capital assets (note 4):			
Land and improvements (note 11)		19,598	19,587
Road materials and supplies		12,311	10,197
Road and roadway structures		283,338	257,429
Equipment		164,809	159,000
Leasehold improvements (note 11)		1,650	1,848
Accumulated depreciation and amortization		(169,210)	(145,697)
Construction in progress		213,355	156,926
Total capital assets, net		525,851	459,290
Restricted assets (note 3)		—	920
Other assets		103	123
	$	573,959	515,576
Liabilities and Fund Equity			
Current liabilities:			
Current portion of long-term debt (notes 5 and 6)	$	2,978	3,050
Accounts payable and accrued liabilities (notes 5, 13, and 14)		8,635	6,730
Payroll liabilities		10,493	9,410
Unearned revenues (note 11)		5,343	5,376
Total current liabilities		27,449	24,566
Long-term debt, less current portion (notes 5 and 6)		24,468	27,446
Environmental remediation reserve (notes 5, 13, and 14)		578	2,371
State of Alaska advances (notes 3, 5, and 8)		615	665
Regulatory liabilities:			
Accrued postretirement and pension benefits (notes 5 and 7)		4,279	17,984
Deferred grant revenue (notes 5 and 8)		345,391	292,294
Total liabilities		402,780	365,326
Fund equity (notes 7 and 9):			
Investment in capital assets, net of related debt and deferred grant revenue (note 4)		153,014	136,500
Restricted for reinvestment in infrastructure (notes 2(a) and 3)		18,165	13,750
Total fund equity		171,179	150,250
Commitments and contingencies (notes 7, 10, 12, 13, and 14)			
	$	573,959	515,576

See accompanying notes to basic financial statements.

ALASKA RAILROAD CORPORATION

Statements of Revenues, Expenses, and Changes in Fund Equity

Years ended December 31, 2005 and 2004

(In thousands)

	2005	2004
Operating revenues:		
Freight (note 10)	$ 94,485	86,516
Passenger	19,472	16,923
Other	573	116
	114,530	103,555
Grant revenue (note 8)	15,115	12,488
	129,645	116,043
Operating expenses (note 8):		
Transportation	34,270	28,124
Passenger services	4,304	3,559
Markets, sales, and service	17,153	14,364
Passenger operations	5,187	4,343
Mechanical	16,877	15,316
Maintenance	28,095	24,224
Engineering and signals	2,510	2,098
Health, safety, and environment	1,884	1,822
General and administrative, net of indirect cost recovery of $1,368 in 2005 and $1,219 in 2004	12,561	12,084
	122,841	105,934
Operating income	6,804	10,109
Nonoperating revenues (expenses):		
Real estate income, less direct expenses of $7,403 in 2005 and $7,066 in 2004 (notes 8 and 11)	6,506	5,980
Investment income	430	371
Interest expense	(1,085)	(1,083)
Total nonoperating revenues	5,851	5,268
Net income (note 2(a))	12,655	15,377
Other change in fund equity:		
Change in pension and postretirement funding status (note 7)	8,274	(2,340)
Change in fund equity	20,929	13,037
Fund equity, beginning of year	150,250	137,213
Fund equity, end of year	$ 171,179	150,250

See accompanying notes to basic financial statements.

ALASKA RAILROAD CORPORATION

Statements of Cash Flows

Years ended December 31, 2005 and 2004

(In thousands)

	2005	2004
Cash flows from operating activities:		
Receipts from customers	$ 112,322	100,871
Operating grants received	3,434	2,173
Payments to suppliers	(46,218)	(49,079)
Payments to employees	(57,702)	(45,807)
Net cash provided by operating activities	11,836	8,158
Cash flows from capital and related financing activities:		
Principal payments on long-term debt	(3,050)	(2,854)
Interest payments on long-term debt	(1,085)	(1,083)
Proceeds from long-term debt	—	13,300
Purchases of capital assets	(90,520)	(102,293)
Proceeds from sales of capital assets	700	71
Increase in deferred revenues, net of advances	61,757	49,432
Net cash used in capital and related financing activities	(32,198)	(43,427)
Cash flows from investing activities:		
Real estate income received, net of direct expenses	10,200	10,374
Interest received	1,350	282
Proceeds from sale of restricted investments	668	8,743
Net cash provided by investing activities	12,218	19,399
Net decrease in cash and cash equivalents	(8,144)	(15,870)
Cash and cash equivalents at beginning of year	10,222	26,092
Cash and cash equivalents at end of year	$ 2,078	10,222
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 6,804	10,109
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	20,224	18,483
Grant revenue on capital assets	(11,681)	(10,315)
Gain on disposal of capital assets	(692)	(20)
Changes in assets and liabilities:		
Increase in materials and supplies	(1,448)	(520)
Increase in accounts receivable	(1,516)	(2,664)
Increase (decrease) in prepaid expenses and other assets	4,274	(4,063)
Increase (decrease) in accounts payable and accrued liabilities	1,905	(3,362)
Increase (decrease) in over recovery of vehicle and equipment allocated costs	107	(2,418)
Increase in payroll liabilities	1,083	975
Increase (decrease) in environmental reserve	(1,793)	(196)
Increase (decrease) in accrued postretirement and pension benefits	(5,431)	2,149
Total adjustments	5,032	(1,951)
Net cash provided by operating activities	$ 11,836	8,158
Supplemental disclosure of noncash activity:		
Depreciation included in real estate activity	$ 3,529	3,261
Increase (decrease) in pension and postretirement funding status	8,274	(2,340)

See accompanying notes to basic financial statements.

(1) Organization and Operations

The United States Congress authorized construction of the Alaska Railroad (ARR) in 1914 and operations began in 1923. The federal government operated the railroad until its sale to the State of Alaska in January 1985. The sale of the ARR to the State of Alaska was authorized under the Alaska Railroad Transfer Act of 1982, which was signed into law on January 14, 1983. The State of Alaska legislature created the Alaska Railroad Corporation (ARRC), a component unit of the State of Alaska, to own and operate the railroad and manage the railroad's rail, industrial, port and other properties. The ARRC commenced operations on January 6, 1985.

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

(2) Summary of Significant Accounting Policies

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

(a) Basis of Accounting

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

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

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

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

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

(b) Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include time deposits, money market accounts and repurchase agreements with original maturities of three months or less.

(c) Materials and Supplies

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

(d) Capital Assets

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

(e) Restricted Assets and Investments

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

(f) Regulatory Liabilities

The ARRC's rates for services are established by the board of directors and are designed to recover the cost of providing the service. For purposes of establishing rates, the ARRC defers the recognition of grant revenues relating to capital assets funded with federal grants, and amortizes the deferred amounts over the life of the related capital assets. Additionally, 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.

(h) Grants

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

(i) Income Taxes

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

(j) Environmental Remediation Costs

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

(k) Vehicle and Equipment Allocated Costs

The ARRC's vehicle and equipment costs for maintenance, fuel, depreciation, and leases are recorded in the vehicle and equipment cost pool. These costs are recovered through various responsibility centers through a fixed charge rate based on usage of vehicles and equipment. Any over or under recovery of actual vehicle and equipment costs is applied against fixed charge rates in subsequent years. Accordingly, the ARRC has recorded under recoveries of $802,000 and $909,000 during the years ended December 31, 2005 and 2004, respectively.

(l) Fair Value of Financial Instruments

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

(m) Reclassifications

Certain reclassifications not affecting net income have been made to the 2005 financial statements to conform with current presentation.

(3) Cash and Investments

As of and for the year ended December 31, 2005, the ARRC had no investment activity. As of and for the year ended December 31, 2004, the ARRC had equity mutual fund activity. The balance of the equity mutual funds at December 31, 2004 was approximately $920,000.

Interest Rate Risk

The ARRC has a formal investment policy that limits the term to five years or less, for investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

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. The ARRC's Investment Policy requires that all investments be collateralized and/or insured.

Concentration of Credit Risk

The ARRC places no limit on the amount the ARRC may invest in any one issuer. At December 31, 2005, the ARRC had no investments.

Custodial Credit Risk – Deposits

In the case of deposits, this is the risk that in the event of a bank failure, the ARRC's deposits may not be returned to it. The ARRC requires all deposits to be insured or collateralized.

At December 31, 2005, the ARRC's carrying amount of cash and cash equivalents was $2,078,000 and the bank balance was $2,511,000. Of the bank balance, $100,000 was covered by federal depository insurance; $1,441,000 was collateralized with securities held by the pledging financial institution's trust department or agent, but not in the ARRC's name; none of the balances were uncollateralized; and $1,074,000 represents money market funds held by the ARRC's agent in the ARRC's name.

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

Custodial Credit Risk – Investments

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 had no debt securities exposed to custodial credit risk at December 31, 2005

(a) Restricted Assets

The market value of restricted assets consists of the following at December 31, 2005 and 2004 (in thousands):

Description of security		2005	2004
Money market accounts	$	1,241	1,909
Equity mutual funds		—	920
Total	$	1,241	2,829

These investments are restricted by the terms of grant or other agreements or by the ARRC's board of directors and are summarized as follows at December 31, 2005 and 2004 (in thousands):

Description of restriction		2005	2004
Capital assets as authorized by the State of Alaska	$	434	477
Capital assets as authorized by the Department of Natural Resources		194	192
Advance grant funding, Taxpayer Relief Act		—	550
Advance grant funding, other federal grants		613	644
Postretirement benefits		—	920
Locomotive purchase		—	46
Total	$	1,241	2,829

During 2005, the ARRC's board of directors restricted $18,165,000 of fund equity for reinvestment in infrastructure.

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

The ARRC also received funding in 1990 from the State of Alaska Department of Natural Resources. These funds are being managed by the ARRC in anticipation of future capital projects. If no capital projects are undertaken, the funds, including accrued interest, will be returned to the Department of Natural Resources. The unspent balance and interest thereon is reported as restricted assets and State of Alaska advances.

As part of the 1997 Taxpayer Relief Act passed by the U.S. Congress, states without Amtrak service are due a benefit in lieu of the tax benefits received through Amtrak subsidies over the years. The ARRC received Alaska's $23,230,000 share of this benefit. The amount received, along with investment income earned thereon, is required to be spent on passenger service improvements or

capital expenses related to State owned rail operations. The unspent portion of the amount received and related investment income is reported as advance grant funding (note 8).

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

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

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

(4) Capital Assets

During 2002 the ARRC received initial approval, which was updated in 2005, of its indirect cost rate agreement from its federal cognizant agency. This agreement allows ARRC to allocate certain general and administrative expenses to grant projects. Indirect costs allocated to capital projects under this agreement totaled $1,368,000 and $1,219,000 during the years ended December 31, 2005 and 2004, respectively.

The following summarizes activity in the capital assets accounts during the years ended December 31, 2005 and 2004 (in thousands):

	Balance at December 31, 2004	Additions	Reclassifications	Reductions	Balance at December 31, 2005
Capital assets not being depreciated:					
Land	$ 19,587	—	11	—	19,598
Road materials and supplies	10,197	2,114	—	—	12,311
Construction in progress	156,926	88,406	(31,977)	—	213,355
Total capital assets not being depreciated	186,710	90,520	(31,966)	—	245,264
Capital assets being depreciated:					
Road and roadway structures	257,429	—	25,909	—	283,338
Equipment	159,000	—	6,057	(248)	164,809
Leasehold improvements	1,848	—	—	(198)	1,650
Total capital assets being depreciated	418,277	—	31,966	(446)	449,797
Less accumulated depreciation for:					
Road and roadway structures	79,669	13,991	—	—	93,660
Equipment	65,573	9,631	—	(240)	74,964
Leasehold improvements	455	131	—	—	586
Total accumulated depreciation	145,697	23,753	—	(240)	169,210
Capital assets being depreciated, net	272,580	(23,753)	31,966	(206)	280,587
Net capital assets	$ 459,290	66,767	—	(206)	525,851

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

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

	2005		2004	
	Grant Funded Depreciation	Non-Grant Funded Depreciation	Grant Funded Depreciation	Non-Grant Funded Depreciation
Transportation	$ 400	28	400	41
Passenger services	139	6	139	6
Markets, sales, and service	94	628	94	587
Passenger operations	1,167	442	1,159	437
Mechanical	1,247	2,832	1,276	2,482
Maintenance	5,278	6,289	4,421	6,182
Engineering and signals	192	184	207	808
Health, safety and environment	—	133	—	86
General and administrative	326	839	9	149
Real estate	2,838	691	2,610	651
	$ 11,681	12,072	10,315	11,429

Fund equity invested in capital assets, net of related debt and deferred grant revenue, is as follows at December 31, 2005 and 2004 (in thousands):

	2005	2004
Net capital assets	$ 525,851	459,290
Long-term debt (note 6)	(27,446)	(30,496)
Deferred grant revenue (note 8)	(345,391)	(292,294)
	$ 153,014	136,500

(5) Long-Term Liabilities

Long-term liability activity is summarized as follows during the years ended December 31, 2005 and 2004 (in thousands):

	Balance at December 31, 2004	Additions	Reductions	Balance at December 31, 2005	Due within one year
Long-term debt	$ 30,496	—	(3,050)	27,446	2,978
Environmental remediation reserve	4,683	—	(1,573)	3,110	2,532
State of Alaska advances	665	—	(50)	615	—
Regulatory liabilities:					
Accrued postretirement and pension benefits	17,984	2,935	(16,640)	4,279	—
Deferred grant revenue	292,294	64,778	(11,681)	345,391	—
Total long-term liabilities	$ 346,122	67,713	(32,994)	380,841	5,510

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

(6) Long-Term Debt

Long-term debt at December 31, 2005 and 2004 consists of the following (in thousands):

	2005	2004
Note payable, secured by equipment, due in monthly payments of $156,934, including interest at 3.79%, matures March 2014.	$ 13,225	14,579
Note payable, secured by equipment, due in monthly payments of $97,249, including interest at 3.83%, matures March 2019.	12,112	12,800
Note payable, secured by equipment, due in monthly payments of $44,226, including interest at 2.55%, matures July 2008.	1,325	1,816
Note payable, secured by equipment, due in monthly payments of $27,557, including interest at 3.35%, matures April 2008.	741	1,042
Note payable, secured by vehicles and equipment, due in monthly payments of $18,415, including variable interest at 56% of prime rate, adjusted monthly, matures April 2006.	43	259
	27,446	30,496
Less current portion	2,978	3,050
	$ 24,468	27,446

Annual payments on debt are scheduled as follows at December 31, 2005 (in thousands):

	Principal	Interest
Year ending December 31:		
2006	$ 2,978	977
2007	3,041	871
2008	2,705	764
2009	2,378	672
2010	2,470	580
2011 – 2015	10,313	1,507
2016 – 2019	3,561	232
	$ 27,446	5,603

The ARRC has arrangements for two short-term unsecured lines of credit. The general purpose line of credit allows borrowing up to $10,000,000 at a rate of 55% of the prime rate of a major bank. The self-insurance line of credit allows borrowing up to $10,000,000 at a rate of 55% of the prime rate of a major bank. None of the lines of credit had an outstanding balance as of December 31, 2005 or 2004.

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

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

(7) Employee Benefits

The ARRC's board of directors has established a method of accounting for pension and postretirement costs which are designed to recover the full costs of these benefit costs. As a result, all accrued liabilities net of accrued assets are reported as regulatory assets and liabilities in the balance sheets. Periodic benefit costs related to these plans are included in operating expenses and capital additions. In 2005, pension costs and accrued benefits under the defined benefit and postretirement 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*. Prior to 2005, ARRC accrued benefits under employee benefit plans were calculated under the provision of FASB Statement No. 87, *Employers' Accounting for Pensions,* and FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. The funded status of the defined benefit plan is reported as regulatory asset of December 31, 2005 of $4,555,000 and a regulatory liability of $2,340,000 at December 31, 2004. The funded status of the postretirement benefit plan is reported as a regulatory liability of $8,834,000 and $15,644,000 at December 31, 2005 and 2004, respectively. The change in pension and postretirement funding status presented as other changes in fund equity of $8,274,000 and $(2,340,000) in 2005 and 2004, respectively, represents the change from the prior year in the unfunded accrued actuarial liability for the defined benefit and post retirement plans.

(a) Defined Benefit Plan

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

The annual pension cost for the year ended December 31, 2005 and related information is as follows:

Actuarial assumptions compounded annually:	
Inflation rate	3.00%
Investment return for funding purposes	7.50
Investment return on employee accounts	7.00
Projected salary increase	4.00
Cost of living allowance	1.75

The following table sets forth the Plan's assets and funded status at December 31, 2005 (in thousands):

Income:		
Contributions received:		
Employee	$	3,214
Employer		668
Investment earnings		3,481
Net accrued		1
Total income		7,364
Disbursements:		
Benefit payments:		
Periodic		466
Nonperiodic:		
Termination		444
Retirement		26
Disability		37
Death		—
Total benefit payments		973
Administrative and investment consulting expenses		259
Total disbursements		1,232
Net income		6,132
Net assets at beginning of year		51,322
Net assets at the end of year		57,454
Actuarial accrued liability (AAL)		52,899
Unfunded (Overfunded) AAL	$	4,555

The ARRC's annual required contribution included in the accompanying financial statements was $668,000 for the year ended December 31, 2005.

The following table sets for the Plan's funded status at December 31, 2004 (in thousands):

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

The following table sets for the Plan's weighted average assumptions used in determining the actuarial present value of the projected benefit obligation at December 31, 2004:

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

Components of net pension costs are as follows for the year ended December 31, 2004 (in thousands):

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

(b) Postretirement Benefits Other Than Pension

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

Beginning in 2005, ARRC's policy is to fund the annual other postemployment benefit (OPEB) cost by funding the annual required contribution. In 2004, ARRC's policy was to pre-fund the cost of medical benefits in amounts determined at the discretion of management. At December 31, 2004, the ARRC had designated assets with a market value of $920,000 for the funding of these benefits (note 3).

The annual post employment benefit cost for the year ended December 31, 2005 and related information is as follows:

Actuarial assumptions used in valuing the liabilities and benefits under the plan:

Discount rate	7.50%
Investment return for funding purposes	7.50
Projected salary increase	Not applicable

The following table sets forth the Plan's assets and funded status for other postemployment benefit obligations (OPEB) at December 31, 2005 (in thousands):

Income:		
Contributions received – employer	$	7,701
Investment earnings		265
Net accrued		—
Total income		7,966
Disbursements:		
Benefit payments payable		336
Administrative and investment consulting expenses		16
Total disbursements		352
Net income		7,614
Net assets at beginning of year		—
Net assets at the end of year		7,614
Actuarial accrued liability (AAL)		16,448
Unfunded (Overfunded) AAL	$	8,834

The ARRC's annual other postemployment benefit (OPEB) cost of $2,268,000 was included in the accompanying financial statements for the year ended December 31, 2005.

Prior to 2005, the ARRC accounted for postretirement health care by accruing benefits over the period in which active employees became eligible for such postretirement benefits. The following table sets forth the Plan's funded status at December 31, 2004 (in thousands):

Change in benefit obligation:		
Benefit obligation at beginning of year	$	14,092
Service cost		1,720
Interest cost		774
Actuarial (gain) loss		(514)
Benefits paid		(306)
Benefit obligation at end of year	$	15,766
Funded status	$	(15,766)
Unamortized prior service costs		(138)
Unrecognized net actuarial loss		260
Accrued benefit cost	$	(15,644)

The components of net periodic cost for these postretirement benefits for the year ended December 31, 2004 are as follows (in thousands):

Service costs	$	1,720
Interest costs		774
Recognized prior service costs		(27)
Recognized net actuarial gains		(11)
Net periodic cost	$	2,456

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

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following effects for December 31, 2004 (in thousands):

		One percentage point increase	**One percentage point decrease**
Effect on total service and interest cost components	$	806	(594)
Effect on postretirement benefit obligation		4,263	(3,194)

(c) Civil Service Retirement System

Federal employees who transferred to the ARRC continue to participate in the Civil Service Retirement System (CSRS), a multi-employer defined benefit plan. ARRC is required to contribute 7% of the transferred employees' base pay. Benefit expense related to CSRS was $440,000 and $474,000 for the years ended December 31, 2005 and 2004, respectively.

(d) Defined Contribution Plan

The ARRC sponsors a defined contribution plan (Plan) under section 401(k) of the IRS Code for employees. All regular employees are eligible to contribute to the Plan. Under the terms of certain collective bargaining agreements, representing 47% 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 $383,000 and $332,000 for the years ended December 31, 2005 and 2004, respectively.

ARRC also sponsors a Section 457 deferred compensation plan under Section 457(b) of the IRS Code for nonrepresented employees.

(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 consists of the following (in thousands):

		2005	2004
Land		$ 1,304	1,304
Road and roadway structures	15 – 32 year life	158,644	140,075
Equipment	5 – 25 year life	37,791	36,964
Construction in process		198,990	147,452
		$ 396,729	325,795

Deferred grant revenue consists of grant funding received for capital assets and is equal to the net book value of assets constructed with that funding. It will generally be amortized over the life of the related capital assets. Deferred grant balances as of December 31 consist of the following (in thousands):

	2005		2004	
	Advance grant funding (receivable)	**Deferred grant revenue**	**Advance grant funding (receivable)**	**Deferred grant revenue**
Federal Railroad Administration:				
Net book value of assets constructed	$ —	104,508	—	101,664
Construction in process	—	125,533	—	89,257
Amount receivable from grantor	(9,346)	—	(6,584)	—
Taxpayer Relief Act:				
Net book value of assets purchased and constructed	—	14,177	—	13,475
Construction in process	—	7,927	—	9,407
Nondepreciable asset	—	(1,303)	—	(1,303)
Grant funding received in advance	—	—	—	—
Investment earnings on funding	—	—	278	—
Federal Transit Administration:				
Net book value of assets purchased and constructed	—	28,613	—	23,578
Construction in process	—	55,641	—	46,550
Amount receivable from grantor	(9,276)	—	(10,224)	—
Federal Emergency Management Agency:				
Net book value of assets constructed	—	1,334	—	1,430
Construction in process	—	566	—	257
Amount receivable from grantor	(566)	—	(315)	—
Department of Interior:				
Grant funding received in advance	578	—	593	—
Accrued derailment expense (note 14)	(578)	—	(593)	—
Department of Agriculture:				
Net book value of assets constructed	—	955	—	1,127
U.S. Fish and Wildlife:				
Construction in process	—	327	—	180
Amount receivable from grantor	(147)	—	(180)	—
Department of Homeland Security:				
Net book value of assets constructed	—	257	—	437
Construction in process	—	53	—	—
Amount receivable from grantor	(53)	—	—	—

	2005		2004	
	Advance grant funding (receivable)	**Deferred grant revenue**	**Advance grant funding (receivable)**	**Deferred grant revenue**
State of Alaska Wishbone Hill Coal Project:				
Net book value of assets purchased	$ —	4,077	—	4,333
Construction in process		1,396	—	1,378
Amount receivable from grantor	—	—	(28)	—
Municipality of Anchorage Ship Creek Economic Development:				
Net book value of assets constructed	—	164	(107)	174
Alaska State Fair:				
Construction in process	—	192	—	298
Rasmuson Foundation:				
Construction in process	—	743	—	—
Amount receivable from grantor	(743)	—	—	—
State of Alaska Other:				
Net book value of asssets constructed	—	—	—	5
Construction in process	—	231	—	47
	$ (20,131)	345,391	(17,160)	292,294

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

	2005	2004
Federal Railroad Administration:		
Depreciation on assets constructed	$ 7,372	6,553
Federal Transit Administration:		
Depreciation on assets purchased and constructed	2,526	2,213
Grant funded maintenance and transit security expense	6,241	4,700
Federal Emergency Management Agency:		
Depreciation on assets constructed	98	126
Grant funded disaster recovery expense	31	82
Department of Agriculture:		
Depreciation on assets constructed	172	172
Department of Interior:		
Grant funding of accrued derailment expense (note 14)	14	182
Derailment expense paid in current year	(14)	(182)
Homeland Security:		
Depreciation on assets purchased and constructed	181	—
Municipality of Anchorage Ship Creek Economic Development:		
Depreciation on assets constructed	10	10
State of Alaska:		
Depreciation on assets purchased	5	—
State of Alaska Wishbone Hill Coal Project:		
Depreciation on assets purchased	257	257
Taxpayer Relief Act:		
Depreciation on assets purchased and constructed	1,060	984
	17,953	15,097
Less grant revenue included in real estate nonoperating revenues	(2,838)	(2,609)
	$ 15,115	12,488

(9) Fund Equity

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

	Investment by the State of Alaska	Cumulative net income	Cumulative other changes in fund equity	Total fund equity
Balance at December 31, 2003	$ 34,174	103,039	—	137,213
Net income	—	15,377	—	15,377
Other changes in fund equity	—	—	(2,340)	(2,340)
Total changes in fund equity				13,037
Balance at December 31, 2004	34,174	118,416	(2,340)	150,250
Net income	—	12,655	—	12,655
Other changes in fund equity	—	—	8,274	8,274
Total changes in fund equity				20,929
Balance at December 31, 2005	$ 34,174	131,071	5,934	171,179

(10) Major Customer

One ARRC customer accounted for 47% and 48% of freight revenue in 2005 and 2004 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 $9,675,000 and $9,093,000 in 2005 and 2004, respectively. The following table summarizes future minimum lease payments as of December 31, 2005 (in thousands):

	Amount
Year ending December 31:	
2006	$ 8,681
2007	8,361
2008	8,094
2009	7,955
2010	7,823
Thereafter	117,294
	$ 158,208

The ARRC has $1,064,000 in rent credits outstanding on these leases at December 31, 2005. The assets provided by tenants in exchange for the rent credits are included in property and equipment and are depreciated over their useful lives. The balance of the rent credits is included in unearned revenue.

(12) Operating Leases and Agreements

The ARRC leases its headquarters, certain operating equipment, and barge services under operating leases and agreements. Payments under the leases and agreements totaled $12,024,000 and $11,330,000 in 2005 and 2004, respectively. Future minimum lease payments as of December 31, 2005 are summarized as follows (in thousands):

	Amount
Year ending December 31:	
2006	$ 12,115
2007	11,214
2008	10,729
2009	10,654
2010	10,595
Thereafter	2,747
	$ 58,054

(13) Insurance

The ARRC is self-insured to certain limits for employee health benefits, personal injury, property and casualty damage claims and establishes reserves for the estimated losses of such claims. The ARRC is also self-insured against workers' compensation claims. The ARRC carries commercial insurance policies limiting ARRC's exposure for health benefits to $5.2 million, for casualty/liability to $50 million and for property to $65 million at December 31, 2004. Self-insurance activity is summarized as follows during the years ended December 31, 2005 and 2004 (in thousands):

	Balance at December 31, 2004	Incurred claims	Claim payments	Balance at December 31, 2005
Employee health benefits	$ 1,338	5,479	(5,473)	1,344
Casualty and liability	2,454	1,710	(1,383)	2,781
Workers' compensation	1,003	1,649	(1,201)	1,451
	$ 4,795	8,838	(8,057)	5,576

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

(14) Commitments and Contingencies

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

During 1999, a derailment at Gold Creek resulted in fuel spills along the ARRC tracks. The ARRC is responsible for the remediation, restoration and monitoring of environmental contamination at this site. The ARRC has accrued its best estimate of its remaining obligation with respect to the site, which were $578,000 and $593,000 at December 31, 2005 and 2004, respectively. The amount expected to be paid within the next year, $159,000 and $91,000 at December 31, 2005 and 2004, respectively, is included in accounts payable and accrued liabilities. The remaining amount is expected to be incurred through 2020 and is reported as environmental remediation reserve. ARRC received grants to cover the costs associated with the Gold Creek derailment and the 1999/2000 winter storm disaster. The grants are expected to cover ARRC's remaining obligation. The aggregate undiscounted amount has been recorded since it represents management's best estimate of the cost, but the payments are not considered to be fixed and reliably determinable. The estimate of costs and their timing of payment could change as a result of changes to the remediation plan, changes in technology available to treat the site and unforeseen circumstances existing at the site. It is not possible to estimate the amount losses may exceed amounts accrued at this time as a result of these factors.

Approximately 73% of the ARRC's labor force is subject to one of five collective bargaining agreements. One of the agreements, representing 40% of the labor force, expired in 2005 and is being renegotiated. Another agreement representing 6% of the labor force expires in 2006.

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

Growing Alaska

The Alaska Railroad is all about
the future and Growing Alaska.
We are the Alaska Railroad,
and ever since we took
the name "Alaska," the Great Land
and its people have always come first.