Alaska Railroad Corporation

2016

Annual Report

Mission

Through excellent customer service and sound business management practices, provide safe, efficient, and economical transportation and real estate services that support and grow economic development opportunities for the State of Alaska.

Alaska Railroad Leadership

Management Team

Bill O'Leary
President & CEO

Doug Engebretson
Chief Operating Officer

Barbara Amy
Chief Financial Officer

Clark Hopp, VP
Engineering & Maintenance

Jim Kubitz, VP
Corporate Planning & Real Estate

James Ratchford
Chief Information Officer

Wendy Lindskoog, VP
Business Management & Corporate Affairs

Dale Wade, VP
Marketing & Customer Service

Bill Hupprich, VP
General Counsel

Eileen Reilly, VP
Advanced Train Control Systems

Board of Directors

Left to right: Vice Chair Bill Sheffield, Commissioner Marc Luiken, Director John Binkley, Commissioner Chris Hladick, Director Linda Leary, Board Chair Jon Cook and Director Jack Burton

2016 Year in Review

Unprecedented Challenges

To say that 2016 proved to be a year full of challenges would be an understatement. Never before has the Alaska Railroad Corporation ("ARRC") had to roll with as many punches as came its way during 2016. Beginning with the continued malaise in the energy markets that had a dampening effect on the entire Alaskan economy, ARRC went to great lengths to scale its freight operations down to match the unprecedented decline in this revenue stream.

Freight Revenue and Other Operating Revenue Decreased 16% from 2015:

- Petroleum product shipments to the Interior down 23% from the prior year
- Decreased North Slope Oilfield activities combined with drops in other commodity-type moves reduced interline barge revenue by 23% from the prior year
- Gravel movements decreased by 11% from the prior year
- Global collapse of the coal market lead to only one coal ship loaded for export in Seward, versus two ships in the prior year.

Recent Changes in Governmental Accounting Standards:

The next significant challenge came in the form of new accounting standards for pension accounting implemented in conjunction with the fiscal year-end 2015 annual audit during the spring of 2016, which resulted in an additional $3.5 million in pension expense in 2016 beyond what had been budgeted for the year.

Impasse on Federal Transit Administration (FTA) Split Letter Relating to Section 5307 Grant Funds:

The third significant challenge, which resulted in a loss of $7.4 million for 2016, came in the form of an impasse between ARRC and the Municipality of Anchorage (MOA) regarding the method for splitting FTA section 5307 grant funds. ARRC and MOA are designated recipients of FTA Urbanized Area Formula Funds under 49 U.S.C. § 5307. Under this program, formula funds flow from FTA to a local area planning organization in a lump sum, where designated recipients are required to agree on how best to split the funds to benefit the area's transportation needs. Since 2006, ARRC and MOA have agreed to split the funds along programmatic lines so that all funds generated by ARRC as "rail tier" funds have gone to ARRC and all funds generated as "bus tier" funds have gone to MOA. During 2016, MOA refused to continue this long-standing practice and demanded instead to redirect rail tier funds to MOA, which is not agreeable to ARRC. Until this impasse is resolved, the flow of funds to ARRC and MOA are delayed, and ARRC is unable to recognize $7.4 million of expected rail tier FTA section 5307 grant revenues for 2016.

Opportunities

Even amidst the challenges ARRC faced during 2016, there were bright spots in the form of business lines where ARRC experienced growth despite the state of the local economy or where ARRC laid the groundwork for new business lines.

Passenger ridership:

- ARRC experienced another year of solid growth in passenger revenue in 2016, increasing by 6% from the prior year.
- Increased winter midweek Aurora train service between Anchorage and Fairbanks during high demand times, provided better service and revenue growth.

Liquefied Natural Gas (LNG):

- ARRC received the nation’s first Federal Railroad Administration (FRA) approval to move LNG by rail during 2015. The September 2016 LNG by Rail demonstration was a tremendous success, providing industry wide exposure and credibility that transporting LNG by rail is a viable option.

Real Estate:

- Through years of coordinated master planning, ARRC and MOA have long envisioned a community development approach that blends residential, recreational, industrial and business uses within the Ship Creek basin. As a first step in this plan, Ship Creek Development LLC and the Peterson Group are developing a new mixed-use project situated on 11 acres of ARRC land near West Second Avenue and Christiansen Drive.

Safety and Infrastructure Improvements:

- Despite the dramatic belt-tightening on the operating side, ARRC continued making substantial safety and infrastructure investments. 2016 capital investments totaled $57.0 million and included significant spending on the federally mandated Positive Train Control safety system in addition to a robust basic infrastructure program addressing rail, ties, ballast, bridges and rolling stock.

Expense Reduction Initiatives:

To address the revenue shortfall, ARRC worked diligently throughout 2016 to identify initiatives for improvement and cost reduction:

- Accelerated energy management program to complete all identified projects within the next four years. Estimated annual savings once system wide energy management projects are completed is expected to exceed $400,000 per year.
- Unbundled health insurance and other targeted benefit changes to reduce personnel costs.
- Surplused 70 aluminum hoppers cars and retired associated debt with cash flow savings of approximately $500,000.
- Refinanced existing debt with total interest expense savings of $300,000.
- Restructured a long term operating contract which will reduce annual costs by approximately $150,000 annually.

2016 Results

Nevertheless, the challenges faced were formidable and severely affected the ARRC income statement. In an attempt to mitigate a 16% decrease in freight revenue, cost cutting measures were initiated in operations which saved approximately $3.5 million. During 2016, ARRC generated total revenues of $169.8 million, which reflects a decrease of approximately $14.0 million, or 7.6%, when compared to the prior year. Total expenses, net of grant revenue were $174.1 million, which reflects an increase of approximately $1.2 million, or 0.7%, when compared to the prior year. As a result, ARRC generated a net loss of $4.4 million.

Looking Forward

In spite of the challenges of 2016, the Alaska Railroad maintains a strong balance sheet with over $1 billion in assets. The ARRC board and management continue to manage conservatively to face the economic headwinds that are challenging Alaska. With steady growth in passenger services and real estate, and ongoing evaluation of all expenses and new revenue opportunities, ARRC will be ready when Alaska's economic situation turns around and will continue to provide the services that Alaskans and visitors to the state need for a long time to come.

2016 Financial Highlights

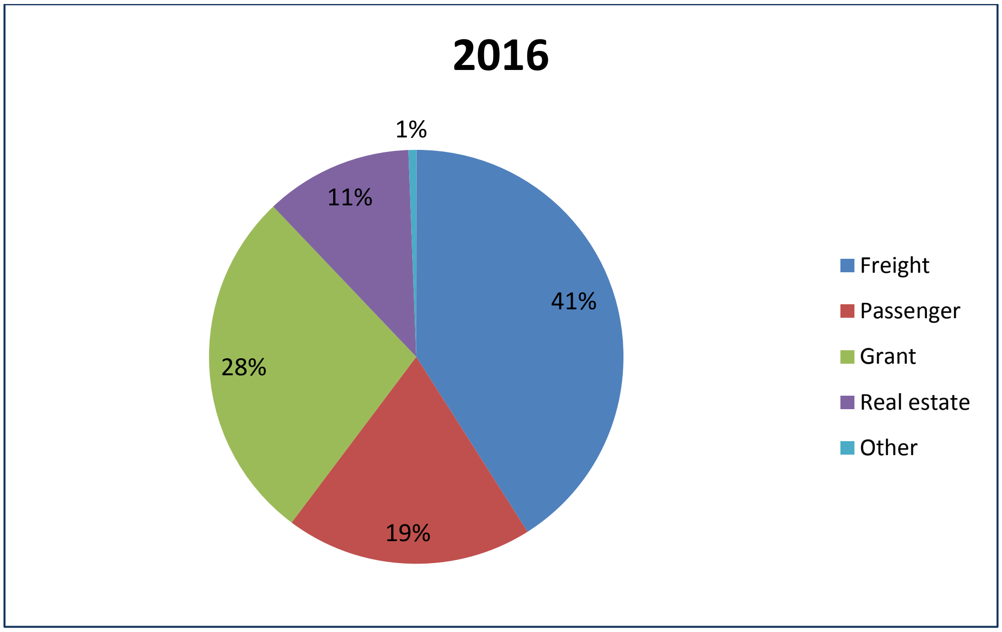
Earnings (in thousands):	2016	2015
Operating revenues:		
Freight	$ 69,578	$ 81,525
Passenger	32,721	30,754
Other	662	1,636
Grant	46,933	49,965
Total operating revenue	149,894	163,880
Operating expenses	161,098	164,436
Operating income	(11,204)	(556)
Nonoperating revenues (expenses):		
Net real estate income	11,695	12,559
Gain (loss) on sale of capital assets	(1,516)	-
Investment income	365	46
Interest expense, net of grant revenue	(3,693)	(1,183)
Net income (loss)	(4,353)	10,866
Net position, beginning of year	320,691	309,825
Net position, end of year	316,338	320,691
Operating Ratio	1.07	1.00

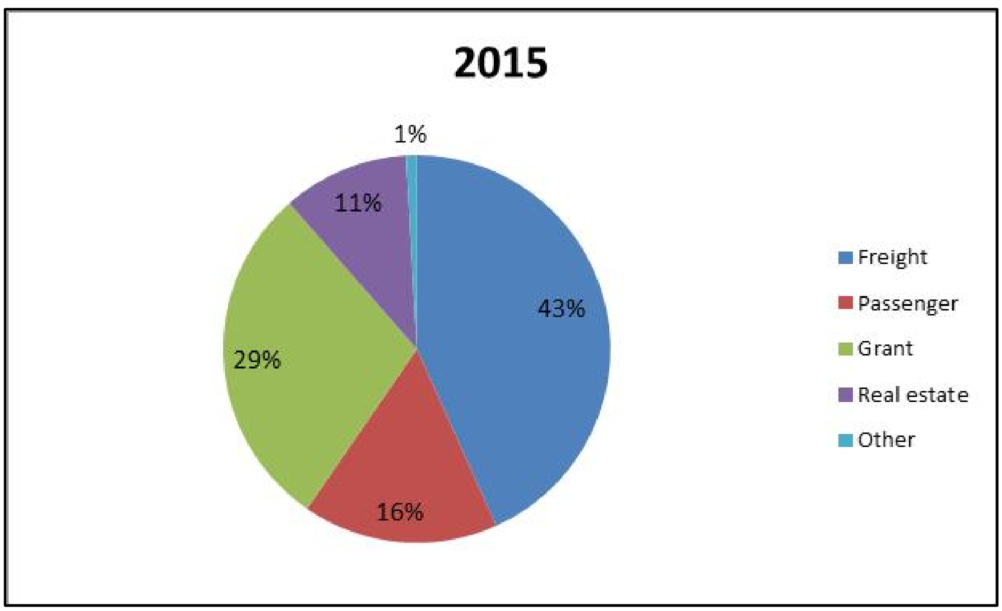
Statements of Net Position (in thousands):	2016	2015
Assets:		
Current assets	$ 118,613	$ 120,599
Capital assets	902,356	913,345
Restricted assets	20,123	42,440
Other assets	27,431	26,121
Deferred outflows	14,537	11,629
Total assets	1,083,060	1,114,134
Liabilities:		
Current liabilities	48,804	48,545
Other liabilities	144,077	155,943
Total liabilities	192,881	204,488
Deferred inflows:		
Accrued postretirement benefits	1,633	-
Unearned grant revenue	572,208	588,955
Total liabilities and deferred inflows	766,722	793,443
Net position	316,338	320,691
Total liabilities, deferred inflows and net position	1,083,060	1,114,134

(continued)

2016 Financial Highlights

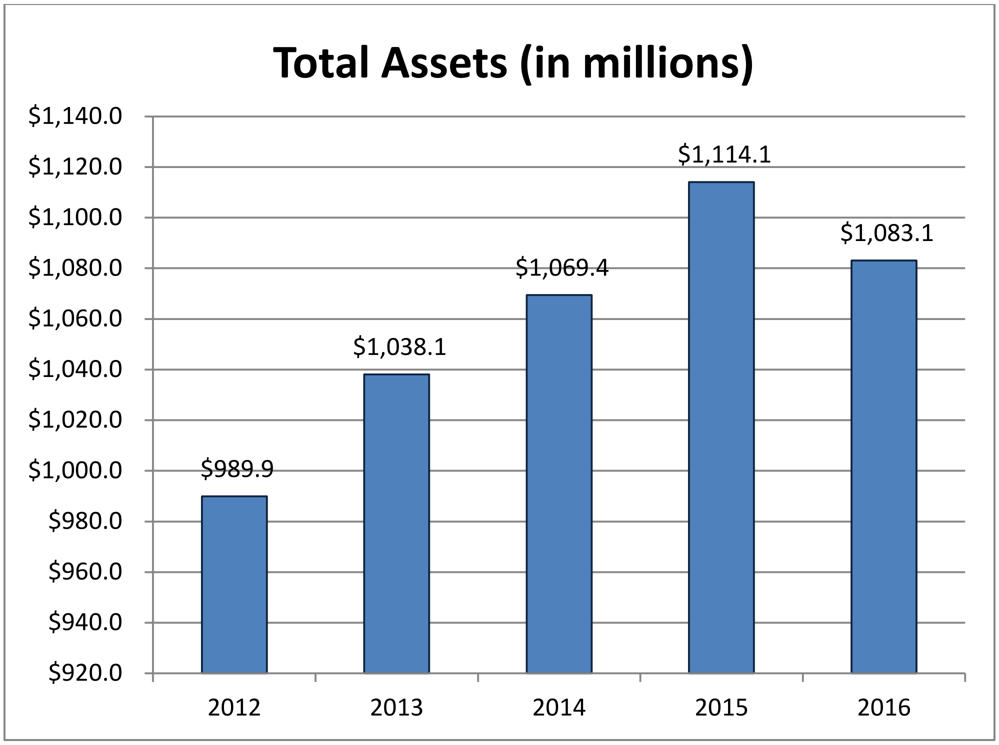
Revenue Mix

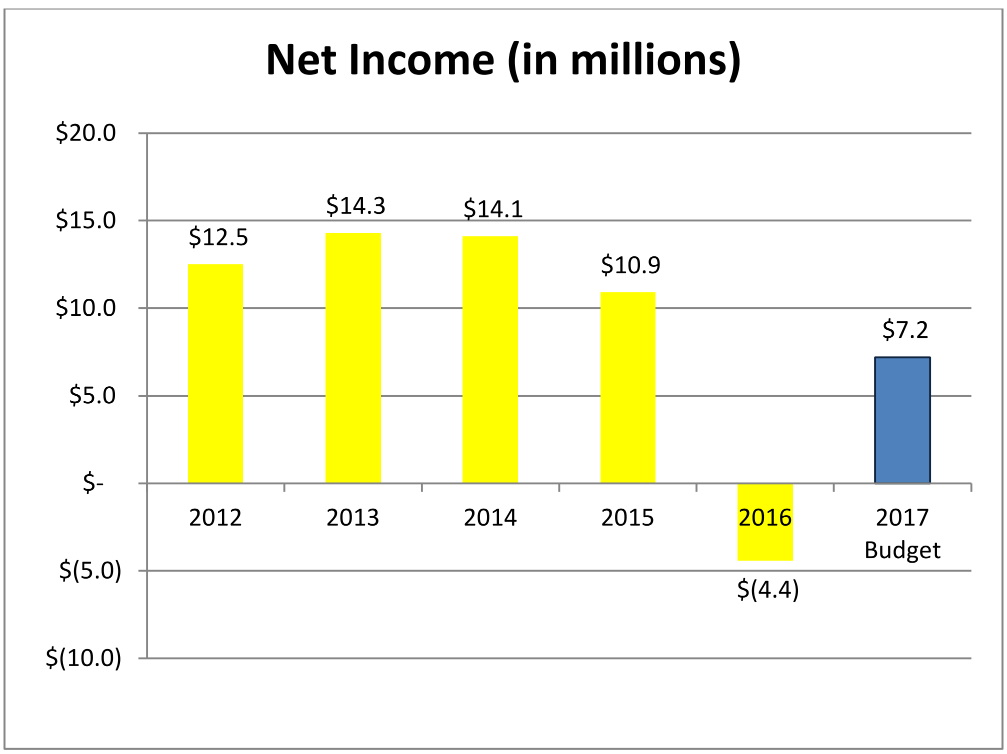




(continued)

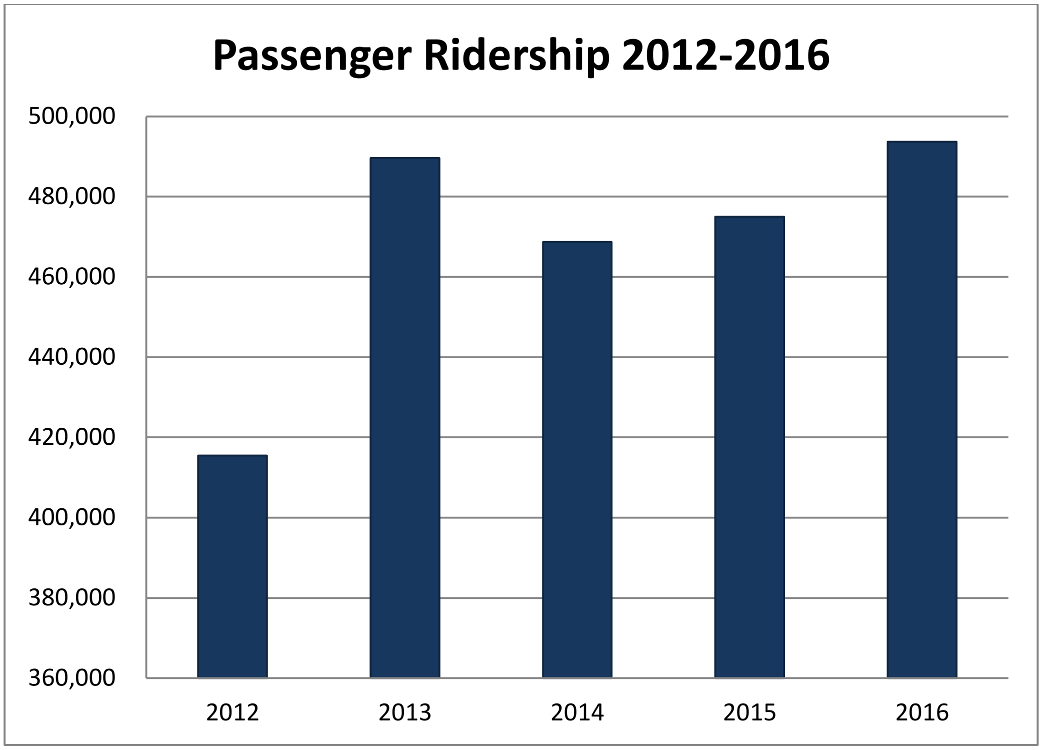
2016 Financial Highlights

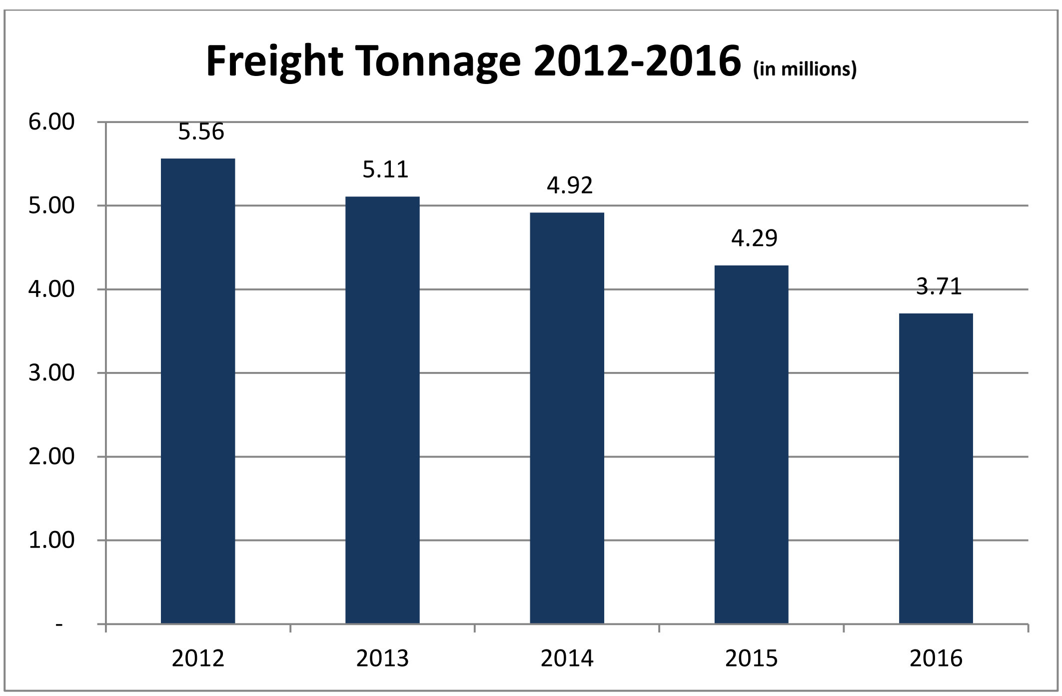




(continued)

2016 Highlights





March 31, 2017

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, 2016.

The financial section of the Annual Report is presented in four 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
- Required supplementary information relating to the ARRC's defined benefit pension and other post- employment benefit plans.

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

327 W. Ship Creek Avenue, Anchorage, Alaska 99501 | Mail to: P.O. Box 107500 Anchorage, Alaska 99510-7500 | 907.265.2300 | AlaskaRailroad.com

KPMG

ALASKA RAILROAD CORPORATION

Financial Statements

December 31, 2016 and 2015

(With Independent Auditors' Report Thereon)

ALASKA RAILROAD CORPORATION

Table of Contents

ALASKA RAILROAD CORPORATION

Management's Discussion and Analysis

December 31, 2016 and 2015

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, 2016 and 2015. Please read it in conjunction with the ARRC's financial statements, which follow this section.

Financial Highlights

The ARRC's total net position decreased 1.4% during the course of this year's operations and increased 5.2% over the course of 2015 operations.

- During 2016, the ARRC's operating revenues were less than operating expenses by $11.2 million, yielding an operating ratio of 1.07. Last year, operating revenues were less than operating expenses by $556,000 and yielded an operating ratio of 1.0.
- The total 2016 operating costs of the ARRC's programs were $161.1 million, a decrease of 2.0% compared to last year. The total 2015 operating costs of the ARRC's programs were $164.4 million, an increase of 0.5% compared to the prior year.
- Expenditures on capital assets totaled $57.0 million during 2016, an increase of 21.3% compared to last year. Expenditures on capital assets totaled $47.4 million during 2015, a decrease of 24.0% compared to last year.
- Grant funding was used for $15.7 million, or 27.5%, of the 2016 capital expenditures. Grant funding was used for $36.8 million, or 78%, of the 2015 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, deferred outflows, liabilities, deferred inflows 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.

In addition to the basic financial statements and accompanying notes, the financial statements present certain required supplementary information regarding the Defined Benefit Pension Plan and Defined Benefit Postretirement Medical Plan. The statements also include notes to the required supplementary information.

Financial Analysis of the Alaska Railroad Corporation

Net position – ARRC's net position decreased 1.4% between fiscal years 2015 and 2016 to approximately $316.3 million. ARRC's net position increased 5.2% between fiscal years 2014 and 2015 to approximately $320.7 million.

		2016	2015	2014
			(In thousands)	
Assets:				
Current assets	$	118,613	120,599	126,289
Capital assets		902,356	913,345	923,413
Other noncurrent assets		47,554	68,561	19,738
Total assets		1,068,523	1,102,505	1,069,440
Deferred outflows		14,537	11,629	—
Total	$	1,083,060	1,114,134	1,069,440
Liabilities:				
Current liabilities	$	48,804	48,545	57,970
Notes payable outstanding, less current installments		11,286	15,330	16,195
Revenue bonds payable, less current portion, net of a unamortized premiums		104,894	118,401	90,031
Net pension liability		25,466	19,728	—
Other liabilities		2,431	2,484	2,879
Deferred inflows:				
Regulatory liabilities:				
Pension and postretirement		1,633	—	42
Unearned grant revenue		572,208	588,955	597,616
Total liabilities and deferred inflows	$	766,722	793,443	764,733
Net position:				
Net investment in capital assets	$	215,053	211,483	204,534
Restricted for reinvestment in infrastructure		101,285	109,208	100,173
Total net position	$	316,338	320,691	304,707

Capital assets – Capital assets, net of accumulated depreciation decreased \$11.0 million in 2016 and \$10.1 million in 2015. During 2016 and 2015, the ARRC continued an extensive capital improvement plan, including bridge rehabilitations and track refurbishing. Also during this time period, ARRC continued developing the federally mandated positive train control system. Capital expenditures, also funded dock and slip work, and vehicle and equipment fleet replacements.

Long-term debt – Notes payable decreased \$4.6 million and \$369,000 in 2016 and 2015, respectively. During 2016, ARRC retired a long-term equipment loan when surplus hopper cars were sold. No new debt was issued during 2016. During 2015, ARRC issued a new long-term loan of \$2.6 million to fund the acquisition of vehicles and equipment and issued \$37.0 million in FTA capital grant receipt bonds to provide funds to finance the federally mandated positive train control system. During 2015, ARRC refunded the callable portions of the 2006 and 2007 FTA grant receipt bonds to take advantage of long-term borrowing rates and reduce interest expense.

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*. Unearned grant revenue relates to capital assets funded with federal grants. Unearned grant revenue decreased \$16.7 million in 2016 and decreased \$8.7 million in 2015. This decrease reflects the amount of capital assets constructed with grant funding, partially offset by grant revenue recognized as the related capital assets are depreciated.

Net other postemployment benefit assets and net pension liabilities – The postretirement benefits assets increased \$1.3 million and the accrued pension benefit liability increased \$5.7 million during 2016. The postretirement benefits asset decreased \$18.8 million and the accrued pension benefit liability decreased \$42,000 during 2015. During 2015, ARRC implemented GASB Statement No. 68, *Accounting and Financial Reporting for Pensions* (GASB 68) and GASB Statement No. 75*, Accounting and Financial Reporting for Postemployment Benefit Plans Other than Pensions* (GASB 75).

Deferred Outflows and Inflows – Deferred outflows or inflows of resources relating to pension and postretirement plans increase or decrease based on the net difference between actual and projected plan earnings, variances in plan activity versus projected activity, or changes in plan assumptions. The deferred outflows of resources will be recognized as expense and the deferred inflows of resources will be recognized as income during the years 2017 thru 2021, as reflected in note 7. Deferred outflows of resources increased \$2.9 million and \$11.6 million during 2016 and 2015, respectively, and the deferred inflows of resources increased \$1.6 million during 2016.

(Continued)

Deferred inflows of resources related to unearned grant revenue decreased $16.7 million and $8.7 million during 2016 and 2015, respectively, for the recognition of grant revenue equal to depreciation and other grant activities as discussed in note 8.

		2016	2015	2014
			(In thousands)	
Deferred outflows:				
Postretirement actuarial (note 7)	$	3,410	2,776	—
Pension actuarial (note 7)		11,127	8,853	—
Total deferred outflows	$	14,537	11,629	—
Deferred inflows:				
Postretirement actuarial (note 7)	$	1,633	—	—
Pension actuarial (note 7)		—	—	42
Regulatory liability – unearned grant revenue (note 8)		572,208	588,955	597,616
Total deferred inflows	$	573,841	588,955	597,658

(Continued)

Change in net position – During 2016, ARRC reported a net loss of $4.3 million, a decrease of $15.2 million from ARRC's reported net income in 2015 of $10.9 million. ARRC's 2015 net income decreased $3.2 million from the prior year net income of $14.1 million.

		2016	2015	2014
			(In thousands)	
Operating revenue:				
Freight	$	69,578	81,525	94,249
Passenger		32,721	30,754	27,605
Other		662	1,636	3,228
Total transportation revenue		102,961	113,915	125,082
Grant revenue		46,933	49,965	42,237
Total		149,894	163,880	167,319
Operating expense:				
Transportation		32,341	34,283	37,624
Passenger		12,857	12,293	10,099
Advanced train control systems		344	315	182
Marketing and customer service		16,248	20,292	22,857
Mechanical		24,371	24,992	26,057
Engineering		47,125	46,791	42,562
Facilities		12,160	13,832	14,904
General and administrative		15,652	11,638	9,300
Total		161,098	164,436	163,585
Operating income (loss)		(11,204)	(556)	3,734
Nonoperating revenues (expenses):				
Corporate planning and real estate, net of expenses		11,695	12,559	11,627
Gain (loss) on sale of capital assets		(1,516)	—	—
Investment income		365	46	20
Interest expense, net of grant revenue		(3,693)	(1,183)	(1,275)
Net income (loss)	$	(4,353)	10,866	14,106

Revenue – The ARRC's total revenues decreased approximately 7.6% and totaled $169.8 million in 2016. The ARRC's total revenues increased approximately 1.4% and totaled $183.8 million in 2015. Approximately 41.0% and 44.4% of the ARRC's revenue comes from freight revenue during 2016 and 2015, respectively, and 19.3% and 16.7% of the revenue comes from passenger services during 2016 and 2015, respectively. The majority of the remaining income relates to real estate activities and federal grant revenue.

Total transportation revenue for 2016 was $10.9 million less than 2015. The decrease in transportation revenue is attributed to a weakened Alaska economy that impacted interline shipments, soft global coal markets and fewer petroleum shipments, which were partially offset by growth in passenger revenue.

Total transportation revenue for 2015 was $11.2 million less than 2014. The decrease in transportation revenue is attributed to weakening global coal markets and fewer petroleum shipments, which were partially offset by shipments for oil field activities and growth in passenger revenue.

Grant revenue – Generally, federal grant revenue is recognized as the capital assets funded by the grants are depreciated. The ARRC also recognizes grant revenue associated with maintenance expense and grant funded bond principal, interest and issuance costs. During 2016, maintenance expenses and interest costs relating to the Federal Transit Administration (FTA) 5307 Urbanized Area Formula Funds were not adjusted by FTA grant revenue. Under this program, formula funds flow from the FTA to a local area planning organization in a lump sum, where designated recipients, ARRC and Municipality of Anchorage (MOA), are required to agree on how best to split the funds to benefit the area's transportation needs. Since 2006, ARRC and MOA have agreed to split the funds along programmatic lines so that all funds generated by ARRC as "rail tier" funds have gone to ARRC and all funds generated as "bus tier" funds have gone to MOA. During 2016, MOA refused to continue this long-standing practice and demanded instead to redirect rail tier funds to MOA, which is not agreeable to ARRC. Until this impasse is resolved, the flow of funds to ARRC and MOA are delayed, and ARRC is unable to recognize $7.4 million of expected rail tier FTA section 5307 grant revenues for 2016.

Operating expenses were $161.1 million in 2016, $164.4 million in 2015 and $163.6 million in 2014, a decrease of $3.3 million or 2.0% from 2015 to 2016 and an increase of $0.8 million or less than 1% from 2014 to 2015.

Real estate expenses were $7.8 million in 2016 and $7.3 million in 2015, and $7.6 million in 2014, an increase 6.6% from 2015 to 2016 and decrease of 3.9% from 2014 to 2015.

(Continued)

Capital Asset and Debt Administration

Capital Assets

At the end of 2016, the ARRC had invested $902.4 million in a broad range of capital assets (net of accumulated depreciation) including land, road and roadway structures, equipment, and leasehold improvements. This amount represents a net decrease (including additions and deductions) of $11.0 million, or 1.2%, over last year. Grants have funded $513.5 million and $584.4 million of the assets, net of accumulated depreciation, at the end of 2016 and 2015, respectively.

		2016	2015	2014
			(In thousands)	
Land and improvements	$	32,683	32,553	32,144
Road materials and supplies		9,308	12,787	10,304
Road and roadway structures		653,663	672,431	694,284
Equipment		146,782	166,892	159,293
Leasehold improvements		262	345	428
Quarry improvements		3,272	3,417	3,534
Construction in progress		56,386	24,920	23,426
Total capital assets, net of accumulated depreciation	$	902,356	913,345	923,413

The ARRC's fiscal year 2017 capital budget approved spending another $28.3 million for capital projects, principally for continued track and bridge rehabilitation, planned replacement of vehicles and equipment, and other infrastructure improvements. The ARRC intends to use federal grant funding for $9.6 million of the capital additions. The remaining capital projects will be funded out of current year earnings and cash flow. During 2015, ARRC issued FTA Capital Grant Receipt Bonds to fund approximately $37.0 million of costs related to the federally mandated Positive Train Control system. Additional detailed information about the ARRC's capital assets is presented in note 4 to the financial statements.

Long-Term Debt

At the end of 2016, the ARRC had $14.2 million in notes payable outstanding, a decrease of 24.4% from 2015, and $117.8 million in revenue bonds payable outstanding, a decrease of 10.1%. At the end of 2015, the ARRC had $18.8 million in notes payable outstanding, a decrease of 1.9% from 2014, and $131.1 million in revenue bonds payable outstanding, an increase of 28.4%. 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. 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.

In August 2015, ARRC executed an advance refunding of the callable maturities of the 2006 and 2007 Capital Grant Receipts Bonds, Series 2006 and 2007 for interest savings. At the same time, ARRC issued new Capital Grant Receipts Bonds Series 2015B. Leading up to the refunding and new money issue, the rating agencies issued updated ratings on June 9, 2015; with Moody's affirming their "A3" rating with a stable outlook and Standard & Poor's reducing their rating from "A+" to "A" and affirming the stable outlook.

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

Next Year's Budget

The 2017 budgets for freight and passenger revenues are $69.0 million and $35.1 million, respectively. As a result, the ARRC's net position is expected to increase $7.2 million or approximately 2.3% by the close of 2017.

Contacting the ARRC's Financial Management

This financial report is designed to provide residents of the State of Alaska and customers and creditors with a general overview of the ARRC's finances and to demonstrate accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Alaska Railroad Corporation, P.O. Box 107500, Anchorage, Alaska 99510-7500, 907-265-2300, or visit the website at www.alaskarailroad.com.

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

Independent Auditors' Report

The Board of Directors
Alaska Railroad Corporation:

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, 2016 and 2015, 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, 2016 and 2015, and the changes in its financial position and its cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matter

Required Supplementary Information

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 1–8 and the schedules relating to the Alaska Railroad Corporation's defined benefit pension and other postemployment benefit (OPEB) plans on pages 47–55 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 29, 2017 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 29, 2017

ALASKA RAILROAD CORPORATION

Statements of Net Position

December 31, 2016 and 2015

(In thousands)

Assets and Deferred Outflows		**2016**	**2015**
Current assets:			
Cash and cash equivalents (note 3)	$	59,023	51,713
Accounts receivable, net of allowance for doubtful accounts of $430 in 2016 and $399 in 2015		12,894	25,336
Grants receivable		11,026	9,332
Materials and supplies		11,851	11,573
Prepaid expenses and other current assets		1,603	1,659
Restricted assets (note 3)		22,216	20,986
Total current assets		118,613	120,599
Capital assets, net (notes 4 and 8)		902,356	913,345
Restricted assets (note 3)		20,123	42,440
Net other postemployment benefit (OPEB) asset (note 7)		27,413	26,103
Other assets		18	18
Total assets		1,068,523	1,102,505
Deferred outflows:			
Postretirement actuarial (note 7)		3,410	2,776
Pension actuarial (note 7)		11,127	8,853
Total deferred outflows		14,537	11,629
Total assets and deferred outflows	$	1,083,060	1,114,134
Liabilities, Deferred Inflows, and Net Position			
Current liabilities:			
Current portion of notes payable (notes 5 and 6)	$	2,894	3,438
Accounts payable and accrued liabilities (notes 5 and 12)		12,406	12,771
Payroll liabilities		10,400	10,083
Environmental remediation reserve (notes 5 and 13)		380	467
Interest payable		2,225	2,497
Over recovery of vehicle and equipment allocated costs (note 2(k))		1,113	763
State of Alaska advances (notes 3 and 5)		2,886	2,026
Unearned revenues		3,555	3,820
Current portion of revenue bonds payable (notes 5 and 6)		12,945	12,680
Total current liabilities		48,804	48,545
Notes payable, less current portion (notes 5 and 6)		11,286	15,330
Revenue bonds payable (net of unamortized premiums), less current portion (notes 5 and 6)		104,894	118,401
Environmental remediation reserve, less current portion (notes 5 and 13)		2,180	2,226
State of Alaska advances, less current portion (notes 3 and 5)		145	153
Payable from restricted assets (note 5)		106	105
Net pension liability (note 7)		25,466	19,728
Total liabilities		192,881	204,488
Deferred inflows:			
Postretirement actuarial (note 7)		1,633	—
Regulatory liability – unearned grant revenue (note 8)		572,208	588,955
Total deferred inflows		573,841	588,955
Total liabilities and deferred inflows		766,722	793,443
Net position:			
Net investment in capital assets (note 4)		215,053	211,483
Restricted for reinvestment in infrastructure (notes 2(a) and 2(l))		101,285	109,208
Total net position		316,338	320,691
Commitments and contingencies (notes 5, 6, 7, 11, 12,13, and 14)			
Total liabilities, deferred inflows, and net position	$	1,083,060	1,114,134

See accompanying notes to financial statements.

ALASKA RAILROAD CORPORATION

Statements of Revenues, Expenses, and Changes in Net Position

Years ended December 31, 2016 and 2015

(In thousands)

		2016	2015
Operating revenues:			
Freight (note 9)	$	69,578	81,525
Passenger		32,721	30,754
Other		662	1,636
		102,961	113,915
Grant revenue (note 8)		46,933	49,965
		149,894	163,880
Operating expenses:			
Transportation		32,341	34,283
Passenger		12,857	12,293
Advanced train control systems		344	315
Marketing and customer service		16,248	20,292
Mechanical		24,371	24,992
Engineering		47,125	46,791
Facilities		12,160	13,832
General and administrative, net of indirect cost recovery of $1,588 in 2016 and $1,716 in 2015		15,652	11,638
		161,098	164,436
Operating loss		(11,204)	(556)
Nonoperating revenues (expenses):			
Real estate income, less direct expenses of $7,808 in 2016 and $7,323 in 2015 (notes 6 and 10)		11,695	12,559
Loss on sale of capital assets		(1,516)	—
Investment income		365	46
Interest expense, net of grant revenue of $0 in 2016 and $3,423 in 2015 (notes 6 and 8)		(3,693)	(1,183)
Total nonoperating revenues		6,851	11,422
Net income (loss)		(4,353)	10,866
Net position, beginning of year		320,691	309,825
Net position, end of year	$	316,338	320,691

See accompanying notes to financial statements.

ALASKA RAILROAD CORPORATION

Statements of Cash Flows

Years ended December 31, 2016 and 2015

(In thousands)

		2016	2015
Cash flows from operating activities:			
Receipts from customers	$	115,403	111,707
Operating grants received		6,849	11,246
Payments to suppliers		(40,884)	(38,901)
Payments to employees		(59,955)	(60,467)
Net cash provided by operating activities		21,413	23,585
Cash flows from capital and related financing activities:			
Proceeds from long-term debt		—	43,934
Principal payments on long-term debt		(17,878)	(15,373)
Interest payments on long-term debt		(3,965)	(4,190)
Grant received for interest expense		—	3,040
Purchases and construction of capital assets		(51,412)	(62,632)
Proceeds from sales of capital assets		2,112	—
Increase in unearned revenues, net of advances		22,543	37,389
Net cash provided by (used for) capital and related financing activities		(48,600)	2,168
Cash flows from investing activities:			
Real estate income and related cash flows		19,238	20,399
Real estate direct expenses paid		(6,194)	(5,877)
Purchases of restricted investments		—	(40,456)
Proceeds from sales of restricted investments		21,088	8,882
Interest received		365	48
Net cash provided by (used for) investing activities		34,497	(17,004)
Net increase in cash and cash equivalents		7,310	8,749
Cash and cash equivalents at beginning of year		51,713	42,964
Cash and cash equivalents at end of year	$	59,023	51,713
Reconciliation of operating income to net cash provided by operating activities:			
Operating loss	$	(11,204)	(556)
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization		59,445	58,450
Bond issuance cost and amortization		48	25
Grant revenue on capital assets		(40,132)	(38,744)
Changes in operating assets and liabilities that provided (used) cash:			
Materials and supplies		(278)	(439)
Accounts receivable		12,442	(2,208)
Prepaid expenses and other assets		56	(344)
Accounts payable and accrued liabilities		(2,651)	6,263
Over (under) recovery of vehicle and equipment allocated costs		350	(185)
Payroll liabilities		317	455
Environmental remediation reserve		(133)	76
Postretirement and pension benefits change in accounting principle		—	1,279
Accrued postretirement and pension benefits		3,153	(487)
Net cash provided by operating activities	$	21,413	23,585
Supplemental schedule of noncash investing and capital and related financing activities:			
Depreciation included in real estate activity	$	28	165
Capital assets acquired through accounts payable		5,341	3,055
Defeasance of revenue bonds		—	70,715

See accompanying notes to 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 to manage the railroad's rail, industrial, port, and other properties. The ARRC commenced operations on January 6, 1985. The investment by the State of Alaska as of December 31, 2016 and 2015 was $34.17 million.

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 of 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)

(b) Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents include time deposits, money market accounts, money market mutual funds, and repurchase agreements with original maturities of three months or less at the time of purchase. Restricted assets are excluded from cash and cash equivalents for purposes of the statements of cash flows.

Money market accounts are valued at amortized cost. Money market mutual funds are recorded at fair value, which is determined by management based on published market prices and quotations from national exchanges.

(c) Materials and Supplies

Materials and supplies inventories are carried at the lower of weighted 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

Restricted assets include interest bearing savings, money market mutual fund accounts, and receivable from Healthcare Trust and are reported at fair value. These assets are restricted as to use by Trust or other third-party agreements.

(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.

(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

Grant revenue is recognized when all eligibility requirements have been met; however, 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.

(j) Environmental Remediation Costs

The ARRC accrues for losses, including legal fees, associated with environmental remediation obligations based on obligating events as defined under GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. Costs of future expenditures for environmental remediation liabilities are not discounted to their present value.

(k) Vehicle and Equipment Allocated Costs

The ARRC's vehicle and equipment costs for maintenance, fuel, depreciation, and leases are recorded in the vehicle and equipment cost pool. These costs are recovered through various responsibility centers through a fixed charge rate based on usage of vehicles and equipment. Any over recovery or under recovery of actual vehicle and equipment cost is applied against fixed charge rates in subsequent years. Accordingly, the ARRC has recorded over recoveries of $1,113,000 and $763,000 as of December 31, 2016 and 2015, respectively.

(l) Net Position

As of December 31, 2016 and 2015, the ARRC's board of directors has restricted $101,285,000 and $109,208,000, respectively, of net position for reinvestment in infrastructure.

(m) Pensions and Defined Benefit Postretirement Medical Plan

For purposes of measuring the net pension liability, net other post employment benefit asset (OPEB), deferred outflows of resources and deferred inflows of resources related to pensions and OPEB asset, and pension and OPEB expense, information about the fiduciary net position of the ARRC's defined benefit plans (the Plans) and additions to/deductions from the Plans' fiduciary net position have been determined on the same basis as they are reported by the Plans. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value. The fair value for mutual fund investments is determined based on published market prices and quotations from national security exchanges. The fair value of real estate and collective funds is determined based on the net asset value (NAV) per share of the fund.

(n) Adoption of Recently Issued Accounting Pronouncements

On January 1, 2016, ARRC adopted GASB Statement No. 72*, Fair Value Measurement and Application* (GASB 72). GASB 72 addresses accounting and financial reporting related to fair value measurements. GASB 72 generally requires investments to be measured at fair value. Investments are defined as a security or other asset that (a) a government holds primarily for the purpose of income or profit and (b) has a present service capacity based solely on its ability to generate cash or to be sold to generate cash. Fair value is described as an exit price. The Statement provides guidance and techniques appropriate to determine fair value.

(Continued)

On January 1, 2016, ARRC adopted certain provisions of GASB Statement No. 73, *Accounting and Financial Reporting for Pensions and Related Assets That Are Not within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements No. 67 and No. 68* (GASB 73). GASB 73 is intended to improve financial reporting of governments whose employees are provided with pensions that are not within the scope of GASB 68, improve the usefulness of information associated with governments that hold assets accumulated for purposes of providing defined benefit pensions not within the scope of GASB 68, and to clarify the application of certain provisions of GASB 67 and 68. The guidance for plans not within the scope of GASB 68 is not applicable to the ARRC.

On January 1, 2016, ARRC adopted GASB Statement No. 76, *The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments* (GASB 76). The objective of GASB 76 is to identify the hierarchy of generally accepted accounting principles (GAAP). GASB 76 reduces the GAAP hierarchy to two categories of authoritative GAAP and addresses the use of authoritative and nonauthoritative literature in the event that the accounting treatment for a transaction or other event is not specified within a source of authoritative GAAP.

On January 1, 2016, ARRC adopted GASB Statement No. 82, *Pension Issues*, an amendment of GASB Statements No. 67, No. 68, and No. 73 (GASB 82) were issued by the GASB in April 2016. GASB 82 addresses (1) presentation of payroll-related measures in required supplementary information, (2) selection of assumptions and treatment of deviations from guidance in Actuarial Standards of Practice for financial reporting purposes, and (3) classification of payments made by employers to satisfy plan member contribution requirements.

(o) Recently Issued Accounting Pronouncements not yet Adopted

GASB Statement No. 84*, Fiduciary Activities* (GASB 84) was issued in January 2017. This Statement establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities. An activity meeting the criteria should be reported in a fiduciary fund in the basic financial statements. Governments with activities meeting the criteria should present a statement of fiduciary net position and a statement of changes in fiduciary net position. GASB 84 is effective for reporting periods beginning after December 15, 2018. The ARRC is currently evaluating the impact GASB 84 will have on its future financial statements.

(3) Deposits

Restricted assets are reported on the statements of net position as follows at December 31, 2016 and 2015:

		2016	2015
		(In thousands)	
Restricted assets – current:			
Money market mutual funds	$	20,353	20,730
Receivable from Healthcare Trust		1,863	256
		22,216	20,986
Restricted assets – long term:			
Interest bearing savings		153	158
Money market mutual funds		17,708	37,741
Receivable from Healthcare Trust		2,262	4,541
		20,123	42,440
	$	42,339	63,426

These assets are restricted by the terms of grant, Trust, bond, or other agreements and are summarized as follows at December 31, 2016 and 2015:

Description of restriction		2016	2015
		(In thousands)	
Capital assets as authorized by the Department of Natural Resources	$	153	158
Advance grant funding		424	440
State of Alaska advance funding for Positive Train Control		1,290	2,026
State of Alaska advance funding for Northern Rail Extension		1,596	—
Projects authorized by bond agreements		16,924	36,942
Welfare Benefits Plan		4,125	4,797
Debt service reserve 2006, 2007, 2015A and 2015B		17,467	18,704
Arbitrage rebate reserve		105	104
Debt service reserve 2012A and 2012B		255	255
	$	42,339	63,426

Cash and cash equivalents consist of the following at December 31, 2016 and 2015:

		2016	2015
		(In thousands)	
Cash	$	2,696	5,121
Money market deposit accounts		10,067	10,049
Money market mutual funds		46,260	36,543
	$	59,023	51,713

(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, 2016, the ARRC's carrying amount of cash and cash equivalents was $59.0 million and the bank balance was $59.5 million. Of the bank balance, $250,000 was covered by federal depository insurance, $56.3 million represents money market funds held by the ARRC's agent in the ARRC's name, and the remaining balance is uncollateralized. At December 31, 2016, the ARRC's carrying amount and bank balance of restricted assets was $42.6 million, all of which was held by a custodian bank in ARRC's name.

At December 31, 2015, the ARRC's carrying amount of cash and cash equivalents was $51.7 million and the bank balance was $52.5 million. Of the bank balance, $250,000 was covered by federal depository insurance, $46.6 million represents money market funds held by the ARRC's agent in the ARRC's name, and the remaining balance is uncollateralized. At December 31, 2015, the ARRC's carrying amount and bank balance of restricted assets was $63.4 million, all of which was held by a custodian bank in ARRC's name.

(b) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. 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

Generally, credit risk is the risk that an issuer of an investment will not fulfill its obligation to the holder of an investment. 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 cash and cash equivalents and its restricted assets consist primarily of money market funds, which are excluded from credit risk disclosure requirements.

(Continued)

(d) Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributable to holding investments from a single issuer. 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, 2016 and 2015.

(f) Fair Value Measurements

The ARRC categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The ARRC has the following recurring fair value measurements as of December 31, 2016 and 2015:

		Fair value measurements using		
	December 31, 2016	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	(In thousands)			
Investments by fair value level:				
Cash and cash equivalents:				
Money market mutual funds	$ 46,260	46,260	—	—
Restricted assets:				
Money market mutual funds	38,061	38,061	—	—
Total investments by fair value level	$ 84,321	84,321	—	—

			Fair value measurements using		
		December 31, 2015	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
			(In thousands)		
Investments by fair value level:					
Cash and cash equivalents:					
Money market mutual funds	$	36,543	36,543	—	—
Restricted assets:					
Money market mutual funds		58,471	58,471	—	—
Total investments by fair value level	$	95,014	95,014	—	—

(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) Circulars, 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 $1,588,000 and $1,716,000 during the years ended December 31, 2016 and 2015, respectively.

The following tables summarize activity in the capital assets accounts during the years ended December 31, 2016 and 2015:

		Balance at December 31, 2015	Increases	Decreases	Balance at December 31, 2016
			(In thousands)		
Capital assets not being depreciated:					
Land and improvements	$	32,553	130	—	32,683
Road materials and supplies		12,787	—	(3,479)	9,308
Construction in progress		24,920	57,014	(25,548)	56,386
Total capital assets not being depreciated		70,260	57,144	(29,027)	98,377
Capital assets being depreciated:					
Road and roadway structures		1,062,385	20,661	—	1,083,046
Equipment		409,526	4,756	(5,485)	408,797
Leasehold improvements		2,172	—	—	2,172
Total capital assets being depreciated		1,474,083	25,417	(5,485)	1,494,015
Capital assets being depleted:					
Quarry improvements		4,114	—	—	4,114
Less accumulated depreciation for:					
Road and roadway structures		389,954	39,429	—	429,383
Equipment		242,634	21,402	(2,021)	262,015
Leasehold improvements		1,827	83	—	1,910
Total accumulated depreciation		634,415	60,914	(2,021)	693,308
Less accumulated depletion for:					
Quarry improvements		697	145	—	842
Capital assets being depreciated and depleted, net		843,085	(35,642)	(3,464)	803,979
Net capital assets	$	913,345	21,502	(32,491)	902,356

	Balance at December 31, 2014	Increases	Decreases	Balance at December 31, 2015
		(In thousands)		
Capital assets not being depreciated:				
Land and improvements	$ 32,144	409	—	32,553
Road materials and supplies	10,304	2,483	—	12,787
Construction in progress	23,426	47,369	(45,875)	24,920
Total capital assets not being depreciated	65,874	50,261	(45,875)	70,260
Capital assets being depreciated:				
Road and roadway structures	1,044,980	17,405	—	1,062,385
Equipment	383,760	28,063	(2,297)	409,526
Leasehold improvements	2,172	—	—	2,172
Total capital assets being depreciated	1,430,912	45,468	(2,297)	1,474,083
Capital assets being depleted:				
Quarry improvements	4,114	—	—	4,114
Less accumulated depreciation for:				
Road and roadway structures	350,696	39,258	—	389,954
Equipment	224,467	20,438	(2,271)	242,634
Leasehold improvements	1,744	83	—	1,827
Total accumulated depreciation	576,907	59,779	(2,271)	634,415
Less accumulated depletion for:				
Quarry improvements	580	117	—	697
Capital assets being depreciated and depleted, net	857,539	(14,428)	(26)	843,085
Net capital assets	$ 923,413	35,833	(45,901)	913,345

(Continued)

Depreciation was charged to the following departments during the years ended December 31, 2016 and 2015:

	2016		2015	
	Grant funded depreciation	**Nongrant funded depreciation**	**Grant funded depreciation**	**Nongrant funded depreciation**
	(In thousands)			
Transportation	$ 6,843	745	5,431	745
Passenger	11	171	11	163
Marketing and customer service	—	904	—	833
Mechanical	3,314	6,425	3,495	6,394
Engineering	26,015	5,941	25,840	5,950
Facilities	3,765	2,268	3,749	2,652
General and administrative	183	2,715	218	2,852
Real estate	28	1,585	168	1,278
	$ 40,159	20,754	38,912	20,867

Net investment in capital assets is as follows at December 31, 2016 and 2015:

	2016	2015
	(In thousands)	
Net capital assets	$ 902,356	913,345
Notes payable (note 6)	(14,180)	(18,768)
Outstanding balance of revenue bonds (note 6)	(117,839)	(131,081)
Assets restricted for projects authorized by revenue bond agreements (note 3)	16,924	36,942
Unearned grant revenue	(572,208)	(588,955)
	$ 215,053	211,483

(Continued)

(5) Long-Term Liabilities

Long-term liability activity is summarized as follows during the years ended December 31, 2016 and 2015:

	Balance at December 31, 2015	Additions	Reductions	Balance at December 31, 2016	Due within one year
			(In thousands)		
Long-term debt:					
Notes payable	$ 18,768	—	(4,588)	14,180	2,894
Revenue bonds payable	117,920	—	(12,680)	105,240	12,945
Plus (less) unamortized amounts:					
Issuance premiums	13,227	—	(610)	12,617	—
Unamortized issuance costs	(66)	48	—	(18)	—
Total revenue bonds payable	131,081	48	(13,290)	117,839	12,945
Environmental remediation reserve	2,693	536	(763)	2,466	286
Other claims	230	—	—	230	—
State of Alaska advances	2,179	1,923	(1,071)	3,031	2,886
Payable from restricted assets	105	1	—	106	106
Total long-term liabilities	$ 155,056	2,508	(19,712)	137,852	19,117

	Balance at December 31, 2014	Additions	Reductions	Balance at December 31, 2015	Due within one year
			(In thousands)		
Long-term debt:					
Notes payable	$ 19,137	2,573	(2,942)	18,768	3,438
Revenue bonds payable	98,185	97,915	(78,180)	117,920	12,680
Plus (less) unamortized amounts:					
Issuance premiums	4,348	12,663	(3,784)	13,227	—
Unamortized issuance costs	(407)	341	—	(66)	—
Total revenue bonds payable	102,126	110,919	(81,964)	131,081	12,680
Environmental remediation reserve	2,617	872	(796)	2,693	467
Other claims	230	—	—	230	—
State of Alaska advances	7,343	—	(5,164)	2,179	2,026
Payable from restricted assets	105	—	—	105	—
Total long-term liabilities	$ 131,558	114,364	(90,866)	155,056	18,611

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 rates of 65.2% to 100% of London Interbank Offered Rate (LIBOR) plus 1.30% to 2.25%. The self-insurance line of credit allows borrowing up to $10,000,000 at rates of 65.2% to 100% of LIBOR plus 1.30% to 2.25%. None of the lines of credit had an outstanding balance at December 31, 2016 or 2015.

ARRC had an irrevocable letter of credit in the amount of $36,000, which expired fully on October 1, 2015.

(Continued)

(6) Long-Term Debt

Long-term debt at December 31, 2016 and 2015 consists of the following:

		2016	2015
		(In thousands)	
Notes payable:			
Note payable, secured by equipment, due in monthly payments of $60,553, including interest at 2.89%, retired September 2016	$	—	1,807
Note payable, secured by real estate revenue, due in monthly payments of $36,210, including interest at 2.65%, matures August 2023		2,530	2,869
Note payable, secured by real estate revenue, due in monthly payments of $48,538, including interest at 2.65%, matures August 2023		3,392	3,846
Note payable, secured by equipment, due in monthly payments of $136,842, including interest at 1.71%, matures August 2019		4,278	5,832
Note payable to State of Alaska, secured by real property, due in annual payments (varies), including interest at 3.00%, matures September 2023		1,757	1,841
Note payable, secured by equipment, due in monthly payments of $32,469, including interest at 1.67%, matures December 2022		2,223	2,573
		14,180	18,768
Less current portion		2,894	3,438
	$	11,286	15,330

	2016	2015
	(In thousands)	
Revenue bonds:		
Revenue Bonds – Series 2015A and 2015B, interest at 4.0%–5.0% payable semi-annually February 1 and August 1, secured by 5307 and 5337 FTA Formula Funds, matures August 2023	$ 110,399	110,578
Revenue Bonds – Series 2006 and 2007, interest at 3.625%–5.25% payable semi-annually February 1 and August 1, secured by 5307, 5309, and 5337 FTA Formula Funds, matures August 2017	7,440	20,503
	117,839	131,081
Less current portion	12,945	12,680
	$ 104,894	118,401

Annual payments on debt are scheduled as follows at December 31, 2016:

	Notes payable		Revenue bonds payable		
	Principal	Interest	Principal	Interest	Total
			(In thousands)		
Year ending December 31:					
2017	$ 2,894	294	12,945	4,973	21,106
2018	2,954	234	13,575	4,325	21,088
2019	2,671	173	14,250	3,634	20,728
2020	1,622	126	14,960	2,909	19,617
2021	1,663	85	15,705	2,147	19,600
2022–2025	2,376	52	33,805	1,852	38,085
	14,180	$ 964	105,240	19,840	140,224
Current portion of principal	(2,894)		(12,945)		(15,839)
Unamortized premium	—		12,617		12,617
Unamortized issuance cost	—		(18)		(18)
Total noncurrent portion	$ 11,286		104,894		136,984

Federal Transit Program – ARRC Participation in Section 5307 Urbanized Area Formula Program and Section 5337 State of Good Repair 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. 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).

(Continued)

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. These ratings were used to determine the ARRC's financial strength for the bond issuance insured under a policy issued by FGIC.

In July 2015, the ARRC executed an advance refunding of the $66.1 million callable maturities of the 2006 and 2007 Capital Grant Receipts Bonds, Series 2006 and 2007, by issuing $63.2 million in new 5.0% Capital Grant Receipts Refunding Bonds, Series 2015A. At the same time, ARRC issued $34.7 million in new Capital Grant Receipts Bonds, Series 2015B with an average interest rate of 5.0%. Net bond proceeds of $70.7 million plus an additional $1.2 million of cash were deposited in an irrevocable trust with an escrow agent to provide for all future debt service payments on the callable maturities of the 2006 and 2007 series bonds. As a result, the callable portion of the 2006 and 2007 Series bonds are considered to be defeased and the liability for those bonds has been removed from the statement of net position. The amount of debt considered defeased was $34.5 million and $69.8 million at December 31, 2016 and 2015, respectively.

The advance refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $1.2 million. This difference was considered to represent the culmination of the earnings process of certain grant proceeds previously deferred and the difference between the reacquisition price and the net carrying amount was reported in the accompanying financial statements as a reduction to deferred grant revenue. The ARRC completed the advance refunding to reduce its total debt service payments over the next six years by $3.2 million and to obtain an economic gain (difference between the present values of the old and new debt service payments) of $2.9 million.

Leading up to the refunding and new money issue, the rating agencies issued updated ratings on June 9, 2015; with Moody's affirming their "A3" rating with a stable outlook and Standard & Poor's reducing their rating from "A+" to "A" and affirming the stable outlook.

On December 4, 2015, the President signed into law Public Law 114-94, titled "Fixing America's Surface Transportation Act" commonly known as the "FAST" Act, as the multi-year surface transportation reauthorization bill. The new multi-year bill increased ARRC's FTA formula funding by approximately 22.3% or $6.2 million.

The following table sets forth the authorized funding allocation of the FTA Section 5307 Formula Program Funds and Section 5337 Formula Program Funds to ARRC in Federal Fiscal Years (FFY) 2016 and the estimated apportionments for FFY 2017 through 2021:

FFY		Section 5307 formula program	Section 5337 formula program	Total
2016 Apportionments	$	11,040,168	22,840,507	33,880,675
2017 Estimated apportionments		10,718,599	23,325,131	34,043,730
2018 Estimated apportionments		10,960,693	23,727,963	34,688,656
2019 Estimated apportionments		11,149,122	24,136,557	35,285,679
2020 Estimated apportionments		11,397,071	24,552,177	35,949,248
2021 Estimated apportionments		11,625,012	24,969,564	36,594,576

The Federal Transit Administration (FTA) 5307 Urbanized Area Formula Funds flow from the FTA to a local area planning organization in a lump sum, where designated recipients, ARRC and MOA, are required to agree on how best to split the funds to benefit the area's transportation needs. Since 2006, ARRC and MOA have agreed to split the funds along programmatic lines so that all funds generated by ARRC as "rail tier" funds have gone to ARRC and all funds generated as "bus tier" funds have gone to MOA. During 2016, MOA refused to continue this long-standing practice and demanded instead to redirect rail tier funds to MOA, which is not agreeable to ARRC. Until this impasse is resolved, the flow of funds to ARRC and MOA are delayed, and the amount ARRC will ultimately receive is uncertain. As a result, ARRC was unable to recognize $7.4 million of expected rail tier FTA section 5307 grant revenues for 2016.

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. There was no rebate due on the Series 2006 during the filing of the 2016 arbitrage certificate. There was no rebate due on the Series 2007 during the filing of the January 2017 arbitrage certificate.

The ARRC expended $18.5 million and $3.7 million during 2016 and 2015, respectively, of the 2015B bond proceeds on eligible capital costs relating to the development of the federally mandated Positive Train Control.

The following table sets forth the interest capitalized or applied to the long-term capital construction projects:

		2016	2015
		(In thousands)	
Capitalized interest:			
Interest expense	$	1,726	796
Less interest income		(113)	(24)
Total capitalized interest	$	1,613	772

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.

Chapter 8, SLA 2015, authorized the ARRC to issue up to $37 million in revenue bonds to finance a positive train control rail transportation safety project that qualifies for federal financial participation and associated costs. On July 15, 2015, the ARRC issued $34.7 million in bonds with a premium of $5.1 million.

(7) Employee Benefits

(a) Alaska Railroad Corporation Pension Plan

The ARRC has a single-employer defined benefit pension plan (Plan) administered by the Tax Deferred Savings and Pension Committee covering all regular represented and nonrepresented employees who are not covered by the Civil Service Retirement System (CSRS). Benefits provided by the Plan include retirement, disability, and death benefits. Benefit terms and contribution rates are established and amended under the authority of the Board of Directors. 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 actuarially determined contribution rate recommended by an independent actuary. The actuarially determined contribution rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. Employees contribute an amount equal to 9% of eligible compensation.

As of December 31, 2016, the Plan assets consist of cash and cash equivalents of less than 1%, fixed income securities 30%, equities 53%, commodities 2%, and real estate investments 15%.

At December 31, the plan membership consisted of the following:

		2016	2015
Inactive plan members or beneficiaries currently receiving benefits	$	244	219
Inactive plan members entitled to but not yet receiving benefits		350	359
Active plan members		679	680
	$	1,273	1,258

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions: At December 31, 2016, the ARRC reported a liability for the pension plan. The net pension liability was measured as of December 31, 2016 and 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of January 1, 2016 and 2015, respectively. For the years ended December 31, 2016 and 2015, the ARRC recognized pension expense of $7,627,000 and $5,272,000, respectively.

At December 31, the ARRC reported deferred outflows of resources and deferred inflows of resources related to pension as follows:

		2016	2015
Deferred outflows of resources		**Deferred outflows of resources**	**Deferred outflows of resources**
		(In thousands)	
Differences between expected and actual experience	$	5,097	—
Net difference between actual and projected earnings on investments		6,030	8,853
Total	$	11,127	8,853

This deferred outflows of resources related to pensions will be recognized in pension expense as follows:

		Amount
		(In thousands)
Year ending December 31:		
2017	$	3,332
2018		3,332
2019		3,332
2020		1,118
2021		13
	$	11,127

Actuarial Assumptions: The total pension liability in the January 1 actuarial valuation was determined using the following actuarial assumptions.

Actuarial assumption	2016	2015
Inflation	2.8%	2.8%
Salary increases	3.0% CPI plus merit based rates	2.8% CPI plus merit based rates
Cost of living allowance	1.4%	1.4%
Retirement, disablement, and termination	Based on 2010-2014 experience study	Based on 2010-2014 experience study
Administrative expenses	1.24% of payroll, based on current year Actuarially Determined Contribution (ADC)	1.27% of payroll, based on current year Actuarially Determined Contribution (ADC)

Mortality rates were based on the Society of Actuaries RP-2000 combined mortality table (65%/35% blended blue/white collar) and the Scale AA generational mortality improvement in longevity that management expects to occur in the future.

The long-term expected rate of return on pension plan investments of 7.5% was determined using a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table:

Asset class	Target allocation	Long-term expected real rate of return
Cash	— %	1.00 %
Total Return Bond	17.00	3.00
Global Bond	7.00	3.00
High Yield Bond	6.00	4.00
Domestic Large Cap	16.00	7.00
Domestic Mid Cap	12.00	8.00
Domestic Small Cap	8.00	9.00
International equity	12.00	6.00
Commodities	8.00	2.00
Real estate	14.00	6.00
Total	100.00 %	

Discount Rate: The discount rate used to measure the total pension liability was 7.5%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at

(Continued)

the current contribution rate and the ARRC contributions will be made based on the actuarially determined contribution rate. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the net pension liability to changes in the discount rate: The following presents the net pension liability calculated using the discount rate of 7.5% as well as what the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower or higher than the current rate:

		1% Decrease (6.5)%	Current discount rate (7.5)%	1% Increase (8.5)%
			(In thousands)	
Net pension liability as of December 31, 2016	$	52,620	25,466	3,117
Net pension liability as of December 31, 2015		43,505	19,728	260

Changes in the net pension liability are as follows:

		Total pension liability (a)	Plan fiduciary net position (b)	Net pension liability (a) – (b)
			(In thousands)	
Balances at January 1, 2016	$	167,130	147,402	19,728
Changes for the year:				
Service cost		5,853	—	5,853
Interest		13,244	—	13,244
Difference between expected and actual experience		6,368	—	6,368
Contributions – employer		—	4,163	(4,163)
Contributions – employee		—	4,383	(4,383)
Net investment income		—	11,774	(11,774)
Benefit payments, including refunds of employee contributions		(5,541)	(5,541)	—
Administrative expenses		—	(593)	593
Net changes		19,924	14,186	5,738
Balances at December 31, 2016	$	187,054	161,588	25,466

		Total pension liability (a)	Plan fiduciary net position (b)	Net pension liability (a) – (b)
			(In thousands)	
Balances at January 1, 2015	$	154,384	145,210	9,174
Changes for the year:				
Service cost		5,834	—	5,834
Interest		11,832	—	11,832
Contributions – employer		—	3,571	(3,571)
Contributions – employee		—	4,290	(4,290)
Net investment income		—	(199)	199
Benefit payments, including refunds of employee contributions		(4,920)	(4,920)	—
Administrative expenses		—	(550)	550
Net changes		12,746	2,192	10,554
Balances at December 31, 2015	$	167,130	147,402	19,728

Additional required supplementary information for ARRC's defined benefit pension plan can be found on pages 47 and 48.

(b) Alaska Railroad Corporation Health Care Trust

The ARRC sponsors a single-employer defined benefit retiree health care plan (Plan) administered by the Nonrepresented Tax Deferred Saving, 457 and Health Care Trust Plan Committee covering nonrepresented and Alaska Railroad Workers (ARW) represented employees, who became employed prior to November 4, 2014, and employees who are not covered by the Civil Service Retirement System (CSRS). The Plan also covers regular represented employees covered under the American Train Dispatchers Association (ATDA) or other represented employees hired before March 4, 2016 for United Transportation Union (UTU), April 2, 2015 for Carmen's Division of Transportation Communication International Union (TCU), and April 26, 2016 for International Brotherhood of Teamsters Local 959 (IBT), as specified in the labor agreements.

The Plan 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 premiums adjusted annually, and contains other cost-sharing features such as deductibles and coinsurance. The ARRC's funding policy is to contribute each year an amount equal to the actuarially determined contribution. Benefit terms and contribution rates are established and amended under the authority of the Board of Directors.

There were no contributions recognized or due by the Plan from the ARRC during the years ended December 31, 2016 or 2015. As of December 31, 2016, the Plan assets are held in Trust and consist of cash and cash equivalents of 5%, fixed income securities 45%, equities 35%, and real estate investments 15%. The value of Trust assets used for GASB 75 excludes certain Trust assets segregated for use toward the ARRC Welfare Benefit Plan.

At December 31, the Plan membership consisted of the following:

	2016	2015
Inactive plan members or beneficiaries currently receiving benefits	32	38
Inactive plan members entitled to but not yet receiving benefits	—	—
Active plan members	444	539
	476	577

The components of the net other postemployment benefit (OPEB) asset for the Plan at December 31, 2016 and 2015, were as follows:

	December 31	
	2016	2015
	(In thousands)	
Total OPEB liability	$ 15,327	14,539
Fiduciary net position	(42,740)	(40,642)
Net OPEB asset	$ (27,413)	(26,103)
Plan fiduciary net position as a percentage of the total OPEB asset	(278.9)%	(279.5)%

OPEB Assets, OPEB Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB: At December 31, 2016, the ARRC reported an asset for the OPEB plan. The net OPEB asset was measured as of December 31, 2016, and the total OPEB asset used to calculate the net OPEB liability was determined by an actuarial valuation as of January 1, 2016. For the years ended December 31, 2016 and 2015, the ARRC recognized net OPEB income of $311,000 and $689,000, respectively.

(Continued)

At December 31, the ARRC reported deferred outflows of resources and deferred inflows of resources related to OPEB as follows:

		2016		2015	
Deferred outflows and (inflows) of resources		**Deferred outflows of resources**	**Deferred inflows of resources**	**Deferred outflows of resources**	**Deferred inflows of resources**
		(In thousands)		(In thousands)	
Differences between expected and actual experience	$	—	(1,633)	—	—
Changes of assumptions		1,285	—	—	—
Net difference between actual and projected earnings on investments		2,125	—	2,776	—
Total	$	3,410	(1,633)	2,776	—

These deferred outflows and inflows of resources related to OPEB will be recognized in OPEB expense or income as follows:

		Amount
		(In thousands)
Year ending December 31:		
2017	$	662
2018		662
2019		662
2020		(31)
2021		(42)
Thereafter		(136)
	$	1,777

(Continued)

Actuarial Assumptions: The total OPEB liability in the January 1 actuarial valuation was determined using the following actuarial assumptions.

Actuarial assumption	2016	2015
Discount rate	6.75% based on crossover test	7.5% based on crossover test
Inflation	2.8%	2.8%
Salary increases	3.0% CPI plus merit based rates	2.8% CPI plus merit based rates
Cost of living allowance	—	1.4%
Retirement, disablement, and termination	Based on 2010-2014 experience study	Based on 2010-2014 experience study
Administrative expenses	0.14% of payroll, based on current year ADC	0.146% of payroll, based on current year ADC
Participation rates	Varies from 35-85%	Varies from 35–85%
Medical trend	7.5%, grading down over eight years to 4.5%	7.5%, grading down over eight years to 4.5%

Mortality rates were based on the Society of Actuaries RP-2000 combined mortality table (65%/35% blended blue/white collar) and the Scale AA generational mortality improvement in longevity that management expects to occur in the future.

(Continued)

The long-term expected rate of return of 6.75% on OPEB plan investments was determined using a building – block method in which best-estimate ranges of expected future real rates of return (expected returns, net of OPEB plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of geometric real rates of return for each major asset class are summarized in the following table:

Asset class	Target allocation	Long-term expected real rate of return
Cash	— %	0.50 %
US TIPS	5.00	2.00
Intermediate Term Bond	30.00	2.50
Global Bond	5.00	2.50
High Yield Bond	10.00	4.00
Domestic Large Cap	15.00	7.00
Domestic Mid Cap	5.00	8.00
Domestic Small Cap	4.00	9.00
US Healthcare (Equity)	5.00	7.50
International equity	6.00	7.25
Real estate	15.00	4.75
Total	100.00 %	

Discount Rate: The discount rate used to measure the total OPEB liability was 6.75%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current contribution rate, and contributions from employers will be made based on the actuarially determine contribution rate. Based on those assumptions, the OPEB plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on OPEB plan investments was applied to all periods of projected benefit payments to determine the total OPEB liability.

Sensitivity of the net OPEB liability to changes in the discount rate: The following presents the net OPEB liability calculated using the discount rate of 6.75% as well as what the net OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower or higher than the current rate:

	1% Decrease (5.75)%	Current discount rate (6.75)%	1% Increase (7.75)%
		(In thousands)	
Net OPEB liability (asset) as of December 31, 2016	$ (24,912)	(27,413)	(29,426)

	1% Decrease (6.5)%	Prior discount rate (7.5)%	1% Increase (8.5)%
		(In thousands)	
Net OPEB liability (asset) as of December 31, 2015	$ (23,934)	(26,103)	(27,861)

Sensitivity of the net OPEB liability to changes in the Medical Cost Trend Rate: The following presents the net OPEB liability calculated using the medical cost trend rate of 7.5% beginning in 2015 reducing over eight years to 4.5%, as well as what the net OPEB liability would be if it were calculated using a trend rate that is 1-percentage-point lower or higher than the current rate:

	1% Decrease (6.5)%	Medical cost trend rate (7.5)%	1% Increase (8.5)%
		(In thousands)	
Net OPEB liability (asset) as of December 31, 2016	$ (29,888)	(27,413)	(24,243)
Net OPEB liability (asset) as of December 31, 2015	(28,276)	(26,103)	(23,347)

Changes in the OPEB liabilities are as follows:

		Total OPEB liability (a)	Plan fiduciary net position (b)	Net OPEB asset (a) – (b)
			(In thousands)	
Balances at January 1, 2016	$	14,539	40,642	(26,103)
Changes for the year:				
Service cost		699	—	699
Interest		985	—	985
Difference between expected and actual experience		(1,832)	—	(1,832)
Changes in assumptions		1,442	—	1,442
Contributions – employer		—	—	—
Net investment income		—	2,670	(2,670)
Benefit payments, including refunds of employee contributions		(506)	(506)	—
Administrative expenses		—	(66)	66
Net changes		788	2,098	(1,310)
Balances at December 31, 2016	$	15,327	42,740	(27,413)

		Total OPEB liability (a)	Plan fiduciary net position (b)	Net OPEB asset (a) – (b)
			(In thousands)	
Balances at January 1, 2015	$	13,078	41,267	(28,189)
Changes for the year:				
Service cost		633	—	633
Interest		1,021	—	1,021
Contributions – employee		—	—	—
Contributions – employer		—	—	—
Net investment income		—	(384)	384
Benefit payments, including refunds of employee contributions		(193)	(193)	—
Administrative expenses		—	(48)	48
Net changes		1,461	(625)	2,086
Balances at December 31, 2015	$	14,539	40,642	(26,103)

Additional required supplementary information for ARRC’s OPEB plan can be found on pages 49 through 51.

(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 $60,000 and $67,000 for the years ended December 31, 2016 and 2015, 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 and the plan document for nonrepresented employees, representing 80% 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 $711,000 and $613,000 for the years ended December 31, 2016 and 2015, respectively.

(e) Alaska Railroad Corporation 457 Deferred Compensation Plan

ARRC sponsors a Section 457 deferred compensation plan (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, 2016 and 2015.

(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, 2016 and 2015 consists of the following:

			2016	2015
			(In thousands)	
Land and improvements		$	8,729	8,729
Road and roadway structures	15–32 year life		656,290	648,214
Equipment	5–25 year life		180,586	180,681
Construction in process			12,864	11,653
		$	858,469	849,277

Grant revenue earned during the years ended December 31, 2016 and 2015 consisted of the following:

		2016	2015
		(In thousands)	
Depreciation on assets constructed with grant funds	$	40,159	38,912
Grant funded maintenance expense		6,759	10,597
Grant funded bond principal, interest, and issuance costs		43	4,046
		46,961	53,555
Less grant revenue included in real estate nonoperating revenues		(28)	(167)
Less grant funded interest on Series 2006, 2007, and 2015A revenue bonds included in interest expense		—	(3,423)
	$	46,933	49,965

The original cost of assets constructed or acquired with Capital Grant Receipts Bonds, Series 2006, 2007, and 2015B consists of the following:

			2016	2015
			(In thousands)	
Road and roadway structures	15–32 year life	$	163,779	163,779
Equipment	5–25 year life		18,960	18,960
Construction in process			24,578	4,429
		$	207,317	187,168

(9) Concentrations

During 2016 and 2015, ARRC entered into separate agreements with two 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 rebate of $2.5 million or a shipping credit of $2.7 million in 2016 and 2015. The qualified track maintenance expenses and the rebate or shipping credit are recorded as net reductions in operating expenses.

A significant portion of ARRC’s funding comes from the federal government in the form of grants. Federal grant funding was used for 28% and 77% of capital expenditures in 2016 and 2015, respectively.

(10) 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 $16,086,000 and $15,996,000 in 2016 and 2015, respectively. The following table summarizes future minimum lease receipts contractually due under long-term agreements as of December 31, 2016:

		Amount (In thousands)
Year ending December 31:		
2017	$	14,138
2018		13,476
2019		12,837
2020		12,521
2021		12,225
Thereafter		166,055
	$	231,252

(11) 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 $9,703,000 and $10,679,000 in 2016 and 2015, respectively. Future minimum lease payments as of December 31, 2016 are summarized as follows:

		Amount (In thousands)
Year ending December 31:		
2017	$	9,255
2018		1,526
2019		18
2020		—
2021		—
Thereafter		—
	$	10,799

(12) 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, including estimates of losses incurred but not reported, based on historical experience adjusted for current trends. 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, 2016 and 2015:

		2016	2015
		(In thousands)	
Casualty/liability	$	200,000	200,000
Property damage		100,000	100,000
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, 2016 and 2015:

		Balance at December 31, 2015	Incurred claims	Claim payments	Balance at December 31, 2016
			(In thousands)		
Employee health benefits	$	1,449	12,005	(12,280)	1,174
Workers' compensation		1,690	1,474	(1,432)	1,732
	$	3,139	13,479	(13,712)	2,906

		Balance at December 31, 2014	Incurred claims	Claim payments	Balance at December 31, 2015
			(In thousands)		
Employee health benefits	$	1,170	11,638	(11,359)	1,449
Workers' compensation		1,862	990	(1,162)	1,690
	$	3,032	12,628	(12,521)	3,139

(13) 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.

(14) Commitments and Contingencies

Approximately 70% of the ARRC's labor force is subject to one of five collective bargaining agreements with various expiration dates. 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 IBT labor agreement will expire April 2019. The ATDA labor agreement will expire May 2017, and negotiations will begin April 2017. The ARW labor agreement will expire November 2017 and negotiations will begin fall 2017. The TCU labor agreement will expire April 2018. The UTU agreement was to expire in February 2019; however the Union agreed to open their labor agreement. The extended UTU labor agreement will now expire February 2021.

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.

(15) Related Party Transactions

The State of Alaska awarded ARRC appropriations for two capital improvement projects totaling $118,100,000. The ARRC has incurred $3,016,000 and $16,362,000 of costs under these appropriations, which are included in accounts receivable, construction in progress, and unearned grant revenue as of December 31, 2016 and December 31, 2015, respectively. Consistent with other grants, revenue from these appropriations will be deferred and recognized over the life of the related capital assets.

REQUIRED SUPPLEMENTARY INFORMATION
(Unaudited)

ALASKA RAILROAD CORPORATION

Required Supplementary Information (Unaudited)

Schedule of Changes in Plan Net Pension Liability and Related Ratios – Defined Benefit Pension Plan

Last 10 Fiscal Years*

(In thousands)

	2016	2015
Total pension liability:		
Service cost	$ 5,853	5,834
Interest	13,244	11,832
Changes of benefit terms	—	—
Differences between expected and actual experience	6,368	—
Changes of assumptions	—	—
Benefit payments, including refunds of member contributions	(5,541)	(4,920)
Net change in total pension liability	19,924	12,746
Total pension liability – beginning	167,130	154,384
Total pension liability – ending (a)	187,054	167,130
Plan fiduciary net position:		
Contributions – employer	4,163	3,571
Contributions – employees	4,383	4,290
Total net investment income	11,774	(199)
Other miscellaneous income	—	—
Benefit payments, including refunds of member contributions	(5,541)	(4,920)
Administrative expenses	(593)	(550)
Net change in plan fiduciary net position	14,186	2,192
Plan fiduciary net position – beginning	147,402	145,210
Plan fiduciary net position – ending (b)	161,588	147,402
Plan's net pension liability (a) – (b)	$ 25,466	19,728
Plan fiduciary net position as a percentage of the total pension liability	86.39 %	88.20 %
Covered-employee payroll	$ 48,705	47,660
Net pension liability as a percentage of covered-employee payroll	52.29 %	41.39 %

* This schedule is intended to present information for 10 years. Additional years will be displayed as they become available.

See accompanying independent auditors' report and notes to required supplementary information.

ALASKA RAILROAD CORPORATION

Required Supplementary Information (Unaudited)

Schedule of ARRC Contributions – Defined Benefit Pension Plan

Last 10 Fiscal Years*

(In thousands)

		2016	2015
Actuarially determined contribution	$	4,163	3,571
Contributions in relation to the actuarially determined contribution		4,163	3,571
Contribution deficiency (excess)	$	—	—
Covered-employee payroll	$	48,705	47,660
Contributions as a percentage of covered-employee payroll		8.55%	7.49%

* This schedule is intended to present information for 10 years. Additional years will be displayed as they become available.

See accompanying independent auditors’ report and notes to required supplementary information.

ALASKA RAILROAD CORPORATION

Required Supplementary Information (Unaudited)

Schedule of Changes in Plan Net OPEB Liability and Related Ratios –
Defined Benefit Postretirement Medical Plan

Last 10 Fiscal Years *

(In thousands)

		2016	2015
Total OPEB liability:			
Service cost	$	699	633
Interest		985	1,021
Changes of benefit terms		—	—
Differences between expected and actual experience		(1,832)	—
Changes of assumptions		1,442	—
Changes in benefit terms		—	—
Benefit payments, net of retiree premiums		(506)	(193)
Net change in total OPEB liability		788	1,461
Total OPEB liability – beginning		14,539	13,078
Total OPEB liability – ending (a)		15,327	14,539
Plan fiduciary net position:			
Contributions – employer		—	—
Total net investment income		2,670	(384)
Other miscellaneous income		—	—
Benefit payments, net of retiree premiums		(506)	(193)
Administrative expenses		(66)	(48)
Net change in plan fiduciary net position		2,098	(625)
Plan fiduciary net position – beginning		40,642	41,267
Plan fiduciary net position – ending (b)		42,740	40,642
Plan's net OPEB liability (asset) (a) – (b)	$	(27,413)	(26,103)
Plan fiduciary net position as a percentage of the total OPEB liability		(278.85)%	(279.54)%
Covered-employee payroll	$	46,941	47,660
Net OPEB liability as a percentage of covered-employee payroll		(58.40)%	(54.77)%

* This schedule is intended to present information for 10 years. Additional years will be displayed as they become available.

See accompanying independent auditors' report and notes to required supplementary information.

ALASKA RAILROAD CORPORATION

Required Supplementary Information (Unaudited)

Schedule of ARRC Contributions – Defined Benefit Postretirement Medical Plan

Last 10 Fiscal Years *

(In thousands)

		2016	2015
Actuarially determined contribution	$	—	—
Contributions in relation to the actuarially determined contribution		—	—
Contribution deficiency (excess)	$	—	—
Covered-employee payroll	$	46,941	47,660
Contributions as a percentage of covered-employee payroll		— %	— %

* This schedule is intended to present information for 10 years. Additional years will be displayed as they become available.

See accompanying independent auditors' report and notes to required supplementary information.

ALASKA RAILROAD CORPORATION

Required Supplementary Information (Unaudited)

Schedule of Investment Returns – Defined Benefit Postretirement Medical Plan

Last 10 Fiscal Years *

	2016	**2015**
Annual money-weighted rate of return, net of investment expense	3.50 %	0.70 %

* This schedule is intended to present information for 10 years. Additional years will be displayed as they become available.

See accompanying independent auditors' report and notes to the required supplementary information.

(1) Actuarial Assumptions and Methods

The significant actuarial assumptions used in the defined benefit pension valuation as of December 31, 2016 are as follows:

(a) Actuarial Valuation Date: January 1, 2016

(b) Amortization Period: The Unfunded Actuarial Accrued Liability is amortized as a level dollar payment over a rolling (open) 30-year period.

(c) Actuarial Determined Contribution: Sum of (1) employer normal cost (2) amortization of unfunded actuarial accrued liability and (3) expected administrative expenses

(d) Asset valuation method: Actuarial value of assets, 5-year smoothed market value, gains/losses recognized over 5 years.

(e) Inflation: 2.8%

(f) Investment rate of return: 7.5%

(g) Administrative Expenses: $593,852 payable as of the last day of the plan year

(h) Cost of Living Allowance: 1.4% (1/2 assumed inflation Tier 1, none for Tier 2)

(i) Mortality: Society of Actuaries RP-2000 combined mortality table (65%/35% blended blue/white collar) and Scale AA generational mortality improvement

(j) Termination: Ultimate withdrawal rates of the V Table (Employee Termination Study, Roger L. Vaughn, 1992)

(k) Disability: 1985 Pension Disability table (blended 80% Class 1 and 20% Class 3)

(Continued)

(l) Retirement: Rates vary based on age. Sample rates follow. Tier 1 deferred vested members are assumed to retire at age 58

Age	Tier 1 rate	Tier 2 rate
55	6.0 %	N/A
56	6.0	N/A
57	12.5	N/A
58	12.5	N/A
59	20.0	N/A
60	20.0	10.0 %
61	20.0	10.0
62	25.0	15.0
63	15.0	15.0
64	20.0	20.0
65	15.0	25.0
66	15.0	25.0
67	25.0	25.0
68	25.0	25.0

The significant actuarial assumptions used in the actuarially determined contribution for the OPEB healthcare plan as of December 31, 2016 are as follows:

(a) Actuarial Valuation Date: January 1, 2016

(b) Amortization Period: The Overfunded Actuarial Accrued Liability is amortized as a level dollar payment over a rolling (open) 6-year period

(c) Actuarially Determined Contribution: Sum of (1) employer normal cost (2) amortization of unfunded actuarial accrued liability and (3) Expected administrative expenses. Not less than $0.

(d) Asset valuation method: Actuarial value of assets, 5-year smoothed market value: gains/losses recognized over 5 years, reduced by Trust payments expected to be made for non-OPEB medical benefits.

(e) Inflation: 2.8%

(f) Investment rate of return: 6.75%

(g) Administrative Expenses: $65,979 payable as of the last day of the plan year

(h) Mortality: Society of Actuaries RP-2000 combined mortality table (65%/35% blended blue/white collar). Scale AA generational mortality improvement

(i) Termination: Ultimate withdrawal rates of the V Table (Employee Termination Study, Roger L. Vaughn, 1992)

(j) Disability: 1985 Pension Disability table (blended 80% Class 1 and 20% Class 3)

(k) Retirement: Rates vary based on age. Sample rates:

Age	Tier 1 rate	Tier 2 rate
55	6.0 %	N/A
56	6.0	N/A
57	12.5	N/A
58	12.5	N/A
59	20.0	N/A
60	20.0	10.0 %
61	20.0	10.0
62	25.0	15.0
63	15.0	15.0
64	20.0	20.0
65	15.0	25.0
66	15.0	25.0
67	25.0	25.0
68	25.0	25.0
69	25.0	25.0
70	100.0	100.0

(l) Medical Trend:

Year	Increase rate
2015	7.5 %
2016	7.0
2017	6.6
2018	6.2
2019	5.8
2020	5.4
2021	5.1
2022	4.8
2023+	4.5

(m) ACA Excise Tax: Estimated based on blended rates.

(n) Participation: 45% of future retirees elect coverage, 85% of future disabled retirees to elect coverage, 25% of disabled retirees under age 65 are Medicare eligible, all retirees over age 65 are assumed Medicare eligible, 55% of nondisabled retirees continue coverage at first Medicare eligibility.

(o) Per capita claims costs:

Age		Old plan		Blue plan		Gold plan	
		Male	Female	Male	Female	Male	Female
50	$	9,418	10,883	8,856	10,285	8,454	9,847
55		12,648	12,802	12,015	12,165	11,538	11,683
60		17,313	15,666	16,601	14,977	16,029	14,437
64		19,353	16,887	18,610	16,177	17,998	15,612
65		6,830	5,658	6,088	4,958	5,477	4,405
70		7,899	6,398	7,041	5,606	6,334	4,981
75		9,393	7,507	8,373	6,578	7,532	5,645
80		11,283	8,957	10,057	7,849	9,048	6,974
85		13,248	10,519	11,808	9,217	10,623	8,190

Changes in Actuarial Methods since the prior Valuation

Defined Benefit OPEB healthcare plan

Participation: The participation assumption changed. The key participation assumption changes are:

(1) Future retirees assumed to elect coverage changed from 55% to 45%,

(2) The percentage of retirees continuing coverage upon reaching Medicare eligibility changed from 90% to 55%, and

(3) Laid off employees accumulate 75% of full-time service in the future, updated from 50%.

Administrative expenses: Administrative expenses changed from 0.146% of payroll to actual expenses paid in the prior year which increased by 3.0%.

Discount rate: The discount rate was changed from 7.5% to 6.75%.

The funding method was changed from projected unit credit in 2015 to entry age normal in 2016.

Alaska Railroad Offices

Alaska Railroad Offices	Physical Location	Phone	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**	**907.224.5550**	**907.265.2660**
Seattle, Washington 98134			
Barge Operations Office	**1140 SW Massachusetts Street**	**206.767.1100**	**206.767.1112**
TOLL FREE NUMBERS			
Corporate Information 1.800.321.6518	**Freight Marketing/ Customer Service 1.800.321.6518**	**Passenger Customer Service 1.800.544.0552**	**Seattle Office 1.800.834.2772**

www.AlaskaRailroad.com