



## SOCIAL SECURITY

November 7, 2006

To: The Honorable Jo Anne B. Barnhart  
Commissioner

This letter transmits the PricewaterhouseCoopers LLP (PwC) *Report of Independent Auditors* on the audit of the Social Security Administration's (SSA) Fiscal Year (FY) 2006 and 2005 financial statements. PwC's Report includes the firm's *Opinion on the Financial Statements*, *Report on Management's Assertion About the Effectiveness of Internal Control*, and *Report on Compliance and Other Matters*.

### **Objective of a Financial Statement Audit**

The objective of a financial statement audit is to determine whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

PwC's audit was made in accordance with generally accepted auditing standards, *Government Auditing Standards* issued by the Comptroller General of the United States, and Office of Management and Budget (OMB) Bulletin No. 06-03, *Audit Requirements for Federal Financial Statements*. The audit included obtaining an understanding of the internal control over financial reporting and testing and evaluating the design and operating effectiveness of the internal control. Because of inherent limitations in any internal control, there is a risk that errors or fraud may occur and not be detected. The risk of fraud is inherent to many of SSA's programs and operations, especially within the Supplemental Security Income program. In our opinion, people outside the organization perpetrate most of the fraud against SSA.

### **Audit of Financial Statements, Effectiveness of Internal Control, and Compliance with Laws and Regulations**

The Chief Financial Officers (CFO) Act of 1990 (P.L. 101-576), as amended, requires SSA's Inspector General or an independent external auditor, as determined by the IG, to audit SSA's financial statements in accordance with applicable standards. Under a contract monitored by the Office of the Inspector General (OIG), PwC, an independent certified public accounting firm, audited SSA's FY 2006 financial statements. PwC also audited the FY 2005 financial statements, presented in SSA's Performance and Accountability Report for FY 2006 for comparative purposes. PwC issued an unqualified opinion on SSA's FY 2006 and 2005 financial statements. PwC also reported that SSA's assertion that its internal control over financial reporting was operating effectively as of September 30, 2006, is fairly stated, in all material respects, based on criteria established under OMB Circular A-123, *Management's Responsibility for Internal Control*.

For FY 2006, the Statement of Social Insurance (SOSI) was added as a basic financial statement subject to audit. No significant findings were noted during the audit of the SOSI and we applaud SSA's effort in preparing for this additional level of audit. In addition, SSA completed its assessment of its internal control over financial reporting in compliance with OMB Circular A-123 within the first year of the 3-year time frame allowed by OMB.

## OIG Evaluation of PwC Audit Performance

To fulfill our responsibilities under the CFO Act and related legislation for ensuring the quality of the audit work performed, we monitored PwC's audit of SSA's FY 2006 financial statements by:

- Reviewing PwC's approach and planning of the audit;
- Evaluating the qualifications and independence of its auditors;
- Monitoring the progress of the audit at key points;
- Examining its workpapers related to planning the audit and assessing SSA's internal control;
- Reviewing PwC's audit report to ensure compliance with Government Auditing Standards and OMB Bulletin 06-03;
- Coordinating the issuance of the audit report; and
- Performing other procedures that we deemed necessary.

PwC is responsible for the attached auditor's report, dated November 7, 2006, and the opinions and conclusions expressed therein. The OIG is responsible for technical and administrative oversight regarding PwC's performance under the terms of the contract. Our review, as differentiated from an audit in accordance with applicable auditing standards, was not intended to enable us to express, and accordingly we do not express, an opinion on SSA's financial statements, management's assertions about the effectiveness of its internal control over financial reporting, or SSA's compliance with certain laws and regulations. However, our monitoring review, as qualified above, disclosed no instances where PwC did not comply with applicable auditing standards.



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## Report of Independent Auditors

To the Honorable Jo Anne B. Barnhart  
Commissioner  
Social Security Administration

In our audit of the Social Security Administration (SSA), we found:

- The consolidated balance sheets of SSA as of September 30, 2006 and 2005, and the related consolidated statements of net cost, of changes in net position, and of financing and the combined statements of budgetary resources for the years then ended and the statement of social insurance as of January 1, 2006 are presented fairly, in all material respects, in conformity with accounting principles generally accepted in the United States of America;
- Management fairly stated that SSA's internal control over financial reporting was operating effectively as of September 30, 2006.
- No reportable instances of noncompliance with the laws, regulations or other matter tested.

The following sections outline each of these conclusions in more detail.

### OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying consolidated balance sheets of SSA as of September 30, 2006 and 2005, and the related consolidated statements of net cost, of changes in net position, and of financing and the combined statements of budgetary resources for the years then ended and the statement of social insurance as of January 1, 2006. These financial statements are the responsibility of SSA's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Office of Management and Budget (OMB) Bulletin No. 06-03. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above and appearing on pages 124 through 150 of this performance and accountability report, present fairly, in all material respects, the financial position of SSA at September 30, 2006 and 2005, and its net cost of operations, changes in net position, budgetary resources and financing for the years then ended and the financial condition of its social



insurance programs as of January 1, 2006, in conformity with accounting principles generally accepted in the United States of America.

Our audit was conducted for the purpose of forming an opinion on the financial statements of SSA taken as a whole. The additional information presented on the statement of social insurance as of January 1, 2006 is not a required part of the financial statements and is presented for purposes of additional analysis. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

As discussed in Note 1 to the financial statements, SSA adopted Statement of Federal Financial Accounting Standards (SFFAS) No. 27, *Earmarked Funds*, effective October 1, 2005. This standard does not permit the restatement of prior periods.

As discussed in Note 17 to the financial statements, SSA adopted SFFAS No. 25, *Reclassification of Stewardship Responsibilities and Eliminating the Current Services Assessment*, and SFFAS No. 26, *Presentation of Significant Assumptions of the Statement of Social Insurance: Amending SFFAS No. 25*, requiring that the statement of social insurance be presented as an integral part of the basic financial statements of the Agency. The statement of social insurance presents the actuarial present value of the Agency's estimated future income to be received from or on behalf of the participants and estimated future costs to be paid to or on behalf of participants during a projection period sufficient to illustrate the long-term sustainability of the social insurance program. In preparing the statement of social insurance, management considers and selects assumptions and data that it believes provide a reasonable basis for the assertions in the statement. However, because of the large number of factors that affect the statement of social insurance and the fact that future events and circumstances cannot be known with certainty, there will be differences between the estimates in the statement of social insurance and the actual results, and those differences may be material.

#### **REPORT ON MANAGEMENT'S ASSERTION ABOUT THE EFFECTIVENESS OF INTERNAL CONTROL**

We have also examined management's assertion, included in the accompanying Federal Manager's Financial Integrity Act (FMFIA) Assurance Statement on Page 60 of this Performance and Accountability Report (PAR), that SSA's internal control over financial reporting was operating effectively as of September 30, 2006 based on criteria established under OMB Circular A-123, *Management's Responsibility for Internal Control*. We did not test all internal controls relevant to the operating objectives broadly defined by the Federal Managers' Financial Integrity Act of 1982. SSA's management is responsible for maintaining effective internal control over financial reporting. Our responsibility is to express an opinion on management's assertion based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants (AICPA), the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and OMB Bulletin No. 06-03 and, accordingly, included obtaining an understanding of the internal control, testing and evaluating the design and operating effectiveness of the internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion.

Because of inherent limitations in any internal control, misstatements due to error or fraud may occur and not be detected. Also, projections of any evaluation of the internal control to future periods are subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



In our opinion, management's assertion that SSA's internal control over financial reporting was operating effectively as of September 30, 2006, is fairly stated, in all material respects, based on criteria established under OMB Circular A-123.

We did note other matters involving the internal control and its operation that we will communicate in a separate letter.

#### **INTERNAL CONTROL RELATED TO KEY PERFORMANCE INDICATORS**

With respect to internal control relevant to data that support reported performance measures on pages 17, 18 and 19 of this performance and accountability report, we obtained an understanding of the design of significant internal control relating to the existence and completeness assertions, as required by OMB Bulletin No. 06-03. Our procedures were not designed to provide assurance on the internal control over reported performance measures and, accordingly, we do not express an opinion on such control.

#### **REPORT ON COMPLIANCE AND OTHER MATTERS**

The management of SSA is responsible for compliance with laws and regulations. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of compliance with certain provisions of laws and regulations, noncompliance with which could have a direct and material effect on the determination of financial statement amounts and certain other laws and regulations specified in OMB Bulletin No. 06-03, including the requirements referred to in the Federal Financial Management Improvement Act (FFMIA) of 1996. We limited our tests of compliance to these provisions, and we did not test compliance with all laws and regulations applicable to SSA. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion.

The results of our tests of compliance disclosed no instances of noncompliance with laws and regulations discussed in the preceding paragraph, exclusive of FFMIA, or other matters that are required to be reported under *Government Auditing Standards* or OMB Bulletin No. 06-03 as of September 30, 2006.

Under FFMIA, we are required to report whether SSA's financial management systems substantially comply with the Federal financial management systems requirements, applicable Federal accounting standards, and the United States Government Standard General Ledger at the transaction level. To meet this requirement, we performed tests of compliance with FFMIA section 803(a) requirements.

The results of our tests disclosed no instances in which SSA's financial management systems did not substantially comply with the three requirements discussed in the preceding paragraph as of September 30, 2006.

#### **OTHER INFORMATION**

The Management's Discussion and Analysis (MD&A) included on pages 6 to 66, and Required Supplementary Information (RSI) included on pages 1 and 2 and 157 and 158 to 173 of this performance and accountability report are not a required part of the financial statements but are supplementary information required by the Federal Accounting Standards Advisory Board and OMB Circular No. A-136, *Financial Reporting Requirements*. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the MD&A and RSI. However, we did not audit the information and express no opinion on it.

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Our audit was conducted for the purpose of forming an opinion on the financial statements of SSA taken as a whole. The Schedule of Budgetary Resources, included on page 157 of this PAR, is not a required part of the financial statements but is supplementary information required by OMB Circular No. A-136, *Financial Reporting Requirements*. This information and the consolidating and combining information included on pages 152 to 156 of this performance and accountability report are presented for purposes of additional analysis and are not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole.

The other accompanying information included on pages 3 to 5, 67 to 123, 174 to 176, and 181 to the end of this PAR, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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This report is intended solely for the information and use of management and the Inspector General of SSA, OMB, the Government Accountability Office and Congress and is not intended to be and should not be used by anyone other than these specified parties.

*PricewaterhouseCoopers LLP*

November 7, 2006