

NRHS AUDIT REPORT

Fiscal Year 2013

May 31, 2014

This is the NRHS Audit Report for Fiscal Year 2013, which ended on December 31, 2013.

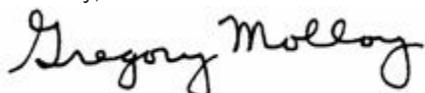
The Audit Report consists of six (6) documents:

- This cover letter (from NRHS),
- 2013 AU-C 260 Letter (from PGA),
- 2013 Adjusting Journal Entries
- 2013 AU-C 265 Letter (from PGA),
- 2013 Financial Statements (from PGA),
- 2013 NRHS Response Letter (from NRHS).

IRS FORM 990

The IRS Form 990 is being drafted based on the audited financial statements and will be posted for review by the NRHS Board of Directors. The 990 will be finalized based on review input after the end of the comments period. The edited 990 will be filed prior to the approved extension date of August 15, 2014 and will become public record after that date.

Sincerely,



Gregory P. Molloy
President



Padden, Guerrini & Associates P.C.

CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

H. David Padden, CPA
Karin M. Guerrini, CPA, CFE, CGMA
Ryan T. Casey, CPA
Stefanie M. Knaub
Frederick A. Tabor, CPA, CGMA

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May 14, 2014

To the Board of Directors and Management
National Railway Historical Society

RE: Communication required under AU-C 260

We have audited the financial statements of National Railway Historical Society as of December 31, 2013, and have issued our report thereon dated May 14, 2014. Professional standards require that we provide you with the following information related to our audit.

Our Responsibility Under U.S. Generally Accepted Auditing Standards

As stated in our engagement letter dated August 3, 2011 our responsibility, as described by professional standards, is to express an opinion about whether the financial statements prepared by management with your oversight are fairly presented, in all material respects, conformity with U.S. generally accepted accounting principles. Our audit of the financial statements does not relieve you or management of your responsibilities.

Planned Scope and Timing of the Audit

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; therefore, our audit involved judgment about the number of transactions to be examined and the areas to be tested.

Our audit included obtaining an understanding of the Society and its environment, including internal control, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures. Material misstatements may result from 1) errors, 2) fraudulent financial reporting, 3) misappropriation of assets, or 4) violations of laws or governmental regulations that are attributable to the entity or to acts by management or employees acting on behalf of the Society. We have communicated any internal control related matters that are required to be communicated under professional standards to you in our AU-C 265 letter dated May 14, 2014.

Planned Scope and Timing of the Audit (Continued)

We began the audit according to the planned scope and timing previously communicated to you in our engagement letter dated August 3, 2011.

Significant Audit Findings

Qualitative Aspects of Accounting Practices

Management is responsible for the selection and use of appropriate accounting policies. The significant accounting policies used by National Railway Historical Society are described in Note 1 to the financial statements. No new accounting policies were adopted and the application of existing policies was not changed during 2013. We noted no transactions entered into by the Society during the year for which there is a lack of authoritative guidance or consensus. All significant transactions have been recognized in the financial statements in the proper period.

Accounting estimates are an integral part of the financial statements prepared by management and are based on management's knowledge and experience about past and current events and assumptions about future events. Certain accounting estimates are particularly sensitive because of their significance to the financial statements and because of the possibility that future events affecting them may differ significantly from those expected.

Difficulties Encountered in Performing the Audit

We encountered no significant difficulties in dealing with management in performing and completing our audit.

Corrected and Uncorrected Misstatements

Professional standards require us to accumulate all known and likely misstatements identified during the audit, other than those that are trivial, and communicate them to the appropriate level of management. Management has corrected all such misstatements. In addition, none of the misstatements detected as a result of audit procedures and corrected by management were material, either individually or in the aggregate, to the financial statements taken as a whole.

Disagreements with Management

For purposes of this letter, professional standards defined a disagreement with management as a financial accounting, reporting, or auditing matter, whether or not resolved to our satisfaction, that could be significant to the financial statements or the auditor's report. We are pleased to report that no such disagreements arose during the course of our audit.

Management Representations

We have requested certain representations from management that are included in the management representation letter dated May 14, 2014.

Significant Audit Findings (Continued)

Management Consultations with Other Independent Accountants

In some cases, management may decide to consult with other accountants about auditing and accounting matters, similar to obtaining a “second opinion” on certain situations. If a consultation involves application of an accounting principle to the Society’s financial statements or a determination of the type of auditor’s opinion that may be expressed on those statement, our professional standards require that consulting accountant to check with us to determine that the consultant has all the relevant facts. To our knowledge, there were no such consultations with other accountants.

Other Audit Findings or Issues

We generally discuss a variety of matters, including the application of accounting principles and auditing standards, with management each year prior to retention as the Society’s auditors. However, these discussions occurred in the normal course of our professional relationship and our responses were not a condition to our retention.

This information is intended solely for the use of the Board of Directors and management of National Railway Historical Society and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

Padden, Guerrini & Associates, P.C.
Certified Public Accountants

Prepared by _____

National Railway Historical Society, Inc
Adjusting Journal Entries

22450YE13

Page 1

Reviewed by _____

ADD

m 5/29/14

Reference	Type	Date Account Number	Description	Debit	Credit	Net Income Effect	Workpaper
01	Adjusting	12/31/13					
		5800	Administrative Office	99.57			
		3900	Retained Earnings		99.57		
						(99.57)	
			To adjust R/E to actual at tlys pm.				
02	Adjusting	12/31/13					
		4390	Other Sales	515.00			
		4310	Emblem Sales Revenue		515.00		
						0.00	
			Per client, to reclass emblem sales to correct account.				
03	Adjusting	12/31/13					
		1600	Historical Items	14,940.00			
		4810	Unrestricted Donations		14,940.00		
						14,940.00	
			To record contribution in-kind of donated rail paintings.				
04	Adjusting	12/31/13					
		1210	Emblem Sales		2,479.82		
		6400	Emblem Sales	2,479.82			
						(2,479.82)	
			To write off 2012 and 2013 convention items.				
05	Adjusting	12/31/13					
		1060	TDA Money Fund		238,550.94		
		1500	Investment Securities	202,375.48			
		4530	Realized Capital Gains	36,175.46			
						(36,175.46)	
			To remove duplicate posting of investment activity.				
06	Adjusting	12/31/13					
		1910	IT Devel-Amortization		5,496.86		
		6900	IT Development	5,496.86			
						(5,496.86)	
			To correct posting of amortization expense.				

Prepared by _____

National Railway Historical Society, Inc
Adjusting Journal Entries

22450YE13

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Reviewed by _____

ADD

Reference	Type	Date Account Number	Description	Debit	Credit	Net Income Effect	Workpaper
07	Adjusting	12/31/13					
		2305	Bulletin Prepress		22,040.00		
		5210	Bulletin Prepress	22,040.00			
		2305	Bulletin Prepress		151.58		
		5232	Postage/UPS	151.58			
			To accrue Bulletin invoices not received until after year end.			(22,191.58)	
08	Adjusting	12/31/13					
		3160	Heritage Fund		29,434.75		
		3210	TR - Library Fund		52.00		
		3220	Grants		6,630.00		
		3240	TR - RailCamp		22,598.50		
		3250	TR - Educational Program		3,037.00		
		3250	TR - Educational Program		570.78		
		3900	Retained Earnings	62,323.03			
		3160	Heritage Fund	9,579.00			
		3220	Grants	705.00			
		3240	TR - RailCamp	5,000.00			
		3900	Retained Earnings		15,284.00		
			To record activity in temporarily restricted net assets.			0.00	
		TOTAL		<u>361,880.80</u>	<u>361,880.80</u>	<u>(51,503.29)</u>	



**Padden, Guerrini
& Associates P.C.**

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May 14, 2014

To the Board of Directors and Management
National Railway Historical Society

RE: Communication required under AU-C 265

In planning and performing our audit of the financial statements of National Railway Historical Society (the Society) as of and for the year ended December 31, 2013, in accordance with auditing standards generally accepted in the United States of America, we considered National Railway Historical Society's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Society's internal control. Accordingly, we do not express an opinion on the effectiveness of the Society's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. We consider the following deficiencies in National Railway Historical Society's internal control to be material weaknesses:

Improve Monthly Closing Procedures – During the audit, we recommended 8 adjusting journal entries. The effect of such entries was to decrease net income and retained earnings by \$51,503. Substantially all of the entries were to correct bookkeeping errors or to make accruals and other adjustments that should have been made as of the year-end. It was also noted that a significant amount of monthly reconciling entries were made as of the year-end in order to reconcile accounts at December 31, 2013. We believe that a review and evaluation of transactions, preparation and review of account reconciliations, creation and retention of certain accounting records and proper monthly closing

procedures would expedite and improve the year-end closing. The Society's management is currently taking steps to ensure the improvement of the monthly closing process.

Bank Reconciliation – At December 31, 2013, the Society's bank reconciliation for the Blackhawk account was out of balance with the general ledger control account by \$1,000. The bank reconciliation prepared at the end of the year by the association management company did not indicate an out of balance condition; however, this reconciliation did not include the correct general ledger balance. Further, it is our understanding that the bank reconciliations were not being prepared timely throughout the year. As a result, material misstatements of the cash account and the misappropriation of cash may occur and not be prevented or detected and corrected on a timely basis.

Financial Statement Preparation – The Society's management is responsible for establishing internal controls for the fair presentation of Society's financial statements in conformity with U.S. generally accepted accounting principles (GAAP). The Society does not have a system of internal controls that would enable management to prepare GAAP financial statements and related footnote disclosures. As such, management requests that we prepare a draft of the financial statements and related footnote disclosures. The outsourcing of the preparation of financial statements is not unusual for an organization of your size and is a result of management's decision to not incur the internal resource cost.

This communication is intended solely for the information and use of the Board of Directors and management, and is not intended to be and should not be used by anyone other than these specified parties.

Sincerely,
Padden, Guerrini & Associates, P.C.
Certified Public Accountants,

NATIONAL RAILWAY HISTORICAL SOCIETY

**FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012
AND
REPORT OF INDEPENDENT
CERTIFIED PUBLIC ACCOUNTANTS
(Audited)**



Padden, Guerrini & Associates P.C.

CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
National Railway Historical Society

Report on the Financial Statements

We have audited the accompanying financial statements of National Railway Historical Society which comprise the statement of financial position as of December 31, 2013 and 2012 and the related statements of activities, and cash flows for the years then ended and the related notes to the financial statements.

Management's Responsibility's for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; 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.

Auditor's 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. 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 auditor's 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 National Railway Historical Society as of December 31, 2013 and 2012, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Padden, Guerrini & Associates, P.C.
Certified Public Accountants

May 14, 2014

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Members: American Institute of Certified Public Accountants ■ Pennsylvania Institute of Certified Public Accountants

NATIONAL RAILWAY HISTORICAL SOCIETY
STATEMENTS OF FINANCIAL POSITION

	December 31	
	2013	2012
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 334,003	\$ 231,166
Accounts receivable	-	48,569
Investments	-	184,629
Inventory	13,393	20,397
Prepaid expenses	4,778	5,730
Other assets	-	2,415
Total Current Assets	<u>352,174</u>	<u>492,906</u>
Historical Collections	<u>14,940</u>	<u>-</u>
Fixed Assets	<u>3,170</u>	<u>2,380</u>
TOTAL ASSETS	<u>\$ 370,284</u>	<u>\$ 495,286</u>
LIABILITIES AND NET ASSETS		
Liabilities		
Accounts payable	\$ 19,976	\$ 28,856
Deferred income	275,724	318,716
Accrued expenses	22,192	23,138
Total Liabilities	<u>317,892</u>	<u>370,710</u>
Net Assets		
Unrestricted	(69,401)	49,822
Temporarily restricted	104,394	57,355
Permanently restricted	17,399	17,399
Total Net Assets	<u>52,392</u>	<u>124,576</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 370,284</u>	<u>\$ 495,286</u>

See notes to the financial statements

NATIONAL RAILWAY HISTORICAL SOCIETY
STATEMENT OF ACTIVITIES
YEAR ENDED DECEMBER 31, 2013

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Support and Revenues				
Member dues	\$ 366,760	\$ -	\$ -	\$ 366,760
Emblem sales	2,964	-	-	2,964
RailCamp	-	-	-	-
Convention	443,373	-	-	443,373
Conferences	5,300	-	-	5,300
Interest and dividend	4,805	571	-	5,376
Contributions	96,948	61,752	-	158,700
Restrictions satisfied by payments	15,284	(15,284)	-	-
Realized and unrealized gains on investments	36,091	-	-	36,091
Miscellaneous	<u>1,081</u>	<u>-</u>	<u>-</u>	<u>1,081</u>
Total Support and Revenues	<u>972,606</u>	<u>47,039</u>	<u>-</u>	<u>1,019,645</u>
Expenses				
Convention	361,683	-	-	361,683
Bulletin	102,543	-	-	102,543
Publication	56,597	-	-	56,597
Membership records	24,165	-	-	24,165
Office	23,281	-	-	23,281
Meeting and travel	36,013	-	-	36,013
Rent	5,625	-	-	5,625
Insurance	6,541	-	-	6,541
Bank and investment fees	19,709	-	-	19,709
Corporate	11,974	-	-	11,974
Professional fees	85,105	-	-	85,105
Advertising	30,996	-	-	30,996
Fundraising	39,762	-	-	39,762
Emblem sales	4,277	-	-	4,277
RailCamp	10,559	-	-	10,559
Grants and donations	50,359	-	-	50,359
Periodical and book purchases	25	-	-	25
Management fees	172,184	-	-	172,184
Depreciation	1,877	-	-	1,877
Other miscellaneous	<u>48,554</u>	<u>-</u>	<u>-</u>	<u>48,554</u>
Total Expenses	<u>1,091,829</u>	<u>-</u>	<u>-</u>	<u>1,091,829</u>
Decrease in Net Assets	(119,223)	47,039	-	(72,184)
Net Assets, Beginning of Year	<u>49,822</u>	<u>57,355</u>	<u>17,399</u>	<u>124,576</u>
Net Assets, End of Year	<u>\$ (69,401)</u>	<u>\$ 104,394</u>	<u>\$ 17,399</u>	<u>\$ 52,392</u>

See notes to the financial statements

NATIONAL RAILWAY HISTORICAL SOCIETY
STATEMENT OF ACTIVITIES
YEAR ENDED DECEMBER 31, 2012

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Support and Revenues				
Member dues	\$ 365,860	\$ -	\$ -	\$ 365,860
Emblem sales	4,519	-	-	4,519
RailCamp	31,842	-	-	31,842
Convention and conferences	452,037	-	-	452,037
Interest and dividend	11,159	521	-	11,680
Contributions	71,929	13,764	-	85,693
Restrictions satisfied by payments	17,080	(17,080)	-	-
Realized and unrealized gains on investments	8,598	-	-	8,598
Miscellaneous	-	-	-	-
	<u>963,024</u>	<u>(2,795)</u>	<u>-</u>	<u>960,229</u>
Expenses				
Convention and conferences	469,235	-	-	469,235
Bulletin	99,070	-	-	99,070
Publication	48,545	-	-	48,545
Membership records	27,595	-	-	27,595
Office	20,526	-	-	20,526
Meeting and travel	51,196	-	-	51,196
Rent	3,156	-	-	3,156
Insurance	8,338	-	-	8,338
Bank and investment fees	25,696	-	-	25,696
Corporate	27,141	-	-	27,141
Professional fees	50,267	-	-	50,267
Advertising	22,698	-	-	22,698
Fundraising	32,390	-	-	32,390
Emblem sales	3,400	-	-	3,400
RailCamp	44,312	-	-	44,312
Grants and donations	50,040	-	-	50,040
Periodical and book purchases	-	-	-	-
Management fees	184,914	-	-	184,914
Depreciation	3,006	-	-	3,006
Other miscellaneous	60,799	-	-	60,799
	<u>1,232,324</u>	<u>-</u>	<u>-</u>	<u>1,232,324</u>
Decrease in Net Assets	(269,300)	(2,795)	-	(272,095)
Net Assets, Beginning of Year	<u>319,122</u>	<u>60,150</u>	<u>17,399</u>	<u>396,671</u>
Net Assets, End of Year	<u>\$ 49,822</u>	<u>\$ 57,355</u>	<u>\$ 17,399</u>	<u>\$ 124,576</u>

See notes to the financial statements

NATIONAL RAILWAY HISTORICAL SOCIETY
STATEMENTS OF CASH FLOWS

	Years Ended December 31	
	2013	2012
Cash Flows From Operating Activities:		
Change in net assets	\$ (72,184)	\$ (272,095)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	1,877	3,006
Unrealized gain (loss) on investments	-	(8,598)
Contributions in-kind	(14,940)	-
Change in assets and liabilities:		
(Increase) decrease in:		
Accounts receivable	48,569	(48,047)
Inventory	7,004	1,917
Prepaid expenses	952	13,982
Other assets	2,415	6,744
Increase (decrease) in		
Accounts payable	(8,880)	16,916
Deferred income	(42,992)	(52,342)
Accrued expenses	(946)	23,138
	(79,125)	(315,379)
Net Cash Used in Operating Activities		
Cash Flows From Investing Activities:		
Purchases of equipment and furniture	(2,667)	-
Investment purchases	-	(13,553)
Investment sales	184,629	280,262
	181,962	266,709
Net Cash Provided by Investing Activities		
Net Increase (Decrease) in Cash	102,837	(48,670)
Cash, Beginning of Year	231,166	279,836
Cash, End of Year	\$ 334,003	\$ 231,166

See notes to the financial statements

NATIONAL RAILWAY HISTORICAL SOCIETY
NOTES TO THE FINANCIAL STATEMENTS
DECEMBER 31, 2013 AND 2012

1. Nature of Activities and Summary of Significant Accounting Policies

Nature of Activities

The National Railway Historical Society, Inc. (the Society) was founded in 1935 and incorporated in Maryland in 1937. The Society is dedicated to the interpretation and preservation of railway education and history. Members of the Society receive various publications throughout the year in exchange for an annual dues payment. The Society is supported primarily through this dues payment, donor contributions and special event revenues. There are local chapters of the Society located in the United States, Canada, Great Britain and Japan. All officers and directors serve voluntarily and without remuneration.

Summary of Significant Accounting Policies

This summary is presented to assist in understanding the Society's financial statements. The financial statements and notes are representations of the Society's management who is responsible for the integrity and objectivity of the financial statements. These accounting policies conform to generally accepted accounting principles and have been consistently applied in the preparation of the financial statements.

Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Financial Statement Presentation - The Society has adopted the provisions of FASC 958-205, "Presentation of Financial Statements for Not-for-Profit Entities." Under FASC 958-205, the Society is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. As permitted by the standard, the Society does not use fund accounting.

Contributions - The Society has also adopted the provisions of FASC 958-605, "Revenue Recognition for Not-for-Profit Entities." Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence or nature of any donor restrictions.

Investments - The Society has adopted the provisions of FASC 958-320, "Investments held by Not-for-Profit Entities." Under FASC 958-320, investments in marketable securities with readily determinable fair values and all investments in debt securities are reported at their fair values in the statement of financial position. Unrealized gains and losses are included in the change in net assets. Investment income and gains restricted by a donor are reported as increases in unrestricted net assets if the restrictions are met (either by passage of time or by use) in the reporting period in which the income and gains are recognized.

Cash and Cash Equivalents - For the purposes of the statement of cash flows, the Society considers all short-term debt securities purchased with a maturity of three months or less to be cash equivalents.

NATIONAL RAILWAY HISTORICAL SOCIETY
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2013 AND 2012

1. Nature of Activities and Summary of Significant Accounting Policies (Continued)

Summary of Significant Accounting Policies (Continued)

Income Taxes - The Society is exempt from all federal and state income taxes, in accordance with Section 501(c)(3) of the Internal Revenue Code.

In July 2006, the Financial Accounting Standards Board (FASB) issued Financial Accounting Standards Board Codification No. 740-10-05, Income Taxes (FASC 740-10-05). FASC 740-10-05 clarifies the accounting of uncertainty in income taxes by prescribing the recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provided guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FASC 740-10-05 is effective for fiscal years beginning after December 15, 2008, and was adopted by the Society for the year ended December 31, 2009.

The Society has reviewed the impact of FASC 740-10-05 on the financial statements and has determined there is no material uncertain tax positions or unrecognized tax benefits and there is no material impact on the statements of financial position, statements of operations and changes in net assets or cash flows.

The IRS Form 990 for the years ended December 31, 2012, 2011 and 2010 remain open for an examination by the IRS.

Inventories - Inventories consist primarily of member length of service award pins and promotional items purchased for resale to members. Promotional items consist primarily of pens, caps, ties, lapel pins, and jackets bearing the Society's emblem. Inventories are stated at the lower of cost determined by the FIFO method.

Furniture, Equipment and Improvements - Furniture, equipment and leasehold improvements are capitalized at cost. It is the Society's policy to capitalize expenditures for those items in excess of \$1,000. Lesser amounts are expensed. Furniture, equipment and improvements are being depreciated over estimated useful lives of three to ten years using a straight-line method. Expenditures for maintenance and repair of equipment are charged to expense as incurred.

Collections - The collections consist of film and photographs, which were acquired through purchases and contributions since the Society's inception, are not recognized as assets on the statement of financial position. Purchases of collection items are recorded as decreases in unrestricted net assets in the year in which the items are acquired or as temporarily or permanently restricted net assets if the assets used to purchase the items are restricted by donors. Contributed collection items are not reflected on the financial statements. As of December 31, 2013, collections consisting of historical paintings are reflected on the financial statements and valued at fair market value.

Subsequent Events – The date to which events occurring after December 31, 2013, the date of the most recent balance sheet, have been evaluated for possible adjustments to the financial statements or disclosure is May 14, 2014, which is the date on which the financial statements were available to be issued.

NATIONAL RAILWAY HISTORICAL SOCIETY
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2013 AND 2012

2. Investments

Investments are stated at fair value and consist of stocks. Fair values at December 31 are summarized as follows:

	<u>2013</u>	<u>2012</u>
Stocks	<u>\$ -</u>	<u>\$ 184,629</u>

The following schedule summarizes the investment return, including income received on short-term investments carried in cash and cash equivalents and certificates of deposit. These items are classified as unrestricted in the statement of activities for the years ended December 31, 2013 and 2012:

	<u>2013</u>	<u>2012</u>
Interest and Dividend Income	\$ 5,376	\$ 11,680
Net realized and Unrealized gains	<u>36,091</u>	<u>8,598</u>
Total Investment Return	<u>\$ 41,467</u>	<u>\$ 20,278</u>

Realized gains and income from permanently restricted net assets are reported as increases in temporarily restricted funds.

4. Disclosure of Cash Balances in Excess of Federally Insured Amounts

The Society maintains its cash in bank deposit accounts that, at times, may exceed federally insured limits. The Society has not experienced any losses in such account. The Society believes it is not exposed to any significant credit risk on cash and cash equivalents.

5. Advertising Costs

The Society expenses advertising costs as they are incurred. Advertising expense for the years ended December 31, 2013 and 2012 was \$30,996 and \$22,698, respectively. No advertising was reported as assets at December 31, 2013 and 2012.

NATIONAL RAILWAY HISTORICAL SOCIETY
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2013 AND 2012

6. Fair Value of Financial Instruments

Effective January 1, 2008, the Society adopted the provisions of FASC 820, "Fair Value Measurements" for assets and liabilities measured and reported at fair value. FASC 820 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements.

FASC 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. FASC 820 requires the use of valuation techniques that are consistent with the market approach, the income approach and/or the cost approach. Inputs to valuation techniques refer to the assumptions that market participants would use in pricing the asset or liability. Inputs may be observable, meaning those that reflect the assumptions market participants would use in pricing the asset or liability developed based on market data obtained from independent sources, or unobservable, meaning those that reflect the reporting entity's own assumptions about the assumptions market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. In that regard, FASC 820 establishes a fair value hierarchy for valuation inputs that gives the highest priority to quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs. The fair value hierarchy is as follows:

Level 1: Quoted prices (unadjusted) for identical assets or liabilities in active markets that the entity has the ability to access as of the measurement date.

Level 2: Significant other observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect a reporting entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

A description of the valuation methodologies used for assets and liabilities measured at fair value, as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

Stocks: Where quoted prices are available in an active market, securities are classified within Level 1 of the valuation hierarchy. Level 1 securities would include highly liquid government bonds and exchange traded equities. If quoted market prices are not available, then fair values are estimated by using pricing models, quoted prices of securities with similar characteristics, or discounted cash flow. Level 2 securities would include U.S. agency securities, mortgage backed agency securities, obligations of states and political subdivisions and certain corporate, asset backed and other securities. In certain cases where there is limited activity or less transparency around inputs to the valuation, securities are classified within Level 3 of the valuation hierarchy.

NATIONAL RAILWAY HISTORICAL SOCIETY
NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)
DECEMBER 31, 2013 AND 2012

6. Fair Value of Financial Instruments (Continued)

The following table summarizes the stocks measured at fair value on a recurring basis as of December 31, 2013 and 2012, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value.

		2013			
		Total	Level 1	Level 2	Level 3
	Stocks	\$ -	\$ -	\$ -	\$ -
		2012			
		Total	Level 1	Level 2	Level 3
	Stocks	\$ 184,629	\$ 184,629	\$ -	\$ -

7. Functional Expenses

Functional expenses for the years ended December 31 are as follows:

	2013	2012
Program services	\$ 763,779	\$ 968,626
Management and general	288,288	207,837
Fundraising	39,762	55,861
	\$ 1,091,829	\$ 1,232,324

8. Operating Losses

The accompanying financial statements have been prepared assuming that the Society will continue as a going concern. As evidenced by the deficit in unrestricted net assets, the Society has incurred net losses in current and prior years.

The Society's management has taken steps to increase revenue and reduce operating expenses. Management believes that actions presently being taken to revise the Society's operating and financial requirements provide the opportunity for the Society to continue as a going concern.

NRHS RESPONSE LETTER

2013 NRHS Audit

May 31, 2014

This is the NRHS management response to issues raised in the AU-C 265 Letter and other documents included in the 2013 Audit Report.

MONTHLY CLOSING PROCEDURES

NRHS concurs that the monthly accounting closings by Fernley & Fernley were deficient in 2013 and caused significant delays in producing accurate financial information. NRHS has already taken steps to fix this problem and expects significantly better reporting in 2014.

To put matters in perspective, NRHS had previously contracted with Fernley & Fernley (F&F) to perform monthly closings, financial reports and other accounting management functions. F&F was performing acceptable accounting work through early 2013, when they sustained an unplanned staffing loss for medical reasons. This was followed by a period of high staff turnover. At the same time, NRHS was dealing with demands that more financial information be made available to the full membership, and Fernley & Fernley had a difficult time producing additional reports in a more readable format. It also became increasingly apparent to NRHS management that the quality of F&F accounting was continuing to deteriorate despite the attempts of F&F management to fix the problems.

NRHS then engaged the services of Your Part-Time Controller (YPTC) to perform the accounting closings, bank reconciliations, financial reports and oversight of bookkeeping that was formerly part of the F&F scope of work. The YPTC responsibilities began as of January 2014. YPTC is a Philadelphia-based accounting firm specializing in service to not-for-profit organizations. Bill payments and basic bookkeeping functions remain with Fernley & Fernley at this time.

After some delays, Fernley & Fernley has started to make internal changes to address their accounting issues, but NRHS management believes that it is still appropriate to remain with the current arrangement (F&F and YPTC) for the time being.

The accounting problems at Fernley & Fernley resulted in incomplete and inaccurate financial statements being released to the NRHS Board of Directors during the middle of 2013. When NRHS management became aware of the extent of the accounting problems, NRHS ceased releasing 2013 financial information containing known errors. With the release of this 2013 audit report and the other improvements that have been implemented, NRHS expects to resume the regular release of financial information.

BANK RECONCILIATIONS

NRHS agrees that bank reconciliations must be done accurately and on a regular basis. The realization that Fernley & Fernley had stopped performing bank reconciliations on a timely basis was one of the reasons that NRHS chose to engage Your Part-Time Controller to provide that service.

NRHS agrees that the lack of timely bank reconciliations makes it more difficult to promptly detect misappropriation of funds. However, the subsequent performance of accurate, although delayed, bank reconciliations has yet to uncover any evidence that any funds were actually misappropriated.

The \$1,000 error cited in the AU-C 265 letter appears to be part of a continuing problem with properly accounting for a security deposit check that was voided and returned by the Alaska Railroad following the 2013 NRHS Convention. The continuing inability of Fernley & Fernley's accounting management to properly record this particular transaction was one of the incidents that first alerted NRHS management to the need to intervene in the accounting system.

ADJUSTING JOURNAL ENTRIES

NRHS management concurs with this list of journal entries and worked with the auditors to develop the list. All entries have been made as instructed.

FINANCIAL STATEMENT PREPARATION

NRHS management concurs with this statement. We continue to believe that engaging an independent auditor to prepare the audited financial statements and footnotes in accordance with GAAP is appropriate for the NRHS as it currently operates.

OPERATING LOSSES

NRHS management is concerned about the continuing operating losses sustained by the Society. While the NRHS has taken steps to build revenue through increased dues income, donations, convention earnings and user fees, revenue has not been sufficient to match either budgeted or unexpected expenses. NRHS management has been concerned for some time that the Society's current business model is not sustainable, and the NRHS Board of Directors approved a strategic plan in 2011 that called for major changes in the Society's business direction. The implementation of that new direction has proven difficult and has met with resistance. As a result of that resistance and slowness to change, NRHS is facing serious financial difficulties. Rebuilding the Society's business model must now be our top priority.