



**NATIONAL GUARD OF THE
COMMONWEALTH OF PUERTO RICO**

**INDEPENDENT AUDITORS' REPORT AND STATEMENT OF CASH RECEIPTS AND CASH
DISBURSEMENTS**

**(WITH THE ADDITIONAL REPORTS AND INFORMATION REQUIRED UNDER
TITLE 2 U.S CODE OF FEDERAL REGULATION PART 200)**

YEAR ENDED JUNE 30, 2018

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO

YEAR ENDED JUNE 30, 2018

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PART I - FINANCIAL SECTION



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INDEPENDENT AUDITOR'S REPORT

**National Guard of the
Commonwealth of Puerto
Rico San Juan, Puerto Rico**

Report on the Financial Statement

We have audited the accompanying Statement of Cash Receipts and Cash Disbursements ("the financial statement") of the National Guard of the Commonwealth of Puerto Rico (the "PRNG") as of and for the year ended June 30, 2018, and the related notes to the financial statement, which collectively comprise the PRNG's basic financial statement as listed in the table of content.

Management's Responsibility for the Financial Statement

Management is responsible for the preparation and fair presentation of this financial statement in accordance with the cash basis of accounting described in Note 1; this includes determining that the cash basis of accounting is acceptable basis for the preparation of the financial statement in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statement that is free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on this financial statement based on our audit. We conducted our audit 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 statement is free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statement. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statement, 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 statement 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 PRNG'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 statement.

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 statement referred to above present fairly, in all material respects, the Statement of Cash Receipts and Cash Disbursements of the PRNG for the year ended June 30, 2018, in conformity with the cash basis of accounting as described in Note 1 to the financial statement. Our opinion is not modified with respect to this matter.

Emphasis of Matters

Basis of Accounting

We draw attention to Note 1 of the financial statement, which describes the basis of accounting. The financial statement is prepared on the cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Uncertainty about Ability to Continue as a Going Concern – Commonwealth of Puerto Rico

As discussed in Note 1, the PRNG is an Executive Agency of the Commonwealth of Puerto Rico. The accompanying financial statement of the PRNG has been prepared assuming that the Commonwealth will continue as a going concern. As discussed in Note 9 to the financial statement, the Commonwealth's recurring deficits, negative financial position, further deterioration of its economic condition, and inability to access the credit markets raises substantial doubt about the Commonwealth's ability to continue as a going concern. Considering that the PRNG is highly dependent on the Commonwealth's appropriations to finance its operations the financial and liquidity of the PRNG could be similarly affected. Our opinion on the Statement of Cash Receipts and Cash Disbursements is not modified with respect to this matter.

Other Matters

Other Information

Our audit was conducted for the purpose of forming an opinion on the PRNG's financial statement as a whole. The accompanying Schedule of Expenditures of Federal Awards is presented for purposes of additional analysis as required by Title 2 U.S. Code of Federal Regulations (CFR) Part 200, *Uniform Administrative Requirements, Costs Principles, and Audit Requirements for Federal Awards* and is not a required part of the basic financial statement. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statement.

The Schedule of Expenditures of Federal Awards is the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the financial statement. Such information has been subjected to the auditing procedures applied in the audit of the financial statement and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statement or to the basic financial statement themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statement as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated March 26, 2019, on our consideration of PRNG's internal control over financial reporting and 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 PRNG's internal control over financial reporting and compliance.

March 26, 2019

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Stamp Number E369886 was
affixed to the original of this
report.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO

STATEMENT OF CASH RECEIPTS AND CASH DISBURSEMENTS

YEAR ENDED JUNE 30, 2018

	<u>General Fund</u>	<u>Special Revenue Fund</u>	<u>Other Governmental Fund</u>	<u>Total Governmental Funds</u>
Cash Receipts:				
Legislative appropriations	\$ 9,344,883	\$ -	\$ 3,781,750	\$ 13,126,633
Federal grants and contribution	<u>-</u>	<u>71,707,590</u>	<u>-</u>	<u>71,707,590</u>
Total cash receipts	<u>9,344,883</u>	<u>71,707,590</u>	<u>3,781,750</u>	<u>84,834,223</u>
Cash Disbursements:				
Administration and direction	1,868,535	-	-	1,868,535
Security and conservation of military facilities	6,678,149	-	-	6,678,149
State guard	106,489	-	-	106,489
Auxiliary services of administration	691,710	-	-	691,710
Special programs	-	-	16,355	16,355
Matching contribution	-	-	3,255,435	3,255,435
Public security activities	<u>-</u>	<u>77,843,871</u>	<u>-</u>	<u>77,843,871</u>
Total cash disbursements	<u>9,344,883</u>	<u>77,843,871</u>	<u>3,271,790</u>	<u>90,460,544</u>
Excess (deficiency) of cash receipts over cash disbursements	<u>\$ -</u>	<u>\$ (6,136,281)</u>	<u>\$ 509,960</u>	<u>\$ (5,626,321)</u>

See accompanying notes to the Combined Statement of Receipt and Disbursements.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO

NOTES TO BASIC FINANCIAL STATEMENT - CASH BASIS

YEAR ENDED JUNE 30, 2018

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The National Guard of the Commonwealth of Puerto Rico (the "PRNG") was created by the Law No. 28 of 1917, which was subsequently amended by Law No. 62 of June 23, 1969, as amended. The Law established the PRNG as the duly authorized governmental agency to protect the lives and properties of the Puerto Rico residents, to preserve the peace, the order and the public security in emergency situations caused by natural disasters or public riots. The PRNG maintains 48 armories and is present in 30 communities. The PRNG, like the National Guards in all 50 states of the United States of America, is a hybrid organization. National Guards are ordinarily under the control of the State (or, in the case of Puerto Rico, of the Commonwealth) officials, but are organized pursuant to federal statute, and in war time or other emergencies, guard units may be brought under Federal control. The Puerto Rico National Guard and Reserve units support the U.S. Army South's (South COM) many multilateral exercises and programs. It is through this integration of the U.S.A. Active Army, National Guard, and Reserves that South COM can maximize resources to carry out missions.

As part of its programs, the PRNG established the Youth Programs to provide a highly disciplined atmosphere fostering academics, leadership development, physical training, and personal growth to educate and train unemployed high school dropout youths and make them productive members of the community. The PRNG also supports communities using their specialized skills. Medical units provide preventive health care, education, and immunizations in low-income neighborhoods. Guard members serve drug and law enforcement agencies through its Counter Drug program, resulting in the confiscation of millions of dollars in illegal drugs. The PRNG conducts three National Guard Bureau sponsored youth programs: STARBASE, Creando and Challenge.

Financial Reporting Entity

The PRNG is for financial reporting purposes part of the Commonwealth of Puerto Rico, its financial data is included as part of the Commonwealth of Puerto Rico's financial statements, and as such, the Department of the Treasury of the Commonwealth of Puerto Rico serves as trustee of the funds assigned to the Department by the Legislative Branch and Federal Agencies. The Treasury Department also handles and records expenditures made with such funds and provides the PRNG with reports regarding such activities.

The financial information included in the accompanying Statement of Cash Receipts and Cash Disbursements was obtained from the Puerto Rico Treasury Department's Integrated Financial Accounting System (PRIFAS) and is issued solely to comply with the Single Audit Act of 1984, P.L. 98-502, and the Single Audit Act Amendments of 1986, P.L. 104-156 and for the information to the federal awarding agencies, pass-through entities, regulators, management and those charged with the governance.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
NOTES TO BASIC FINANCIAL STATEMENTS - CASH BASIS (CONTINUED)
YEAR ENDED JUNE 30, 2018

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Presentation

The accounts of the PRNG are organized on the basis of the three fund types: general fund, special revenue fund, and others governmental funds. The PRNG maintains appropriations for several individual state and federal funds within each fund type. As more fully explained in the section "Basis of Accounting" below, each fund is accounted for with a set of accounts which include only receipts and disbursements. No balance sheet accounts are reported. The individual funds account for the governmental resources allocated to them for purposes of carrying on specific activities in accordance with laws, regulations and other restrictions. State funds are appropriated by the Legislature of the Commonwealth of Puerto Rico and are funds through which most functions typically are financed. Federal funds reflect the federal financial assistance managed by the PRNG from programs funded by the Federal Government. The individual funds included in these fund types are classified accordance with their cost category.

The following governmental fund types are used by the PRNG:

General Fund - The general fund is the primary operating fund of the PRNG. It is used to account for all financial resources, except those required to be accounted for in another fund. The current financial resources accounted for in this fund consist of legislative appropriations approved by the Commonwealth of Puerto Rico. The general fund is divided in the following programs:

Administration and Direction - This program is used to account for resources and expenditures related to the supervision and coordination of all services and operation of the National Guard of Puerto Rico.

Security and Conservation of Military Facilities - This program is used to account for resources and expenditures related to the security of military installations, as well as the operation and maintenance of their physical facilities. This program uses state resources and, in some cases, federal funds through service agreements with the Federal National Guard section.

State Guard - This program is used to account for resources and expenditures related to the security, protection, and health services of Puerto Rico, especially in those cases in which the Governor of Puerto Rico activates the State Guard.

Auxiliary Services of Administration - This program is used to account for resources and expenditures related to auxiliary activities and complementary services of all the offices and programs that use state funds and federal service agreements for its operation.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
NOTES TO BASIC FINANCIAL STATEMENTS - CASH BASIS (CONTINUED)
YEAR ENDED JUNE 30, 2018

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Basis of Presentation (Continued)

Special Revenue Fund - This fund is used to account for specific revenue sources that are legally restricted to cover disbursements for specific purposes in accordance with the federal regulations. The resources and expenditures accounted for in this fund include the proceeds received from the USA Department of Defense and Department of Homeland Security (DHS) to support the operation and maintenance of the National Guard facilities and Federal Emergency Management Agency (FEMA).

Other Governmental Funds - This fund is used to account for resources or funds that are deposited for specific purposes with applicable laws. They may come from service fees, donations, and private entities, other collections from governmental entities, and authorizations by the Legislative of the Commonwealth of Puerto Rico, which are designed to attain specific purposes. The expenditures charged to these accounts are authorized by legislation previously approved.

Basis of Accounting

The PRNG follows a receipts and disbursements method of accounting to account for all funds administered under this method, cash or funds transfer-in are recognized as revenues when received, and expenditures are recognized when funds are disbursed or transferred-out. Therefore, the Statement of Cash Receipts and Cash Disbursements is not intended to present the PRNG's results of operations in accordance with generally accepted accounting principles in the United States of America.

Stewardship, Compliance, and Accountability

Budgetary Accounting

The PRNG's budget is integrated within the general budget of the Commonwealth. The budget is adopted in accordance with a statutory basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. Under the statutory basis of accounting, the PRNG uses encumbrance accounting to record the full amount of purchase orders, contracts, and other commitments of appropriated resources as deductions from the appropriation prior to actual expenditure. In the governmental funds, encumbrance accounting is a significant aspect of budgetary control.

Encumbrances lapse the year following the end of the fiscal year when the encumbrance was established in accordance with Act No. 123 of August 17, 2001, which amended the then existing appropriations and encumbrances lapsing provisions of Act No. 230 of July 23, 1974. Unencumbered appropriations lapse at fiscal year-end.

On April 29, 2017, Act No. 26 establish that allocations and funds without a specific economic year, that have remained on the books without movement of disbursement or obligation for one year will be considered as having fulfilled their purposes, thus, they will be closed and entered into the General Fund; to provide that those special funds created by Law for specific purposes will be credited to the State Treasury's General Fund and will be deposited in the current bank account of the Secretary of the Treasury for the latter to have full dominion over the same.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
NOTES TO BASIC FINANCIAL STATEMENTS - CASH BASIS (CONTINUED)
YEAR ENDED JUNE 30, 2018

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Budgetary Information

On January 2, 2017, the Governor of Puerto Rico signed the Executive Order No. 2017-005, which required that all departments, agencies, and instrumentalities of the Government of Puerto Rico to implement the Zero-Base Budget methodology for the preparation of the budget for fiscal year 2017-2018 and subsequent fiscal years, per the applicable techniques and approaches of Zero-Base Budget and should be in conformity with the Fiscal Plan approved by the Oversight Board for Puerto Rico, pursuant to the Federal Law Pub. L. 114-187, Puerto Rico Oversight, Management and Economic Stability Act (PROMESA).

The financial statement is presented at the programmatic level. However, budgetary control and accounting are maintained at a level more detailed to provide management control, in detail, of the expenses to the appropriate level of the budget.

Federal grant funds can be carried over a specified amount of time, upon request to, and approval by the federal agencies. The financial statement is presented at the programmatic level. However, budgetary control and accounting is exercised at a lower level providing management with detailed control over expenditures at an appropriated budget level. Budgetary Comparison Schedule is not legally required to do so.

Cash with fiscal agents (Department of the Treasury of the Commonwealth of Puerto Rico)

The funds of the PRDE are under the custody and control of the Secretary of the Treasury Department of Puerto Rico pursuant to Act No. 230 of July 23, 1974, as amended, known as "Commonwealth of Puerto Rico Accounting Law". The Treasury Department follows the practice of pooling cash equivalents under the custody and control of the Secretary of the Treasury. The funds of the PRGN in such pooled cash accounts are available to meet its current operating requirements.

Custodial Credit Risk

Custodial Credit Risk is the risk that, in the event of the failure of a depository financial institution, the PRGN will not be able to recover its cash and investments or will not be able to recover collateral securities that are in the possession of an outside party.

As of June 30, 2017, the PRGN has operating accounts with "Banco Popular of Puerto Rico" and in commingled banks accounts kept by the PR Department of the Treasury. Pursuant to Act 21 of the Commonwealth and certain of its instrumentalities that used the Governmental Development Bank of Puerto Rico (GDB) as its main depository institution have opened accounts in private banks and have ceased depositing at the GDB. In addition, on April 28, 2017, the Financial Oversight and Management Board for Puerto Rico approved GDB's fiscal plan, as required by Public Law 114-187 Puerto Rico Oversight, Management and Economic Stability Act, also known as "PROMESA". This plan establishes an orderly wind-down, financial restructuring and closing of GDB's operations.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
NOTES TO BASIC FINANCIAL STATEMENTS - CASH BASIS (CONTINUED)
YEAR ENDED JUNE 30, 2018

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Custodial Credit Risk (Continued)

Management has concluded that, based on facts explained above, the custodial risk on deposits in GDB is high. Notwithstanding, the PRNG concluded that the final amount of the custodial credit risk on the deposits in GDB cannot be reasonably estimated until GDB concludes its restructuring process. Deposits in commercial banks in Puerto Rico are insured up to \$250,000 per institution by the FDIC; amounts in excess of the FDIC limits are collateralized by securities held by the banks.

Budgetary Accounting

Formal budgetary accounting is employed as a management control tool for all funds of the PRNG. Annual operating budgets are adopted each fiscal year through passage of an annual budget, which is approved by the Legislature of the Commonwealth of Puerto Rico and amended, if is required, throughout the year. Budgetary control procedures required the obligation of funds before purchase orders can be placed; it means that applicable appropriations must be reserved before purchase orders or contracts can be entered into. Obligated appropriations at year-end carryover to the next fiscal year and are not reported as part of the next fiscal year's budget. For budgetary purposes, encumbrances accounting is used. The encumbrances (that is, purchase order and contracts) are considered expenditures when paid.

Excess (deficiency) Statement Line

The excess (deficiency) of receipts over (under) disbursement statement line represents a summation of the combined receipts and disbursements. Consequently, amounts shown in this line is not comparable to an excess or deficiency over funds assigned and do not represent a deficit of the PRNG.

Restrictions of Cash Balances

Restrictions of cash balance represent portions of cash balances that are legally segregated for a specific future use or are not appropriable for disbursements. The PRNG has the following restrictions of cash balances:

Encumbrances - Represent future expenditures under purchase orders, contracts, and other commitments. These committed amounts generally will become liabilities in future periods as the goods or services are received.

Federal Cooperative Agreement - Represent monies to finance federal programs for operations and maintenance of military facilities, and youth programs.

Other purposes - Represent future cash disbursements under purchase orders and commitments. These committed amounts represent a restriction of appropriations and generally will become cash disbursements in future periods as the goods or services are received.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
NOTES TO BASIC FINANCIAL STATEMENTS - CASH BASIS (CONTINUED)
YEAR ENDED JUNE 30, 2018

2. PENSION PLAN BENEFITS

On August 23, 2017, the Governor signed the Act No. 106 of 2017, known as the "Act to Guarantee Payment to Our Retirees and Establish a New Defined Contribution Plan for Public Employees".

Prior to the enactment of Act No. 106 of 2017, the PRNG contributed to the Employees' Retirement System of the Government of Puerto Rico, created pursuant to Act No. 447 of May 15, 1951, as amended, administered by the Employee's Retirement System of the Government of Puerto Rico and its Instrumentalities (ERS). ERS covered all regular full-time public employees working for the central government, the municipalities of Puerto Rico and certain public corporations not having their own retirement systems. Employees participating in the Retirement System were covered of different benefit structures, principally dependent on their hire date, which included a cost sharing multi-employer defined benefit program, a defined contribution program (System 2000 Program) and a defined contribution hybrid program.

New Defined Contribution Plan (NDCP)

Act No. 106 of 2017 creates the legal framework so that the Commonwealth can guarantee payments to pensioners through the PayGo system. Under a PayGo system, the Commonwealth makes pension payments from the General Fund, to the extent money is available, and municipalities and public corporations will reimburse the Commonwealth for any payments made on behalf of their employees. Act No. 106 of 2017 also created a Defined Contribution Plan, similar to a 401(k) plan, under a trust, which guarantees the contributions of public servants, because future benefits will not be paid by the Retirement Systems.

Under the PayGo System implemented, participant shall contribute a minimum of eight-point five percent of his/her monthly remuneration to his NDCP, up to the limit established by the Code. In addition, may voluntarily contribute additional amounts, as permitted by the Code. Also, the participants in the NDCP shall have the right to adjust their current contribution to Retirement Systems to the minimum authorized. Participants in the NDCP may adjust the percentage they wish to contribute to said Plan from time to time but may never be less than the minimum percent required by the Act 106 of 2017. In addition, the employee will continue to pay 0.25% of his salary to \$5,000 monthly, to cover a disability insurance. Employees will be able to retire with the pension benefits determined under Act 3 of 2013, plus any benefit earned under the new defined benefit plan.

Total employee required contributions under the New Defined Contribution Program during the year ended June 30, 2018, amounted to approximately \$724,000. The PRNG required contribution through the Pay Go System during the year ended June 30, 2018, amounted to approximately \$8,094,000. These amounts represented 100% of the required contribution for the corresponding year.

Defined Contribution Hybrid Program

On April 4, 2013, the Legislature enacted Act No. 3 which amended Act No. 447, Act No. 1 and Act No. 305 to establish, among other things, a defined contribution program similar to the System 2000 Program (the Defined Contribution Hybrid Program) to be administered by the Retirement System. Act No. 3 froze all retirement benefits accrued through June 30, 2013 under the Defined Benefit Program, and thereafter, all future benefits were to accrue under the defined contribution formula used for the 2000 System Program participants. Also, Act No. 3 amended the provisions of the different benefit structures under the Retirement System.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
NOTES TO BASIC FINANCIAL STATEMENTS - CASH BASIS (CONTINUED)
YEAR ENDED JUNE 30, 2018

2. PENSION PLAN BENEFITS (CONTINUED)

System 2000 Program

The Legislature enacted Act No. 305 on September 24, 1999, which amended Act No. 447 to create, among other things, the System 2000 Program, a new benefit structure, similar to a cash balance plan (defined contribution plan). All regular employees hired for the first time on or after January 1, 2000, and former employees who participated in the Defined Benefit Program, received a refund of their contributions, and were rehired on or after January 1, 2000, became members of the System 2000 Program as a condition to their employment. In addition, employees who at December 31, 1999 were participants of the Defined Benefit Program had the option, up to March 31, 2000, to irrevocably transfer their prior contributions to the Defined Benefit Program plus interest thereon to the System 2000 Program.

Defined Benefit Program

Pursuant to Act No. 447 of May 15, 1951, as amended, all regular employees of the PRNG hired before January 1, 2000 and less than 55 years of age at the date of employment became members of the Retirement System, under the Defined Benefit Program, as a condition of their employment.

Members who had attained 55 years of age and had completed at least 25 years of creditable service, or members who had attained 58 years of age and have completed 10 years of creditable service, were entitled to an annual benefit payable monthly for life. The amount of the annuity shall be 1.5% of the average compensation, as defined, multiplied by the number of years of creditable service up to 20 years, plus 2% of the average compensation, as defined, multiplied by the number of years of creditable service in excess of 20 years. The annuity for which the participant was eligible, is limited to a minimum of \$500 per month and a maximum of 75% of the average compensation, as defined.

3. COMPENSATED ABSENCES

The vacation policy of the Commonwealth of Puerto Rico that applies to the employees of the PRNG provides for the accumulation of 2.5 days per month (2 days, per month for employees hired after February 8, 2017). Vacation time accumulated is fully vested to the employees from the first day of work up to a maximum of 60 days. Also, PRNG's employees accumulate sick leave at a rate of 1.5 days per month (1 day, per month for employees hired after February 8, 2017), up to a maximum of 90 days. Upon retirement, an employee receives compensation for all accumulated unpaid leave at a current rate, if the employee has at least ten years of service with the Commonwealth of Puerto Rico.

Paternity leave will have a fifteen-day period after the child is born. There will also be an hour each workday for breastfeeding mothers (divided into two 30-minute periods) after their maternity leave, which will last eight weeks.

Reduction of Working Day - Act No. 8 of February 6, 2017 establishes that any employee will have the option of requesting a voluntary reduction of their working day by means of a prior agreement with their employer, for a reduction period equivalent to one day of work.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
NOTES TO BASIC FINANCIAL STATEMENTS - CASH BASIS (CONTINUED)
YEAR ENDED JUNE 30, 2018

4. TERMINATION BENEFITS

On July 2, 2010, the Commonwealth enacted Act No. 70 to establish a program that provides benefits for early retirement or economic incentives for voluntary employment termination to eligible employees, as defined, including employees of the PRNG. Act No. 70 establishes that early retirement benefits will be provided to eligible employees that have completed between 15 to 29 years of credited service in the Retirement System and will consist of biweekly benefits ranging from 37.5% to 50% of each employee's salary, as defined. In this early retirement benefit program, the PRNG will make the employee and the employer's contributions to the Retirement System and pay the corresponding pension until the employee complies with the requirement age and 30 years of credited service.

Economic incentives were available to eligible employees who had less than 15 years of credited service, who had at least 30 years of credited service and the age for retirement, or who had the age for retirement. Economic incentives consisted of a lump-sum payment ranging from one-month to six-month salary based on employment years. For eligible employees that chose the economic incentives and had at least 30 years of credited service and the age for retirement, or had the age for retirement, the PRNG will make the employee and the employer's contributions to the Retirement System for a five-year period. Additionally, eligible employees that chose to participate in the early retirement benefit program, chose the economic incentive and had less than 15 years of credited service were eligible to receive health plan coverage for up to 12 months in a health plan selected by the management of the PRNG. No information for payments for termination benefits made by the PRNG during the fiscal year ended was available for disclosure.

5. LEASE COMMITMENTS

The PRNG rents its facilities through operating lease agreements with the Puerto Rico Industrial Development, Puerto Rico Port Authority and the Puerto Rico Land Administration, instrumentalities of the Commonwealth of Puerto Rico. The agreements with the governmental instrumentalities provide for rental fees significantly below market value. Rent disbursements under such lease agreements for the fiscal years ended June 30, 2018, were approximately \$24,550. As of the date of these financial statements were issued, the PRNG was negotiating various expired lease agreements, including some whose monthly payments have been withheld until the contract is renewed.

Future minimum rental payments as of June 30, 2018 are as follows:

<u>Year Ending June 30,</u>	<u>Amount</u>
2019	12,012
2020	16,012
2021	18,012
2022	18,006
2023	26,000
Thereafter	<u>100,000</u>
	<u>\$ 190,042</u>

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
NOTES TO BASIC FINANCIAL STATEMENTS - CASH BASIS (CONTINUED)

YEAR ENDED JUNE 30, 2018

6. RISK FINANCING

The PRNG is exposed to various risks of loss related to torts, theft of, damage to, or destruction of assets, errors and omissions, injuries to employees' health, and natural disasters. Commercial insurance policies covering such risk are negotiated by the Puerto Rico Treasury Department and costs are allocated among all the municipalities and Commonwealth of Puerto Rico instrumentalities. Also, principal officials of the PRNG are covered under various surety bonds. Management believes such coverage is sufficient to preclude any significant uninsured losses to the PRNG.

The PRNG obtains workers compensation insurance through the State Insurance Fund Corporation (SIFC), a component unit of the Commonwealth of Puerto Rico. This insurance covers workers against injuries, disability or death because of work or employment-related accidents, or because of illness suffered as a consequence of their employment.

The PRNG obtains unemployment compensation, non-occupational disability, and drivers' insurance coverage for its employees through various insurance programs administered by the Department of Labor and Human Resources of the Commonwealth of Puerto Rico (DOLHR). These insurance programs cover workers against unemployment and provide supplementary insurance coverage for temporary disability, or death because work or employment-related accidents or non-occupational disability and drivers' insurance premiums are paid to DOLHR on a cost reimbursement basis.

7. FUND ADVANCES

The PRNG receives fund advances from the Treasury Department of Puerto Rico for the interim financing of FEMA federal program, as authorized by Act No. 21 of 1979. This Act establishes that all fund advances made will be reimbursed to the General Fund of the Commonwealth's Treasury as the corresponding federal funds are received. During the fiscal year ended June 30, 2018, the Commonwealth's Treasury transferred approximately \$21 million to PRNG to finance FEMA emergency protective. FEMA funds were granted on a reimbursement basis.

8. COMMITMENTS AND CONTINGENCIES

Litigation - The PRNG is defendant in lawsuits arising in the normal course of operations, principally from claims for alleged violation of civil rights and discrimination in employment practices. According to the laws of the Commonwealth of Puerto Rico, the PRNG is fully represented by the Puerto Rico Department of Justice in defense of all legal cases against the PRNG. Any claims with negative financial impact will be paid from the General Fund of the Commonwealth of Puerto Rico, with no effect on the budget or resources of the PRNG.

Federal Awards - The PRNG participates in a number of federal financial assistance programs funded by the Federal Government. Expenditures financed by these programs are subject to financial and compliance audits by the appropriated grantors or their representatives. If expenditures are disallowed due to noncompliance with grant program regulations, the PRNG may be required to reimburse the grantors for such expenditures.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
NOTES TO BASIC FINANCIAL STATEMENTS - CASH BASIS (CONTINUED)
YEAR ENDED JUNE 30, 2018

8. COMMITMENTS AND CONTINGENCIES (CONTINUED)

The Report on Compliance with Requirements Applicable to Each Major Federal Award Program and on Internal Control over Compliance in Accordance with Uniform Guidance for the year ended June 30, 2018, not disclosed instances of noncompliance with applicable laws and regulations that were considered to be material weaknesses.

Other Audits - The PRNG is also audited by the Office of the Controller for Puerto Rico (the Controller), the Office of the Inspector General of the USDE (OIG), the Puerto Rico Department of Treasury and other grantor agencies or institutions. The Controller has issued several reports on audits over the operations and management of the PRGB, some of which involve federal programs.

9. GOING CONCERN - COMMONWEALTH OF PUERTO RICO

The PRNG is highly dependent on the Commonwealth's appropriations to finance its operations and matching the federal award received. The financial difficulties being experienced by the Commonwealth may have significant adverse impacts on the PRNG's operations in the near term, given its reliance on Commonwealth's appropriations and lack of available funding alternatives at reasonable interest rates.

10. SUBSEQUENT EVENTS

Subsequent events were evaluated through March 26, 2019, the date the financial statements were available to be issued. No significant events that should have been recorded or disclosed in the financial statement were noted, except for the event described in Note 9 affecting the fiscal year 2018-2019.

PART II - COMPLIANCE SECTION

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO

SCHEDULE OF EXPENDITURE OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2018

Federal Grantor/ Pass-through Grantor/Program or Cluster Title	Federal CFDA Number	Pass-through Entity Identifying Number	Federal Expenditures
CASH ASSISTANCE:			
U.S. DEPARTMENT OF DEFENSE NATIONAL GUARD BUREAU			
Program Title:			
National Guard Military Operations and Maintenance (O&M) Projects	12.401	N/A	\$ 20,731,643
National Guard Youth Challenge Program	12.404	N/A	<u>3,020,280</u>
			<u>23,751,923</u>
U.S. DEPARTMENT OF HOMELAND SECURITY Federal Emergency Management Agency (FEMA)			
Program Title:			
Disaster Grants – Public Assistance	97.036	N/A	<u>54,091,948</u>
			<u>\$ 77,843,871</u>

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
SCHEDULE OF EXPENDITURE OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2018

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
NOTES TO SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
YEAR ENDED JUNE 30, 2018

1. BASIS OF PRESENTATION

The accompanying Schedule of Expenditures of Federal Awards (the Schedule) includes the federal grant activity of the National Guard of the Commonwealth of Puerto Rico (the PRNG) under programs of the federal government for the year ended June 30, 2018. The information in this Schedule is presented in accordance with the requirements of OMB Uniform Guidance, Audits of States, Local Governments, and Non-Profits Organizations. Because the Schedule presents only a selected portion of the operations of the PRNG, it is not intended to and does not purport to present the financial position, changes in net position, or cash flows of the PRNG.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of the significant accounting policies used in the preparation of the schedule:

a. Expenditures reported on the Schedule are reported on the receipts and disbursements method of accounting. It is drawn primarily from the PRNG's internal accounting records, which are the basis for the PRNG's Statement of Receipts and Disbursements. Such expenditures are recognized following the cost principles contained in the OMB Uniform Guidance, Cost Principles for States, Local, and Indian Tribal Governments, wherein certain types of expenditures are not allowable or are limited as to reimbursement.

b. The titles of federal awards included in the Schedule are presented as described in the Catalog of Federal Domestic Assistance.

State or local government redistributions of federal awards to the PRNG, known as "pass-through awards" should be treated by the PRNG as though they were received directly from the federal government. The Uniform Guidance requires the Schedule to include the name of the "pass-through entity" and the identifying number assigned by the "pass-through entity" for the federal awards received as a sub-recipient. Numbers identified as N/A are not applicable and numbers identified as N/AV are not available.

3. RELATIONSHIP TO THE STATEMENT

Expenditures included in the Schedule agree with the amounts included in the accompanying Statement of Receipts and Disbursements – Governmental Funds.

4. INDIRECT COST RATE

The PRNG has elected not to use the ten percent of the minimum indirect cost rate allowed under the Uniform Guidance.

**INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL OVER
FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

**National Guard of the
Commonwealth of Puerto
Rico San Juan, Puerto Rico**

We have audited, in accordance with the 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, the Statement of Cash Receipts and Cash Disbursements (the financial statement) of the National Guard of the Commonwealth of Puerto Rico (the "PRNG") for the year ended June 30, 2018, and the related notes to this financial statement, which collectively comprise the PRNG's financial statement, and have issued our report thereon dated March 26, 2019. Our report includes an emphasis of a matter paragraph which states along with other matters about uncertainty about the Commonwealth of Puerto Rico. The PRNG as an executive agency of the Commonwealth of Puerto Rico and the Statement of Cash Receipts and Cash Disbursements of the PRNG has been prepared assuming that the Commonwealth's ability to continue as a going concern. Our report includes also a paragraph indicating that the financial statement is prepared on a cash basis of accounting principles generally accepted in the United State of America. Our opinion is not modified with respect to this matter.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statement, we considered the PRNG's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statement, but not for the purpose of expressing an opinion on the effectiveness of PRNG's internal control. Accordingly, we do not express an opinion on the effectiveness of the PRNG's internal control.

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 PRNG's financial statement will not be prevented or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the PRNG's financial statement is free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. 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 disclosed no instance of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Crome PR PSC

March 26, 2019

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affixed to the original of this
report

**INDEPENDENT AUDITOR'S REPORT ON
COMPLIANCE FOR EACH MAJOR PROGRAM AND
ON INTERNAL CONTROL OVER COMPLIANCE
REQUIRED BY THE UNIFORM GUIDANCE**

**National Guard of the
Commonwealth of Puerto
Rico San Juan, Puerto Rico**

Report on Compliance for Each Major Federal Program

We have audited the National Guard of the Commonwealth of Puerto Rico's (the PRNG) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have direct and material effect on each of the PRNG's major federal programs for the year ended June 30, 2018. The PRNG's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations, and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for each of the PRNG's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance 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 the audit requirements of *Title 2 U.S. Code of Federal Regulations Part 200, Uniform Administrative Requirements, Costs Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the PRNG's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the PRNG's compliance.

Opinion on Each Major Federal Programs

In our opinion, the PRNG complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2018.

Report on Internal Control Over Compliance

Management of the PRNG is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above.

In planning and performing our audit of compliance, we considered the PRNG's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with the Uniform Guidance, but not for the purpose of expressing an opinion on the effectiveness of the internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the PRNG's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

March 26, 2019

Crowe PR PSC

Stamp number E369888 was affixed to the original of this report.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

YEAR ENDED JUNE 30, 2018

SECTION I - SUMMARY OF AUDITOR'S RESULTS

Financial statements

Type of auditor's report issued:	Unmodified
Internal control over financial reporting:	
• Material weakness identified?	No
• Significant deficiencies identified that are not considered to be material weakness(es)?	No
Noncompliance material to financial statements noted?	No

Federal awards

Internal control over major programs:	
• Material weakness(es) identified?	No
• Significant deficiencies(s) identified that are not considered to be material weaknesses?	No
Type of auditor's report issued on compliance for major programs?	Unmodified
Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?	No

Identification of major programs

<i>Name of Federal Program or Cluster.</i>	<i>CFDA Number.</i>
Disaster Grants – Public Assistance (Presidentially Declared Disasters)	97.036
Dollar threshold used to distinguish between Type A and Type B programs:	\$ 2,335,316
Auditee qualified as a low-risk auditee?	Yes

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2018

SECTION II - FINANCIAL STATEMENT FINDINGS SECTION

There were no findings related to the financial statements for the year ended June 30, 2018, which are required to be reported in accordance with Generally Accepted Government Auditing Standards.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2018

SECTION III - MAJOR FEDERAL AWARD PROGRAM FINDINGS AND QUESTIONED COSTS

There were no findings or questioned costs for federal awards for the year ended June 30, 2018.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
SUMMARY SCHEDULE OF PRIOR AUDITS' FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2018

SECTION IV - PRIOR AUDITS' FINDINGS AND QUESTIONED COSTS

There were no findings or questioned costs for Federal Awards for the year ended June 30, 2017.