

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, 2019

PART I - FINANCIAL SECTION

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, 2019, 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 Matter

Basis of Accounting

We draw attention to Note 1 of the financial statement, which describes the basis of accounting. The accompanying 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.

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.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
STATEMENT OF CASH RECEIPTS AND CASH DISBURSEMENTS
YEAR ENDED JUNE 30, 2019

	<u>General Fund</u>	<u>Special Revenue Fund</u>	<u>Other Governmental Fund</u>	<u>Total Governmental Funds</u>
Cash Receipts:				
Legislative appropriations	\$ 9,553,568	\$ -	\$ 10,747,580	\$ 20,301,148
Federal grants and contribution	-	52,493,198	-	52,493,198
Total cash receipts	<u>9,553,568</u>	<u>52,493,198</u>	<u>10,747,580</u>	<u>72,794,346</u>
Cash Disbursements:				
Payroll and related expenses	4,867,120	-	-	4,867,120
Facilities and payments for services	1,142,364	-	-	1,142,364
State matching fund allocation	3,391,500	-	3,829,399	7,220,899
Material and supplies	75,850	-	-	75,850
Transportation expenses	6,141	-	-	6,141
Equipment purchased	13,118	-	-	13,118
Purchased services	25,597	-	-	25,597
Other operating expenses	31,878	-	-	31,878
Security and maintenance of military facilities	-	26,429,347	-	26,429,347
Emergency protective measurements	-	17,252,705	-	17,252,705
Military training to civilian youths	-	3,876,069	-	3,876,069
Total cash disbursements	<u>9,553,568</u>	<u>47,558,121</u>	<u>3,829,399</u>	<u>60,941,088</u>
Excess of cash receipts over cash disbursements	<u>\$ -</u>	<u>\$ 4,935,077</u>	<u>\$ 6,918,181</u>	<u>\$ 11,853,258</u>

See accompanying notes to the Statement of Receipt and Disbursements.

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

YEAR ENDED JUNE 30, 2019

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

Financial Statements - Measurement Focus and Basis of Accounting (Continued)

This cash basis of accounting differs from GAAP primarily because revenue (cash receipts) are recognized when received in cash rather than when earned and susceptible to accrual, and expenditures (cash disbursement) are recognized when paid rather than when incurred or subject to accrual. The amounts reported as cash receipts are those received during the fiscal year 2018-2019. No accrual is recognized.

Capital assets resulting from cash transactions are reported as cash disbursements in the acquiring governmental fund upon cash acquisition. No capital assets are recorded in PRNG's financial statement. No long-term debt is reported in PRNG's financial statement. No accrued compensated absences are reported in PRNG's financial statement. Compensated absences resulting from cash transactions are reported as cash disbursements in the governmental funds column upon cash payment.

The accounts of PRNG are organized on the basis of fund types, which are responsible for the coordination, receipt, and management of funds. These are composed of three funds which are described below. The accounts of PRNG are accounted for with a set of accounts which only include cash receipts and cash disbursements. No balance sheet accounts are maintained or reported.

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 separately. 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:

Management and General Administration - 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.

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 (DoD) and Department of Homeland Security (DHS) to support the operation and maintenance of the National Guard facilities and Federal Emergency Management Agency (FEMA).

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
NOTES TO BASIC FINANCIAL STATEMENTS - CASH BASIS (CONTINUED)
YEAR ENDED JUNE 30, 2019

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

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.

Cash with Fiscal Agents (Department of the Treasury of the Commonwealth of Puerto Rico)

The funds of the PRNG 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 PRNG in such pooled cash accounts are available to meet its current operating requirements.

Fund Advances

PRNG receives fund advances from the Treasury Department of Puerto Rico for the interim financing of federal programs, 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, 2019, funds were not advanced to PRNG for this purpose.

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 or surplus of the PRNG. The excess noted for the year ended June 30, 2019 is attributable mainly to insurance claim proceed by \$6,755,667, net of adjuster's fees, related to property, casualty damages caused by the Hurricane Maria which struck the island on September 20, 2017.

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

YEAR ENDED JUNE 30, 2019

4. 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 measures that were returned to Puerto Rico Treasury Department during the fiscal years ended June 30, 2019 and 2018, as funds were withdrawn from FEMA, as funds were received on a reimbursement basis. No additional funds were transferred from the Commonwealth to PRNG during the fiscal year ended June 30, 2019 for this purpose.

5. RETIREMENT PLAN

The PRNG's employees had historically participated in the Employees Retirement System (ERS) of the Commonwealth of Puerto Rico. For further information about pension benefits accumulated by active employees to the enactment of Act No. 3 of 2013, which in substance eliminated pension contributions by the employer, refer to the latest audited financial statements of the ERS, as of June 30, 2016.

PayGo Pension Reform

On June 27, 2017, the Treasury Department issued Circular Letter No. 1300-46-17 in order to convey to the central government agencies, public corporations, and municipalities the new implementation procedures to adopt, effective July 1, 2017, a new "pay-as-you-go" (PayGo) mechanism for the Commonwealth Retirement Systems. With the start of fiscal year 2018, employers' contributions, contributions ordered by special laws, and the additional uniform contribution were all eliminated. ERS will determine and administer the payment amount per retiree that will be charged to each agency, public corporation and municipality, including the PRNG.

In addition to the establishment of the PayGo mechanism, on August 23, 2017, the Governor signed into law the *Act to Guarantee the Payment to Our Pensioners and Establish a New Plan for Defined Contributions for Public Servants (Act No. 106)*, which reformed the Commonwealth Retirement Systems so that their active participants would deposit their individual contributions in a new Defined Contributions Plan, similar to a 401(k) plan, that will be managed by a private entity. Act No. 106 created the legal framework so that the Commonwealth can make payments to pensioners through the PayGo system.

Act No. 106, among other things, amended Act No. 12 of October 19, 1954 with respect to the ERS's governance, funding and benefits for active members of the actual program and new hired members. Under Act No. 106, the ERS's Board of Trustees was substituted with a new retirement board (the Retirement Board), which was responsible for governing all Commonwealth Retirement Systems.

Act No. 106 terminated the previously existing pension programs for ERS participants as of June 30, 2017. The members of the prior programs and new system members hired on and after July 1, 2017 will be enrolled in a new defined contributions program that will be selected by the Retirement Board. The accumulated balance on the accounts of the prior program will be transferred to the members account in the new defined contributions program. ERS's active members in the defined contributions program will retain their benefits as stated under Act 91 of March 29, 2003.

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

YEAR ENDED JUNE 30, 2019

7. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Other Audits - The PRNG is also audited by the Office of the Controller for Puerto Rico (the Controller), the Office of the Inspector General, 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 PRNG, some of which involve federal programs.

8. GOING CONCERN - COMMONWEALTH OF PUERTO RICO

On May 3, 2017, the Commonwealth of Puerto Rico and the Puerto Rico Oversight, Management, and Economic Stability Act, 48 USC sec. 2101 et seq. (PROMESA) filed for bankruptcy under Title III of PROMESA in what is poised to become one of the largest bankruptcies in the United States history. After the commencement of the Commonwealth's Title III case, numerous motions and adversary proceedings have been filed both by and against the Commonwealth regarding creditor rights to Commonwealth assets.

On February 28, 2020, the Oversight Board filed an amended Joint Plan and Disclosure Statement, however, the Disclosure Statement has not been approved for solicitation to creditors for voting. Therefore, the Disclosure Statement and Joint Plan remain subject to Title III Court approval. However, due to the COVID-19 pandemic, the Oversight Board has publicly mentioned that the Joint Plan will be revisited. There, it is impracticable to determine the scope of the Joint Plan's changes, and the final Plan that the Title III Court will ultimately confirm.

The PRNG is highly dependent on the Commonwealth's appropriations to finance its operations and to match the federal awards received. It is impractical to determine how the final resolution of the Commonwealth's Title III case, will impact the PRNG's operations. This matter will be exacerbated by the worldwide pandemic, more fully disclosed in Note 9.

9. SUBSEQUENT EVENTS

Subsequent events were evaluated through March 10, 2020, 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 matter described below:

Effective for the fiscal year 2019-2020 the vacation leave will be increased from 15 to 30 days annually (2.5 hour per month) up to a maximum of sixty working days, and sick leave from 12 to 18 days annually (1.5 hour per month), prospectively.

During January 2020, the southwestern part of the island of Puerto Rico was struck by a series of strong earthquakes, including six that were of magnitude 5 or greater. The largest and most damaging of this sequence occurred on January 7, 2020 and had a magnitude of 6.4 Mw and a maximum felt intensity of VII (Very strong) on the Modified Mercalli intensity scale. Management is in process of assessing the property's damages caused by the earthquakes and determine an estimate of replacement or repair cost that may arise.

As we release the financial statements, the worldwide spread of the coronavirus may impact our governmental activities. The Island of Puerto Rico is under a four-week lockdown until April 12, 2020, and the PRNG has been activated to provide medical services, among other. FEMA has agreed to support this activation, by providing grants equal to 75% of certain costs to be incurred, to be matched by the Commonwealth. Until FEMA funds are released, the Commonwealth is temporarily providing all funds. The extent of this matter, however, will depend on future developments, which are highly uncertain and cannot be predicted.

PART II - COMPLIANCE SECTION

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO

SCHEDULE OF EXPENDITURE OF FEDERAL AWARDS

YEAR ENDED JUNE 30, 2019

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, 2019. 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:

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.

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/A 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.

5. MATCHING COSTS

Matching costs, such as the nonfederal share of certain program costs, are not included in the accompanying Schedule.

6. CONTINGENCIES

The grant amounts received are subject to audit and adjustment. If any expenditure is disallowed by the grantor agencies as a result of such an audit, any claim for reimbursement to the grantor agencies would become a liability of the University. In the opinion of management, all grant expenditures are in compliance with the terms of the grant agreements and applicable federal laws and regulations.

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.

March 10, 2020

Stamp number Exxxx was
affixed to the original of this
report

Other Matters

The results of our auditing procedures disclosed instances of noncompliance which are required to be reported in accordance with the Uniform Guidance and which are described in the accompanying schedule of findings and questioned costs as item 2019-01. Our opinion on each major federal program is not modified with respect to these matters.

The PRNG's response to the noncompliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. The PRNG's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

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, we did identify certain deficiencies in internal control over compliance, described in the accompanying schedule of findings and questioned costs as item 2019-01, that we consider to be significant deficiencies.

The PRNG's response to the noncompliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. The PRNG's response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
 SCHEDULE OF FINDINGS AND QUESTIONED COSTS
 YEAR ENDED JUNE 30, 2019

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?	Yes
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>
National Guard Military Operations and Maintenance (O&M) Projects	12.401
National Guard Challenge Program	12.402

Dollar threshold used to distinguish between Type A and Type B programs:	\$ 1,426,744.
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Auditee qualified as a low-risk auditee?	No
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NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
SCHEDULE OF FINDINGS AND QUESTIONED COSTS (CONTINUED)
YEAR ENDED JUNE 30, 2019

SECTION III - MAJOR FEDERAL AWARD PROGRAM FINDINGS AND QUESTIONED COSTS

Finding Number: 2019-01	Procurement Standards
Compliance Requirement:	Procurement, Suspension and Debarment
Finding Type:	Noncompliance and Significant Deficiency in Internal Control
Federal Agency:	Department of Defense.
Federal Programs:	
CFDA 12.401	National Guard Military Operations and Maintenance (O&M) Projects
CFDA 12.402	National Guard Challenge Program

Condition

As result of our compliance audit procedures, the auditors were unable to ascertain that the PRGN complied with the procurement requirements in one construction contract to perform permanent work and roof repair services to multiple facilities of PRNG because the contract file was not available for our review. The only information readily available was the amount (cost) of each service acquired.

Criteria

§ 2CFR 200.317 Procurements by states - When procuring property and services under a Federal award, a state must follow the same policies and procedures it uses for procurements from its non-Federal funds. The state will comply with § 200.322 Procurement of recovered materials and ensure that every purchase order or other contract includes any clauses required by section § 200.326 Contract provisions.

§ 2CFR 200.318 (j) - The non-federal entity must maintain records sufficient to detail the history of procurement. These records will include, but are not necessarily limited to the following: rationale for the method of procurement, selection of type, selection or rejection, and the basis for the contract price.

Cause

The PRNG is a department of the Commonwealth of PR and the procurement process for the acquisition of certain construction work and for the supply of products, for several dependencies of the Commonwealth, has been delegated to Administration of General Service ("ASG"). The auditor requested access to the contract file to verify the existence and ascertain if the appropriate cost analysis was performed in connection with procurement actions, including contract modification and the analysis performed that supports the procurement standards but the contract file was not available for our review, because it is under control and custody of ASG. In its WEB page, however, ASG, published the contractual cost for all bids awarded by them.

Effect

The auditors were unable to determine compliance with the procurement requirements, and the pervasiveness of this matter could not be determined.

NATIONAL GUARD OF THE COMMONWEALTH OF PUERTO RICO
SUMMARY SCHEDULE OF PRIOR AUDITS' FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2019

SECTION IV - PRIOR AUDITS' FINDINGS AND QUESTIONED COSTS

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