



Department of Defense INSTRUCTION

NUMBER 7600.06

November 5, 2012

Incorporating Change 1, Effective April 20, 2020

IG DoD

SUBJECT: Audit of Nonappropriated Fund Instrumentalities (NAFI) and Related Activities

References: See Enclosure 1

1. **PURPOSE.** This Instruction reissues DoD Instruction (DoDI) 7600.6 (Reference (a)) in accordance with the authority in DoD Directive (DoDD) 5106.01 (Reference (b)) to update established policy and assigned responsibilities for audits of NAFI and related activities.

2. **APPLICABILITY.** This Instruction applies to OSD, the Military Departments, the Office of the Chairman of the Joint Chiefs of Staff and the Joint Staff, the Combatant Commands, the Office of the Inspector General of the Department of Defense (IG DoD), the Defense Agencies, the DoD Field Activities, and all other organizational entities within the DoD (hereinafter referred to collectively as the “DoD Components”).

3. **DEFINITIONS.** See Glossary.

4. **POLICY.** It is DoD policy that:
 - a. The Secretaries of the Military Departments prescribe procedures to provide adequate audit coverage of NAFIs, as required in accordance with DoDI 7600.02 (Reference (c)).

 - b. In accordance with DoDI 1015.15 (Reference (d)), annual audits shall be conducted for all NAFIs with annual revenues or expenses exceeding \$10 million, with the exception of NAFIs in Program Group VI – Special Purpose Central Funds, and NAFIs supporting highly sensitive operations.
 - (1) For purposes of this Instruction, annual revenues or expenses shall include resources recorded in the nonappropriated fund (NAF) financial records, to include appropriations provided to a NAFI under a memorandum of agreement and treated and expended as NAF following the procedures established in Reference (d).

(2) In order to maintain integrity of financial records, annual financial audits shall be conducted, regardless of the dollar threshold of revenues and expenses, for Special Purpose Central Funds and those NAFIs with operations deemed to be highly sensitive.

c. NAFIs shall contract with a licensed Certified Public Accountant (CPA) firm to satisfy the financial statement audit requirement, as established in Reference (d). DoD personnel, rather than CPA firms, should be used for audits involving potential fraud or other serious improprieties.

d. NAF accounting systems must comply with generally accepted accounting principles (GAAP) in accordance with accounting standards distributed by the Financial Accounting Standards Board. NAF accounting systems shall comply with the uniform chart of accounts established in DoD 7000.14-R (Reference (e)), except the Armed Services Exchanges, which maintain a uniform chart of accounts in accordance with Reference (d).

e. Results from audits shall be made available directly to the audited entity in the form of a report in accordance with Government Auditing Standards (Reference (f)).

f. All audits shall be accomplished in accordance with the requirements of Reference (c) and Reference (f).

g. The establishment, management, and control of NAFIs and the financial management of supporting resources shall be accomplished in accordance with Reference (d).

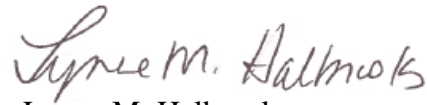
5. RESPONSIBILITIES. See Enclosure 2.

6. PROCEDURES. See Enclosure 3.

7. RELEASABILITY. **Cleared for public release.** This Instruction is available on the Directives Division Website at <https://www.esd.whs.mil/DD/>.

8. SUMMARY OF CHANGE 1. The change to this issuance updates references and removes expiration language in accordance with current Chief Management Officer of the Department of Defense direction.

9. EFFECTIVE DATE. This Instruction is effective November 5, 2012.



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Principal Deputy Inspector General
Performing the Duties of the
Inspector General of the
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Enclosures

1. References
2. Responsibilities
3. Procedures

Glossary

ENCLOSURE 1

REFERENCES

- (a) DoD Instruction 7600.6, "Audit of Nonappropriated Fund Instrumentalities and Related Activities," January 16, 2004 (hereby cancelled)
- (b) DoD Directive 5106.01, "Inspector General of the Department of Defense (IG DoD)," April 20, 2012, as amended
- (c) DoD Instruction 7600.02, "Audit Policies," October 16, 2014, as amended
- (d) DoD Instruction 1015.15, "Establishment, Management, and Control of Nonappropriated Fund Instrumentalities and Financial Management of Supporting Resources," October 31, 2007, as amended
- (e) DoD 7000.14-R, Volume 13, "Department of Defense Financial Management Regulations (FMRs)," current edition
- (f) Comptroller General of the United States, "Government Auditing Standards," current edition
- (g) Appendix 3 of title 5, United States Code
- (h) DoD Instruction 7650.03, "Follow-Up on Inspector General of the Department of Defense (IG DoD) and Internal Audit Reports," December 18, 2014, as amended
- (i) DoD Instruction 5010.40, "Managers' Internal Control Program Procedures," May 30, 2013
- (j) DoD Instruction 1330.09, "Armed Services Exchange Policy," December 7, 2005
- (k) DoD Instruction 1015.08, "DoD Civilian Employee Morale, Welfare, and Recreation (MWR) Activities and Supporting Nonappropriated Fund Instrumentalities (NAFI)," December 23, 2005
- (l) DoD Instruction 1000.15, "Procedures and Support for Non-Federal Entities Authorized to Operate on DoD Installations," October 24, 2008

ENCLOSURE 2

RESPONSIBILITIES

1. IG DoD. The IG DoD shall establish and monitor adherence to standards, policies, and procedures for the performance of DoD audits in accordance with Reference (b) and Appendix 3 of title 5, United States Code (Reference (g)).

2. SECRETARIES OF THE MILITARY DEPARTMENTS. The Secretaries of the Military Departments shall:

a. Require that adequate audit coverage is provided for NAFIs.

b. Issue guidance that requires reports of audits to be directed to the appropriate management level with the authority and responsibility to ensure that corrective action is taken on the findings and recommendations.

c. Require that follow-up and resolution of audit recommendations are accomplished in accordance with DoDI 7650.03 (Reference (h)).

d. Authorize staffing to conduct NAFI audits when the magnitude of operations, an internal review, or a local audit justifies it.

e. Establish a committee made up of senior officials, independent of NAFI management, to oversee its NAFI audits. They shall establish audit requirements, which will include performance audits and attestation engagements. The requirements shall be based upon risk assessments, contract deliverables, and the CPA firm's contract for the financial statement audit.

f. Analyze audits of NAFIs and prepare advisory or trend reports to help NAFI managers improve internal controls and operations.

3. HEADS OF THE MILITARY DEPARTMENT AUDIT ORGANIZATIONS. The Heads of the Military Department audit organizations shall:

a. Require that NAFIs within their cognizance are provided adequate audit coverage.

b. Assist management to determine the frequency and scope of audit coverage for the individual NAFIs.

c. Serve as the advisor to the audit committee, but shall not be a voting member.

d. Audit and review NAFIs based on risk assessment criteria, when appropriate.

e. Provide technical guidance and periodically review audits conducted by NAFI internal audit staffs and CPAs to ensure that such audits conform with References (c) and (f).

4. DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY. The Director, Defense Contract Audit Agency, under the authority, direction, and control of the Under Secretary of Defense (Comptroller)/Chief Financial Officer, Department of Defense, shall:

a. Provide, upon request, reimbursable audit services for evaluations of price proposals for negotiated contracts exceeding \$650,000 and costs incurred under cost reimbursement or incentive-type contracts.

b. On a limited basis, perform reimbursable reviews of contracts that include clauses guaranteeing that prices shall not exceed those offered to other customers.

ENCLOSURE 3

PROCEDURES

1. TYPES AND OBJECTIVES OF NAFI AUDITS

a. Financial audits provide an opinion on whether the financial position of the NAFIs and the results of operations and cash flows are presented fairly, when applicable, in accordance with GAAP and DoD policy. An example is the audit contracted with a licensed CPA firm to satisfy the financial statement audit requirement, as established in Reference (f). Other types of financial audits can include auditing compliance with applicable requirements relating to NAFI programs.

b. Performance audits determine whether desired NAFI program results are achieved and resources are safeguarded and managed economically and efficiently. Performance audit objectives vary widely. Examples of performance audit objectives include determining whether NAFI internal control systems are adequate and effective, and whether fees assessed cover costs. In addition, performance audit objectives could include whether applicable laws, regulations, and established NAFI policies and procedures are followed.

c. Attestation engagements report on a subject matter or an assertion about a subject matter that is the responsibility of another party. The three types of attestation engagements are an examination, review, or agreed-upon procedures. Attestation engagements can have a broad range of objectives. Examples of attestation engagements include an examination of a NAFI's internal control over financial reporting and a review of a NAFI's accuracy and reliability of reported performance measures.

2. FREQUENCY OF AUDIT COVERAGE AND RISK FACTORS

a. Performance audits and attestation engagements shall be completed as deemed necessary (by the NAFI Internal Audit Staff, CPA firms, Military Department Audit Agencies, or the IG DoD) based on risk assessments and resource availability.

b. NAFIs shall be evaluated to determine the frequency of audit coverage. In assessing the risk, the following factors shall be considered:

- (1) Susceptibility to fraud, waste, and abuse.
- (2) Visibility and impact.
- (3) Time elapsed since the last audit.
- (4) Adequacy of internal control systems.
- (5) Effectiveness of controls for information technology systems.

- (6) Materiality of annual revenues and expenses.
- (7) Extent and results of oversight coverage by other DoD organizations.
- (8) Results of prior audits.
- (9) Extent and adequacy of operating policies and procedures.

c. Groups of activities, including those operating as an entity, may be audited as a system or on a functional basis. Examples of functions that can be audited are personnel management and NAF investments or treasury management. In such instances, a single audit report or appraisal may be prepared in order to present an opinion or evaluation of the overall operations of the system or function. The audit report or appraisal will be based on the results derived from the audits of the individual activities selected by the auditors as representative of the system or function. The results would be projected to an evaluation or conclusion of the effectiveness of the overall system or function or its appropriate elements. An auditable system shall include:

- (1) A uniform accounting system in conformance with the DoD uniform chart of accounts.
- (2) Adequate internal control procedures.
- (3) Organizational controls.
- (4) A consolidation of the reports of the accounting system into meaningful financial summaries for the group. Military Service operating management shall use the consolidated reports as a basis for overall control and direction.
- (5) An auditor who is planning to perform a NAFI audit shall consider the functional weaknesses identified in vulnerability assessments and management control reviews under the requirements of DoDI 5010.40 (Reference (i)).

3. CONDUCTING AND FUNDING AUDITS

a. Performance audits and attestation engagements may be completed using NAFI internal audit staffs or reimbursing Military Department audit organizations. Annual financial statement audits shall be accomplished by contracting with CPA firms. NAF support of NAFI audits is the preferred method for funding the audit.

b. Appropriated funds and/or personnel may be used to support NAFI audits when considered necessary by the Head of the DoD Component, and is not prohibited by law or regulation.

c. The annual financial statement audit shall include the central NAFIs (if maintained) and regional, installation, or base NAFIs as may be deemed necessary. This is required in order to

obtain relevant, accurate, and complete financial information for the NAFIs under the cognizance of the Military Departments.

d. Specific policies and responsibilities regarding audits of NAFI and Armed Services exchange credit systems are contained in Reference (d) and DoDI 1330.09 (Reference (j)).

e. Specific policies and responsibilities regarding audits on civilian morale, welfare, and recreation (MWR) NAFIs are contained in DoDI 1015.08 (Reference (k)).

f. Non-Federal entities, as defined by DoDI 1000.15 (Reference (l)), that operate on DoD installations shall not receive funds (appropriated or nonappropriated) or personnel support for auditing their operations. However, to protect the interest of the United States, Heads of DoD Components may authorize support for official inquiries into operations of private organizations on DoD installations. Non-Federal entities include veterans' organizations, parent-teacher associations, model clubs, thrift clubs, and residential community associations.

g. When groups of appropriated and non-appropriated fund activities are operating as an entity, such as the MWR Program, non-reimbursable use of appropriated funds and/or personnel may be used unless prohibited by law or regulation.

GLOSSARY

PART I. ABBREVIATIONS AND ACRONYMS

CPA	certified public accountant
DoDD	DoD directive
DoDI	DoD instruction
GAAP	generally accepted accounting principles
IG DoD	Inspector General of the Department of Defense
MWR	morale, welfare, and recreation
NAF	nonappropriated fund
NAFI	nonappropriated fund instrumentalities

PART II. DEFINITIONS

Unless otherwise noted, these terms and their definitions are for the purpose of this Instruction.

annual financial audits. Defined in Reference (f).

highly sensitive operations. Operations that are susceptible to potential fraud, large public exposure, and a high degree of investment activity or other risks.

Military Department audit organizations. The Army Audit Agency; the Naval Audit Service; and Air Force Audit Agency.

NAFI internal audit staffs. The Army and Air Force Exchange Service; the Marine Corps Nonappropriated Fund Audit Service, and Navy Exchange Service Command.

performance audits and attestation engagements. Defined by Reference (f).