



Department of Defense INSTRUCTION

AD-A272 534



April 16, 1987
NUMBER 7600.6

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IG, DoD

SUBJECT: Audit of Nonappropriated Fund Instrumentalities and Related Activities

- References:
- (a) DoD Instruction 7600.6, "Audit of Nonappropriated Funds and Related Activities," January 4, 1974 (hereby canceled)
 - (b) DoD Directive 1015.1, "Establishment, Management, and Control of Nonappropriated Fund Instrumentalities," August 19, 1981
 - (c) DoD Directive 7600.2, "Audit Policies," January 10, 1985
 - (d) Comptroller General of the United States, "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions," February 27, 1981
 - (e) through (n), see enclosure 1

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A. REISSUANCE AND PURPOSE

This Instruction:

1. Reissues reference (a) to update policies, responsibilities, and procedures.
2. Provides for the categories of activities established in reference (b).

B. APPLICABILITY

This Instruction applies to the Office of the Secretary of Defense (OSD), the Military Departments, the Unified and Specified Commands, the Inspector General, Department of Defense (IG, DoD), and the Defense Agencies (hereafter referred to collectively as "DoD Components").

C. DEFINITION

DoD Central Internal Audit Organizations. The Army Audit Agency; Naval Audit Service; Air Force Audit Agency; and the Office of the Assistant Inspector General for Auditing, Office of the Inspector General (OIG), Department of Defense.

D. POLICY

As stated in DoD Directive 7600.2 (reference (c)), it is DoD policy to provide adequate audit coverage of Nonappropriated Fund Instrumentalities (NAFIs). The primary objectives of such audits shall be to determine whether internal control systems are adequate, resources are safeguarded and managed economically and efficiently, and desired program results are achieved. Particular attention should be placed on identifying potential fraud, waste, or abuse in operations. To the extent possible, audits should be conducted on a system

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or functional basis, rather than on an activity basis, and the reliability and accuracy of ADP systems should be verified. The results of such system or functional audits should be made available to the NAFI community in the form of reports and/or internal control checklists. Department of Defense personnel, rather than certified public accounting firms, should be used for audits involving potential fraud or other serious improprieties.

E. RESPONSIBILITIES

1. The Heads of DoD Components shall:

- a. Ensure that adequate audit coverage is provided for NAFIs.
- b. Require that all audits are accomplished in accordance with the requirements of DoD Directive 7600.2 and the Comptroller General of the U.S. standards (references (c) and (d)).
- c. Establish procedures that shall require reports of audits to be directed to the management level having the authority and responsibility to ensure that corrective action is taken on the findings and recommendations.
- d. Ensure that followup and resolution of audit recommendations are accomplished according to DoD Directive 7650.3 (reference (e)).
- e. Authorize, when justified by magnitude of operations, internal review staffing to conduct NAFI audits.
- f. Ensure that contracts with certified public accountants comply with DoD Directive 7600.9 (reference (f)).
- g. Analyze audits of NAFIs and prepare advisory or trend reports to assist managers of NAFIs in improving internal controls and operations.

2. The Heads of the DoD Central Internal Audit Organizations shall:

- a. Ensure that NAFIs within their cognizance are provided adequate audit coverage.
- b. Assist management in determining the frequency and scope of audit coverage for individual NAFIs.
- c. Perform system or functional reviews of NAFIs based on the application of risk assessment criteria.
- d. Provide technical guidance and periodic review of audits conducted by DoD internal review organizations, NAFI internal review staffs, and certified public accountants to ensure that such audits conform with Comptroller General of the U.S. standards and DoD Directive 7600.9 (references (d) and (f)).

3. The Director, Defense Contract Audit Agency, shall:

a. Provide, upon request, reimbursable audit services for evaluations of price proposals for negotiated contracts that exceed \$100,000 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 will not exceed those offered other customers. These reviews shall only be performed when the Defense Contract Audit Agency (DCAA) has resources available based on competing audit needs.

F. PROCEDURES

1. Type and Frequency of Audit Coverage

a. Annual audits, which may be financial and compliance in nature, as defined by the Comptroller General of the U.S. standards (reference (d)), shall be conducted for all NAFIs with annual revenues or expenses that exceed \$5 million and those NAFIs with operations deemed to be highly sensitive (e.g., potential fraud, large public exposure, etc.). Excluded from the requirement for annual audits based on exceeding the dollar limitation are groups of activities, including those operating as an entity, such as the Army Installation Morale, Welfare, and Recreation Fund (IMWRF). Other exceptions to the dollar limitation must be approved in writing by the IG, DoD.

b. For all NAFIs, the preferred method of audit coverage shall be through performance audits.

c. NAFIs shall be evaluated to determine whether audit coverage is warranted and, if so, the frequency and level of such coverage. In assessing the risk and, therefore, the need for audit coverage, the following factors shall be considered:

- (1) Adequacy of internal control systems.
- (2) Effectiveness of controls for ADP systems.
- (3) Extent of annual revenues and expenses.
- (4) Extent and results of oversight coverage by other DoD organizations.
- (5) Results of prior audits.
- (6) Extent and adequacy of operating policies and procedures.

d. The scope and frequency of NAFI audit coverage must also be correlated with available resources and competing audit needs.

e. 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 cash controls. 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 would 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 the following:

- (1) A uniform accounting system.
- (2) Adequate internal control procedures.
- (3) Central direction by operating management.

(4) A consolidation of the reports of the accounting system into meaningful financial summaries for the group. The consolidated reports shall be used by central operating management as a basis for overall control and direction.

f. An auditor preparing to do a NAFI audit shall consider the functional weaknesses identified in vulnerability assessments and management control reviews initiated under the Internal Management Control Program (reference (g)).

2. Responsibilities for Conducting and Funding Audits

a. Nonappropriated funding support of NAFI audits is the preferred method. This may be done by using NAFI internal review staffs, contracting with certified public accountants, or reimbursing DoD central internal audit organizations.

b. When groups of appropriated and nonappropriated fund activities are operating as an entity, such as the IMWRF, nonreimbursable use of appropriated funds and/or personnel is authorized.

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

d. Specific policies and responsibilities for Armed Services exchanges are contained in DoD Directive 1330.9 (reference (h)).

e. Private organizations on DoD installations shall not be provided fund (appropriated or nonappropriated) or personnel support for auditing their operations. However, to protect the interest of the United States, the head of a DoD Component may authorize such support for official inquiries into operations of private organizations on DoD installations.

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G. CATEGORIES OF NONAPPROPRIATED FUND INSTRUMENTALITIES AND RELATED ACTIVITIES AND PRIVATE ORGANIZATIONS

Definitions of NAFIs and related activities and private organizations on DoD installations are contained in DoD Directive 1015.1 and DoD Instruction 1000.15 (references (b) and (i)). Guidance on funding and financial management of NAFIs is outlined in DoD Directive 1015.6 and DoD Instruction 7000.12 (references (j) and (k)). Based on references (b) and (i), NAFIs and related activities and private organizations are divided into the following nine categories:

1. Armed Services Exchanges. Examples of these activities (DoD Directive 1330.9, reference (h)) are the headquarters level exchange fund, retail store, barber shop, and laundry.
2. Other Resale & Revenue Sharing. Examples of these activities are civilian dining/vending services, Stars and Stripes, and Class VI Stores (DoD Directive 1015.3 and DoD 1015.3-R, references (l) and (m)).
3. Military General Welfare & Recreation (MGW&R). Examples of these activities are headquarters level MGW&R funds, libraries, swimming pools, and golf.
4. Civilian Employee General Welfare & Recreation. Examples of these activities (DoD Directive 1015.8, reference (n)) are headquarters funds and civilian welfare/recreation activities.
5. Open Messes. Examples of these activities (DoD Directive 1015.3 and DoD 1015.3-R, references (l) and (m)) are Commissioned Officers Open Mess, Noncommissioned Officers Open Mess, and Enlisted Open Mess.
6. Other Membership Associations. Examples of these activities are amateur radio, boating/sailing, and rod and gun.
7. Common Support Service NAFIs. This includes headquarters level, major command level, and installation common support services funds.
8. Supplemental Mission Services NAFIs. Examples of these activities are billeting/housing supplemental mission funds, animal care funds, and chaplain religious funds.
9. Private Organizations on DoD Installations. Examples of these activities are veterans' organizations, parent-teacher associations, model clubs, and thrift shops.

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H. EFFECTIVE DATE AND IMPLEMENTATION

This Instruction is effective immediately. Forward one copy of implementing documents to the Inspector General, Department of Defense, within 120 days.


Derek J. Vander Schaaf
Deputy Inspector General

Enclosure - 1
References

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REFERENCES, continued

- (e) DoD Directive 7650.3, "Follow-up on General Accounting Office, DoD Inspector General, Internal Audit, and Internal Review Reports," March 19, 1985
- (f) DoD Directive 7600.9, "Contracting for Audit Services," May 8, 1985
- (g) DoD Directive 5010.38, "Internal Management Control Program," July 16, 1984
- (h) DoD Directive 1330.9, "Armed Services Exchange Regulations," December 15, 1986
- (i) DoD Instruction 1000.15, "Private Organizations on DoD Installations," September 22, 1978
- (j) DoD Directive 1015.6, "Funding of Morale, Welfare, and Recreation Programs," August 3, 1984
- (k) DoD Instruction 7000.12, "Financial Management of Morale, Welfare and Recreational Activities," September 4, 1980
- (l) DoD Directive 1015.3, "Armed Services Military Club and Package Stores," May 14, 1982
- (m) DoD 1015.3-R, "Armed Services Military Club and Package Store Regulations," May 1982, authorized by DoD Directive 1015.3, May 14, 1982
- (n) DoD Directive 1015.8, "DoD Civilian Employee Morale, Welfare, and Recreation (MWR) Activities and Supporting Nonappropriated Fund Instrumentalities (NAFIs)," October 22, 1985