



# Department of Defense **INSTRUCTION**

**NUMBER 7600.6**  
January 16, 2004

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IG, DoD

**SUBJECT:** Audit of Nonappropriated Fund Instrumentalities and Related Activities

- References:
- (a) DoD Instruction 7600.6, "Audit of Nonappropriated Fund Instrumentalities and Related Activities," April 16, 1987 (hereby canceled)
  - (b) DoD Directive 1015.14, "Establishment, Management, and Control of Nonappropriated Fund Instrumentalities and Financial Management of Supporting Resource," July 16, 2003
  - (c) DoD Directive 7600.2, "Audit Policies," February 2, 1991
  - (d) Comptroller General of the United States, "Government Auditing Standards (Yellow Book)," current edition<sup>1</sup>
  - (e) through (h), see enclosure 1

## 1. REISSUANCE AND PURPOSE

This Instruction:

- 1.1. Reissues reference (a).
- 1.2. Provides for the categories of activities established in reference (b).

## 2. APPLICABILITY

This Instruction applies to the Office of the Secretary of Defense, the Military Departments, the Chairman of the Joint Chiefs of Staff, the Combatant Commands, the Inspector General of the Department of Defense (IG DoD), the Defense Agencies, the DoD Field Activities, and all other organizational entities in the Department of Defense (hereafter referred to collectively as "the DoD Components"). The term "Military Services," as used herein, refers to the Army, the Navy, the Air Force, and the Marine Corps.

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<sup>1</sup> The Yellow Book can be viewed at [www.gao.gov](http://www.gao.gov) or copies can be purchased via the Internet at: <http://bookstore.gpo.gov>

### 3. DEFINITION

Military Service Audit Organizations. The Army Audit Agency; the Naval Audit Service; and the Air Force Audit Agency.

### 4. POLICY

It is DoD policy, under DoD Directive 7600.2 (reference (c)), that the Secretaries of the Military Services prescribe procedures to provide adequate audit coverage of Nonappropriated Fund Instrumentalities (NAFIs). Further guidance may be found at enclosure 2.

### 5. RESPONSIBILITIES

5.1. The Inspector General of the Department of Defense shall provide general audit oversight responsibility within the Department of Defense.

5.2. The Secretaries of the Military Services shall:

5.2.1. Ensure that adequate audit coverage is provided for NAFIs.

5.2.2. Require that all audits be accomplished in accordance with the requirements of reference (c) and the Yellow Book (reference (d)).

5.2.3. Issue guidance that requires 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.

5.2.4. Ensure that follow-up and resolution of audit recommendations are accomplished according to DoD Directive 7650.3 (reference (e)).

5.2.5. Authorize, when justified by magnitude of operations, internal review, or local audit staffing to conduct NAFI audits.

5.2.6. Establish a committee made up of senior officials, independent of NAFI management, to oversee its NAFI audits. They shall establish audit requirements including performance audits and attestation engagements based upon application of risk assessments, identify contract deliverables, and monitor the contract for the certified public accounting (CPA) firm's execution of the financial statement audit.

5.2.7. Analyze audits of NAFIs and prepare advisory or trend reports to assist managers of NAFIs in improving internal controls and operations.

5.3. The Heads of the Military Service Audit Organizations shall:

5.3.1. Ensure that NAFIs within their cognizance are provided adequate audit coverage.

5.3.2. Assist management in determining the frequency and scope of audit coverage for individual NAFIs.

5.3.3. Serve as the advisor to the audit committee; however, audit agency personnel cannot be a voting member of an audit committee.

5.3.4. Perform audits and reviews of NAFIs based on the application of risk assessment criteria.

5.3.5. Provide technical guidance and periodically review audits conducted by DoD internal review or local audit organizations and NAFI internal review staffs, and certified public accountants to ensure that such audits conform with references (c) and (d).

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

5.4.1. Provide, upon request, reimbursable audit services for evaluations of price proposals for negotiated contracts that exceed \$500,000 and costs incurred under cost reimbursement or incentive-type contracts.

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

6. PROCEDURES

6.1. Type and Frequency of Audit Coverage

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

6.1.1.1. Adequacy of internal control systems.

6.1.1.2. Effectiveness of controls for information technology systems.

6.1.1.3. Extent of annual revenues and expenses.

6.1.1.4. Extent and results of oversight coverage by other DoD organizations.

6.1.1.5. Results of prior audits.

6.1.1.6. Extent and adequacy of operating policies and procedures.

6.1.2. The scope and frequency of NAFI audit coverage must also be correlated with available resources and competing audit needs. NAFI should contract with a CPA firm to satisfy the financial statement audit required by paragraph 6.2.

6.1.3. 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:

6.1.3.1. A uniform accounting system.

6.1.3.2. Adequate internal control procedures.

6.1.3.3. Organizational control.

6.1.3.4. 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.

6.1.4. An auditor, planning to perform a NAFI audit, shall consider the functional weaknesses identified in vulnerability assessments and management control reviews under the requirements of DoD Directive 5010.38 (reference (f)).

## 6.2. Conducting and Funding Audits

6.2.1. Nonappropriated funding support of NAFI audits is the preferred method. Performance audits and attestation engagements may be completed using NAFI internal review staffs, or reimbursing Military Service audit organizations. Annual financial statement audits should be accomplished by contracting with certified public accountants.

6.2.2. When groups of appropriated and nonappropriated fund activities are operating as an entity, such as the Military Morale, Welfare, and Recreation Programs, nonreimbursable use of appropriated funds and/or personnel is authorized.

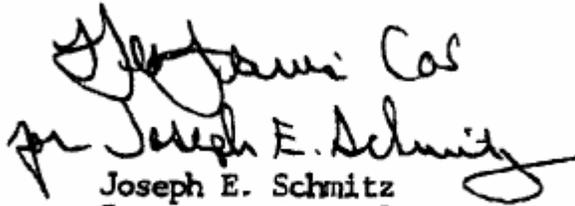
6.2.3. Appropriated funds and/or personnel may be used to support NAFI audits when considered necessary by the Heads of the DoD Component and not prohibited by law or regulation.

6.2.4. Specific policies and responsibilities regarding audits on Armed Services exchanges are contained in DoD Directive 1330.9 (reference (g)).

6.2.5. Private organizations on DoD installations shall not be provided funds (appropriated or nonappropriated) or personnel support for auditing their operations. However, to protect the interest of the United States, the Heads of a DoD Component may authorize such support for official inquiries into operations of private organizations on DoD installations. Private organizations, governed by DoD Instruction 1000.15 (reference (h)), include veterans' organizations, parent-teacher associations, model clubs, and thrift shops.

7. EFFECTIVE DATE

This Instruction is effective immediately.

  
Joseph E. Schmitz  
Inspector General,  
Department of Defense

Enclosures - 2

E1. References, continued

E2. Guidance

E1. ENCLOSURE 1

REFERENCES, continued

- (e) DoD Directive 7650.3, "Follow-up on General Accounting Office, DoD Inspector General, and Internal Audit Reports," September 5, 1989
- (f) DoD Directive 5010.38, "Management Control (MC) Program," August 26, 1996
- (g) DoD Directive 1330.9, "Armed Services Exchange Policy," November 27, 2002
- (h) DoD Instruction 1000.15, "Private Organizations on DoD Installations," October 23, 1997

## E2. ENCLOSURE 2

### GUIDANCE

E2.1.1. The primary objectives of NAFI audits are to determine whether:

E2.1.1.1. Internal control systems are adequate.

E2.1.1.2. Resources are safeguarded and managed economically and efficiently.

E2.1.1.3. Information technology systems are reliable and accurate.

E2.1.1.4. Potential fraud, waste, or abuse in operations is identified.

E2.1.1.5. Desired program results are achieved.

E2.1.2. The results of audits should be made available directly to the audited entity in the form of a written report or some other retrievable form.

E2.1.3. Annual financial audits, as defined by reference (d), shall be conducted for all NAFIs with annual revenues or expenses that exceed \$7 million and those NAFIs with operations deemed to be highly sensitive (e.g., potential fraud, large public exposure, etc.). The Office of the IG DoD shall approve exceptions to the dollar limitation in writing. Other audits should be completed as deemed necessary by management based on risk assessments and within resource availability.

E2.1.3.1. Each Military Service shall require a financial audit of its NAFIs by an independent audit organization. The financial audit shall include the central NAFIs (if maintained) and such other regional, installations or base NAFIs as may be necessary to obtain properly certified statements as to the financial condition of the NAFIs under the cognizance of the Military Services.

E2.1.3.2. The audited financial statements shall be the basis for the Military Services' annual reports submitted to the Principal Deputy Under Secretary of Defense for Personnel and Readiness in accordance with subparagraph 5.5.2. of reference (b).

E2.1.4. DoD personnel, rather than CPA firms, should be used for audits involving potential fraud or other serious improprieties.