

VOLUME 13, CHAPTER 8: “NONAPPROPRIATED FUND PAYROLL”**SUMMARY OF MAJOR CHANGES**

Changes are identified in this table and also denoted by [blue font](#).

Substantive revisions are denoted by an asterisk (*) symbol preceding the section, paragraph, table, or figure that includes the revision.

Unless otherwise noted, chapters referenced are contained in this volume.

Hyperlinks are denoted by [bold, italic, blue, and underlined font](#).

The previous version dated [November 2022](#) is archived.

| PARAGRAPH | EXPLANATION OF CHANGE/REVISION | PURPOSE |
|-----------|---|----------|
| All | Updated formatting and hyperlinks to comply with current administrative instructions. | Revision |

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CHAPTER 8

NONAPPROPRIATED FUND PAYROLL

1.0 GENERAL

1.1 Purpose

This chapter provides the standard Nonappropriated Fund (NAF) policy for DoD NAF payroll and applies to DoD NAF employees. NAF instrumentality (NAFI) programs and facilities must be operated, maintained, and funded as an integral part of the DoD personnel and readiness program. NAF employees are not paid from funds appropriated by Congress but from funds generated by NAIs. NAF employees are Federal employees, but they are not covered by most laws administered by the Office of Personnel Management (OPM), unless specifically provided by statute. Policy in this chapter applies to all NAIs, NAF Human Resources (HR), NAF payroll offices, and their supporting accounting offices (AOs).

1.2 Authoritative Guidance

The policy and related requirements prescribed are in accordance with the applicable provisions of:

1.2.1. DoD Instruction [\(DoDI\) 1015.15](#), “Establishment, Management, and Control of Nonappropriated Fund Instrumentalities and Financial Management of Supporting Resources;”

1.2.2. [DoDI 1400.25](#), “Civilian Personnel Management System;”

1.2.3. [DoDI 5010.40](#), “Managers’ Internal Control Program Procedures;”

1.2.4. [DoDI 7600.06](#), “Audit of Nonappropriated Fund Instrumentalities and Related Activities;”

1.2.5. Internal Revenue Service [\(IRS\) Publication 15](#) (Circular E), “Employer’s Tax Guide;” [Publication 15-A](#), “Employer’s Supplemental Tax Guide;” and [Publication 1244](#), “Employee’s Daily Record of Tips and Report to Employer;”

1.2.6. Office of Management and Budget [\(OMB\) Circular A-123](#), “Management’s Responsibility for Enterprise Risk Management and Internal Control;”

1.2.7. [OMB, Circular A-130, Appendix II](#), “Implementation of the Government Paperwork Elimination Act;” and

1.2.8. Title 5, United States Code, section 5514 ([5 U.S.C. § 5514](#)), “Installment deduction for indebtedness to the United States.”

2.0 PAYROLL OVERSIGHT

Defense Civilian Personnel Advisory Service ([DCPAS](#)), NAF Personnel Policy Division is responsible for developing, coordinating, and publishing DoD-wide civilian HR policy concerning NAF employees. DCPAS policy covers staffing, workforce relations, pay, classification, leave, and employee benefits. DCPAS is also responsible for implementing the DoD Employee Benefit Portability Act and the congressional mandate for a single, uniform health benefits program for NAF employees. DoD NAF HR policy is found in DoDI 1400.25, with volumes in the 1400 series.

2.1 Payroll Objectives

All NAF payroll systems that are being designed and implemented, or are in use, must operate in accordance with authoritative guidance in paragraph 1.2 and Volume 1. All payroll systems must provide, at a minimum, the following:

2.1.1. Complete, accurate, and prompt processing and accounting for pay, leave, and deductions;

2.1.2. Complete, accurate, and prompt generation and maintenance of payroll records and transactions;

2.1.3. Timely access to complete and accurate information to those customers internal and external to the NAFI who require the information;

2.1.4. Timely and proper interaction of payroll systems with the core financial systems;
and

2.1.5. Adequate internal controls to ensure that payroll systems are operating as intended.

2.2 AO Responsibilities

AOs must ensure all payroll information (including accrued payroll and benefits) is passed to the accounting system (whether systemically or manually), update the appropriate NAF Standard General Ledger (NAFSGL) accounts, and meet reporting requirements specified in DoDI 1015.15 and Volume 13, Chapter 7. AOs are also responsible for the compilation of financial statements.

2.3 NAFI Responsibilities

It is the responsibility of each NAFI to be knowledgeable of the legal requirements governing its payroll operations. NAFIs will establish the administrative workweek, basic workweek, workday, meal periods, legal holidays, administrative leave, flexible and compressed work schedules, compensatory time off for religious observances, and volunteer activities in accordance with DoDI 1400.25, Volume 1406, “Nonappropriated Fund (NAF) Attendance and

Leave.” Compensatory time off may be granted to NAF employees, at their request, instead of overtime pay for overtime work. See DoDI 1400.25, Volume 1405, “Nonappropriated Fund Pay, Awards, and Allowances.” NAFIs must ensure that each position is assigned to its proper occupational category, title, code, grade, or pay band level, consistent with the duties and responsibilities of the position, and proper job-grading standards in DoDI 1400.25, Volume 1407, “Nonappropriated Fund Classification.” The NAFI must work closely with the AO and payroll office to ensure the payroll objectives are met.

2.4 Payroll Office Responsibilities

The NAF payroll office has primary responsibility for all payroll processing and must work closely with the supporting NAF personnel office, NAFIs, and NAF employees to:

2.4.1. Maintain accurate records to satisfy employee needs and NAFI accounting requirements, and to comply with federal, state, and local statutory requirements;

2.4.2. Ensure safekeeping of pay information with adequate controls;

2.4.3. Promptly process all documents received affecting pay in accordance with established schedules;

2.4.4. Obtain information necessary to correct errors detected, including erroneous deductions, deductions not withheld, and over deductions by contacting the submitting office or employee;

2.4.5. Make timely disbursement of employees’ pay and supplemental payments when required;

2.4.6. Provide documentation to the NAF personnel office to support retirement actions; and

2.4.7. Submit tax reports to federal, state, and local authorities.

3.0 BASIC AND PREMIUM PAY

Authorized pay systems for NAF employees are described in DoDI 1400.25, Volume 1405. Laws and policy governing the application of rates of basic pay and premium pay for NAF employees are contained or referenced in that DoD issuance.

4.0 TIPS AND SERVICE CHARGES

NAF employees may receive tips from customers which are not negotiated by the NAFI via cash, check, debit card or credit card (e.g., customer adds to a credit card sales ticket). Debit and credit card tips may be immediately paid to the employee or recorded as a liability in the accounting records to be paid to the employee during payroll processing. NAF employees must report tips received, regardless of payment method, to the NAFI by the 10th day after the month

that the tips are received if those tips total \$20 or more in a month. Employees must report the tips on [IRS Form 4070](#), Employee's Report of Tips to Employer, or a similar form. NAFIs may, at their discretion, distribute service charges (amount added to a customer's ticket) to employees. Service charges distributed to employees are treated as wages and are not required to be included as tips on IRS Form 4070. For further information on tip reporting, refer to IRS Publication 15.

5.0 ALLOWANCES AND OTHER SPECIAL ENTITLEMENTS

DoDI 1400.25, Volume 1405 covers allowances and other special entitlements for NAF employees. The payment of allowances and differentials to NAF employees in overseas and foreign areas must comply with DoDI 1400.25, Volume 1412, "Nonappropriated Fund Overseas Allowances and Differentials, and Employment in Foreign Areas."

6.0 PAYROLL DEDUCTIONS

Payroll deductions or withholdings made from an employee's pay must be properly authorized by the employee (or made in accordance with applicable laws), adequately documented, and paid when due to the appropriate recipient in the amount authorized.

6.1 Taxes

Tax collections represent liabilities that are settled when funds are remitted to the designated authorities. Refer to IRS Publications 15 and 15-A for information on employer identification number, tax withholding, depositing, and reporting.

6.1.1. Employee Versus Independent Contractor. An employer must generally withhold Federal income taxes, and withhold and pay Social Security and Medicare taxes, for its employees. An employer does not generally have to withhold or pay taxes on payments to independent contractors. To determine whether an individual is an employee or an independent contractor under common law, the relationship of the worker and the business must be examined. IRS Publication 15-A provides the guidelines for determining whether an individual is an employee under the common law rules. These rules assist in identifying whether sufficient control is present to establish an employer-employee relationship.

6.1.2. Withholding State and Local Income Taxes. The payroll office will withhold taxes from the wages of civilian employees and remit them to tax jurisdictions wherever the Federal Government has entered into agreements for withholding taxes. State and local taxes must be withheld from the pay of enlisted personnel compensated from NAF for work performed during off-duty hours.

6.1.3. Foreign Taxes. NAFIs located in foreign countries will neither pay to, nor collect for, any foreign country or political subdivision, any tax unless the United States has consented to levy collection by treaty, convention, or Executive agreement.

6.1.4. Federal Insurance Contributions Act (FICA). The payroll office will withhold a set percentage of an employee's salary each pay period to pay the employee's share of FICA

contribution. FICA also requires that the NAFI contribute a set percentage of an employee's salary to the Social Security Trust Fund and the Medicare Trust Funds.

6.2 Other Deductions

[Dependent upon Service Component policy, and pay system capability](#), if an eligible NAF employee elects to participate in other NAF benefits programs (to include retirement, group life, medical, dental, long-term care insurance, flexible spending accounts, and 401(k) savings plan benefits), deductions will be made, as applicable. Employee-elected deductions may also be made for U.S. Savings Bonds, contributions to the Combined Federal Campaign, union dues (as applicable), and allotments to financial institutions, such as credit unions, banks, or other savings institutions. In accordance with 5 U.S.C. § 5514, NAF employees are subject to installment deductions from pay to collect debts owed to Federal agencies.

6.3 Garnishment of Wages

NAF employees are subject to court-ordered garnishment of wages for alimony, child support, bankruptcy, commercial debts, and federal tax levies. Refer to DoDI 1400.25, Volume 1405 for further authorities governing NAF employee garnishments.

6.4 Administrative Offset for Erroneous Overpayments

In accordance with 5 U.S.C. § 5514, NAFI employees are subject to salary offset for collection of debts in the same manner as DoD civilian employees, including debts owed to NAFIs or appropriated fund (APF) activities. NAF payroll offices must ensure procedures are developed to comply with the requirements of 5 U.S.C. § 5514. NAF payroll offices must refer to Volume 8, Chapter 8 and Volume 16, Chapters 2 and 4 in developing indebtedness and debt collection procedures for NAFIs.

6.5 Order of Precedence for Deductions

If the gross salary of an employee is not sufficient to permit all deductions to be made, then deductions will be made in the order of precedence established by the OPM Personnel Policy Memorandum [PPM-2008-01](#), "Order Of Precedence When Gross Pay Is Not Sufficient To Permit All Deductions," dated July 30, 2008. NAFIs must consult policy, legal staff, and collective bargaining agreements to ensure the proper order of precedence is followed.

7.0 EMPLOYEE BENEFIT PORTABILITY PROGRAM

7.1 General

The Portability of Benefits for Nonappropriated Fund Employees Act of 1990 (Portability Act), Public Law ([Pub. L.](#)) [101-508](#), section 7202 provides portability of pay and benefits for employees moving between NAF and APF positions. Under the Portability Act, employees who move with a break in service of no more than three days between NAF and APF positions may be eligible for pay, leave, reduction-in-force, and retirement benefit protection. The protection provided by the Portability Act, particularly protection in the area of retirement coverage elections,

was subsequently expanded by [Pub. L. 104-106](#), section 1043, enacted in 1996. In 2002, [Pub. L. 107-107](#), section 1131 further expanded the retirement election opportunity to make it easier for employees to continue retirement coverage after moving between NAF and APF positions. Under current retirement portability law, eligible employees who move with a break in service of no more than one year between NAF positions and retirement-covered civil service positions in any Federal agency may elect to continue retirement coverage in the losing employment system's retirement plan without the vesting requirement. Additionally, Pub. L. 107-107, section 1132 permits employees in both Civil Service Retirement System (CSRS) and Federal Employee Retirement System (FERS) to use prior NAF service to qualify for an immediate retirement. An employee who elects to remain covered in the losing employment system is excluded from coverage under the gaining DoD Agency for all subsequent periods of employment including periods of service as a reemployed annuitant. Refer to DoDI 1400.25, Volume 1408, "Insurance and Annuities for Nonappropriated Fund Employees," and the [DoD Portability of Benefits Reference Guide](#) for additional information.

7.2 Leave Transfer

In accordance with the Portability Act, accrued annual and sick leave hours will transfer within DoD to the gaining activity, without exchange of funds, if there is a break in service of no more than three days. Employees are not entitled to receive lump-sum payment for accumulated/accrued annual leave. Refer to DoDI 1400.25, Volume 1406 for additional guidance.

7.2.1. NAF to APF Transfer. When a NAF employee transfers to an APF position, the AO or NAF payroll office will make applicable entries to the appropriate NAFSGL accounts to eliminate the annual leave liability (consult local procedures for additional information). The value of the income resulting from the elimination of the liability will be recorded as specific non-operating income in the appropriate NAFSGL account.

7.2.2. APF to NAF Transfer. When an APF employee transfers to a NAF position, the AO or NAF payroll office will record the total dollar amount of accumulated/accrued annual leave to the appropriate NAFSGL accounts to recognize the annual leave liability (consult local procedures for additional information). The value of the expense resulting from the recognition of the liability will be recorded as specific non-operating expense in the appropriate NAFSGL account.

7.2.3. Annual Leave Lump-Sum Repayment. Employees who are covered under the provisions of the Portability Act and were paid lump-sum leave payments between January 1, 1987 and April 15, 1991, because of a transfer between APF and NAF positions, may repay those lump-sum payments and receive credit of the leave. Employees who separated from Federal service between January 1, 1987 and April 15, 1991, and who were subsequently rehired, may also have the opportunity to repay the lump-sum leave and receive credit.

7.3 Portability Retirement Records

NAF HR/payroll offices are responsible for providing and processing forms for employees who are retiring under either CSRS or FERS. OMB Circular A-130, Appendix II prescribes the

use of electronic processes and digital signatures whenever it is possible and in the best interest of the Government. The NAF HR/payroll offices must fulfill the following general responsibilities relating to CSRS or FERS (for further information on portability retirement, refer to Volume 8, Chapter 4, section 4.3).

7.3.1. NAF HR/payroll offices must prepare and maintain a Standard Form [\(SF\) 2806](#) (CSRS) or an [SF 3100](#) (FERS), Individual Retirement Record, for each employee subject to either CSRS or FERS. Each SF 2806/SF 3100 must be correct, complete, clear in every detail, and properly certified to ensure timely and accurate closeout procedures when an employee is separated or transferred to the paying jurisdiction of another agency.

7.3.2. NAF HR/payroll offices must maintain adequate control over retirement records and associated monetary balances.

7.3.3. NAF HR/payroll offices must promptly send claims and records. The OPM address is:

CSRS/FERS Retirement Records
Office of Personnel Management
Retirement Operations Center
P.O. Box 45
Boyers, PA 16017-0045

7.3.4. NAF HR/payroll offices must withhold retirement deductions from employees' salaries, make agency contributions, and send the deductions/contributions to OPM for deposit. Deductions begin on the day the employee acquires coverage under the retirement system and must be prorated for partial pay periods. FICA contributions must be withheld and reported in accordance with current guidance from the U.S. Department of Treasury. Employee retirement deductions, employer contributions, employee contributions to applicable 401(k) plans, and loan repayments will be made biweekly and submitted to the appropriate NAF employee benefit system. Thrift Savings Plan (TSP) deductions and the employer's matching contributions must be forwarded to the TSP.

8.0 LEAVE ACCRUAL

8.1 Annual Leave

The accrual of annual leave is material and must be recognized as a liability and expensed monthly in the individual NAFI's accounting records. The individual leave records or annual leave report, showing the accumulated leave balance for all employees, will be used as the subsidiary ledger to the appropriate NAFSGL account for each NAFI.

8.2 Sick Leave

The monthly accrual of sick leave is not a liability to the NAFI. Sick leave used monthly will be recognized as an expense in the individual NAFI's accounting records.

8.3 NAFI to NAFI Leave Transfer

When a NAF employee transfers from one NAFI to another, the accrued annual leave hours and dollar amount may be transferred to the gaining NAFI if both employers and employee agree. If the employee elects not to have the annual leave transferred to the gaining NAFI, then the losing NAFI will make a lump-sum leave payment to the employee. If the DoD Component head has implemented policy that permits NAF employees transferring between the NAF activities to receive partial payment of any unused annual leave to their credit at the time of separation, the employee may also elect to transfer part of the annual leave balance and take a lump-sum payment for the remaining portion. Accrued sick leave hours will transfer to the gaining NAFI with no exchange of funds. See DoDI 1400.25, Volume 1406 for additional guidance.

9.0 SEVERANCE AND SEPARATION BENEFITS

DoDI 1015.15 specifies that NAFIs must set aside and invest funds on a regular basis to ensure sufficient cash availability to defray payment of severance benefits for U.S. and Foreign National employees upon their separation from NAFI employment. NAFIs will ensure that the estimated liability for a business-based action is accrued when probable and a separation allowance is accrued on a monthly basis where applicable. DoDI 1400.25, Volume 1405 describes the eligibility criteria, exclusions, and conditions under which NAF employees may receive severance pay and the computation and payment requirements.

10.0 PAYROLL DISBURSEMENTS

All payroll disbursements must be paid to NAF employees by electronic fund transfer (EFT) unless the head of the agency or designee has granted a waiver. The head of the agency or designee may waive the EFT requirement upon receipt of written certification from the employee that states that he or she does not have an account with a financial institution or providing some other extenuating circumstance.

11.0 RECORDS RETENTION AND STORAGE

NAF payroll offices are required to keep records sufficient to support all transactions relevant to matters concerning NAF payroll. In accordance with IRS Publication 15, records of employment taxes must be maintained for a period of 4 years following the due date of such tax or from the date for which such tax has been paid, whichever date is later. Aggregate records documenting payroll disbursed in each pay period (base pay, additions to and deductions from pay, and leave balances) must be stored and transferred to the [National Personnel Records Center](#) for 56 years' retention, in accordance with the National Archives and Records Administration [General Records Schedule 2.4](#).

12.0 INTERNAL CONTROL STANDARDS

A key to effective payroll operations is the maintenance of internal controls over those operations. Internal control standards are outlined in the OMB Circular A-123; DoDI 1015.15, [subparagraph 6.7.3](#); DoDI 5010.40; and DoDI 7600.06. All DoD NAF organizations must ensure that these standards are followed for payroll operations as well as for the methods and procedures adopted for processing and auditing payrolls.