

VOLUME 13, CHAPTER 1: “INTRODUCTION TO NONAPPROPRIATED FUND ACCOUNTING”

SUMMARY OF MAJOR CHANGES

All changes are 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 [July 2013](#) is archived.

PARAGRAPH	EXPLANATION OF CHANGE/REVISION	PURPOSE
All	Reformatted chapter and updated hyperlinks in accordance with current administrative instructions.	Revision
010101	Added an “Overview” paragraph to comply with current administrative instructions.	Addition
010103	Added an “Authoritative Guidance” paragraph to comply with current administrative instructions.	Addition
010302	Added a list of required annual reports per Department of Defense Instruction 1015.15, “Establishment, Management, and Control of Nonappropriated Fund Instrumentalities and Financial Management of Supporting Resources.”	Addition
0105	Relocated paragraph on Internal Controls and updated the paragraph for clarity.	Revision

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CHAPTER 1

INTRODUCTION TO NONAPPROPRIATED FUND ACCOUNTING

0101 GENERAL

*010101. Overview

Nonappropriated Fund (NAF) accounting applies to all NAF Instrumentalities (NAFIs) and their supporting Accounting Offices (AOs), except the Military (Armed) Service Exchanges. NAFs are separate from appropriated funds (APFs) of the U.S. Treasury. NAFs are not commingled with APFs and are managed separately from APFs, even when used to support a common program.

010102. Purpose

This chapter provides a list of definitions, reporting requirements, accounting standards, internal controls, and audit requirements for NAFIs.

*010103. Authoritative Guidance

The accounting policies, and related requirements prescribed, are in accordance with the applicable provisions of:

A. Department of Defense Instruction (DoDI) 1015.15, “Establishment, Management, and Control of Nonappropriated Fund Instrumentalities and Financial Management of Supporting Resources;” and

B. Financial Accounting Standards Board Accounting Standards Codification (ASC). Users can obtain free access to the ASC by registering for the Basic View, which allows browsing by ASC topic.

0102 DEFINITIONS

010201. APFs

APFs are monies paid out of the U.S. Treasury pursuant to statutory authority granted by Congress to the DoD to incur obligations and make payments. The term “appropriation” means a provision of law (not necessarily in an appropriations act) authorizing the expenditure of funds for a given purpose. In most cases, appropriations are of two types, annual and multi-year. Congress approves the appropriation acts that specify the purposes for which the APFs are used. Specific accounting policies for APFs are described in Volume 4. For additional information on the use of and accounting for APFs for NAF activities, refer to DoDI 1015.15.

010202. Balance Sheet

The Balance Sheet is a financial statement that shows an entity's financial position at a certain point in time (usually at the end of an accounting period). It represents the entity's assets, liabilities, and net worth (or fund equity).

010203. Chart of Accounts

The chart of accounts is a list of ledger account names, [descriptions](#), and numbers arranged in the order in which they customarily appear in the financial statements. The chart serves as a useful source for locating a given account within the ledger. The chart of accounts for NAFs is established to comply with [FASB and DoDI 1015.15](#) reporting requirements, and [is maintained on the *DoD NAF Accounting website*](#).

010204. Comparability

Comparability is the similarity and consistency of information produced by an entity from period to period and by others operating in similar circumstances. The value and usefulness of information depends greatly on the degree to which it is comparable to information from prior periods and to similar information reported by others.

010205. Consistency

Consistency is the uniformity of accounting procedures used by an accounting entity from period to period.

010206. Cost-Benefit Analysis ([CBA](#))

CBA is an analytic technique that compares the costs and benefits of investments, programs, or policy actions in order to determine which alternative or alternatives maximize net benefits (economic efficiency). CBA attempts to consider all costs and benefits.

010207. General Ledger

The general ledger is a summary of all the transactions that occur for each NAFI. Separate accounts exist for individual assets, liabilities, net worth, [income](#), and expenses. The general ledger is the core of the NAF accounting system and contains all of the accounting entries for the current period. The general ledger accounts are found in [the NAF Standard General Ledger on the *DoD NAF Accounting website*](#).

010208. Internal Controls

Internal controls are tools to help program and financial managers achieve desired results and safeguard the integrity of their programs.

010209. Interpretation

Interpretation is an opinion regarding a set of facts. A degree of subjectivity is involved on the part of the individual, based on experience and judgment.

010210. Materiality

Materiality refers to the magnitude of an omission or misstatement of accounting data that misleads financial statement readers. Information is material when it is of such magnitude or significance that its omission or misstatement leads to a misinterpretation of the financial information. For example, amounts in a financial statement that are too small to make a difference or affect the reliability of information may be omitted because they are immaterial. In addition to magnitude, the nature of the item is considered when making a materiality judgment. For reporting purposes that require the level of materiality to be quantified, materiality **must** be defined as one percent of the total assets in the Balance Sheet for each NAFI. For those NAF activities required to report on a consolidated basis, the threshold of materiality **must** be one percent of the assets in the consolidated Balance Sheet.

010211. NAFs

NAFs are government monies that are not appropriated by Congress and are not held within the U.S. Treasury. These are separate funds that are **not** recorded in the books of the Department of the Treasury.

010212. NAFI

A NAFI is a fiscal entity of the U.S. Government that is supported in whole or in part by NAFs. In accordance with DoDI 1015.15, paragraph 6, NAFIs are categorized into six Program Groups: Military Morale, Welfare, and Recreation (MWR), Military (Armed) Service Exchanges, Civilian MWR, Lodging Program Supplemental Mission Funds, Supplemental Mission Funds, and Special Purpose Central Funds. A NAFI acts in its own name to provide or assist the Secretaries of the Military Departments to provide programs for DoD personnel. See the definition of NAFI in DoDI 1015.15, Enclosure 2, for further clarification.

010213. Recording

Recording is the accurate documentation of business transactions. Recording is an essential requirement of both manual and automated accounting systems.

010214. Relevance

Relevance is the capacity of information to make a difference in decision-making. For instance, relevant information must be available in a timely manner to ensure its value in decision-making.

010215. Reliability

In financial accounting theory, reliability describes information that is reasonably free from error and bias and accurately presents the facts.

010216. Statement of Cash Flows

The Statement of Cash Flows is a financial statement for a given period that provides information about an entity's cash receipts and cash disbursements as they apply to operating, investing, and financing activities.

010217. Statement of Income and Expense

The Statement of Income and Expense is a financial statement showing the elements (income and expense) used in arriving at the net income for the accounting period or over a certain period of time.

010218. Subsidiary Ledgers

Subsidiary ledgers are a group of related accounts supporting the balance of a control account in the general ledger. In some cases, a simple file system or the equivalent may be adequate if it substantiates the general ledger account balance. Three typical subsidiary ledgers are accounts receivable, prepaid accounts, and accounts payable.

010219. Summarizing

Summarizing is the process of bringing together financial information to develop financial statements or reports. Examples of the most commonly used financial statements are the Balance Sheet, Statement of Income and Expense, and Statement of Cash Flows.

010220. Timeliness

Timeliness is prompt reporting of financial information to users for their maximum benefit. Financial data is recorded as soon as practical after the occurrence of a transaction.

010221. Trial Balance

A trial balance is a listing of the accounts in the general ledger along with each account's balance in the appropriate debit or credit column. AOs will prepare an end-of-month trial balance of the general ledger accounts to ensure total debits equal total credits.

0103 ANNUAL REPORTING REQUIREMENTS

010301. Annual Reporting Period

The annual accounting reporting period for DoD NAFIs begins October 1 of each year and ends September 30 of the following year.

*010302. Reports

Financial reports are prepared annually for each NAFI and must include notes to accompany the financial statements. The following NAFI financial reports are explained in Chapter 7:

- A. Balance Sheet;
- B. Reconciliation of Net Worth;
- C. Statement of Income and Expense;
- D. Schedule A – APF and NAF Expense Summary; and
- E. Statement of Cash Flows.

010303. Financial Statement Disclosures

Financial reports must include full and adequate disclosure of financial and accounting information in accordance with Chapter 7 specific reporting requirements (e.g., disclosure of fund equity adjustments and eliminating entry transactions between NAFIs); this includes Military Service Headquarters, Major Command or Region, and installation NAFIs. Following these requirements ensures that financial and accounting information is properly treated in preparation of reports.

0104 ACCOUNTING STANDARDS

010401. Generally Accepted Accounting Principles (GAAP)

The term GAAP encompasses the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. GAAP includes not only broad guidelines of general application, but also detailed practices and procedures. These conventions, rules, and procedures establish a standard by which to measure financial presentations.

A. Judgment. Although there are numerous sources of GAAP, some judgment is necessary to determine whether:

1. The accounting principles selected and applied have general acceptance;

2. The accounting principles are appropriate in the circumstances;
3. Financial statements, including related notes, are informative of matters that may affect their use, understanding, and interpretation;
4. Information presented in the financial statements is classified and summarized in a reasonable manner, i.e., it is neither too detailed nor too condensed; and
5. Financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows stated within a range of acceptable limits, i.e., limits that are reasonable and attainable.

B. [FASB Codification](#). The American Institute of Certified Public Accountants (AICPA) Council designated the Federal Accounting Standards Advisory Board as the body that promulgates GAAP for federal entities and the FASB as the organization that establishes standards for financial accounting and reporting in the private sector. Since NAFI business operations are similar to the private sector, financial statements are prepared and presented to comply with accounting standards promulgated by FASB. The FASB Accounting Standards Codification is the single source of authoritative nongovernmental U.S. GAAP, and is available as an advanced application that allows users to access authoritative content, perform research, and submit feedback. Effective for interim and annual periods ending after September 15, 2009, the Codification supersedes all previous GAAP standards. All other accounting literature not included in the Codification is considered non-authoritative. The Codification structure is significantly different from the structure of the previous standards and is composed of the following literature issued by various standard setters:

1. FASB:
 - a. Statements,
 - b. Interpretations,
 - c. Technical Bulletins,
 - d. Technical Staff Positions, and
 - e. Staff Implementation Guides;
2. Emerging Issues Task Force:
 - a. Abstracts, and
 - b. Topic D;
3. Derivative Implementation Group Issues;

4. Accounting Principles Board Opinions;
5. Accounting Research Bulletins;
6. Accounting Interpretations; and
7. AICPA:
 - a. Statements of Position,
 - b. Audit and Accounting Guides,
 - c. Practice Bulletins, and
 - d. Technical Inquiry Service.

C. Other Considerations. An important aspect of GAAP, as applied to government entities, is the recognition of the variety of legal and contractual considerations typical of the government environment. These considerations underlie and are reflected in the fund structure, basis of accounting, and other principles that distinguish governmental accounting from private sector accounting. Some of the types of laws and regulations that may have a direct and material effect on the determination of amounts in a NAF activity's financial statements include:

1. Requirements for reporting to DoD and others;
2. Restrictions on the use of APFs;
3. Restrictions on expenditures, including construction;
4. Restrictions on investments; and
5. Laws and regulations for NAF, Civil Service, and military personnel.

010402. Accrual Accounting

NAFIs use the accrual basis of accounting. Under accrual accounting, transactions and other economic events are recorded when they occur. **Income and expense** are recognized and reported when earned or incurred. Accrual accounting emphasizes matching **associated income** and expense in the period in which they occur and contributes to effective financial control over resources and cost of operations. **Accrual accounting** is essential in developing adequate **income** and cost information.

010403. AO Responsibilities

AOs provide centralized professional accounting services to NAFIs. AO responsibilities include:

- A. Maintain all books of original entry, the general ledger, and related subsidiary ledgers;
- B. Maintain fixed asset records;
- C. Prepare all disbursement vouchers and checks after assuring availability of funds and pay liabilities of all supported NAFIs;
- D. Maintain payroll records if performing payroll functions;
- E. Prepare required periodic financial reports with ratios and percentages as requested. AOs also report variances in relation to established standards or approved budget goals upon request;
- F. Prepare other information when requested by NAFI management or higher authority. For example, AOs may supply financial analysis with an MWR activity's financial statements or provide variance from budget data or historical information for use in preparation of NAFI budgets;
- G. Prepare and distribute financial reports to all supported NAFIs;
- H. Prepare an annual operating budget for the AO. When more than one NAFI is supported by an AO, then a schedule is prepared that shows the estimated amounts to be assessed each supported NAFI;
- I. Reconcile the bank accounts of supported NAFIs. Review daily account balances shown on monthly bank statements to make sure that insurance and collateral are sufficient. Notify NAFI managers of missing or delayed deposit or check documentation;
- J. Compute and bill service fees to recover operating costs;
- K. Review documentation for completeness and accuracy;
- L. Provide documentation to internal and external independent auditors, as required;
- M. Prepare aged accounts receivable and accounts payable reports;
- N. Maintain awareness of all changes that affect financial reporting; and

O. Review requests for making adjustments to fund equity or net worth. Non-receipt of accounting documents or failure to record documents received does not constitute a valid equity adjustment.

010404. Accounting Changes

The term “accounting change” means a change in an accounting principle or an accounting estimate. When an accounting change is made, appropriate footnote disclosure is required to provide justification for the accounting change and its effect on the financial statements.

A. Change in Accounting Principle. A change in accounting principle results from an adoption of a generally accepted accounting principle different from the one previously used for reporting purposes to include the methods for applying the new principle. A characteristic of a change in accounting principle is that it concerns a choice from among two or more generally accepted accounting principles. In the preparation of financial statements, there is a presumption that an accounting principle, once adopted, is not changed in accounting for events and transactions of a similar type. Consistent use of accounting principles from one accounting period to another enhances the utility of financial statements to users by facilitating analysis and understanding of comparative accounting data. Generally, the past financial statements are restated to reflect a change in accounting principle.

B. Change in Accounting Estimate. A change in an estimate used in accounting is a necessary consequence of periodic presentations of financial statements. A change in accounting estimate results from new information or subsequent developments and accordingly from better insight or improved judgment. Preparing financial statements requires estimating the effects of future events. Examples of items for which estimates are necessary are uncollectible receivables, inventory obsolescence, service lives, and salvage values of fixed assets. Future events and their effects cannot be predicted with certainty. Estimating, therefore, requires the exercise of judgment. Accounting estimates may change as new events occur, as more experience is acquired, or as additional information is obtained. A change in accounting estimate is accounted for prospectively over current and future years, which will cause a change to the expense account in future years. Prior years are not restated.

010405. Accounting Errors

Errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, oversight, or misuse of facts that existed at the time the financial statements were prepared. A change from an accounting principle that is not generally accepted to one that is generally accepted is a correction of an error. The past financial statements are restated to reflect the corrections.

*0105 INTERNAL CONTROLS

NAFIs must establish and operate internal control programs in accordance with a range of guidance. The Office of Management and Budget [Circular A-123](#), “Management’s Responsibility for Enterprise Risk Management and Internal Control,” and the statute it implements, the Federal

Managers' Financial Integrity Act ([FMFIA](#)) of 1982, are at the center of the existing Federal requirements to improve internal controls. Circular A-123 provides guidance on using the range of tools at the disposal of agency managers to achieve desired program results and meet the requirements of the FMFIA of 1982. The Circular provides internal control standards and specific requirements for conducting management's assessment of the effectiveness of internal controls over financial reporting. For additional guidance, refer to DoDI [5010.40](#), "Managers' Internal Control Program Procedures," and DoDI 1015.15. See Volume 1, Chapter 3, section 0303 for additional guidance on appropriate internal controls, including verifying the authorization of recorded transactions.

0106 AUDIT REQUIREMENTS

010601. Audit Policy

Policy regarding the audit of NAFIs and related activities is prescribed in [DoDI 7600.06](#), "Audit of Nonappropriated Fund Instrumentalities (NAFI) and Related Activities." NAFIs will have access to the results of system or functional audits in the form of reports.

010602. Audit Frequency

DoD policy is to provide adequate audit coverage of NAFIs to include annual financial statement audits. Each Military Service is required by [DoDI 7600.06](#) to have independent certified public accountants conduct an annual financial audit of NAFIs with annual income or expenses exceeding \$10 million. If directives require or circumstances warrant, additional audits may be scheduled as instructed by DoD Component authority.

010603. Audit Objectives

The primary objectives of NAFI audits are to determine whether internal control systems are adequate, the financial statements fairly represent the results of operations, applicable laws and regulations are followed, and desired program results are achieved. Particular attention is placed on identifying potential fraud, waste, or abuse in operations.