

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

All changes are denoted by **blue font**.

Substantive revisions are denoted by an * 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 August 2011 is archived.

PARAGRAPH	EXPLANATION OF CHANGE/REVISION	PURPOSE
All	Reworded chapter for clarity and updated hyperlinks.	Update
0802	Changed Civilian Personnel Management Service to Defense Civilian Personnel Advisory Service to reflect the organization's name change.	Update
0804	Clarified that nonappropriated fund employees must report tips received of \$20 or more in a month, to the Internal Revenue Service.	Update
080702. A&B	Modified paragraphs to show only nonappropriated leave transfer data since appropriated fund data is addressed in Volume 8, Chapter 4.	Update
080703.C	Deleted Federal Employee Retirement System (FERS) address and combined with Civil Service Retirement System (CSRS); FERS and CSRS retirement documents are now sent to the same address.	Update

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CHAPTER 8

NONAPPROPRIATED FUND PAYROLL

0801 OVERVIEW

080101. Purpose

This chapter provides the standard Nonappropriated Fund (NAF) policies for NAF payroll. NAF employees are not paid from funds appropriated by Congress but from funds generated by Nonappropriated Fund Instrumentalities (NAFIs). 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.

080102. Scope

Policies in this chapter apply to all NAFIs, NAF payroll offices, and their supporting accounting offices (AOs). In accordance with Department of Defense Instruction (DODI) [1015.15](#), Establishment, Management, and Control of Nonappropriated Fund Instrumentalities and Financial Management of Supporting Resources, section 5.4 they do not apply to the Armed Service Exchanges.

*0802 PAYROLL OVERSIGHT

[Defense Civilian Personnel Advisory Service \(DCPAS\) NAF Personnel Policy Division](#) is responsible for developing, coordinating, and publishing Department of Defense (DoD) wide civilian human resource (HR) policy concerning DoD NAF employees. DCPAS policies cover 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](#), DoD Civilian Personnel Management, with volumes (chapters) in the 1400 series.

080201. Payroll Objectives

All NAF payroll systems that are being designed and implemented, or are in use, must operate in accordance with laws, regulations, policies, and judicial decisions. All payroll systems must provide, at a minimum, the following objectives:

- A. Complete, accurate, and prompt processing and accounting for pay, leave, and deductions;
- B. Complete, accurate, and prompt generation and maintenance of payroll records and transactions;

- C. Timely access to complete and accurate information to those customers internal and external to the NAFI who require the information;
- D. Timely and proper interaction of payroll systems with the core financial systems; and
- E. Adequate internal controls, to ensure that payroll systems are operating as intended.

080202. Accounting Office 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 general ledger 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.

080203. Nonappropriated Fund Instrumentalities 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 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 (NAF) Pay and Allowances. NAFIs shall 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 (NAF) Classification. The NAFI must work closely with the AO and payroll office to ensure the payroll objectives are met.

080204. 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:

- A. **Maintain** accurate records to satisfy employee needs and NAFI accounting requirements, and comply with federal, state, and local statutory requirements;
- B. **Ensure** safekeeping of pay information with adequate controls;
- C. **Promptly** process all documents received affecting pay in accordance with established schedules;

- D. Obtain information necessary to correct errors detected, including erroneous deductions, deductions not withheld, and over deductions by contacting the submitting office or employee;
- E. Make timely disbursement of employees' pay and supplemental payments when required;
- F. Provide documentation to the NAF personnel office to support retirement actions; and
- G. Submit tax reports to federal, state, and local authorities.

0803 BASIC AND PREMIUM PAY

Authorized pay systems for DoD NAF employees are described in DODI 1400.25, [Volume 1405](#). Laws and policies governing the application of rates of basic pay and premium pay for DoD NAF employees are contained or referenced in that DoD issuance.

*0804 TIPS AND SERVICE CHARGES

NAF employees may receive cash or charge (e.g., customer adds to a credit card sales ticket) tips from customers which are not negotiated by the NAFI. Charge 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, whether cash or charge, [if those tips total \\$20 or more](#) in a month on Internal Revenue Service (IRS) Form 4070, located in [Publication 1244](#), Employees Daily Record of Tips and Report to Employer, or a similar report, to the NAFI by the 10th day after the month that the tips are received. 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](#), (Circular E), Employer's Tax Guide.

0805 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 shall comply with [DODI 1400.25, Volume 1412](#), Nonappropriated Fund (NAF) Overseas Allowances and Differentials, and [Employment in Foreign Areas](#).

0806 PAYROLL DEDUCTIONS

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

080601. Taxes

The collection of taxes represents liabilities that are settled when funds are remitted to the designated authorities. Refer to IRS Publication 15, and [IRS Publication 15-A](#), Employer's Supplemental Tax Guide, for information on employer identification number, tax withholding, depositing, and reporting.

A. Common Law Rules. 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.

B. 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 shall be withheld from the pay of enlisted personnel compensated from NAF for work performed during off-duty hours.

C. Foreign Taxes. NAFIs located in foreign countries will not 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.

D. Federal Insurance Contributions Act (FICA). The payroll office will withhold a set percentage of an employee's salary each pay period. FICA also requires that the NAFI match the employee's amount and contribute the money to a Government account known as the Social Security Trust Fund.

080602. Other Deductions

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 Public Law (P.L.) 110-181 - FY 2008 National Defense Authorization Act (NDAA), [section 652](#), NAF employees are subject to installment deductions from pay to collect debts for Federal agencies.

080603. 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 information and specific rules applicable to court ordered garnishments.

080604. [Administrative Offset for Erroneous Overpayments](#)

In accordance with [Title 5, United States Code, section 5514](#), Installment Deduction for Indebtedness to the United States. NAFI employees are subject to salary offset for collection of debts in the same manner as military members and DoD civilian employees. All NAF employees are subject to salary offset for collection of debts owed to NAFIs or appropriated fund activities [in accordance with 5 U.S.C. section 5514](#), Installment Deduction for Indebtedness to the United States. NAF payroll offices shall ensure procedures are developed to comply with the requirements of 5 U.S.C. 5514. NAF payroll offices shall refer to Volume 8, Chapter 8 and Volume 5, Chapter 28 and use the applicable guidance in developing indebtedness and debt collection procedures for NAFIs.

080605. 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 [“Order of Precedence”](#). NAFIs must consult policies, legal staff, and collective bargaining agreements to ensure the proper Order of Precedence is followed.

0807 EMPLOYEE BENEFIT PORTABILITY PROGRAM

080701. General

[The Portability of Benefits for NAF Employees Act](#) was enacted in 1990 to provide portability of pay and benefits for employees moving between NAF and appropriated fund (APF) positions. Under the Portability Act, employees who move with a break in service of no more than three days between DoD NAF and DoD 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 P.L. 104-106, Section 1043](#) enacted in 1996, expanded the authorities provided by the Portability Act, primarily in the area of retirement coverage elections. Section 1131 of the National Defense Authorization Act for Fiscal Year 2002 [and P.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 DoD 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, [P.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 \(NAF\) Employees](#), and the [Portability Handbook](#), Portability of Benefits for Moves Between Civil Service and NAF Employment Systems Reference Guide, for additional information.

*080702. Leave Transfer

In accordance with instructions in the Portability of Benefits for NAF Employees 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.

*A. NAF to APF Transfer. When a NAF employee transfers to an APF position, the AO will [make applicable entries](#) to the appropriate NAF general ledger accounts to eliminate the annual leave liability. The value of the income resulting from the elimination of the liability will be recorded as a specific non-operating income in the appropriate general ledger account.

*B. APF to NAF Transfer. When an APF employee transfers to a NAF position, the AO will record the total dollar amount of accumulated/accrued annual leave to the appropriate NAFIs general ledger accounts to [recognize the annual leave liability](#). The value of the expense resulting from the recognition of the liability will be recorded as a specific non-operating expense in the appropriate general ledger account.

C. Annual Leave Lump Sum Repayment. Employees who are covered under the provisions of the Portability of Benefits for NAF Employees Act of 1990 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.

*080703. Portability Retirement Records

NAF payroll offices are responsible for providing and processing forms for employees who are retiring under either CSRS or FERS. The 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, paragraph 0403, Retirement [Deductions](#).

A. Prepare and maintain a [Standard Form 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.

B. Maintain adequate control over retirement records and associated monetary balances.

C. Promptly send claims and records. OPM requires all Federal agencies to deliver at least 80 percent of all claims for benefits to OPM within 30 days of the retirement or separation date. The OPM address is:

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

D. Withhold retirement deductions from employees' salaries, make agency contributions, and send these to OPM for deposit. Thrift Savings Plan (TSP) contributions and the employer's match must be forwarded to the TSP. Deductions begin on the day the employee acquires coverage under the retirement system and must be prorated for partial pay periods. FICA shall be withheld and reported in accordance with current guidance from the 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.

0808 LEAVE ACCRUAL

080801. Annual Leave.

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

080802. 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 NAFIs accounting records.

080803. 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. 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.

0809 SEVERANCE AND SEPARATION BENEFITS

[DODI 1015.15](#) specifies that NAFIs shall 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.

0810 PAYROLL DISBURSEMENTS

All payroll disbursements shall 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 which states that *he or she does* not have an account with a financial institution or *providing* some other extenuating circumstance.

0811 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 shall 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. Documentation on pay shall be stored and transferred to the National Personnel Records Center, St. Louis, MO, for 56 years retention in accordance with the National Archives and Records Administration [General Records Schedule 2](#).

0812 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 Office of Management and Budget [\(OMB\) Circular A-123](#), [DODI 1015.15, paragraph 6.7.3](#), [DODI 5010.40](#) *Managers' Internal Control Program Procedures* and [DODI 7600.06](#) *Audit of Nonappropriated Fund Instrumentalities (NAFI) and Related Activities*. All DoD NAF organizations must ensure that these standards are followed for the organization of payroll operations as well as to the methods and procedures adopted for processing and auditing payrolls.