



DEFENSE CONTRACT AUDIT AGENCY
DEPARTMENT OF DEFENSE
8725 JOHN J. KINGMAN ROAD, SUITE 2135
FORT BELVOIR, VA 22060-6219

IN REPLY REFER TO

PAC 730.3.B.03/2012-07

April 24, 2014
14-PAC-005(R)

MEMORANDUM FOR REGIONAL DIRECTORS, DCAA
HEADS OF PRINCIPAL STAFF ELEMENTS, HQ, DCAA

SUBJECT: Audit Guidance on Allowability of Independent Research and Development under January 2012 Change to DFARS 231.205-18(c)(iii)(C)

DFARS now requires certain contractors to report Independent Research and Development (IR&D) information to the Defense Technical Information Center (DTIC) in order to claim the costs as allowable.

Applicability of Reporting Requirement

The DTIC reporting requirement applies to IR&D project costs:

- incurred on or after January 30, 2012;
- allocated to contracts awarded on or after January 30, 2012; and
- incurred at major contractors defined in DFARS 231.205-18(a) whose covered segments allocated a total of \$11 million in IR&D and B&P (Bid & Proposal) cost to covered contracts during the preceding fiscal year.

Contractors should provide only unclassified project data. Auditors at the home office and segment levels should coordinate to consistently identify IR&D/B&P costs allocated to covered contracts and covered segments.

Timing of Required IR&D Reports

Contractors subject to the regulation must:

- input project information to the DTIC database no later than three months after the end of the contractor fiscal year (CFY) in which the contractor initially incurs the associated IR&D;
- annually update information in the database for ongoing projects (no later than three months after the end of the CFY in which the associated IR&D cost is incurred); and
- update the database when the contractor considers the project completed.

SUBJECT: Audit Guidance on Allowability of Independent Research and Development under January 2012 Change to DFARS 231.205-18(c)(iii)(C)

However, in recognition of the confusion indicated by some contractors regarding submittal timeframes, DPAP guidance allows contractors until the end of CFY 2014 to input the CFYs 2012 and 2013 project information (see Enclosure 2).

Approximate IR&D Expenditures in DTIC Database vs. Amounts in Incurred Cost Submissions

Government personnel will use contractors' approximate IR&D expenditures in the DTIC database to get a sense of the scale and importance of the project, but the amounts in the DTIC database are not required to reflect actual expenditures. There is no expectation of reconciliation between the cost information in the database and the actual costs claimed in the incurred submission.

Impact on Forward Pricing, Incurred Cost, and Accounting System Audits

When evaluating forward pricing rates, incurred costs, and accounting systems; audit teams should consider the adequacy of policies and procedures, and the emerging record of contractor compliance with the new DFARS requirement.

- **Forward Pricing** – Audit teams should consider whether a reduction to the forecast based on the contractor's ability to appropriately complete the requirements to input data into the DTIC system. This may occur, for example, if contractor management state they do not intend to comply, or if the contractor did not submit the information, as required, and has not taken action to correct the condition in the future.
- **Incurred Cost** – If the contractor fails to input the IR&D information into the DTIC database, the costs are expressly unallowable; audit teams should question the costs and recommend application of penalties. If the team identifies significant expressly unallowable costs, consider reporting a noncompliance with CAS 405, Accounting for unallowable costs.
- **Accounting System** – Audit teams should consider whether the contractor's failure to have adequate internal controls to ensure compliance with the regulation results in an accounting system deficiency.

Testing Beyond the Reporting Requirement

Auditors should continue to perform other necessary procedures to evaluate IR&D allowability. IR&D costs, even if reported timely to the DTIC, may still be unallowable. Refer to CAM Chapter 7, Section 15.

SUBJECT: Audit Guidance on Allowability of Independent Research and Development under January 2012 Change to DFARS 231.205-18(c)(iii)(C)

Coordination with ACO

DFARS 231.205-18(c) limits allowable IR&D to projects of potential interest to the DoD and assigns responsibility for that determination to the cognizant ACO. ACOs may use the DTIC information, and may require additional support from the contractor, to determine whether a project is of potential interest to the DoD; the audit team should coordinate any errors or inconsistencies in the DTIC data with the ACO.

Additional Sources

- The Director Defense Procurement and Acquisition Policy (DPAP) issued clarifying guidance on the new rule on February 3, 2014 (see Enclosure 2)
- Auditors also can find guidance relating to this regulation at the Frequently Asked Questions (FAQs) on the Defense Innovation Marketplace website at <http://www.defenseinnovationmarketplace.mil/>.

Conclusion

FAO personnel should direct questions to their regional points of contact, and regional personnel should contact Policy Accounting and Cost Principles Division at (703) 767-3250 or by e-mail at DCAA-PAC@dcaa.mil.

/Signed/

Donald J. McKenzie
Assistant Director
Policy and Plans

Enclosures:

1. Frequently Asked Questions
2. DPAP Memorandum dated February 3, 2014

DISTRIBUTION: E

DFARS 231.205-18(c)(iii)(C) IR&D Reporting Requirement Frequently Asked Questions

1. Identifying Major Contractors Required to Comply with DFARS 231.205-18(c)(iii)

Question 1a: Where can I find a more detailed definition of a “major contractor” subject to the requirements in DFARS 231.205-18(c)(iii)?

Answer: DFARS 231.205-18(a) defines contractors subject to DFARS 231.205-18(c)(iii). To summarize, contractors subject to the regulation are those “whose covered segments allocated a total of more than \$11,000,000 in IR&D/B&P costs to covered contracts during the preceding fiscal year.” Covered segments are those that allocated more than \$1.1 million in IR&D/B&P to covered contracts during the preceding fiscal year. Covered contracts include both DoD prime and subcontracts exceeding the simplified acquisition threshold (FAR 2.101), except for fixed-priced contracts and subcontracts without cost incentives.

Question 1b: FAOs and regions report IR&D/B&P expenditures at the major contractors each year. Can DCAA Headquarters distribute that data to assist the FAOs in identifying covered segments?

Answer: FAOs responsible for audits at major contractors provide the data annually, so these FAOs already should have this information. FAOs at the segment and home office (or CAC) level should coordinate to ensure consistent identification of “covered” segments, and appropriate sharing of the annual IR&D and B&P data.

2. Testing Contractor Compliance with DFARS 231.205-18(c)(iii)

Question 2a: When should the audit team begin testing whether contractors submitted the required IR&D project information to the DTIC database?

Answer: Consider testing for compliance after the contractor is required to input IR&D project information as a condition of allowability. Contractors normally should report the required information to the DTIC no later than three months after the end of the CFY in which the contractor incurs the IR&D project costs that are subject to the new regulation. However, projects that generate CFY 2012 and 2013 costs may be input as late as CFY 2014.

Example: A contractor whose fiscal year ends on December 31 reports CFY 2014 IR&D project information no later than March 31, 2015. If the project continues into CFYs 2016 and 2017, the contractor updates the database annually, no later than March 31. If the contractor closes out the project in 2017, the contractor should update the database to indicate the project is complete by March 31, 2018.

DFARS 231.205-18(c)(iii)(C) IR&D Reporting Requirement Frequently Asked Questions

Example: A contractor whose fiscal year ends on December 31 would normally report CFY 2012 IR&D project information before March 31, 2013. However, in accordance with DPAP's memorandum on February 3, 2014 (Enclosure 2), the contractor must input the related project information by the end of CFY 2014 (i.e., December 31, 2014). The contractor updates the database annually in the subsequent years the project remains open, and provides the appropriate input when the project is completed.

We do not expect FAOs to set up a specific assignment for testing compliance, but audit teams should consider including steps in other audits.

Question 2b: Should we supplement reports already issued to include questioned costs because the contractor has not provided the required input to the DTIC?

Answer: Based on the timing for initial compliance, we do not expect FAOs will need to supplement audits already issued. However, FAOs should coordinate with regions on questions about a specific audit report.

Question 2c: Under which assignment does the audit team test whether contractor policies and procedures are adequate to ensure that contractors input IR&D information timely to the DTIC database?

Answer: In addition to accounting system audits, the audit team would document their understanding of contractor policies and procedures related to the IR&D reporting requirement under any audit (e.g., incurred cost, forward pricing) that results in an opinion on the allowability of significant IR&D costs at a major contractor, as defined in DFARS 231.205-18(a). If the audit team selects IR&D cost for testing based on the risk assessment, and the team finds the contractor does not report the IR&D information timely to the DTIC, they should consider whether contractor internal controls are adequate, including policies and procedures. We are revising the risk assessment steps for forward pricing rates and incurred costs to include obtaining an understanding of the contractors' procedures for compliance with its responsibilities under DFARS 231.205-18(c)(iii).

Question 2d: How can the audit team find out more about the instructions and forms for database input, and other information contractors need to comply with the requirement? Will the team be able to test whether the IR&D project data input provided by the contractor is consistent with the contents of the DTIC database?

Answer: The Defense Innovation Marketplace website provides access to the database for registered users and also links to instructions for data input along with frequently asked questions (<http://www.defenseinnovationmarketplace.mil/>). Regions will coordinate with FAOs to provide a process to obtain access to the database and search capabilities, as needed.

DFARS 231.205-18(c)(iii)(C) IR&D Reporting Requirement Frequently Asked Questions

Question 2e: The guidance states that the audit team should coordinate errors and inconsistencies with the ACO, but also states the amounts in the DTIC database, since they are approximate dollars, are not required to reconcile to accounting records. What types of errors or inconsistencies does the guidance contemplate?

Answer: The audit team should test whether the contractor provided the required input to the DTIC database and whether the project description and other identifying information is consistent with IR&D project descriptions in the contractor's supporting documentation in the accounting records. If project descriptions in the DTIC database are not consistent with descriptions in the accounting records, the ACO may make a decision on a project's potential interest to the DoD based on incorrect data. Therefore, the audit team should bring errors or inconsistencies to the attention of the ACO.

Question 2f: Why would the amounts in the DTIC database be different from the costs incurred by the contractor?

Answer: In promulgating the DFARS change, the DoD did not intend to require reporting of actual project costs. The DTIC instructions require the contractor to provide the "approximate dollars to be spent in the Fiscal Year." Therefore, we would not expect the amounts to reconcile with incurred costs.

Question 2g: What steps should the audit team take to test for potential interest to the Government? Is the audit team responsible for determining whether the IR&D project is of potential interest to the DoD?

Answer: See CAM 7-1500 for more information on IR&D audit approaches, including the requirement for potential interest to the DoD. Coordinate with the ACO and request technical assistance when needed.

Question 2h: What were the prior compliance reporting requirements if the new rule is effective January 30, 2012? What historical compliance with DTIC reporting requirements should the audit team evaluate for forward pricing audits?

Answer: IR&D costs incurred prior to January 30, 2012, or allocated to contracts awarded prior to January 30, 2012, are not subject to the mandatory DTIC reporting requirement. There is no historical experience for compliance until after the contractor is required to report the IR&D project data in accordance with the new rule.

3. Expressly Unallowable Cost

Question 3: If the IR&D project cost is unallowable because the contractor failed to submit the required data to the DTIC, is the unallowable cost subject to penalties in accordance with FAR 42.709?

DFARS 231.205-18(c)(iii)(C) IR&D Reporting Requirement Frequently Asked Questions

Answer: Yes, DFARS 231.205-18(c)(iii)(C) is very explicit: “For a contractor’s annual IR&D costs to be allowable, the IR&D projects generating the costs must be reported to the Defense Technical Information Center (DTIC)...” Because there is no uncertainty in this position, the costs are “expressly unallowable” and, therefore, subject to the penalty provision of FAR 42.709-1. Our guidance is consistent with the Frequently Asked Questions on the Defense Innovation Marketplace website (<http://www.defenseinnovationmarketplace.mil/faq.html>).

4. Reporting Audit Results

Question 4: Should the audit team establish dual rates if they question significant IR&D costs related to the DTIC reporting requirement, and the contractor allocates the IR&D costs under audit to contracts subject to DFARS, and others not subject to DFARS?

Answer: The audit team may report dual rates if the auditor questions IR&D cost because the contractor did not report IR&D projects to the DTIC, as required, and the contractor allocates significant IR&D to some contracts subject to, and others not subject to, the DFARS. The audit team should include information in the audit report note on the applicability of significant questioned costs to particular contracts.



OFFICE OF THE UNDER SECRETARY OF DEFENSE
3000 DEFENSE PENTAGON
WASHINGTON, DC 20301-3000

FEB 8 2014

MEMORANDUM FOR DIRECTOR, DEFENSE CONTRACT MANAGEMENT AGENCY
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

SUBJECT: Clarification of Defense Federal Acquisition Regulation Supplement Requirement of Major Contractors to Report Independent Research and Development Projects

The Defense Federal Acquisition Regulation Supplement (DFARS) Final Rule for Independent Research and Development (IR&D) Technical Descriptions added a provision to Contract Cost Principles at DFARS 231.205-18(c)(iii)(C) that became effective January 30, 2012. The rule provides for a major contractor's annual IR&D costs to be allowable only if the contractor reports its IR&D projects to the Defense Technical Information Center (DTIC) via an on-line form, with updates at least annually and upon project completion.

While many contractors have reported project information related to contractor fiscal years (CFY) 2012 and 2013 IR&D projects, others indicated confusion regarding submittal timeframes. Therefore, I am extending the reporting period for CFYs 2012 and 2013 until the end of CFY 2014. I ask that you communicate this to the contractors under your cognizance.

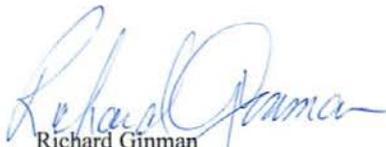
Administrative Contracting Officers (ACOs) should request access to the Defense Innovation Marketplace database using the instructions listed on the website (<http://www.defenseinnovationmarketplace.mil/>), and use the project summaries submitted to the database to determine whether IR&D projects are of potential interest to DoD as required in DFARS 231.205-18(c)(iv).

ACO's should communicate with contractors subject to the reporting requirement to promote compliance and adequate support for the allowability of IR&D costs, as follows:

- Contractors must report projects generating IR&D costs by entering them into the secure portal at the Defense Innovation Marketplace no later than three months after the end of the CFY in which the contractors initially incur the cost. Each project summary generates a Record Number as a unique identifier. First time project submissions will be labeled "New Start".
- For ongoing projects, updated project summaries must be submitted for each CFY as long as the project is open. The update must be submitted no later than three months after the end of each CFY. These project summaries will be labeled "Follow On" in the project status field and will generate a new Record Number when submitted.
- When the contractor considers the project completed, the contractor must submit a final updated project summary and change the project status field to "complete". IR&D costs are unallowable if the contractor does not report or update the related IR&D project information no later than three months after the end of the CFY in which the contractor incurs the costs, and those CFY costs remain unallowable even if the contractor submits the information later.

- Since the input may also support forward pricing estimates for IR&D, contractors should be strongly encouraged to input the data as soon as possible, and update the information as the project progresses.
- Contractors are required to provide IR&D supporting data in addition to the project information reported to DTIC, as needed to support ACO DFARS 231.205-18(c)(iv) determinations or audits of IR&D costs in accordance with applicable laws and regulations.
- It is important to communicate that **there is no expectation of reconciliation between the cost information in the database and the costs claimed in the incurred cost submission**, only that the claimed project was in fact, entered into the database, updated annually, and updated when the project is complete.

Questions may be directed to Mr. Gary Catt, 703-693-7062 or gary.r.catt2.civ@mail.mil.



Richard Ginman
Director, Defense Procurement
and Acquisition Policy

cc:
Commander, United States Special Operations Command
(ATTN: Acquisition Executive)
Commander, United States Transportation Command
(ATTN: Acquisition Executive)
Deputy Assistant Secretary of the Army
(Procurement)
Deputy Assistant Secretary of the Navy
(Acquisition and Procurement)
Deputy Assistant Secretary of the Air Force
(Contracting)
Directors of the Defense Agencies
Directors of the DoD Field Activities