This chapter provides guidance for performing audits of cooperative research consortiums. This guidance is specifically targeted at partnerships, joint ventures, or corporations (referred to in this section as consortiums) formed pursuant to the National Cooperative Research Act. Guidance on other organizational structures chosen by a contractor to carry on its business or to bid on Government contracts is provided in Chapter 37.

This chapter addresses the following topics:

16-1 General
16-2 Accounting Considerations
16-3 Classification of Costs and Audit Considerations

16-1 General

In 1984, Congress passed the National Cooperative Research Act. This act eased antitrust laws to allow companies in the same industry to jointly develop new technology. Under the Act, research and development is usually funded cooperatively to develop base technology for use by member firms individually in proprietary applications. The Act covers research and development activities up to the prototype stage. Cooperative research consortiums are usually formed to explore specific research areas.

16-2 Accounting Considerations

While the terms and conditions of these agreements may suggest they are contracts, they are not the type of contract contemplated under FAR 31.205-18(a) that would preclude the recovery of IR&D costs. R&D costs incurred by a defense contractor pursuant to a cooperative agreement may be considered as allowable IR&D costs if the work performed would have resulted in allowable IR&D costs had there been no cooperative agreement.

Consortium costs will most likely be charged to indirect cost pools, primarily as Manufacturing and Production Engineering (MPE) or IR&D. The audit review of consortium costs must consider the different accounting treatment afforded MPE costs versus IR&D costs.
MPE (FAR 31.205-25) does not cover basic and applied research effort related to new technology, materials, systems, processes, methods, equipment, tools, and techniques. These are all covered by the IR&D/B&P cost principle, FAR 31.205-18. Nor does MPE cover any development effort for manufacturing or production materials, systems, process, methods, equipment, tools and techniques, that are intended for sale. These costs are also covered by the IR&D/B&P cost principle. MPE covers only developing and deploying new or improved methods of producing a product or service when such new or improved technology is to be used in the contractor's own productive facilities.

16-3 Classification of Costs and Audit Considerations

To properly classify consortium costs, the nature and purpose of the projects involved must be determined. Although FAR clearly delineates between IR&D and MPE costs, the technical nature of this work may make it difficult to distinguish between independent research and development and development effort not intended for sale. To assist the auditor in making these decisions, Government technical specialist assistance should be sought. Procedures for identifying and obtaining technical specialist assistance are outlined in Appendix D.

The contractor should be able to provide documentation to support the nature and purpose of consortium projects. The contractor should also provide all legal documents (e.g., partnership agreements, shareholder agreements, certificates of incorporation, technology agreements) which pertain to the creation of the consortium. These documents often contain valuable information regarding the purpose of the consortium as well as information on other accounting issues such as income/loss distribution, payment schedules, and ownership of products or technology developed by the consortium.

When reviewing the nature and purpose of specific projects engaged in by a consortium, the following additional sources of information may prove helpful:

1. contractor interoffice memos discussing the project,
2. articles in company newsletters or journals,
3. slides/charts/minutes from company briefings or conferences,
4. papers or speeches to professional organizations or conferences, and
5. newspaper articles.

In addition to the distinction between MPE costs and IR&D costs, there are other important audit considerations pertaining to consortiums.

1. Costs for consortiums may be charged to an account for trade and professional organizations. Included in these costs may be both basic membership fees and sponsorship fees for specialized research and development programs. The classification and allowability of these sponsorship fees will depend upon the nature and purpose of the research programs and the company's intended use of the resulting technology.
2. An important consideration is the accounting treatment given any income/loss of the consortium. Usually, the consortium agreement provides for distribution of net income/loss to the individual member companies. The applicable portion of any income relating to allowable cost should be credited to the Government in accordance with FAR 31.201-5.

3. There may be significant related party transactions between the consortium and its members. A consortium may hire one or more member companies to provide a variety of services. For example, a member company may provide a consortium with executive search services or legal support. The applicable portion of any payment relating to an allowable cost should be credited to the Government in accordance with FAR 31.201-5.

4. The employees of a member company may be temporarily assigned to the consortium. The consortium may reimburse the company for employees’ salary and relocation expenses. The accounting for the employee’s salary and any reimbursement a member company receives for the loan of its employee should be determined.