DoD Issues White Paper Aimed at IR&D Costs

posted on: Monday, September 21, 2015

On August 26, 2015, the Department of Defense ("DOD") issued a White Paper announcing that, beginning in FY 2017, all defense contractors will be required to notify DOD before undertaking any new Independent Research and Development ("IR&D") projects if contractors would like their IR&D costs to be deemed allowable. Entitled “Enhancing the Effectiveness of Independent Research and Development,” the White Paper explains that both DOD and the Industrial Base need to work together to ensure the department has visibility into “government-reimbursed IR&D efforts.” Specifically, the White Paper states, “[t]o ensure that a two way dialogue occurs between the Department and IR&D performing organizations and to provide for some minimum oversight of IR&D, the department believes that proposed new IR&D efforts should be communicated to appropriate DOD personnel prior to the initiation of these investments and that results from these investments should also be shared with appropriate DOD personnel.”

IR&D costs are governed currently by FAR 31.205-18 and Cost Accounting Standard 420 which allow companies to engage in research and development efforts, independent of any particular contract, with the Government agreeing to reimburse all reasonable, allowable, and allocable IR&D costs. Technology developed under IR&D is considered “developed exclusively at private expense” even though it is reimbursed by the Government as an indirect cost. The United States Court of Appeals for the Federal Circuit clarified that research and development costs not specifically required by a contract may be treated as IR&D under FAR 31.205-18, noting that contractors have “considerable freedom” in the classification of particular costs. ATK Thiokol, Inc. v. United States, 598 F. 3d 1329 (Fed. Cir. 2010). The recent White Paper, however, may signal the beginning of the end of contractors’ full independence.

Notably, however, the recent White Paper is not the Government’s first attempt to require contractors to report IR&D projects. In 2011, DOD issued a proposed rule requiring contractors to report to the Defense Technical Information Center (“DTIC”) IR&D projects generating annual costs of more than $50,000 as a condition for allowability. 76 Fed. Reg. 11414 (March 2, 2011). By the time the final rule was issued in 2012, DOD changed the threshold for reporting to “major contractors” only, i.e., those contractors whose covered segments allocated a total of more than $11 million in IR&D/Bid & Proposal costs. 77 Fed. Reg. 4632 (Jan. 30, 2012) (codified at 48 C.F.R. Part 231). The 2012 rule also only vaguely addressed whether these reports would affect cost allowability. The recent White Paper has no threshold and directly addresses allowability.

According to the White Paper, DOD’s intent is that by FY 2017, “every new IR&D project will be preceded by an engagement with appropriate DOD technical or operational staff to ensure that the department is aware of the goals and plans for the effort and that Industry is informed of related ongoing efforts and future potential opportunities from the Department.” To document this, DOD will require contractors to record the name of the government party with whom, and date when, the technical interchange took place prior to the IR&D project initiation and to provide this information as part of the required IR&D submissions made to the DTIC IR&D electronic portal. Most notably, the White Paper explains that the Defense Contract Management Agency (“DCMA”) and the Defense Contract Auditing Agency (“DCAA”) “will use these DTIC inputs when making allowability determinations for IR&D costs.”
The White Paper leaves open several questions, not the least of which is how exactly DCMA and DCAA will use this information in their allowability determinations. Fortunately, the White Paper directs the Defense Federal Acquisition Regulations Council to draft a proposed DFARS rule and begin the public rulemaking process, which will include an opportunity for public comment. Stay tuned for further updates as this White Paper progresses into a proposed rule.

Copyright © 2015, Sheppard Mullin Richter & Hampton LLP.

Source URL: http://www.natlawreview.com/article/dod-issues-white-paper-aimed-ird-costs