

PV/PI, R&D, and IR&D Categorization and Treatment of Costs



A. DOCUMENT CONTROL

POLICY NUMBER:	
EFFECTIVE DATE:	Click or tap to enter a date.
FUNCTION:	USG COMPLIANCE
POLICY OWNER (TITLE):	SR. DIRECTOR, USG COMPLIANCE
RENEWAL DATE:	Click or tap to enter a date.

B. GENERAL

Summary of the Policy.

This policy defines the proper categorization of PV/PI, R&D and IR&D and the proper accounting treatment of costs.

Purpose of the Policy.

To establish parameters on how to categorize research and development efforts.

When a cost is IR&D, to establish a written record of all IR&D costs in a manner which meets the requirements under the Federal Acquisition Regulation (FAR), the Cost Accounting Standards (CAS), the Truth in Negotiations Act (TINA) and, for defense projects, the Defense Federal Acquisition Regulation Supplement (DFARS) in order to ensure that all IR&D programs are allowable.

To whom is the Policy applicable (specify all that apply):

Geographic area: ☒ Global ☐ US Only ☐ Country Specific:

Covered persons: ☒ Employees ☐ Board members ☐ Non-permanent staff¹ ☐ Other:

Definitions of terms/key words:

Private Venture/Private Investment: Independent company-funded Research & Development that is not charged to contracts or indirect pools. The company bears the cost of these efforts in hopes to expand the business base and recover these costs through the profits of new contracts, or alternatively through product pricing of licenses and royalties.

Research and Development (R&D): Research and Development efforts funded directly through the government through contracts. There is a final cost objective associated with the work.

¹ Non-permanent staff means agency staff, consultants, contractors and any other temporary staff.

Independent Research and Development (IR&D): Company independent efforts for research and development that are generally allowable as indirect costs provided the cost are reasonable and allocable. IR&D is a period cost and is reimbursed by the US Government through G&A. IR&D is not sponsored by or required in the performance of a contract and consists of projects falling within the four following areas: (1) "basic research", (2) "applied research", (3) "development", and (4) "systems and other concept formulation studies", all of which are defined in the FAR. Note: Deferred IR&D is not allowable per FAR 31.205-18(e).

Direct Contract Effort: Effort specifically required by a contract

Major Contractor: As defined by DFARS 231.205-18, any contractor 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. For purposes of calculating the dollar threshold amounts to determine whether a contractor meets the definition of "major contractor," do not include contractor segments allocating less than \$1,100,000 of IR&D/B&P costs to covered contracts during the preceding fiscal year.

Specific Requirement: The contract includes research and development efforts in its scope of work or facts related to the pricing of the contract, such as basis of estimates or technical descriptions includes R&D efforts.

"Generic" IR&D: Refers to the practice of developing a base technology using IR&D effort that has a potential application beyond a single contract. It is that potential application to multiple contracts that precludes the effort from being required in, or sponsored by, a contract absent a specific requirement in a contract.

Parallel Contract Effort: The tailoring, leveraging, or synergizing of development effort to the work of an existing or contemplated contract to enhance performance of that contract.

C. POLICY

Details of the Policy.

When accounting for IR&D costs for US Government (USG) contracts, FAR 31.205.18 Independent Research and Development and Bid and Proposal Costs and DFARS 231.205-18 Independent Research and Development and Bid and Proposal Costs must be read in conjunction with CAS 420.

Determining the Classification of Cost

When planning statements of work (SOW), sites should document the following information to determine whether the effort is contract effort, R&D, IR&D, or PV/PI:

- What is the principle purpose for which the effort is to be undertaken
- What caused the effort to be undertaken
- What is the goal of the effort
- What funds were used for the effort
- What will benefit from the effort (contract or multiple contracts, or future contracts with business base expansion?)

Classification as Direct Contract Effort

Sites should perform an analysis of:

- Terms and conditions of relevant contracts
- Whether relevant contracts funded the R&D effort
- Whether the party undertaking the R&D effort had a reasonable belief that the R&D effort created a reasonable opportunity of future contracts

Contracts should be written so that required and/or excluded effort is both easily identified and unambiguous, and sites should carefully read existing contracts when assessing whether an existing or new R&D project may be classified as an IR&D project.

When there is no specific requirement stated in the contract, R&D effort is not required in the performance of a contract and may be IR&D.

The decision as to whether the cost is R&D or IR&D is often made using the site's best technical and legal judgment after a thorough review of the nature of the effort in question. The initial classification may change over time, and sites should monitor and document if such a change occurs.

How to Charge Effort that is No Longer Specifically Required by a Contract

R&D effort that had been contract effort and is now being independently pursued by the site and is no longer specifically required by a contract may be classified as IR&D. Identifying the continuing R&D effort that previously had been contract effort as IR&D is proper only after the contract that had required the effort is complete. Important to determining when a contract is complete is the type of contract involved and its specific terms. A cost reimbursement contract is complete when contract funds have been exhausted. Conversely, a fixed-price contract is complete only after the deliverables have been accepted. When continuing R&D effort after contract completion, CAES must understand the complete nature of the relevant contract and document the basis for the decision to convert the R&D from contract to IR&D effort.

Classification of Private Venture/Private Investment

Private venture/private investment (PV/PI) costs should be classified as unallowable costs.

Unallowable R&D – Charging PV/PI

IR&D is not to be confused with R&D. Often times, contracts require research and development, or a contract can be for research and development. When an R&D contract runs out of funding, if a contractor continues to work on the contract at its own expense, the work continues as R&D and is considered an unallowable contract cost and can be charged to PV/PI.

Classification of Internal Research and Development

IR&D projects must meet the test for being “of potential interest to the (US) Department of Defense (DoD)” in order for the costs to be allowable to DoD contracts. Such projects include activities that:

- Enable superior performance of future United States weapons systems;
- Reduce acquisition cost and life-cycle costs of military systems;
- Strengthen the defense industrial and technology base of the US;
- Enhance the industrial competitiveness of the US;
- Promote the development of critical technologies defined under 10 U.S.C. 2522;
- Increase the development and promotion of efficient and effective technologies useful for both the private commercial sector and the public sector; or
- Provide efficient and effective technologies for achieving such environmental benefits as improved environmental data gathering, environmental cleanup and restoration, pollution-reduction in manufacturing, environmental conservation, and environmentally safe management of facilities.

R&D effort is IR&D effort unless it is:

- Reimbursed by grant or contract
- Specifically required in the performance of a contract
- A cooperative arrangement is not involved

R&D effort implicitly required by a contract because it is necessary to perform the contract is considered IR&D effort if there are multiple uses or future contracts that may benefit. However, R&D effort expended that benefits a single contract is specifically required by that contract and must be charged as a direct contract effort.

Determining Whether Costs are Required in the Performance of a Contract

Sites should carefully analyze tasks in an IR&D project and tasks called out in contract(s). When there is doubt, sites should document and elevate the issue within the organization to formulate a reasonable and documented decision.

The following checklist should be used to establish whether the effort is IR&D. “Yes” answers indicates that the effort is IR&D:

1. Does the effort meet the definition of IR&D?
2. Is there an absence of:
 - a. Any specific requirement for the R&D effort in the contract’s scope of work;
 - b. Any estimated cost for the R&D effort in the contract’s estimated costs; and
 - c. Other facts that would show that the buyer intended to pay for the R&D effort?
3. At the time the effort is planned, was there a reasonable expectation of multiple future use? (i.e., multiple contracts even if with only one buyer?)

Ensuring the ability to answer “Yes” to the above questions requires careful contract drafting to support decision to classify the work as IR&D. Careful documentation (e.g., delineations of work) regarding the nature of the work, why it is not specifically required by a contract and why a reasonable expectation of multiple use exists; and clear and consistently applied cost accounting practices that specify that this effort is IR&D in the circumstances just described.

When IR&D is present, sites should establish separate work order numbers, project management oversight and approval of IR&D projects and their costs. Effort sponsored by contract funds should be administered separately from effort sponsored by contractor funds. Administrative separation entails separate SOWs, work authorizations, subcontracts, and cost segregation.

Reporting IR&D Cost

DFARS 231.205-18 states that covered major contractors should annually report all IR&D projects through the Defense Technical Information Center (DTIC) through an online reporting tool. Failure to properly and timely report on IR&D projects will render the associated costs unallowable, and potentially subject CAES to penalties for claiming expressly unallowable costs. Sites should compile IR&D projects and submit them to XXXXX (job title) to be uploaded to DTIC no later than March XX of each year.

DTIC Reporting

1. The IR&D projects generating the costs must be reported to the Defense Technical Information Center (DTIC) using the DTIC's on-line input form and instructions at <http://www.defenseinnovationmarketplace.mil>;
2. The inputs must be updated at least annually and when the project is completed; and
3. Copies of the input and updates must be made available for review by the cognizant administrative contracting officer (ACO) and the cognizant Defense Contract Audit Agency auditor to support the allowability of the costs

When IR&D Efforts Bear a Relationship to a Contract

On some occasions, an IR&D project will eventually bear a relationship to contract-required work. Once that relationship exists, sites should determine how to classify any effort that will continue under the project. When this situation exists, the terms "generic IR&D" or "parallel IR&D efforts" are often used to signify that at least some identifiable R&D effort is not required by a contract, and can thus be classified as IR&D.

Generic IR&D

IR&D projects with sufficiently general applicability can be described as "generic". It is that potential application to multiple contracts that precludes the effort from being required in a contract absent a specific requirement in a contract.

Where a market fails to materialize beyond a single contract, the total effort is not required in the performance of that contract so long as CAES has a reasonable expectation of multiple use, regardless of how many years it takes for another contract to materialize.

Sites should expect that DCAA will request support for future potential applications by reviewing planning, budgeting, and project description information. A reasonable basis for potential applications, such as market, strategic, or through business plans should be documented and

available for audit. When this type of support exists for potential application beyond a single contract, the R&D effort is generic, and therefore an IR&D effort. However, the continuation of generic IR&D should not be based on the award or progress of a particular contract.

IR&D Timing – Parallel IR&D

Parallel IR&D efforts occur when a generic IR&D project continues after specific applications of efforts are developed as direct contract costs. Government contract regulations do not prohibit parallel contract effort. Sites should have the following internal controls in place to mitigate risk related to parallel contract effort and IR&D:

- There should be no double recovery of costs
- The specifications, tasks, BOEs, or project statements should articulate clearly the distinctions between the contract (direct) an IR&D (indirect) effort. This requires the use of consistent terminology in all relevant documents and will avoid later allegations of improper classification undertaken to avoid cost recovery limitations as either direct contract cost or as indirect costs.
- Undertake IR&D work, if possible, without conditioning it to start upon receipt of a given contract. This does not preclude tailoring authorized IR&D project work to increase the technical synergy between it and the related work required in performance of the contract.

When the Purpose of Effort Changes During Performance of a Contract

The primary purpose of an effort determines its proper classification. Sites should charge its costs in a manner that is consistent with how costs are charged for other types of effort in similar circumstances. Costs must be accumulated in accordance with established cost accounting practices. Thus, if the effort in question would result in indirect costs in similar circumstances, that cost may not be accumulated directly into the cost of an R&D project. If the type of effort being performed changes during the performance of a contract, sites can change the classification of cost going forward, but all cost incurred should remain assigned to their cost objectives, with the exception of reclassifying them as PV/PI.

How the Effort of an R&D Task that is Partially Sponsored by a Contract Should be Classified

A contract may partially “sponsor” R&D effort even if no generic IR&D exists already. CAES and a customer may identify a subject for R&D and choose to split the effort between the contract and contractor-funded work. Contract sponsorship of a portion of an R&D project does not make the entire project ineligible as IR&D. So long as the remaining portion of the work also is not sponsored or required by the terms of the contract, the site may treat the work as IR&D. If the remaining portion of the work is sponsored or required by the terms of the contract, CAES must charge that portion of the effort as unallowable to Private Venture/Private Investment. When these divisions of R&D effort are made, their boundaries must be defined clearly both to CAES personnel and to the government in its contractual and IR&D project approval capacities.

How the Effort for a Contract Requirement Involving Efforts Already Being Performed Under an IR&D Project Should be Classified

If it appears from a request for proposal (RFP) that a proposed contract will require the performance of certain R&D effort, which CAES is presently performing under an IR&D project, the site has three options:

1. The site may leave the overlapping effort within the scope of the IR&D project and attempt to convince the buyer to revise the proposed contract SOW so as to specifically exclude from the proposed contract the technical effort the contractor contemplates completing under the IR&D project.
2. The site may continue to identify all overlapping efforts as IR&D until the date of contract award. In some instances, the site may need to amend the contract proposal to exclude the "overlapping" work performed as IR&D prior to the estimated award date. The site then should propose contract costs only to perform the remaining overlapping work not already performed as IR&D. The site should update the cost charging as necessary if the actual contract award date varies from the estimate. Finally, the site should discontinue the IR&D effort after the award date and leave all IR&D effort as recorded prior to that date.
3. The site may redefine the scope of the IR&D project in question to exclude tasks included in the contract SOW and then identify the effort of the tasks included in SOW as contract effort.

Pre-Contract Costs

In certain circumstances, sites will perform effort prior to the award of a contract that relates to the subsequently executed contract. To the extent that this effort is expressly required by the contract or is something exclusively caused by, or benefitting, the contract, the effort is contract effort and not IR&D.

Accounting Treatment

- A. The basic unit for the identification and accumulation of IR&D is the individual IR&D project.
- B. IR&D project costs should consist of all allowable costs, except business unit general and administrative expenses.
- C. IR&D cost shall be allocated as part of the G&A pool, therefore allocated to final cost objectives as a G&A cost.

Internal Controls

To ensure recovery of R&D costs, sites must:

- Plan and then document the reasons and circumstances for undertaking an effort
- Read and thoroughly understand the relevant contracts
- Ensure consistency of documentation between contract language, documents supporting contract efforts (BOEs), contract pricing/costing documents, contract technical descriptions and similar language, and documents supporting indirect efforts

D. Other Related Documents

Name of document <i>(include hyperlinks)</i> :	Document ID Number

E. VERSION HISTORY

Version #	Description of change	Effective date:
		Click or tap to enter a date.
		Click or tap to enter a date.
		Click or tap to enter a date.
		Click or tap to enter a date.
		Click or tap to enter a date.

BREACHES OF THIS POLICY:

Compliance with this Policy is mandatory in all cases. Any breaches of this Policy will result in disciplinary action, up to and including termination of employment. Employees must report any actual or suspected breach of this Policy. Reports can be made via your line manager or the CAES Helpline.