

Research and Development Financing Arrangements

Research and development financing arrangement is an off-balance sheet form of financing. A sponsoring firm that wants to hide its research and development costs and liabilities creates a partnership and assumes general interest in the partnership. It obtains limited partners who contribute cash for their limited partnership interests. These limited partners are usually officers or directors of the firm.

The sponsoring firm then conducts research and development for the partnership for a fee. This fee usually just covers the research and development costs the sponsoring firm incurs. Furthermore, the partnership is usually structured in such a way that the sponsoring firm reaps most of the benefits that result from the research and development.

A sponsoring firm that engages in the above practice effectively obtains its research and development without having to recognize a liability.

FASB is aware of this technique, and it has ruled when these transactions should be recognized as liabilities and when they should not. However, these rules are open to interpretation. And some firms skirt the rules. Any research and development financing arrangement should be studied more closely.