

March 28, 2007

Ms. Elizabeth Hickey  
Director of Technical Activities  
International Accounting Standards Board  
30 Cannon Street, London EC4M 6XH  
United Kingdom

Dear Elizabeth,

**RE: The accounting for Government Grants received from the Office of the  
Chief Scientist in Israel according to IFRS**

**A. Background**

“The Office of the Chief Scientist” (hereafter – “the OCS”), an institute of the Israeli Government, provides Israeli entities with grants for research and development efforts (hereafter – “the OCS Support Programs”). Under the OCS Support Programs, royalties of 3%-5% are payable on revenues derived from products and services developed from a project so funded, up to 100% (in various cases, more than 100%) of the amount of the grant received (dollar linked) with the addition of annual interest at a rate based on LIBOR.

In the case that a project that was partly financed as above does not generate income, there is no obligation to pay any such royalties.

**B. Current accounting treatment by Israeli entities**

**1. Current accounting treatment according to Israeli practice**

In the era before the decision to adopt IFRS in Israel, Israeli companies used to adopt the accounting treatment in US GAAP, in the absence of an Israeli standard. Therefore the accounting for research and development costs and the related grants is based on US practice.

According to this practice research and development costs are expensed as incurred, i.e. there is no capitalization of development costs, except for costs of developing software which are capitalized according to the terms defined in SFAS 86. The grants received under OCS Support Programs, are recorded as income at the time the grants are received or receivable as an offset to the related research and development expenses.

Royalties paid or payable are recorded as part of cost of sales when revenues from the products developed from a project so funded are recognized.

## **2. Accounting treatment by Israeli companies reporting to the Securities and Exchange Commission<sup>\*</sup>**

The amounts of grants received under OCS Support Programs, are usually recorded as income at the time the grants are received or receivable, since, at the said time, successful development of the related project is not probable and therefore it is not probable that these amounts will be returned.

The research and development grants are presented in the income statement as an offset to related research and development expenses. If material, the amounts of grants are presented separately on the face of the statement. Royalties paid or payable are expensed and are classified as part of cost of sales.

If it is probable at the date of receipt that the entity will have to repay any amount of the grants received, those amounts are recorded as a liability as distinct from being recorded as income.

### **C. The Accounting Issue under IFRS**

Several International Financial Reporting Standards might be relevant for the accounting under IFRS regarding the abovementioned grants: IAS 20 - as forgivable loans, IAS 37 - as contingent liability or IAS 39 - as financial liability with contingent settlement provisions.

We would greatly appreciate learning your view regarding the accounting for the abovementioned grants under IFRS, initially and subsequently.

Sincerely,

Dov Sapir, CPA, Chairman

Israel Accounting Standard Board

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<sup>\*</sup> Based on International Financial Reporting and Disclosure Issues in the Division of Corporation Finance - *November 1, 2004* - APPENDIX A — COUNTRY SPECIFIC ISSUES – issued by the United States Securities and Exchange Commission (SEC).