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Eli Lilly and Company  
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**Date:** August 30, 2002

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Re: Proposed Interpretation of ARB No. 51

Ms. Suzanne Bielstein  
Director of Major Projects and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

**Letter of Comment No:** 69  
**File Reference:** 1082-200  
**Date Received:** 08/30/02

Subject: File Reference No. 1082-200

Dear Ms. Bielstein:

Eli Lilly and Company appreciates the opportunity to respond to the Exposure Draft (ED), Proposed Interpretation of ARB No. 51 – *Consolidation of Certain Special-Purposes Entities* (the Interpretation). We support the Board's overall effort to address the issues related to accounting for special-purposes entities (SPEs) and agree with the need for revised guidance on consolidation of SPEs. Based on our review of the Interpretation, we have the following comments and concerns:

Substantive Operating Entities

We support the Board's inclusion of paragraph 8.c in the Interpretation even though we understand that concern has been expressed about this paragraph because of the potential for unintended consequences. We agree with the Board that it makes sense to include this paragraph because otherwise you could have two different and unrelated entities consolidating the same assets and liabilities. We also recognize that it is practically impossible to have an Interpretation that would address every possible scenario. One of the goals of this ED is to address SPEs that are not consolidated by anyone. We believe this goal has been accomplished with the current ED.

Determining the Primary Beneficiary

We support the Board's concept of a primary beneficiary but believe that certain guidelines outlined in the ED may be very difficult and complicated to implement. Quite often, an SPE involves numerous parties that have relationships with the SPE that are considered variable interests. Applying expected values to potential losses, especially in complicated arrangements, will be very difficult. Considerable judgment would be

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required by the parties involved and they may not all reach the same conclusion. Probabilities are highly subjective and vary significantly over time. As a result two or more parties may perform an analysis and come to different conclusions regarding who the primary beneficiary is resulting in the possibility that more than one party or nobody consolidates the SPE. Performing an analysis based on expected losses instead of applying expected values to potential losses would simplify the analysis and make it more operational resulting in more consistent application of the Interpretation.

#### Analysis of Variable Interests

The current Interpretation requires an assessment of the variable interests each reporting period which could result in the primary beneficiary shifting during the transaction with one party potentially consolidating the SPE and then deconsolidating it at a later date. The act of consolidating and deconsolidating would be very difficult and quite complicated requiring a significant amount of effort. It seems that this accounting should be simplified. In addition, the act of consolidating and deconsolidating would make the comparability of financial statements between periods difficult and confusing for investors. When consolidation does take place by a primary beneficiary, we recommend that historical cost be used instead of fair value unless historical value cannot be obtained.

For the assessment of variable interests each reporting period, we strongly support the inclusion of footnote 5 to paragraph 14. An entity should not be required to take extraordinary measures in an attempt to gather data from other entities to make the consolidation assessment. Although we strongly support this footnote, we would suggest modifying the language in the footnote to state that “an entity is not required to take measures outside of its normal course of business to find out information about the actions of other unrelated parties that might cause the entity to become the primary beneficiary or to cease to be the primary beneficiary.” We believe this language further clarifies the expectations of an entity that has a variable interest in an SPE.

#### Consolidation of the SPE by a Primary Beneficiary

We believe that a primary beneficiary should only consolidate an SPE when it holds a majority of the variable interests, not just a significant portion of the variable interests. We find it difficult to understand why this requirement would not be aligned with an analysis based on voting interests where consolidation is required based on holding a majority of the voting equity. A shareholder that holds a minority voting interest is not required to consolidate the entity and does not perform an analysis to determine if it holds a significantly greater share of the voting interests than other shareholders. We recommend limiting consolidation to situations where a party holds a majority of the variable interests.

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## Analysis of an SPE

Due to the complicated nature of the Interpretation, we recommend including actual examples of how to apply the Interpretation. These examples should include the identification of variable interests and the comparison of them to determine who the primary beneficiary is.

Also, since the release of the Interpretation, several groups have created flowcharts to be used in the analysis of an SPE to determine which entity should consolidate the SPE. We have found these flowcharts to be very helpful and would recommend including one in the final Interpretation.

## Impact on Accounting for "Virtual" Corporate Joint Ventures

We are concerned with the impact the Interpretation might have on the accounting for "virtual" corporate joint ventures that are owned 50/50 by the joint venture partners and have no employees because all needed services are provided under contract with the partners (making them an SPE under paragraph 7.a). It is not inconceivable that many of these 50/50 joint ventures operate at losses or near break-even because they provide services or products at cost to the joint venture partners. It would also not be unusual for these joint ventures to be funded on an as needed basis.

As a consequence, it is quite possible that the equity investments of both joint venture partners would fail paragraph 9.b., as the current funding would not be sufficient to fund future operations. (We note that paragraph 10 states that an equity investment that fails to meet one or more of the conditions in paragraph 9 is to be considered a variable interest.) This would result in a requirement for the joint venture partners to assess the need for consolidation based on variable interests rather than voting interests as they have in the past. Confusion is likely in many situations where all rights and responsibilities are evenly divided, yet paragraph 16 seems intended to force one party to consolidate through its statement that "an SPE can have only one primary beneficiary." It seems that this could result in some surprising and unintended consequences as joint ventures that are jointly operated and controlled may now end up being consolidated by one of the partners, despite the fact that they cannot make any operating decisions without the concurrence of the other partner.

Currently, EITF 96-16 would preclude consolidation by an owner that does not have control. However, it appears that the Board would no longer have EITF 96-16 apply in a situation like this as footnote 2 to paragraph 3 states that SPEs are scoped out of the Interpretation only if "the shareholders as a group have the power to control the enterprise and the equity investment meets the other requirements of this Interpretation." In this example, the shareholders as a group would have the power to control the enterprise, but the equity investments would not meet the requirement in 9.b.

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Effective Date

Given the broad implications of this Interpretation and the expectation that the final Interpretation will be issued sometime in the fourth quarter of this year, we believe it will be very difficult for companies to adopt this guidance as of the beginning of the fiscal period beginning April 1, 2003. Companies already have other standards and guidance that must be implemented between now and early next year. We believe that the Board should delay the effective date to the fourth quarter of 2003.

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We appreciate the opportunity to express our views and concerns regarding the Proposed Interpretation of ARB No. 51. If you would like to discuss our response further, please feel free to contact me at (317) 276-2024 or by e-mail at Hanish\_Arnold\_C@Lilly.com.

Sincerely,

Arnold C. Hanish  
Executive Director, Finance  
and Chief Accounting Officer