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July 1, 2002

Letter of Comment No: 13
File Reference: 1100-163
Date Received: 7/1/02

Major Project & Technical Director
File Reference 1100-163
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed Statement of Financial Accounting Standards – *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*

Dear Director:

Eli Lilly and Company appreciates the opportunity to respond to the Exposure Draft, Proposed Statement of Financial Accounting Standards (SFAS) – *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (referred to as “Proposed Statement”).

We fully support the Board’s ongoing effort to improve the understanding of SFAS 133 and provide consistency in the financial reporting of derivative instruments and other financial contracts. The incorporation of certain Statement 133 Implementation Issues addressed by the Derivatives Implementation Group (DIG) into SFAS 133 will add clarity to the current statement. We continue to look to the DIG for guidance in applying SFAS 133, particularly in the current environment of complex structured transactions. We do not disagree with any of the proposed changes to SFAS 133, and would support any endeavor by the Board in the future to identify and resolve issues regarding the interpretation of this complex statement.

The proposed changes to the definition of a derivative in paragraph 6(b) of SFAS 133 should result in more consistency in the reporting of financial contracts with similar characteristics. Due to the “decision-tree” approach to the definition, we would recommend a flowchart presentation of the definition (similar to pages 240-241 of the current statement). Within the flowchart, financial contracts that do not meet the definition of a derivative in paragraph 6 (and are not exempt from the scope of SFAS 133 per paragraphs 10-11) should then be referenced to the definition of an embedded derivative in paragraph 12.

With respect to the “normal purchases and normal sales” description in paragraph 10, we believe the use of specific examples will result in improved comprehension of the

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definition. Most of the proposed changes to the definition were addressed in Statement 133 Implementation Issues and incorporated into paragraph 10. Similarly, we would

recommend that other significant issues addressed by the DIG be incorporated into SFAS 133. For instance, the much-publicized Statement 133 Implementation Issue G20 - *Cash Flow Hedges: Assessing and Measuring the Effectiveness of a Purchased Option Used in a Cash Flow Hedge*, significantly changed the approach entities can take to assess the effectiveness of purchased options. We recognize the proposed modification to paragraph 30(d) to "allow" the assessment of effectiveness and measurement of ineffectiveness to be based on the total change in an options value. In addition, we believe FAS 133 should be amended to provide the criteria provided in Issue G20 for perfect effectiveness in a hedging relationship that utilizes an option, similar to the criteria provided in paragraph 65 related to forward contracts and paragraph 68 related to interest rate swaps.

We appreciate the opportunity to express our view and concerns in regards to this proposed statement. If you have any questions regarding our response or would like to discuss our comments, please feel free to call me at (317) 276-2024.

Sincerely,

ELI LILLY AND COMPANY

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