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Date: September 3, 2008

Mr. Russell G. Golden Technical Director Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 127

Re: File Reference No. 1590-100 Proposed Statement of Financial Accounting Standards, Accounting for Hedging Activities an amendment of FASB Statement No. 133

Dear Mr. Golden:

Eli Lilly and Company appreciates the opportunity to comment on the Proposed Statement of Financial Accounting Standards, Accounting for Hedging Activities an amendment of FASB Statement No. 133. Our response includes a summary of our overall concerns and our reply to certain issues requested by the Board.

While we support the changes related to simplifying the evaluation of the hedge effectiveness from "highly" to "reasonably" effective by using qualitative factors only and the elimination of ongoing effectiveness testing, we oppose the prohibition on bifurcation-by-risks for both late hedges and pre-issuance hedges and the elimination of the "shortcut" and "matched terms" method because they produce accounting results that are inconsistent with our risk management strategy at Eli Lilly and Company.

Below are responses to specific issues addressed by the Board in the proposed Statement.

Issue 1: For the reasons stated in paragraph A16 of this proposed Statement, the Board decided to eliminate (with two exceptions) the ability of an entity to designate individual risks as the hedged risk in a fair value or cash flow hedge. As a result of that change, the financial statements would reflect information about the risks in the hedged item or transaction that an entity both chooses to manage and not to manage as part of a particular hedging relationship. Do you believe that the proposed Statement would improve or impair the usefulness of financial statements by eliminating the ability of an entity to designate individual risks and requiring the reporting of the risks inherent in the hedged item or transaction?

The elimination of the bifurcate-by-risk approach for financial instrument hedges would create significant volatility and discourage late hedges even when they create economic value. This would force entities to recognize changes in extremely hard to manage risks such as their own credit risk which most entities do not choose to hedge. We believe this change only affects companies that choose to hedge and would create inconsistencies in financial reporting. As such the proposed Statement will not satisfy one of the objectives of the Board as stated in the proposed Statement, which is to "improve the financial reporting of hedging activities to make the accounting model and associated disclosures more useful and easier to understand for users of financial statements". Furthermore due to legitimate concerns such as insider information, the marketplace does not offer an effective hedging instrument for a company's own creditworthiness.

To illustrate the issue, we have historically used interest rate swaps to protect our income statement against fluctuations in interest rates, primarily to reduce our exposure to changes in LIBOR. While our hedging

strategy has proven to be "highly" effective in reducing our exposure to interest rate risk and we have not seen any material impact on our earnings, we are concerned that the application of changes in our own credit rating would cause a significant and unmanageable amount of volatility to flow through our earnings. Increased volatility would result from an improved credit rating. There is a negative correlation between the value of derivatives and a company's credit rating. Therefore while an improvement in a company's credit rating is regarded as "favorable" by our investors, the mark-to-market effect on our earnings is regarded as "unfavorable" because it reduces earnings. The volatility in our earnings would suggest increased exposure, when the hedge was not designated for all risks. Therefore, we do not agree that entities should not be allowed to bifurcate risk for designated hedging (i.e., choose to hedge only certain risks).

Issue 2: For the reasons stated in paragraph A18-A20, the Board decided to continue to permit an entity the ability to designate the following individual risks the hedged risk in a fair value or cash flow hedge: (a) interest rate risk related to its own issued debt (that is, its liability for funds borrowed), if hedged at inception, and (b) foreign currency exchange rate. For those two exceptions, the financial statements would not reflect information about the risks that an entity chooses not to manage as part of a particular hedging relationship. Do you believe the Board should continue to permit an entity to designate those individual risks as a hedged risk?

Although we agree that entities should be allowed to continue to designate the individual risk for interest rate risk related to its own issued debt at inception and foreign currency exchange rate, we have concerns about prohibiting hedging of interest rate risk after the inception of the debt. We have historically entered into swaps after the issuance of debt in response to changes in the interest rate environment, changes in our balance sheet profile, or market conditions and have been successful in achieving high effectiveness. We do not see the relevance in the Board's view in paragraph A18 of the proposed Statement where it distinguishes between 1) synthetically created variable-rate or fixed-rate debt when hedging debt at inception, and 2) transforming fair value risk to cash flow risk or vice versa for asset/liability management purposes or risk management purposes or an entity taking a position on the future movement of interest rates when entering into late hedges. We believe in both scenarios an entity is attempting to achieve the same results, whether the need arises at inception of the debt or at a later time. We believe entities have historically been successful in achieving high effectiveness in late hedging under the current FASB Statement No. 133 rules and should continue to be allowed to enter into late hedges provided high effectiveness can be supported.

Issue 3: This proposed Statement would eliminate the shortcut method and critical terms matching. Therefore, an entity would no longer have the ability upon compliance with strict criteria to assume a hedging relationship is highly effective and recognize no ineffectiveness in earnings during the term of the hedge. As a result, when accounting for the hedging relationship, an entity would be required, in all cases, to independently determine the changes in fair value of the hedged item for fair value hedges and the present value of the cumulative change in expected future cash flows on the hedged transaction. Do you foresee any significant operational concerns or constraints in calculating ineffectiveness for fair value hedging relationships and cash flow hedging relationships? Do you believe that the proposed statement would improve or impair the usefulness of financial statements by eliminating the shortcut method and critical terms matching, which would eliminate the ability of an entity to assume a hedging relationship is highly effective and to recognize no ineffectiveness in earnings?

Although the proposed elimination of the shortcut method and critical terms matching would eliminate some complexities in certain hedging strategies, particularly when hypothetical derivatives are used, for certain perfectly-matched hedges (i.e., fair value hedge of interest rate risk at inception of the debt), the difficulties and time involved in determining the fair value of both the hedging instrument and the hedged item would outweigh any potential improvements to the financial statements. We clearly do not foresee how this change would materially change the usefulness of the financial statements and do not believe this supports the Boards

objective to simplify accounting for hedging activities. We believe that a compromise could be reached whereby certain perfectly-matched hedges could continue the use of the shortcut method.

Issue 4: The proposed Statement would modify the effectiveness threshold necessary for applying hedge accounting from highly effective to reasonably effective at offsetting changes in fair value or variability in cash flows. Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?

Under the proposed Statement, we do not believe there is a clear understanding of the reasonably effective requirements, and believe additional guidance should be provided to assist entities in complying with this judgmental criteria. Current guidance in FASB Statement No. 133 provides for a practical application of the "highly effective" criteria which is a range of 80-125%. We agree that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate because it will allow increased hedging opportunities for entities. However, unless there is additional practical guidance included in the proposed Statement, we believe this change will create major practice issues rather than resolve any current practice issues and this does not achieve one of the objectives of the Board of resolving major practice issues.

In addition to the above issues, we believe the proposed Statement will provide information to investors without justifying the related costs in a period when we should be moving toward convergence with IFRS. We believe that U.S. public companies will adopt IFRS in the near future, and therefore the elimination of the shortcut method and "critical terms match" which are consistent with IAS 39 will impose a significant cost for companies when the switch happens with no meaningful benefit. We recognize that fair value measurement for financial instruments is an essential tool in resolving major practices issues related to hedge accounting. However, given the foreseeable adoption of IFRS by US corporations, we believe the Board should revise the proposed amendment to achieve convergence toward IAS 39 or delay this project until the adoption of IAS 39.

We appreciate the opportunity to comment on 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