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**Date:** March 1, 2011

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Financial Accounting Standards Board  
401 Merritt 7, PO Box 5116  
Norwalk, CT 06856-5116  
United States

**Re: Discussion Paper – Effective Dates and Transition Methods (October 19, 2010)  
File Reference No. 1890-100**

Dear Technical Director:

Eli Lilly and Company (“Lilly”) appreciates the opportunity to comment to the Financial Accounting Standards Board (“Board”) on the Discussion Paper (“DP”) on Effective Dates and Transition Methods. Lilly is a large, multinational pharmaceutical company, with presence in over 60 country jurisdictions, and creates and delivers innovative medicines that enable people to live longer, healthier, and more active lives.

Out of seven projects that are subject of this DP, the ones that will likely have more impact on Lilly are revenue recognition, leases, financial instruments and financial statement (“F/S”) presentation. Although the F/S presentation exposure draft has not been issued, based on the staff draft issued, we believe it will be the most challenging from an IT systems perspective. The critical success factors for implementation include IT changes and the resources needed to evaluate the new standards and train all the stakeholders.

Based on our assessment of the projects, the IT changes for both ERP and ancillary systems will take the longest lead time to implement. Most companies that have major ERP systems such as SAP use release schedules as a mechanism to implement the changes in a systematic fashion. For example at Lilly, SAP has two release schedules per year and the scope for each release is typically identified 2-3 years in advance. Companies will need time to absorb and interpret the changes at a granular level once the final standards are issued so that IT solutions can be identified and incorporated as part of the release schedules. Companies also need to factor additional time for third party ancillary IT systems that interface to their ERP system, such as for financial instruments or for leases. IT changes are only a component of the overall transition. In addition, companies should not underestimate the time that it will take to rollout the training to all the groups impacted including all of the overseas affiliates.

The number of changes brought by the new standards is unprecedented. Each company will be greatly impacted differently and the transition will require careful planning, evaluation and implementation, overlaid by proper internal controls. The extent of the changes and impact will vary greatly by company, depending on their structure, resources, and the specific standards. For example, a company may have limited resources, have multiple instances of various ERP systems or different systems, and affiliates in multitude of countries, compared to other companies that may not have as complex of an environment.

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We want to embed the changes within our core systems as opposed to the way numerous other companies have chosen to adopt via spreadsheets. We believe from an overall control perspective, it will be more effective and efficient to have the changes embedded at the transaction level. As a result, we ask the Board to provide some flexibility in giving companies a choice of adopting a single date or a sequential approach, provided that the effective date is within the designated timeframe. We acknowledge the concerns raised by some of the lack of comparability between companies, but think that those concerns can be addressed with the appropriate disclosures in the financial statements. Given the above factors for conversion and if the final standards are issued by the end of 2011, we ask the Board to consider an effective date of no earlier than January 1, 2015. In that scenario, it would give companies only one year to prepare for the transition before having to capture the first comparative period, e.g. January 1, 2013.

The other consideration is determining whether to apply a retrospective or prospective method. Most of the convergence projects require some degree of retrospective application, which would mean three years of financial data and, for public companies, the five year selected financial data table in Form 10-K. In addition to having IT systems ready to capture the information, the financial data (except for the 5-year supplemental data) would have to be audited for each of those periods. Limiting retrospective application to the immediately preceding year would be a meaningful compromise to help companies during this unprecedented transition, while still providing beneficial information to the users of financial statements. The limited retrospective application would mean one year of historical comparative information, similar to the existing requirements under IFRS. Furthermore, if the FASB allowed a limited retrospective approach and aligned the effective dates with the IASB, companies could roll out the changes at the same time, that is, conforming the comparative periods and having the same opening balance sheet date. Taking this approach would also help companies in the future, should the SEC mandate International Financial Reporting Standards ("IFRS") for U.S. listed companies.

While we understand that the Board is seeking input on selecting a specific transition method, it is difficult to decide given that the standards are not yet final, among other factors. If we had to choose, our preference would be to lean towards a single date approach to gain efficiencies from an IT and training perspective. There may also be merit in considering a hybrid approach, whereby a group of standards would have one effective date, and some of the more challenging standards could be delayed such as the F/S presentation project. We refer to our response in question 5 for the pros and cons of these approaches. In stressing that each company has unique circumstances in how they will be impacted, one could easily argue for either of the approaches. If there was one new standard to implement, the Board could follow historical transition methods. What makes this situation unique are the number of standards being proposed and the breadth and scope of the changes. We encourage the Board to consider providing flexibility with an outside date and allow early adoption for those that can.

Our response to the specific questions in the DP is included in the attached Appendix.

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We appreciate the opportunity to express our views and concerns regarding the Discussion Paper. If you have any questions regarding our response, or would like to discuss our comments further, please call me at (317) 276-2024.

Sincerely,

S/Arnold Hanish  
Vice President, Finance,  
and Chief Accounting Officer

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## APPENDIX

### QUESTION 1:

Please describe the entity (or the individual) responding to this Discussion Paper.

For example:

- a. Please indicate whether you are primarily a preparer of financial statements, an auditor, or an investor, creditor, or other user of financial statements (such as a regulator). Please also indicate whether you primarily prepare, use, or audit financial information prepared in accordance with U.S. GAAP, IFRSs, or both.
- b. If you are a preparer of financial statements, please describe your primary business or businesses, their size (in terms of the numbers of employees or other relevant metric), and whether you have securities registered on a securities exchange.
- c. If you are an auditor, please indicate the size of your firm and whether your practice focuses primarily on public companies, private entities, or both.
- d. If you are an investor, creditor, or other user of financial statements, please describe your job function (buy side/sell side/regulator/credit analyst/lending officer), your investment perspective (long, long/short, equity, or fixed income), and the industries or sectors you specialize in, if any.
- e. Please describe the degree to which each of the proposed new standards will likely affect you and the factors driving that effect (for example, preparers of financial statements might explain the frequency or materiality of the transactions to their business and investors might explain the significance of the transactions to the particular industries or sectors they follow).

Response:

- a. We are a preparer of financial statements and prepare in accordance with U.S. GAAP.
- b. Lilly is a large, multinational public pharmaceutical company, with presence in over 60 country jurisdictions. Annual revenue is \$23 billion with over 38,000 employees.
- e. We refer to our comments throughout the letter for the degree to which each of the proposed new standards will likely impact our company.

### QUESTION 2:

Focusing only on those proposals that have been published as Exposure Drafts (accounting for financial instruments, other comprehensive income, revenue recognition, and leases):

- a. How much time will you need to learn about each proposal, appropriately train personnel, plan for, and implement or otherwise adapt to each the new standard?
- b. What are the types of costs you expect to incur in planning for and adapting to the new requirements and what are the primary drivers of those costs? What is the relative significance of each cost component?

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**Response:**

While we evaluated and commented on the proposals as they were issued, there is still a lot of work to be done before the new standards can be implemented. The amount of time needed to learn and implement each standard will depend on the extent of changes for a company as well as any further changes before the final standards are issued. Once the standards are finalized, companies will need to evaluate at a more granular level.

We believe IT changes will take the longest lead time, as discussed in further detail in question 5. Part of rolling out the standards to affiliates or other groups within a company is two-fold: the accounting changes and the mechanism to record or report the changes (e.g. IT systems). If the SEC insists on 3 years of comparative data, we ask the Boards to consider an effective date no earlier than January 1, 2015.

Out of the three major exposure drafts issued (financial instruments, revenue recognition and leases), leases and revenue recognition will have a pervasive impact given their global footprint. We have thousands of leases globally in over 60 countries that range from real estate, equipment, and car leases. All the contracts would have to be reviewed and accounted for under the new guidance. Revenue recognition would be equally challenging given the need to adjust for credit risk at the point of sale.

While the exposure draft has not been issued for financial statement presentation, based on the published staff draft, we believe F/S would be the most complex out of all convergence projects to implement due to the required ERP system changes needed such as the rollforwards of all significant balance sheet accounts and the direct method of cash flows. Given the lag in the timeline for this project compared to the others and its broad scope, a longer lead time may be needed to implement this standard, for example, 5 years from the time the final standard is issued.

- b. IT costs would form the majority of the implementation costs followed by human capital. Many companies have been streamlining their operations and reducing headcount over the last several years. Thus given the scope of the changes, companies may have to rely on third party consultants, which would increase the costs, compared to using internal resources.

**QUESTION 3:**

**Do you foresee other effects on the broader financial reporting system arising from these new standards? For example, will the new financial reporting requirements conflict with other regulatory or tax reporting requirements? Will they give rise to a need for changes in auditing standards?**

**Response:**

We believe the proposals will have a broad financial and operational impact to companies.

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- The tax authorities will need to perform a comprehensive review of the tax regulations based on the new standards to determine any necessary changes. Companies will then need to incorporate the potential tax changes as part of their analysis. For example, the IRS will need to determine whether tax method changes will be required based on the proposed accounting changes. Another example relates to leases. Some state taxes are based on an apportionment of a company's fixed asset value. Once all leases are capitalized, it is not clear whether the new capital leases will need to be included as part of the state tax calculations.
  - Internal controls will need to be considered and revised. With the increased use of judgment and estimates, particularly for standards that impact global subsidiaries, creating accounting policies to ensure consistent application will be challenging.
  - Companies will need to review contracts such as debt covenants and mergers and acquisition ("M&A") agreements. For example, M&A can relate to existing contracts such as licensing arrangements that reference payments based on sales. Business development will also need to consider M&A deals that are currently being negotiated in light of future accounting changes.
  - Companies will need to consider the structure of future compensation plans that are based on financial metrics.
  - There also needs to be consideration for the auditors to review and sign-off on all the changes. While new standards have been implemented in the past, what makes this situation unique is the sheer number and significance of changes from all the standards and that all the companies will be implementing at the same time. This will likely place a strain on auditor resources, similar to what was experienced for SOx implementation.

**QUESTION 4:**

**In the context of a broad implementation plan covering all the new requirements, do you agree with the transition method as proposed for each project? If not, what changes would you recommend and why? In particular, please explain the primary advantages of your recommended changes and their affect on the cost of adapting to the new reporting requirements.**

**Response:**

Our views below reflect our comment letters submitted for each proposal.

For revenue recognition, we do not agree with the proposed full retrospective application. We ask the Board to consider a prospective approach, whereby the new standard would be applied to new contracts entered into after the beginning of the first comparative period, including appropriate the disclosures. This would provide a balance between the overwhelming amount of work required to review all contracts, retroactively adjust revenues and meet investor needs.

For leases, we agree that the Boards' simplified retrospective approach provides comparable information at a lower cost than a full retrospective approach.

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For the FASB financial instruments exposure draft, we agree the transition requirements to adopt the proposal through a cumulative-effect adjustment to the balance sheet immediately preceding the effective date is the most practicable method of applying the change in accounting principle.

**QUESTION 5:**

**In thinking about an overall implementation plan covering all of the standards that are the subject of this Discussion Paper:**

- a. Do you prefer the single date approach or the sequential approach? Why? What are the advantages and disadvantages of your preferred approach? How would your preferred approach minimize the cost of implementation or bring other benefits? Please describe the sources of those benefits (for example, economies of scale, minimizing disruption, or other synergistic benefits).**
- b. Under a single date approach, what should the mandatory effective date be and why?**
- c. Under the sequential approach, how should the new standards be sequenced (or grouped) and what should the mandatory effective dates for each group be? Please explain the primary factors that drive your recommended adoption sequence, such as the impact of interdependencies among the new standards.**
- d. Do you think another approach would be viable and preferable? If so, please describe that approach and its advantages.**

**Response:**

- a. We believe companies should be given the choice to adopt either a single date or sequential approach, depending on their resources and structure, and provided that the company adopts the new standards within the required timeframe. While our preference would lean towards a single date approach to gain efficiencies from an IT and training perspective, there may also be merit in considering a hybrid approach between both methods, particularly for more challenging standards to implement such as the financial statement presentation project.

**Considerations of a Single Date Approach**

**Parallel Reporting and IT Considerations**

Most of the new standards will require significant system changes to allow companies to properly track and capture the changes on a global basis. Also given the increased judgment that is being introduced in the new standards, companies may want to run parallel reporting or capture the information concurrently with the old and new standards during the comparative years. In determining whether to capture the information concurrently, a company would need to take the following factors into account:

- Extent of using estimates and avoiding the use of hindsight upon implementation;
- Determining whether the changes are pervasive throughout the company, globally or concentrated in one location or region;
- Ease of capturing and reporting the information on a consolidated basis;
  - Whether a company has one or multiple EPR platforms;
  - Would companies try to automate the changes in their ERP or other IT systems or rely on Excel or other manual workarounds?

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- Available company resources to incorporate the IT changes and training.

The answer to the above questions would create unique circumstances in how companies can and are able to adopt the new standards.

We refer to our comments in question 2 regarding the time and resources required to implement the proposals. Based on our review, it may be more effective to track the old and new standards concurrently for financial instruments, revenue recognition and leases as they require significant use of judgment and estimates. Recreating historical information for the comparative years during the year of adoption would be more challenging. Running parallel reporting would also reduce the likelihood of using the benefit of hindsight. Financial statement presentation would be the most complex from a system point of view and would require significant IT resources to develop and implement. If a single date approach timeline was required for the other projects, we, therefore, would ask the Board to delay the financial statement project, either on its own or with the rest of standards.

In order to incorporate the changes required by the new standards, a company will need plenty of lead time to include the changes as part of our normal SAP release schedule. Most major ERP systems use the concept of release schedules to roll out the changes in a systematic way. The schedules identify the specific changes that need to be made for each release. For example, our SAP releases occur twice a year, one in the spring and one in the fall. The scope of each release is typically scheduled at least 2-3 years in advance. Therefore, in terms of determining whether a company should adopt the single date or sequential approach, it may be more efficient to communicate and develop all IT system requirements for the new standards at one time versus staggered over time as the IT solution for the various changes may be interdependent and may drive different solutions.

The IT requirements are not limited to the ERP systems. Many companies also rely on third party ancillary systems that interface or provide information for their ERP system, such as investment (financial instruments) and lease software. Some of the third party providers that we talked to about the proposals indicated that they would not work on any system redesign until the final standards were issued with a date certain. Once the standards are issued and depending on the date certain, it would take some of the providers 9 months to a year to update their software so that we could then incorporate the changes into our system and processes.

### **Training and Implementation**

The other major consideration for determining a single date or a sequential approach are the staffing resources needed to evaluate the new standards, train and implement on a global basis. Within a company, there will be some groups that may be impacted more than others such as the finance/accounting, tax and treasury functions. Communicating all the changes at once may be a more efficient approach for some companies.

In terms of implementation, some of the standards are more pervasive throughout a company, such as leases. Based on our experience, some of our overseas affiliates are more familiar with their local GAAP, compared to U.S. GAAP. Thus, when new standards are implemented, it may be easier to communicate the changes at one time rather than over multiple years. Even with a sequential approach, unless there is enough time between the effective dates of each standard,

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the resource pools (such as IT, finance, tax, and Treasury) may still overlap and resources would be strained over a longer period of time.

### **Financial Reporting and Investor Communication**

Given the number of years of comparative information that needs to be presented, adopting a single date approach would confine the changes to the three years presented. If new standards require retrospective application and have sequential effective dates, it would extend the number of periods that companies have to present the changes. There would be a continual change of comparative information over an extended period of time and it would make it more difficult for the users of financial statements to understand the changes.

### **Compensation Plans**

Companies will also need to consider how the new standards will impact their compensation plans. Compensation plans include executive compensation, equity programs, bonus, etc. For example, companies will need to determine how to incorporate the changes for equity programs (e.g. awards) that vest over multiple years.

### **Advantages of Sequential Approach**

We understand that each company's circumstances will be unique given their infrastructure and how the new standards will impact them. One could argue the above points to favor a staggered approach. Some of the advantages of a sequential approach include:

- Companies would have more time and resources to evaluate and implement the changes, which would minimize or better manage disruption to the organization.
  - External auditor considerations – With a single date approach, external auditors may have limited resources and knowledge to audit all their clients that are implementing all the changes at once, similar to what companies faced in implementing Sarbanes-Oxley.
- b. Based on the above comments and assuming the final standards are issued at the end of 2011, for a single date approach, we ask the Boards to consider an effective date no earlier than January 1, 2015. It would give companies at least one year to prepare for the transition before having to capture the first comparative period, e.g. January 1, 2013.

#### **QUESTION 6:**

**Should the Board give companies the option of adopting some or all of the new standards before their mandatory effective date? Why or why not? Which ones? What restrictions, if any, should there be on early adoption (for example, are there related requirements that should be adopted at the same time)?**

#### **Response:**

Yes, we believe the Board should allow companies to early adopt all standards with no restrictions around applying standards in groups or introduce other requirements that would deter companies from

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early adopting such as onerous reconciliations prior to a standard's effective date, similar to what was proposed at one time for the U.S. IFRS transition. If a company chose to adopt early, providing the appropriate disclosures to explain the changes and transition would help the users understand the financial statements. Giving companies a choice will provide the greatest flexibility given their structure, resources and the impact the new standards may or may not have on their operations. We refer to our comments in question 5 for further details.

Alternatively, should the Board could allow early adoption, but place requirements to adopt certain standards in groups, we believe there are some standards that are interrelated that could be grouped together such as leases and revenue recognition. If a specific sequential approach is mandated and it does not group related standards together, we ask the Boards to provide additional guidance on how to bridge the gaps or how to resolve conflicts between the standards.

**QUESTION 7:**

**For which standards, if any, should the Board provide particular types of entities a delayed effective date? How long should such a delay be and to which entities should it apply? What would be the primary advantages and disadvantages of the delay to each class of stakeholders (financial statement preparers, financial statement users, and auditors)? Should companies eligible for a delayed effective date have the option of adopting the requirements as of an earlier date?**

**Response:**

As commented in our response in questions 2 and 5, we believe the Boards should provide a delayed effective date for the financial statement presentation project as it is further in the timeline, compared to the other projects. In addition, the proposed changes based on the staff draft issued will require significant IT system changes, particularly if the Board moves forward with the requirement of the direct method of cash flows. It would also make sense to delay implementation for this project given that it is not interdependent on other proposals.

**QUESTION 8:**

**Should the FASB and IASB require the same effective dates and transition methods for their comparable standards? Why or why not?**

**Response:**

Yes, the FASB and IASB should have the same effective dates and transition methods for their comparable standards. While U.S. multinational companies will still be preparing financial statements in accordance with U.S. GAAP, pending the SEC's decision on IFRS, some companies have a lot of overseas subsidiaries that require the use of IFRS for local statutory reporting. Aligning the effective dates would

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streamline the reporting between consolidated and local results by reducing the number of differences between U.S. and local GAAP that must be maintained by an affiliate.

We believe requiring the same transition methods between both Boards (FASB and IASB) is more critical as a departure between the two would create permanent differences for companies that prepare U.S. GAAP and IFRS financial statements. This would undermine the convergence efforts in moving to one global set of standards. The problem would be further compounded if the SEC were to mandate adoption of IFRS as published by the IASB. To illustrate this point, if the FASB proposed a prospective application for a standard, and later the SEC mandated IFRS (as published by the IASB) that required full retrospective application, a company would have to convert twice based on the different accounting treatments.

**QUESTION 9:**

**How does the Foundation's ongoing evaluation of standards setting for private companies affect your views on the questions raised in this Discussion Paper?**

**Response:**

Since we are a public company, we refrain from commenting on private entities.