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

Re:  File Reference No. 2018-240, Collaborative Arrangements (Topic 808), Targeted Improvements

Dear Director:

Eli Lilly and Company (“Lilly”) appreciates the opportunity to comment on the Financial Accounting Standards Board’s Proposed Accounting Standards Update, Collaborative Arrangements (Topic 808), Targeted Improvements (the “proposed ASU”). Lilly is a multinational pharmaceutical and animal health company.

In general, we support the addition of literature that clarifies the interaction of Topic 808 and Topic 606. Specifically, whether Topic 606 should be applied to certain transactions in collaborative arrangements. The addition of Topic 606 has created challenges in our industry in assessing which parts, if any, of collaborations are in the scope of Topic 606. Determining the unit of account upon which this assessment is to be made is particularly challenging. The unit of account determination is critical to the accounting model for a collaborative arrangement as it impacts recognition patterns and (potentially) classification. The current lack of guidance and examples in this area has enhanced the problem, leading to diverse interpretations among preparers and auditors.

We acknowledge the challenge of developing a one-size-fits-all model for collaborations, as each arrangement has its own unique complexities. Generally speaking, we are supportive of a model that would ultimately allow the following possible outcomes:

- Reimbursements from a collaborative partner for specific expenses incurred can be classified as an offset of those specific expenses. We prefer that unit of account procedures not require these reimbursements to be combined with other forms of consideration which could potentially affect the income statement classification and recognition.
• Consideration received from a partner that is associated with third party sales can be recognized as revenue (e.g. inventory supplied to partner, royalties, profit share, sales-based milestones).
• In transactions when the partner is not considered a customer, but the entity is analogizing to Topic 606 for recognition and measurement, the entity can apply an accounting policy election (with appropriate disclosure of the policy) to recognize as revenue the related consideration received from a partner.

Following are responses to selected questions in the proposed ASU:

**Question 1:** Would the amendments in this proposed Update clarify when a transaction between collaborative participants is within the scope of the revenue guidance in Topic 606? Would the proposed amendments reduce diversity in practice in this area? If not, please explain why.

**Question 4:** Would the proposed amendments on the unit of account clarify that the unit-of-account guidance in Topic 606 should be applied for determining if a transaction is within the scope of Topic 606? If not, please explain why.

With respect to Questions 1 and 4, in the absence of examples that illustrate specific application of the proposed new language in paragraphs 808-10-15-5A through 15-5C, it is difficult to fully understand how the Board intends preparers to apply the guidance in determining the unit of account, which seems to drive the determination of what falls in scope of Topic 606. This is an excellent opportunity to update the examples in Topic 808 and clarify the process of arriving at the units of account, rather than beginning the example with the results of that process. We believe failing to 1) clarify the language in 15-5A and 15-5B, or 2) provide examples of how to apply the unit of account guidance in those paragraphs, will result in continued diversity in practice. The unit of account is essential to the accounting for these arrangements; therefore, if the Board’s goal is to reduce diversity, we believe clear guidance on unit of account determination is critical.

Paragraph 15-5A indicates the starting point of the scoping process is at the “component” level of a collaborative arrangement. If any piece of that “component” is within the scope of Topic 606, the entity applies 606-10-15-4 to determine how to separate and initially measure that component.

• It is not clear what is meant by a “component”. Clarifying guidance is needed.
  o Is this consistent with the promised goods/services concept in Topic 606 (i.e. the inputs to the Step 2 analysis in Topic 606)? If so, it is difficult to understand how a single promised good/service could possibly be further divided and considered partially within the scope of Topic 606.
  o Is this consistent with the performance obligation concept in Topic 606 (i.e. the outputs of the Step 2 analysis in Topic 606)? If so, we believe this is one of the
most challenging areas of collaborations because they can have both customer and non-customer elements. The difficulty arises when trying to determine if a customer element should be combined with a non-customer element.

- Is a “component” neither of the above?

Paragraph 15-5B begins with the concept of a promised good or service and incorporates the criteria of Topic 606 in which it is aggregated until distinct. Paragraph 15-5B refers to a “distinct element”. Based on the language in the preceding sentence, it seems the Board is referring to a distinct promised good/service (i.e. a performance obligation that is the output of Step 2 in Topic 606). If this is the case, we suggest using terminology that is consistent with Topic 606 since anything accounted for in paragraph 15-5B is in the scope of Topic 606.

With regard to paragraphs 15-5A and 15-5B, it is not clear to us if it is possible to have a final unit of account that contains both a performance obligation in which the collaborative partner is a customer and a performance obligation in which the collaborative partner is not a customer. This needs clarification. We believe this should be allowed. For example, if a company grants a license of intellectual property to their collaborative partner and is also obligated to perform research and development activities. The company could take a position that the out-license and research and development activities are a combined performance obligation (and any upfront payment received is recognized over the R&D period). Based on their business model, the company could consider the out-licensing of their intellectual property as a contract with a customer, but performing research and development activities not a contract with a customer.

**Question 2: Is additional guidance necessary to determine whether a collaborative participant is a customer? If so, please provide suggestions.**

Entities should have flexibility in making this determination based upon their specific business model. We do not believe additional guidance is needed.

**Question 3: Are the proposed amendments on presentation in paragraph 808-10-45-3 operable? Would the proposed amendments reduce diversity in practice in this area?**

The proposed amendments in 808-10-45-3 create complexity. By adding new guidance that precludes revenue recognition for a collaborative arrangement unless 1) the collaborative partner is a customer, or 2) the transaction is directly related to a third-party sale, the proposed guidance has created an increased level of significance on the determination of whether the collaborative partner is a customer. We see this as being an area of sensitivity for preparers and auditors given the implications of revenue/non-revenue classification.

The proposed guidance is taking an unnecessary stance on forcing non-revenue classification when the counterparty is not a customer. Topic 606 disclosures clearly contemplate the reporting of revenue for transactions when the other party is not a customer (see 606-10-50-4). We believe revenue classification should also be allowable as a policy election if the entity is analogizing to Topic 606 for recognition and measurement. Current disclosure requirements for collaborative
arrangements, including the income statement line items where transactions are recorded, provide sufficient transparency and are easy for users to follow. Given the current transparency, this new non-revenue concept seems to be non-value add.

To the extent this new non-revenue concept is retained, we also recommend clarification on what is meant by “transactions in a collaborative arrangement that are related to a third-party sale”. We note paragraph BC20 in the Basis for Conclusions indicates these types of transactions include “(a) sales of ‘production inputs’ or other items to a collaborative partner that are eventually sold to a third party or (b) profit share receivables from collaborative partners for third-party sales.” Given its significance to revenue classification in the proposed model, we recommend the Board include these examples in the codified Topic 808 language. For the avoidance of doubt, we suggest the Board include additional examples such as inventory sold to a collaborative partner that they sell to end customers, royalties, and sales-based milestones. We also recommend that the Board include in the guidance the verbiage in BC21 clarifying the Board’s intent that an entity can apply Topic 606 by analogy or as a policy election without being required to apply all of the guidance in Topic 606, as long as it does not present the transaction as revenue.

**Question 5:** Should a reporting entity be required to provide additional recurring disclosures (that is, incremental disclosures to those required in Topic 808 and Topic 606) because of the proposed amendments? If so, what additional recurring disclosures should be required?

We do not believe additional recurring disclosures are necessary. Required disclosures under existing guidance are sufficient.

**Question 6:** Do you agree with the proposed transition requirements, including the retrospective application to the adoption date of Topic 606? If not, what transition method would be more appropriate and why?

We prefer the Board also include an option for prospective application in addition to the existing retrospective application method.

**Question 7:** How much time is needed to implement the proposed amendments? Should early adoption be permitted?

The implementation time required will vary depending upon the final language in the ASU. If the new non-revenue concepts of this proposed ASU are removed, we would expect that six months should be sufficient for implementation. If the new non-revenue concepts remain, we would expected a longer implementation timeline as this could result in companies having to devote more effort in evaluating the customer/non-customer conclusions in arrangements, given the potential of a change in income statement classification. For example, there could be transactions in which companies currently analogize to Topic 606 and report consideration earned as revenue; whereas under the proposed model, this may have to be a non-revenue classification.
We believe early adoption should be permitted.

We appreciate the opportunity to express our view and concerns regarding the proposed ASU. If you have any questions regarding our response, or would like to discuss our comments further, please call me at (317) 651-2310.

Sincerely,

ELI LILLY AND COMPANY

/s/Donald A. Zakrowski

Donald A. Zakrowski
Vice President, Finance and
Chief Accounting Officer