Dear Director:

Eli Lilly and Company ("Lilly") appreciates the opportunity to comment on the Financial Accounting Standards Board’s (the “Board”) Proposed Accounting Standards Update, “Revenue from Contracts with Customers (Topic 606), Identifying Performance Obligations and Licensing” (the “proposed Update”). Lilly is a multinational pharmaceutical and animal health company with legal entities in over 50 jurisdictions.

Following are responses to selected questions in the proposed Update:

**Question 2:** Paragraph 606-10-25-16A specifies that an entity is not required to identify goods or services promised to a customer that are immaterial in the context of the contract. Would the proposed amendment reduce the cost and complexity of applying Topic 606? If not, please explain why.

Yes, we believe this proposed amendment would simplify our contract analysis in applying Topic 606. We agree with the Board’s conclusions in BC11 that an entity should consider whether a promised good or service is material only at the contract level because it would be unduly burdensome to require an entity to aggregate and determine the effect on its financial statements of those items or activities determined to be immaterial at the contract level. We fully support these changes as proposed.

**Question 3:** Paragraph 606-10-25-18A permits an election to account for shipping and handling as an activity to fulfill a promise to transfer a good if the shipping and handling activities are performed after a customer has obtained control of the good. Would the proposed amendment reduce the cost and complexity of applying Topic 606? If not, please explain why.
Yes, we believe this proposed amendment would simplify our contract analysis in applying Topic 606 by removing the need to assess whether shipping and handling is a promised service. We fully support these changes as proposed.

Question 4: Would the revisions to paragraph 606-10-25-21 and the related examples improve the operability of Topic 606 by better articulating the separately identifiable principle and better linking the factors to that principle? If not, what alternatives do you suggest and why?

We believe the revisions and related examples are an improvement. However, there are areas of revision that we would like the Board to consider as follows:

It is a common practice in the life sciences industry for a pharmaceutical company to license to a customer its patent rights to a drug and also promise to manufacture the drug compound for that same customer. An example of this type of arrangement is illustrated in Example 56. Case A of Example 56 states, “no other entity can manufacture this drug because of the highly specialized nature of the manufacturing process. As a result, the license cannot be purchased separately from the manufacturing service.” In Case B of Example 56, “the manufacturing process used to produce the drug is not unique or specialized, and several other entities also can manufacture the drug for the customer.” Because this is the only example in the new guidance on determining if a license of intellectual property is distinct when coupled with a promise to manufacture the drug, we are concerned that some may interpret Example 56 to mean that a manufacturing process must be specialized or unique in nature in order to prevent the customer from being able to purchase a license and manufacturing service separately. We’d like it to be clear that a specialized or unique manufacturing process is not the only reason other entities cannot manufacture a drug. For example, other entities may not be able to manufacture a drug without significant delay because of a required regulatory approval process that results in the licensee insisting that the licensor continue to supply product until a new manufacturer obtains regulatory approval. An additional example, or an acknowledgement that there could be other reasons preventing other entities from manufacturing a drug, are both possible solutions to clarify the intent.

We also believe further clarification is needed on the concepts of “highly interrelated” and “highly dependent” when assessing the criteria in 606-10-25-21. Specifically, we believe the proposed Update should be more explicit in indicating that a customer’s ability to derive its intended benefit from the contract may depend on the entity transferring two or more goods or services. We believe it should be clear that, if a customer wouldn’t be willing to enter into a contract without the inclusion of two or more goods or services (because the absence of one of the goods or services would significantly diminish the value of the contract for the customer), those goods or services are highly interrelated/highly interdependent and therefore not separately identifiable.

We note the Board’s conclusions in BC31 as follows:

- “…whether two or more promises in a contract are highly interrelated or highly interdependent in accordance with paragraph 606-10-25-21(c) considers both fulfillment
and beneficial interdependence. An entity may be able to fulfill its promise to transfer each good or service in the contract independently of the other, but each good or service may significantly affect the other’s utility (that is, its ability to provide benefit or value) to the customer.”

- “Utility also is relevant in evaluating whether two or more promises in a contract are separately identifiable. This is because even if two or more goods or services are capable of being distinct because the customer can derive some measure of economic benefit from each one, the customer’s ability to derive its intended benefit from the contract may depend on the entity transferring each of those goods or services.”

We believe the Board’s conclusions from BC31 provide an excellent clarification of this concept and should be more prominent within the guidance. We suggest moving the language in BC31 into the guidance of 606-10-25.

**Question 5: Would the revisions to paragraphs 606-10-55-54 through 55-64, as well as the revisions and additions to the related examples, improve the operability of the implementation guidance about determining the nature of an entity’s promise in granting a license? That is, would the revisions clarify when the nature of an entity’s promise is to provide a right to access the entity’s intellectual property or to provide a right to use the entity’s intellectual property as it exists at the point in time the license is granted? If not, what alternatives do you suggest and why?**

We believe the revisions clarify when the nature of an entity’s promise is to provide a right to access or right to use the entity’s intellectual property. However, we believe the proposed model should be modified to address situations in which an entity does not expect to perform after the transfer of symbolic intellectual property. For example, when an entity licenses the brand name of a consumer product to a licensee and it is clear the licensor will not be promoting the brand over the license period.

We note in BC52 the Board’s outreach suggested that arrangements resulting in no continuing performance by the entity after transfer of symbolic intellectual property are few in number. However, the proposed presumption that a license of symbolic intellectual property will require continuing involvement by the entity completely ignores these instances, rare as they may be. As proposed, the presumption will lead to an accounting result that is counterintuitive for situations in which an entity does not expect to perform after the transfer of symbolic intellectual property – revenue will be deferred and recognized over a period of time, despite the entity having no further performance obligations. Rather than ignoring these situations, we propose adding a step, after an entity determines that licensed intellectual property is symbolic, in which the entity considers if they expect to perform after making the symbolic intellectual property available to the customer. If there is no expectation to perform, the entity would recognize revenue at the point in time the intellectual property is made available. If there is an expectation to perform, the entity would recognize the revenue over the period of performance. We acknowledge the concern noted in BC52 of such an additional step being less operable for entities with a significant number of licensing arrangements and entities with diversified operations. In order to address that concern, we suggest also providing an option
whereby entities can elect a policy to recognize revenue for all licenses of symbolic intellectual property over time (essentially bypassing the additional step we’re proposing). We believe the combination of the additional step and policy election option would provide a reasonable accounting path for all arrangements to license symbolic intellectual property, not just the most common arrangements.

We also note the complexity that could arise for cases involving a perpetual license of symbolic intellectual property. We are curious if the Board has considered providing a framework for entities to apply in determining the term over which to recognize revenue for a license of symbolic intellectual property that continues into perpetuity. Without a framework, we are concerned that entities will struggle to apply the revenue recognition guidance for perpetual licenses.

Question 6: The revisions to paragraph 606-10-55-57 that state an entity should consider the nature of its promise in granting a license of intellectual property when accounting for a single performance obligation. Does this revision clarify the scope and applicability of the licensing implementation guidance? If not, why?

Yes, the revisions clarify the scope and applicability of the licensing implementation guidance. We fully support these changes as proposed.

Question 7: Would the revisions to paragraph 606-10-55-64 adequately communicate the Board’s intent (a) that restrictions of time, geographical region, or use in a license of intellectual property are attributes of the license (and, therefore, do not affect the nature of an entity’s promise in granting a license or its assessment of the goods or services promised in a contract with a customer) and (b) about determining when a contractual provision is a restriction of the customer’s right to use or right to access the entity’s intellectual property? If not, what alternatives do you suggest and why?

Yes, the revisions adequately communicate the Board’s intent for both matters. We fully support these changes as proposed.

Question 8: Would paragraphs 606-10-55-65 through 55-65B and the related example clarify the scope and applicability of the guidance on sales-based and usage-based royalties promised in exchange for a license of intellectual property? If not, what alternatives do you suggest and why?

We believe the Board needs to provide additional guidance beyond the proposed edits to these paragraphs.

We would like the Board to provide additional insight on determining if a license of intellectual property is the predominant item to which the royalty relates. Paragraph 55-65A states, “for example, when the customer would ascribe significantly more value to the license than to the other goods or services to which the royalty relates”. While we agree in principle with the
overall concept the Board has proposed, we recall the following viewpoint which was informally
expressed related to this issue: If an entity determines that two or more goods or services are
not distinct, it would seem difficult to conclude that the license is the predominant item to which
the royalty relates.

Perhaps this viewpoint assumed that the individual good or service must be valued by assuming
the other good or service in the combined unit of account isn’t present (which isn’t possible for
goods or services that aren’t capable of being distinct, and results in distorted individual values
for goods or services that are highly interrelated). We believe that when valuing an individual
good or service for purposes of applying paragraph 55-65A, an entity should assume that the
other goods or services in the combined unit of account are present. If this is indeed the
Board’s intent, perhaps it could be more explicitly stated.

The following example illustrates our interpretation for applying the guidance in paragraph 55-
65A, which we hope reflects the Board’s intentions for determining if a customer would ascribe
significantly more value to the license than to the other goods or services to which the royalty
relates:

Assume we are licensing our intellectual property to a customer coupled with an
obligation to supply product to that customer. Similar to Case A of Example 56, we’ve
determined that the customer cannot benefit from the license without the
manufacturing service; therefore the license and manufacturing service are not distinct.
In this situation, we would apply the proposed guidance in paragraph 55-65A by first
valuing the manufacturing service. To determine the value of the manufacturing service
to the customer, we would compare the supply pricing terms to fair market values, with
any value to the customer being derived from a favorable variance in the supply pricing.
Any remaining value not ascribed to the manufacturing service would be presumed to
reside in the license. So, if the supply pricing terms are in-line with fair market values,
we would likely conclude that the customer would ascribe significantly more value to
the license than to the manufacturing service and, therefore, the license of intellectual
property is the predominant item to which the royalty relates. Our concern is that
without added clarity, some might believe it would always be difficult to conclude that
the license is the predominant item to which the royalty relates in this situation where
the license and the supply arrangement are not distinct.

We also believe the Board should define the term “royalty”. Traditional sales and usage-based
royalties will likely be easily identifiable as royalties within the scope of this guidance. However,
we believe it would be beneficial for the Board to address if there can be “in-substance
royalties” within the scope of this guidance, such as sales-based milestones.

Other Items:

Paragraph 606-10-55-64 lists factors that an entity should disregard when determining whether
a license provides a right to access the entity’s intellectual property or a right to use the entity’s
intellectual property or when identifying the promises in a contract. The guidance in 55-64(b)
lists “ Guarantees provided by the entity that it has a valid patent to intellectual property and
that it will defend that patent from unauthorized use”. Paragraph BC48 provides the Board’s conclusions on 55-64. BC48(b) states, “The entity’s guarantees that it has a valid patent to intellectual property and that it will defend and maintain that patent...” Based on the language in BC48, it appears that it is the Board’s intent that an entity’s guarantee to maintain a patent is also a factor that an entity should disregard. We suggest that the Board revise paragraph 606-10-55-64 to include the concept of routine legal maintenance of a patent.

Conclusion
We appreciate the opportunity to express our view 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) 651-2310.

Sincerely,

ELI LILLY AND COMPANY

/s/Donald A. Zakrowski

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