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September 30, 2010

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

Re: File Reference No. 1810-100 – Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities

Dear Director:

Eli Lilly and Company ("Lilly") appreciates the opportunity to comment on the Financial Accounting Standards Board's (the "FASB") Exposure Draft (the "ED") "Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities".

Lilly supports the FASB's objective to develop a new, comprehensive standard for financial instruments that is principle-based and less complex. We believe certain proposed changes will bring the standard closer to a principles-based approach. We commend the FASB on its efforts to simplify hedge accounting. We are concerned, however, that many of the proposed changes will create a more complex standard and will result in significant system and operational challenges, particularly for non-financial institutions, as well as counterintuitive financial results in certain instances. Specifically, we are concerned about; 1) the fair value default requirement which fails to consider the entity's business strategy and does not recognize that fair values are not readily available for certain financial instruments, including privately-held equity investments, 2) the reflection of changes in an entity's own credit risk in net income, 3) the extensive presentation requirements in lieu of current disclosure requirements, 4) continued differences in FASB and IASB proposed standards, 5) the proposed interest income recognition model, and 6) certain aspects of the proposed hedging model.

In addition, we are seriously concerned about the timing of this exposure draft as it relates to the convergence with the International Accounting Standards Board's (the "IASB") accounting for financial instruments. The FASB and IASB appear to be working independently on changes to accounting for financial instruments. This will require entities to review and comprehend revised US GAAP as well as revised IASB standards and doesn't appear to bring guidance on financial instruments closer to convergence. We strongly believe both boards should work together to create a converged standard and not create multiple revisions that require multiple implementations.

Overall, we believe the proposed presentation guidance would primarily benefit financial statements for financial institutions and many of the requirements would add little value to financial statements of non-financial institutions.

Following are responses to certain questions addressed in the ED.

Do you agree with the scope of financial instruments included in this proposed Update? If not, which other financial instruments do you believe should be excluded or which financial instruments should be included that are proposed to be excluded? Why?

It is unclear how short-term investments classified as cash equivalents and short-term debt issued in the form of commercial paper fit into the scope of this ED. Will entities be allowed the use of a practical expedient such as the assumption that fair value approximates amortized cost?

Question 3

The proposed guidance would require deposit-type and investment contracts of insurance and other entities to be measured at fair value. Do you agree that deposit-type and investment contracts should be included in the scope? If not, why?

We believe that deposit-type and investment contracts should not be included in the scope of financial instruments requiring fair value measurement. These securities are typically highly rated held-to-maturity investments that frequently have a very small, illiquid secondary market. Therefore, pricing received in the secondary market might not reflect the actual value of the security. Additionally, obtaining market pricing on these securities could lead to measurement gain or loss that will never be realized because the investments always mature at par.

Question 4

The proposed guidance would require an entity to not only determine if they have significant influence over the investee as described currently in Topic 323 on accounting for equity method investments and joint ventures but also to determine if the operations of the investee are related to the entity's consolidated business to qualify for the equity method of accounting. Do you agree with this proposed change to the criteria for equity method of accounting? If not, why?

Investments meeting the "significant influence" criteria should be accounted for under the equity method regardless of the similarities between the business operations of the entity and the investee. Related business operations of an entity and the investee should be a "factor" in determining if the entity has significant influence, but should not override the "significant influence" criteria. The addition of the "related" criteria will result in entities being forced to create a fair value for privately-held investments that is recognized in net income, thus leading to more operations burden and complexity, as well as potentially unreliable results.

Question 13

The Board believes that both fair value information and amortized cost information should be provided for financial instruments an entity intends to hold for collection or payment(s) of contractual cash flows. Most Board members believe that this information should be provided in the totals on the face of the financial statements with changes in fair value recognized in reported stockholders' equity as a net increase (decrease) in net assets. Some Board members believe fair value should be presented parenthetically in the statement of financial position. The basis for conclusions and the alternative views describe the reasons for those views. Do you believe the default measurement attribute for financial

instruments should be fair value? If not, why? Do you believe that certain financial instruments should be measured using a different measurement attribute? If so, why?

We are not a proponent of establishing fair value as the most relevant measure of financial instruments. We believe business strategy should be a relevant factor in determining whether an asset is measured at fair value through net income or fair value through OCI. For non-financial institutions that do not consider investing as a core business, publicly-traded equity investments should be fair valued through OCI thus eliminating the volatility in net income due to market gains and losses. Additionally, entities should not be forced to "create" a fair value for privately-held investments and nonmarketable equity securities. The proposed change will not result in more useful, transparent and relevant information to investors. We are an advocate of measuring liabilities at amortized cost as further discussed in Question 18 below.

Further, we do not advocate overpowering the face of the financial statements with multiple presentations of financial information. The current requirement to disclose in the footnotes fair value information related to financial instruments provides attainable adequate information for non-financial institutions whose business strategy does not involve trading strategies.

Question 16

The proposed guidance would require an entity to decide whether to measure a financial instrument at fair value with all changes in fair value recognized in net income, at fair value with qualifying changes in fair value recognized in other comprehensive income, or at amortized cost (for certain financial liabilities) at initial recognition. The proposed guidance would prohibit an entity from subsequently changing that decision. Do you agree that reclassifications should be prohibited? If not, in which circumstances do you believe that reclassifications should be permitted or required? Why?

Although reclassifications should be infrequent, if an entity's business model changes, reclassifications should be permitted because: 1) accurate classification of financial instruments based on an entity's business strategy should be the ultimate outcome; 2) convergence with the IASB's standard should be considered; and 3) entities may have multiple business strategies that are continually being evaluated.

Question 18

Do you agree that a financial liability should be permitted to be measured at amortized cost if it meets the criteria for recognizing qualifying changes in fair value in other comprehensive income and if measuring the liability at fair value would create or exacerbate a measurement attribute mismatch? If not, why?

We strongly support the ability to measure financial liabilities at amortized cost, particularly due to differences in the composition of financial assets and liabilities between financial institutions and non-financial institutions. As a non-financial institution, a significant amount of non-financial assets are not measured at fair value. We believe the current requirements to disclose the fair value of financial liabilities provides adequate information in statements of non-financial institutions.

Do you agree that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to a debt instrument measured at fair value with qualifying changes in fair value recognized in other comprehensive income in combination with other deferred tax assets of the entity (rather than segregated and analyzed separately)? If not, why?

Currently, there are two views acceptable to the SEC regarding how to assess the need for a valuation allowance against deferred tax assets ("DTAs") related to unrealized losses on debt securities when these losses are recognized through Other Comprehensive Income ("OCI").

Under one view ("View 1"), an entity's intent and ability to hold debt securities with unrealized losses until maturity can be characterized as a tax planning strategy. Under View 1, by holding the security to maturity, the DTAs for unrealized losses are expected to reverse, naturally, over time; this expected reversal acts as positive evidence to overcome the need for a valuation allowance.

Under another view ("View 2"), the recovery of DTAs for unrealized losses should be evaluated no differently than any other DTAs. Under View 2, valuation allowances may need to be established if significant negative evidence exists, such as cumulative losses in recent years, that indicates it is not more likely than not some (or all) of an entity's DTAs will be realized. Under View 2, if there is a change in judgment about the need for, or the amount of, a valuation allowance in subsequent periods, then that change would be reported in income tax expense in continuing operations. However, changes in the underlying item—in this case the amount of unrealized losses on debt securities—would be reported as a component of OCI.

In the ED, the utilization of View 2 is proposed as the exclusive view to be applied by financial statement preparers.

We believe the exclusive application of View 2 will result in a lack of symmetry between amounts reported in OCI and the tax effect of these items reported in continuing operations. This lack of symmetry will result in financial statements that are "mismatched" in presentation and that are more difficult for readers to understand. As a result, we do not recommend View 2 be adopted as the exclusive method for financial statement preparers.

We acknowledge the Board's stated belief that the "ultimate income tax conclusion be based on the entity's entire tax position." [BC166]. As a means to further the Board's stated belief in BC 166, we would propose certain modifications to the ED that would assist in achieving this aim, but would also promote symmetry between the reporting of items in OCI and their related tax effect.

One potential modification is currently present in International Financial Reporting Standards in IAS 12, *Income Taxes*. Under IAS 12, paragraph 61A, current and deferred tax shall be recognized outside of profit or loss if the tax relates to items that are recognized, <u>in the same or different periods</u>, outside profit or loss. This paragraph applies to items recognized directly in equity or in other comprehensive income, and is commonly referred to as "backwards tracing". The modification to allow backwards tracing would promote symmetry between the reporting of items in OCI with their related tax effect, including the tax effect for changes in judgment in subsequent periods regarding the need for valuation allowances against DTAs. Additionally, this modification would bring the Board and the IASB closer on at least one aspect of accounting for income taxes.

We recognize that ASC 740 currently does not permit backwards tracing, and recognize the Board may not yet be prepared to adopt backwards tracing in its entirety. As a result, another potential modification to the ED could be to permit backwards tracing, but limit its application. The application of backwards tracing in this instance could be limited to the tax effects of subsequent period changes in judgment about valuation allowances for items that are still accounted for in OCI.

In the event the Board decides to move forward with the exclusive method proposed in Question 20, we recommend the Board allow those preparers who have been utilizing another currently acceptable method to record the impact of this change in OCI, or through retained earnings, as of the date of adoption.

Question 28

Do you believe that the proposed criteria for recognizing qualifying changes in fair value in other comprehensive income are operational? If not, why?

We support the continued effort to adopt principles-based guidance, but recognize operational concerns could be an aftereffect. The cash flow characteristics criteria are clear and should not contribute to operational difficulties and inconsistencies, however, the business strategy criterion is subjective and will most likely result in inconsistent application of the guidance. Significant judgment will be imposed on entities regarding the appropriate level of aggregation to evaluate the business strategy, comparing management's strategy and management's intent, and defining when financial instruments are held for a "significant portion of their contractual term". Without detracting from the principles-based approach, additional examples could provide helpful guidance.

Question 30

Do you believe the proposed criteria are operational to qualify for measuring a financial liability at amortized cost? If not, why?

The measurement attribute mismatch criteria, though not principles-based, are beneficial. We are supportive of providing guidance for non-financial institutions that is distinguishable from requirements for financial institutions and believe this qualification addresses the distinction. As indicated in our response to Question 35, we believe further distinctions between financial institutions and non-financial institutions should be applied to the presentation and disclosure guidance.

Question 32

For financial liabilities measured at fair value with all changes in fair value recognized in net income, do you agree that separate presentation of changes in an entity's credit standing (excluding changes in the price of credit) is appropriate, or do you believe that it is more appropriate to recognize the changes in an entity's credit standing (with or without changes in the price of credit) in other comprehensive income, which would be consistent with the IASB's tentative decisions on financial liabilities measured at fair value under the fair value option? Why?

We believe it is more appropriate to recognize changes in fair value stemming from changes in an entity's own credit standing in other comprehensive income. In addition to being consistent with the IASB's tentative proposal, such treatment will serve to reduce income statement volatility and reduce

any user confusion that may result from the fact that changes in an entity's credit standing would have an inverse correlation to the earnings impact (e.g., an entity would recognize a gain from its own credit downgrade and a loss from an increase in its own credit rating). The presentation requirement to show changes in an entity's credit standing in other comprehensive income would retain the same level of disclosure/transparency without the potential income statement volatility and misconception.

Question 33

Appendix B describes two possible methods for determining the change in fair value of a financial liability attributable to a change in the entity's credit standing (excluding the changes in the price of credit). What are the strengths and weaknesses of each method? Would it be appropriate to use either method as long as it was done consistently, or would it be better to use Method 2 for all entities given that some entities are not rated? Alternatively, are there better methods for determining the change in fair value attributable to a change in the entity's credit standing, excluding the price of credit? If so, please explain why those methods would better measure that change.

Method 1 in Appendix B has the advantages of being a more straightforward and standardized method that would be less burdensome to administer for the reporting entity and more readily understandable from a user perspective. Method 1 provides a clear trigger – a change in credit rating – to require this analysis. Regardless, the detailed methodology for conducting the analysis, including estimating changes in fair value based on measures of what the entity's discount rate would have been without the ratings change, may vary radically in practice and as a result may provide little benefit to users of the financial statements.

Method 2 has an additional shortcoming. In addition to lack of a standardized methodology for conducting the analysis, this method would result in increased administrative burden for reporting entities since the analysis would be conducted each period rather than upon the occurrence of a triggering event.

An alternative method of determining the change in fair value attributable to a change in the entity's credit standing is the use of trading prices for Credit Default Swaps (CDS) of a given entity as a proxy for the change in fair value.

The primary drawback of relying on changes in an entity's credit rating is the lag time between the triggering event and the change in the credit rating, which can be significant. Prices for CDS are more real-time and market-based, however, not always available for all entities. In addition, CDS trading levels can be volatile and are likely to reflect risk in the overall market and industry sector in addition to entity-specific risks.

Question 34

The methods described in Appendix B for determining the change in fair value of a financial liability attributable to a change in an entity's credit standing (excluding the changes in the price of credit) assume that the entity would look to the cost of debt of other entities in its industry to estimate the change in credit standing, excluding the change in the price of credit. Is it appropriate to look to other entities within an entity's industry, or should some other index, such as all entities in the market of a similar size or all entities in the industry of a similar size, be used? If so, please explain why another index would better measure the change in the price of credit.

Looking to comparable entities for an understanding of the fair value impact of a specific entity's credit standing has two primary shortcomings. First, each comparable entity that is used as a point of comparison will itself be subject to changes in its credit standing in addition to changes in the price of credit overall. While these individual factors and movements may cancel each other out or at least be mitigated through the use of a large number of comparable entities, they still may taint any true view of "the market". Second, the choice of comparable entities is largely subjective. Even within a given industry, certain companies may be viewed as more "comparable" to a given entity than others, and understandably so. Such additional factors an entity may consider when choosing a set of comparable companies include size, geography, product mix, growth profile, and other industry-specific metrics. Given these shortcomings, we would recommend additional guidance calling for the use of well-known market indices that incorporate both industry and ratings level factors (i.e., "AA rated industrials") to better standardize this analysis. This will benefit both preparers and users of the financial statements.

Question 35

For financial instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income, do you believe that the presentation of amortized cost, the allowance for credit losses (for financial assets), the amount needed to reconcile amortized cost less the allowance for credit losses to fair value, and fair value on the face of the statement of financial position will provide decision-useful information? If yes, how will the information provided be used in your analysis of an entity? If not, why?

We are not supportive of the radical changes to the face of the financial statements, particularly for non-financial institutions. The FASB's proposal is intended to improve comparability of financial statements across entities and provide more relevant and reliable information that can be used to evaluate an entity's performance. For non-financial institutions, investing and financing activities are not considered the primary operations of the entity. Financial statement users will undoubtedly be more interested in analyzing the operations related to the primary business purpose of the entity. We therefore would suggest retaining the current fair value disclosures in the financial statement footnotes for non-financial institutions. Entities meeting the criteria included in paragraph 39 of the ED for the determination of measurement mismatch (i.e., an entity for which less than 50 percent of consolidated recognized assets are subsequently measured at fair value) should be exempt from presentation requirements.

Question 38

Do you believe that an entity should immediately recognize a credit impairment in net income when the entity does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected for purchased financial asset(s) as proposed in this Update, or do you believe that an entity should recognize initially expected credit losses over the life of the financial instrument as a reduction in interest income, as proposed in the IASB Exposure Draft on impairment?

We generally support the modified expected loss approach advocated by the FASB in lieu of the IASB's expected loss approach. For entities evaluating credit losses on an individual basis, it would be difficult to determine with any accuracy which instruments will most likely incur credit losses in the future upon initial recognition of financial assets. We therefore, support the FASB's use of a trigger (e.g., when the

entity does not expect to collect all contractual amounts for originated financial assets and all amounts originally expected to be collected for purchased financial assets) versus the IASB's use of a general upfront allowance. Although we support the FASB's consideration of past events and existing conditions when evaluating financial assets for credit impairments, we urge the Board to allow the inclusion of near-term trends or forecasts in the evaluation. It would be challenging to ignore certain economic factors potentially impacting expected cash flows for the next 12 to 24 months.

We are profoundly troubled by the divergence between the FASB and the IASB as to the timing of recognition of credit impairments and do not support any changes to the current impairment model until the gap is closed between the Boards conflicting views.

Question 39

Do you agree that a credit impairment should not result from a decline in cash flows expected to be collected due to changes in foreign exchange rates, changes in expected prepayments, or changes in a variable interest rate? If not, why?

We agree. Credit impairments should be based on the inability to collect cash flows and should exclude adjustments for foreign exchange rates, changes in expected prepayments or changes in a variable interest rate. We believe the inclusion of these adjustments would reduce comparability among entities. In addition, these adjustments do not represent factors that give rise to credit impairments.

Question 40

For a financial asset evaluated in a pool, the proposed guidance does not specify a particular methodology to be applied by individual entities for determining historical loss rates. Should a specific method be prescribed for determining historical loss rates? If yes, what specific method would you recommend and why?

In an effort to bring the standard closer to a principles-based approach, we would not propose that a specific methodology for determining historical loss rates be mandated in the guidance, however, additional examples would be beneficial.

Question 42

If a financial asset that is evaluated for impairment on an individual basis has no indicators of being individually impaired, the proposed guidance would require an entity to determine whether assessing the financial asset together with other financial assets that have similar characteristics indicates that a credit impairment exists. The amount of the credit impairment, if any, would be measured by applying the historical loss rate (adjusted for existing economic factors and conditions) applicable to the group of similar financial assets to the individual financial asset. Do you agree with this requirement? If not, why?

Although we are supportive of the ability to evaluate impairment of debt securities on a pooling basis, we are not in favor of the two-step approach that ultimately results from electing to evaluate impairment on an individual basis. Per paragraph BC181 of the ED, "debt securities will more often have unique risk characteristics that will result in their being evaluated individually". If an entity has chosen to evaluate credit impairment on an individual basis due to unique risk characteristics, why is there a

further requirement to "assess the financial asset together with other financial assets with similar risk characteristics" as indicated in paragraph BC192 of the ED? The decision to evaluate impairment on an individual basis or a pooling basis should be the sole requirement.

Question 46

Do you agree that an entity should assume that economic conditions existing at the reporting date would remain unchanged in determining whether a credit impairment exists, or do you believe that an expected loss approach that would include forecasting future events or economic conditions that did not exist at the end of the reporting period would be more appropriate? Are both methods operational? If no, why?

We concur with the shared objective of the FASB and the IASB to provide for earlier recognition of impairment losses and we believe both models will achieve that objective. We, however, support the FASB's modified incurred loss model as opposed to the IASB's expected loss model. The inclusion of potential future events in the determination of initial credit losses (expected loss model) adds additional guesswork over and above the judgmental process of reviewing past events and existing circumstances (modified incurred loss model). Upon acquisition of an asset, it is not easy to determine which instruments will most likely incur credit losses in the future, particularly when the asset was assumed to have been acquired at fair value. It would be operationally burdensome for non-financial institutions to build an obscure provision over the life of the instrument for credit losses that may never transpire.

Question 49

Do you agree that the difference in the amount of interest contractually due that exceeds interest accrued on the basis of an entity's current estimate of cash flows expected to be collected for financial assets should be recognized as an increase to the allowance for credit losses? If not, why?

We strongly oppose the inclusion of the excess of contractual interest collected over interest accrued in the allowance for credit losses for the following reasons: 1) Interest that is contractually due and collected should be reflected as interest income regardless of the estimated amount of interest accrued; 2) commingling interest income adjustments with credit impairments in the allowance account defeats the purpose of establishing a separate allowance account (as opposed to reducing amortized cost as is currently the case with impaired debt securities); and 3) this change would impose considerable and costly changes to IT systems.

Question 53

The method of recognizing interest income will result in the allowance for credit impairments presented in the statement of financial position not equaling cumulative credit impairments recognized in net income because a portion of the allowance will reflect the excess of the amount of interest contractually due over interest income recognized. Do you believe that this is understandable and will provide decision-useful information? If yes, how will the information provided be used? If not, why?

As indicated in Question 49 above, we believe this will result in a meaningless commingled allowance that will require extensive disclosures and/or additional presentations in order for readers to comprehend. In addition, we do not believe this will provide decision-useful information.

Do you believe that modifying the effectiveness threshold from highly effective to reasonably effective is appropriate? Why or why not?

We concur with the proposal to lower the effectiveness threshold as this change will broaden the ability for entities to qualify for hedge accounting and will simplify the accounting and assessments of effectiveness for hedging activities, all objectives of the ED. Although the burden of proof remains with the entity and any ineffectiveness will be recognized in earnings, this modification will increase subjectivity in determining whether a hedging relationship qualifies for hedge accounting (e.g., no bright line). Although we support a principles-based approach, it's inevitable that entities will be compelled to debate with auditors over the definition of *reasonably effective* possibly resulting in disqualified hedges. We therefore propose that additional examples or illustrative scenarios be provided in the guidance to clarify the definition of *reasonably effective* without using bright lines.

In light of the IASB's expected exposure draft on hedge accounting, we would suggest that entities have the opportunity to provide further comments related to the hedge accounting guidance included in this ED subsequent to the September 30, 2010 deadline. It would be beneficial to have sufficient time to compare the FASB exposure draft to the IASB exposure draft and provide additional comments.

Question 57

Should no effectiveness evaluation be required under any circumstances after inception of a hedging relationship if it was determined at inception that the hedging relationship was expected to be reasonably effective over the expected hedge term? Why or why not?

Paragraph 113 of the ED states that, "an entity shall not assume at inception that there will never be any ineffectiveness to recognize in net income during the period of the hedge". A qualitative assessment at inception, therefore, should identify potential sources of ineffectiveness and conclude why those potential sources do not currently negate a *reasonably effective* assessment. Going forward, this qualitative assessment should not change unless those identified circumstances (e.g., potential sources of ineffectiveness identified at inception) change. Accordingly, we concur with the requirements in paragraph 117 of the ED that entities should reassess effectiveness qualitatively only if changes in circumstances suggest that the hedging relationship is no longer *reasonably effective*. We do not agree that no effectiveness evaluation should be required under "any" circumstances after inception of the hedging relationship because certain circumstantial changes could impact the assessment of effectiveness.

The criterion included in paragraph 116.b. of the ED to be used for providing the basis of a *reasonably effective* assessment (e.g., "factors supporting a conclusion" of *reasonably effective*) is vague. Although we support the effort to reduce excessive quantitative analysis and promote more practical guidance, entities need to comprehend how auditors will evaluate the "holistic consideration of all the facts and circumstances that led an entity to enter into a hedging relationship" per paragraph BC220 of the ED so as to prevent disqualified hedges.

Do you believe that requiring an effectiveness evaluation after inception only if certain circumstances suggest that the hedging relationship may no longer be reasonably effective would result in a reduction in the number of times hedging relationships would be discontinued? Why or why not?

See response to Question 57. Our concern is that the practical guidelines included in the ED related to hedge effectiveness may be construed differently by preparers of financial information than by auditors of those entities, potentially resulting in discontinued hedges.

Question 61

Do you foresee any significant operational concerns or constraints in calculating ineffectiveness for cash flow hedging relationships? If yes, what constraints do you foresee and how would you alleviate them?

The elimination of the *shortcut* and *critical terms match* approaches of measuring ineffectiveness, ultimately forcing the *long haul* method, creates double the calculations of effectiveness which in many instances will result in minimal or negligible amounts of ineffectiveness. We are aware of the inconsistencies inherent in current practice in applying the *shortcut* and *critical terms match* approaches and in some cases, the resulting disqualification of hedges. However, for plain-vanilla hedging relationships (e.g., single matching maturity date and notional amount for hedging instrument and hedged item, at-market rate for hedging instrument, matching risk exposure), particularly interest-rate swaps used in fair value hedges of fixed-rate debt and certain forward contracts, we believe the cost of calculating hedge ineffectiveness for both the hedging instrument and hedged items outweighs the benefit of reflecting insignificant amounts of hedge ineffectiveness in net income.

In addition, entities currently using these methods will need sufficient time to develop *long haul* methodologies. An alternative approach would be to allow a method permissible under IFRS to hedge only the portion of the cash flows associated with the hedged risk. This method simplifies the calculation of hedge ineffectiveness and is a more appropriate measure of ineffectiveness, as it ignores changes in credit spreads, and only considers the interest rate components that have been designated in the hedging relationships. Comprehensive examples of *long haul* methods should be integrated into the guidance related to measuring hedge effectiveness.

Question 62

Do you foresee any significant operational concerns or constraints in creating processes that will determine when changes in circumstances suggest that a hedging relationship may no longer be reasonably effective without requiring reassessment of the hedge effectiveness at each reporting period? If yes, what constraints do you foresee and how would you alleviate them?

See responses to Questions 57 and 58. Generally we support the principles-based approach, however, due to the ambiguous nature of the guidance we are concerned auditors or regulators will enforce their views and challenge other reasonable positions.

Do you foresee any significant operational concerns or constraints arising from the inability to discontinue fair value hedge accounting or cash flow hedge accounting by simply dedesignating the hedging relationship? If yes, what constraints do you foresee and how would you alleviate them?

Although entities can achieve the equivalent of a dedesignated hedge by entering into offsetting hedges or terminating existing hedges, these alternatives create additional costs, unnecessary documentation and hedging transactions. We do not believe the ability to dedesignate hedges leads to earnings management by entities because future changes in fair value of financial instruments are not predictable. Entities are subjected to the potential risk of market changes if they elect to dedesignate and are accountable for any impact to earnings. It is administratively easier to dedesignate a hedge than to enter into a new hedge, and the impact to an entity's net income is essentially the same.

Question 64

Do you foresee any significant operational concerns or constraints arising from the required concurrent documentation of the effective termination of a hedging derivative attributable to the entity's entering into an offsetting derivative instrument? If yes, what constraints do you foresee and how would you alleviate them?

See response to Question 63.

Question 65

Do you agree with the proposed disclosure requirements? If not, which disclosure requirement do you believe should not be required and why?

Refer to response to Question 35 where we discuss our opposition to the presentation requirements, particularly for non-financial institutions, and suggest reverting to footnote disclosure as an alternative approach.

Question 68

Do you agree with the transition provision in this proposed Update? If not, why?

We agree the transition requirements to adopt the ED 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. As this proposal represents a complete overhaul of accounting for financial instruments, we believe applying the guidance to all prior-period financial statements presented would be burdensome.

Question 70

How much time do you believe is needed to implement the proposed guidance?

We are concerned about the timing of this ED as it relates to the convergence with IASB. Once the IASB ED for hedging is issued, entities will require adequate time to review and comprehend both standards.

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In addition, we anticipate the Boards will attempt to bring the guidance on financial instruments closer to convergence requiring reexamination of the standards.

Non-financial institutions will be dependent on financial institutions for most of the disclosure and presentation information and therefore, may need an effective date subsequent to that of financial institutions.

Question 71

Do you believe the proposed transition provision is operational? If not, why?

Additional transition guidance for hedge accounting is crucial pertaining to dedesignation and redesignation requirements.

Conclusion

Overall, we are most concerned about the timing of this ED in light of the convergence project with the IASB on financial instruments. While simplifications have been proposed for hedge accounting, we are not convinced the proposed ED meets the objective of reducing the complexities of measurement and classification of financial instruments. As indicated in our responses above, we believe many of the presentation requirements should not pertain to non-financial institutions. We would also suggest that entities have the opportunity to provide further comments related to this exposure draft subsequent to the September 30, 2010 deadline. It would be beneficial to have sufficient time to compare the FASB exposure draft to the IASB exposure draft on hedge accounting and provide additional comments.

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

Sincerely,

ELI LILLY AND COMPANY

/s/Arnold C. Hanish

Arnold C. Hanish
Vice President, Finance and
Chief Accounting Officer