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March 7, 2003

CL 118

Ms. Kimberley Crook
Project Manager
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
United Kingdom

Re: Comments on ED 2 *Share-based Payment*

Dear Ms. Crook:

Eli Lilly and Company appreciates the opportunity to comment on ED 2 *Share-based Payment*.

Issuance-Paragraphs 4-6

We agree with the FASB's interpretation of issuance in Statement 123. Consideration must be exchanged in order for equity instruments to be issued. We believe the measurement focus should be on the fair value of equity instruments issued rather than on the net assets received which is the basis for the IASB approach. Performance based options are granted but not issued until the specific performance condition has been achieved. We do not agree with the IASB's approach of recording expense on performance based options regardless of whether or not the performance condition was met.

Attribution of Compensation Cost-Paragraph 15

We disagree with the IASB's unit of service approach as it is not clear how this would be an improvement to the FASB's Statement 123. We believe that compensation cost should be expensed over the period the employee provides services. For cliff vesting instruments, expense is recognized in a straight-line method. We think that this type of attribution provides consistency when comparing financial statements among companies and accurately reflects the economics of the transaction. We believe that the design of the option program reflects the value of the services provided by the employees.

Forfeitures-Paragraph 16

We disagree with the IASB's conclusion on forfeitures. We do not support the notion that this should be considered in determining the fair value of each option at grant date. We feel that it is inappropriate to recognize compensation expense related to a forfeited equity instrument. If the option is never issued, the employee gets no benefit and the employer incurs no cost. It does not make sense to record expense in this situation. The option is considered issued at the vesting date and forfeited options are not considered issued. We agree that compensation cost should be based on the actual number of shares issued. For example, consider the structure of a contract with a vendor that required 5 years worth of service for $5000 and it included a rebate clause of $2000 if they wanted out of the agreement before the fifth year. If the vendor activated the rebate clause, we would record a net expense of $3000 not the full $5000.

Measuring Fair Value of Employee Stock Options-Paragraphs 17-25

We believe that standard option pricing models overstate the value of employee stock options. An adjustment must be made for the lack of transferability inherent in this type of option in order to properly reflect its value. We disagree that the adjustment to the life of the stock option is sufficient in accounting for this (expected life vs. contractual life).

We agree that no specific option pricing model should be required by the standard. We would support suggested guidelines in determining the assumptions used in order to enhance consistency among companies. We think that guidelines in the following areas would be helpful.

- Expected life of the option
- Volatility
- Expected dividends
- Effect of lack of transferability
- Risk-free interest rate

Income Taxes-Paragraph 31

We disagree with the IASB's approach to income taxes. The income statement volatility that would result from reflecting all tax benefits through income would misrepresent the economics of the exchange. A preferable method is to tax effect the transactions initially and any difference should be reflected in equity. The goal is to match the tax effect with the compensation expense recognized. Any other method could lead to misleading results in the income statement.

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

Sincerely,

ELI LILLY AND COMPANY

S/Arnold C. Hanish
Executive Director, Finance and
Chief Accounting Officer