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Eli Lilly and Company

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Office of the Secretary
PCAOB
1666 K Street N.W
Washington, D.C. 20006-2803

Re: PCAOB Rulemaking Docket Matter No. 34

Dear Board Members:

Eli Lilly and Company ("Lilly") appreciates the opportunity to comment to the Public Company Accounting Oversight Board ("PCAOB") on the PCAOB Release No. 2016-003, *The Auditor's Report on an Audit of Financial Statements when the Auditor Expresses an Unqualified Opinion; and Related Amendments to PCAOB Standards* (the Reproposal). Lilly is a multinational pharmaceutical and animal health company, with more than 200 legal entities in over 80 jurisdictions.

Lilly understands the PCAOB's objective is to revamp the existing Auditor's Reporting Model in an effort to "increase the informational value of the auditor's report to promote the usefulness and relevance of the audit and the related auditor's report." Lilly provided comments in 2013 for the original proposal. Lilly appreciates the PCAOB's consideration of comments provided on the original proposal and recognizes the Reproposal addresses some of the concerns shared. For example, we appreciate that the PCAOB has taken into consideration the comments raised by stakeholders and has limited the Critical Audit Matters ("CAMs") scope.

Critical Audit Matters

While the Reproposal limits the CAMs scope, we believe it remains inconsistent with the US regulatory reporting framework. According to the framework, management is responsible for financial statement and related disclosures. According to the Reproposal, CAMs should be selected from "any matter that was communicated or required to be communicated to the audit committee." This sets the auditor up to be responsible for disclosing information about the company that is not previously disclosed. Many companies, us included, are concerned that the auditor's report would disclose information not otherwise disclosed about the company. The explanatory note in the Reproposal articulates the auditor is "not expected to provide information about the company that has not been made publicly available". But, the significant caveat "unless such information is necessary to describe the principal considerations that led the auditor to determine a matter is a CAM" instructs the auditor to do exactly that.

We are most concerned about the potential for the auditor to disclose information in their report that the company is not required to disclose, by the SEC or FASB, making the auditor the original source of the information. The auditor could identify a CAM around a transaction that has not yet been recorded in the financial statements by management due to timing or facts and circumstances of the item (e.g., restructuring, product returns reserve, impairment, etc.). Based on the facts and circumstances, restructuring charges may not be required, under accounting standards, to be recorded until the following year; however, the auditor may disclose this item as a CAM in the prior year audit report if it meets the CAM criteria. Disclosing this as a CAM would make it public information before the company discloses the information to those affected and the public. Additionally, even though the company may disclose information about product returns reserves, for example, the auditor's report may disclose details that are currently not required to be disclosed like specific products and liability balances.

It seems counterintuitive that a company would need to disclose information not because of the accounting standards but because of the potential to appear as a CAM. The Reproposal could lead to tension from the auditor pushing the company to disclose information because the auditor will include it in the auditor's report. The company should not be burdened with de facto disclosure rules arising from the auditor's report. We suggest that SEC and FASB disclosure rules be used to determine specific information that should be shared about CAMs.

We believe CAMs should be limited to only matters already disclosed in the critical accounting policies section of the MD&A (Management's Discussion and Analysis). There is already a robust process that exists between management and the auditors as to the identification of, and reporting on critical accounting policies and estimates. CAMs by their definition should not differ from those items. This allows the majority of information disclosed to be provided by management.

If the PCAOB requires a broader scope for CAMs than matters already disclosed in the critical accounting policies, CAMs should be limited to matters that are material to the financial statements. We believe that certain proposed changes that have remained in the Reproposal, in particular the requirement that any matter that "relates to accounts or disclosures that are material to the financial statements" be included in the definition of CAMs, could have an adverse impact on companies, auditors and financial statement users. It is not sufficiently clear how an entity would make an assessment of whether a matter is included in this definition. The Reproposal attempts to clarify the meaning through explanation and example. In our opinion this attempt does not provide sufficient clarity. We suggest, at a minimum, simply limiting CAMs to matters that are material to the financial statements.

The addition of CAMs will significantly increase the length of the auditor's report. At our request, our auditor developed an example of the auditor's report including CAMs per the original proposal. Even though the Reproposal attempts to limit the scope of CAMs, the same CAMs would be included considering the Reproposal. In addition, the auditor report grew from one page to four pages and includes items already disclosed in the company report. It is difficult to see the value of having the auditor's report repeat information already disclosed. Duplication should be avoided. We suggest "refer to the relevant financial statement accounts" be removed. The auditor's report should reference relevant disclosures to avoid duplication. At a minimum, the auditor should be encouraged to coordinate descriptions of overlapping topics with management and to avoid duplication in reporting.

Auditors have no obligation to disclose significant deficiencies. They are reported to the audit committee, but not publicly disclosed. We believe current standards for communicating control deficiencies are clear and would like the Reproposal to avoid confusion. We appreciate there were modifications to the 2013 proposal to address this concern but think more clarity would be good. We suggest the following: "the auditors have no obligation to disclose significant deficiencies."

Auditor Tenure

We recognize the change to disclose the firm tenure rather than the engagement partner tenure is an improvement. However, we believe that including this type of information within the audit report could be misleading to investors as there is no substantiated evidence to support that audit tenure has an impact on the quality of the audit. The inclusion of this information could lead investors to infer that if the company has a new auditor or if a company and auditor have a longstanding relationship that the audit opinion is not as reliable. Auditor tenure is more appropriately considered a corporate governance matter.

Conclusion

Again, Lilly appreciates PCAOB's changes in the Reproposal that reflect consideration of comments provided. However, we still have significant concerns that the auditor is being asked to share with management the responsibility for disclosing company information.

We believe there is still a significant opportunity to clarify definitions which should lead to an efficient, consistent application. Additionally, the Reproposal's guidance remains unclear and will be confusing to implement. We again urge the PCAOB to carefully consider and evaluate the impact that these proposals would have on the companies and the auditors who would be required to comply with any new standards issued and the related implications. We also urge the PCAOB to carefully consider the cost/benefit of all of the proposed alternatives prior to implementing any new standards.

We appreciate the opportunity to express our views and concerns regarding the concept release.
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