

Notes to Financial Statements

December 31, 2015

1. Significant Accounting Policies

Description of Organization

Lilly Endowment Inc. (the Endowment) is an Indianapolis based, private philanthropic foundation created by three members of the Lilly family through gifts of stock in their pharmaceutical business, Eli Lilly and Company. The stock of Eli Lilly and Company continues to be the Endowment's most significant asset. The Endowment supports the causes of religion, education and community development. The Internal Revenue Service has determined that the Endowment is exempt from federal income tax under Section 501(a) of the Internal Revenue Code. It remains a private foundation subject to federal excise tax on net investment income.

Basis of Presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States (U.S.GAAP). Preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, income, expense and related disclosures at the date of the financial statements and during the reporting period. Actual results could differ from those estimates. Subsequent events have been evaluated through April 22, 2016, the date these financial statements were available to be issued.

Cash and Equivalents

Investments with original maturities of three months or less at the time of purchase are considered to be cash equivalents.

Investments

Investments are stated at fair value in accordance with the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 958, *Not for Profit Entities*. Investments comprise equity and fixed income securities, which are recorded at market-quoted fair values. Changes in fair value are recorded in the statement of activities and changes in unrestricted net assets. There are no restrictions on investments.

Realized gains and losses from the sales of Eli Lilly and Company common stock are calculated using the first-in, first-out method of allocating cost.

Facilities and Equipment

Expenditures for facilities and equipment are expensed as paid. The amounts expensed during 2015 and 2014, are not material to the financial statements.

Grants

The Endowment primarily makes grants to organizations that qualify as public charities under the Internal Revenue Code (the Code). When distributions are made to organizations other than public charities, the Endowment assumes expenditure responsibility as required under applicable federal law. All grants are approved by the Board of Directors or its authorized representatives and are accrued when approved.

Income Recognition

Income is recognized when amounts are realizable and earned. Interest income is recorded on the accrual basis and dividends are recorded on the ex-dividend date.

Reclassifications

Certain amounts in the 2014 financial statements have been reclassified to conform to the presentation of the 2015 financial statements.

2. Change in Accounting Policy

In 2015, the Endowment elected to change its accounting policy for recognition of dividend income from the declaration date to the ex-dividend date. This change is in accordance with ASC Topic 250, *Accounting Changes and Error Corrections*, and has been applied retrospectively to all periods presented. The Endowment elected to make this change to the dividend income recognition accounting policy to better align income recognition with the date that shares of stock must be owned in order to be entitled to receive dividends. The impact on the previously issued 2014 financial statements was as follows:

	As Adjusted	As Originally Reported	Effect of Change
Dividend receivable	\$ —	\$ 65,702,902	\$ (65,702,902)
Total assets	10,001,643,224	10,067,346,126	(65,702,902)
Unrestricted net assets	9,801,222,873	9,866,925,775	(65,702,902)
Total income	\$ 278,259,090	\$ 277,483,298	\$ 775,792
Increase in unrestricted net assets	2,309,453,982	2,308,678,190	775,792
Beginning unrestricted net assets at January 1, 2014	\$ 7,491,768,891	\$ 7,558,247,585	\$ (66,478,694)

3. Required Distributions

The Code provides that the Endowment generally must distribute for charitable purposes 5% of the average market value of its investment assets. The Endowment must make additional qualifying distributions of approximately \$440,000,000, before January 1, 2017, to meet the 2015 minimum distribution requirements.

4. Other Receivables

Other receivables represent the fair value of future cash flows to be received from the Endowment's split-interest agreements. Amounts recorded are subject to subsequent changes in fair value, which would be recorded in the statement of activities and changes in unrestricted net assets under other income (deductions). These changes totaled a deduction of \$2,129,142 during 2015 and income of \$650,309 during 2014.

5. Fair Value of Financial Instruments

The Endowment determines fair values based on the framework for measuring fair value under ASC Topic 820, *Fair Value Measurements*. The following table summarizes fair value information at December 31, 2015 and 2014.

Description	Cost	Quoted Prices in Active Markets for Identical Assets (Level 1)	Observable Inputs (Level 2)	Fair Value (Carrying Value)
December 31, 2015				
Cash equivalents	\$ 49,088,338	\$ 49,091,071	\$ –	\$ 49,091,071
Fixed income securities	22,570,259	–	22,436,993	22,436,993
Marketable securities	870,167,031	11,685,271,254	–	11,685,271,254
	941,825,628	11,734,362,325	22,436,993	11,756,799,318
Other receivables	–	1,970,024	16,903,302	18,873,326
	<u>\$ 941,825,628</u>	<u>\$ 11,736,332,349</u>	<u>\$ 39,340,295</u>	<u>\$ 11,775,672,644</u>
December 31, 2014				
Cash equivalents	\$ 82,500,410	\$ 82,422,800	\$ –	\$ 82,422,800
Fixed income securities	92,787,318	–	92,502,243	92,502,243
Marketable securities	613,922,474	9,752,789,511	–	9,752,789,511
	789,210,202	9,835,212,311	92,502,243	9,927,714,554
Other receivables	–	5,817,442	21,031,358	26,848,800
	<u>\$ 789,210,202</u>	<u>\$ 9,841,029,753</u>	<u>\$ 113,533,601</u>	<u>\$ 9,954,563,354</u>

Transfers between levels, if any, are recorded at the beginning of the reporting period. There were no transfers between Levels 1, 2, and 3 during the years ended December 31, 2015 and 2014.

The fair value for marketable securities is determined using quoted market values. Fair values of fixed income securities are based on quoted market prices, where available. These fair values are obtained primarily from third-party pricing services. United States Government securities represent Level 1 securities, while Level 2 securities primarily include corporate securities. For fixed income securities that are not based on quoted market values, the value is determined by pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. The fair value of other receivables is based on observable inputs using quoted market values and a combination of a market and income approach determined based on future cash flows. Inputs in this valuation methodology include the initial value of the Endowment's split-interest agreement, the Endowment's interest percentage in the split-interest agreement, annuity percentage per the split interest agreement, estimated rate of return and discount rate.

6. Federal Excise Taxes

The Endowment is subject to federal excise taxes imposed on private foundations at 2%, or at 1% if certain conditions are met. The excise tax

is imposed on net investment income, as defined under federal law, which includes interest, dividends, and net realized gains on the sale of investments. The Endowment qualified for a 1% excise tax rate for the year ended December 31, 2015, and a 2% excise tax rate for the year ended December 31, 2014. Federal excise tax expense on realized amounts was \$5,556,531 and \$10,673,253 for the years ended December 31, 2015 and 2014, respectively. The Endowment made estimated excise tax payments totaling \$10,770,000 and \$10,780,000 during 2015 and 2014, respectively. Due to estimated tax overpayments during these years, the Endowment recorded a receivable of \$5,213,469 and \$106,747 at December 31, 2015 and 2014, respectively.

The Endowment recorded an additional liability of \$33,790,627 and \$43,701,820 for the year-ended December 31, 2015 and 2014, respectively, for deferred federal excise tax related to unrealized gains on investments.

The Endowment is subject to routine audits by taxing jurisdictions. The Endowment believes it is no longer subject to income tax examinations for years prior to 2012 due to three-year statute of limitations.

If incurred, any interest and penalties would be recorded as a component of excise tax.