

# Notes to Financial Statements

December 31, 2013

## 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 (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 March 24, 2014, the date these financial statements were 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 are comprised of 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 2013 and 2012 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. 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 and are accrued when approved.

### Income Recognition

Income is recognized when amounts are realizable and earned.

## 2. Required Distributions

The Internal Revenue Code provides that the Endowment generally must distribute for charitable purposes 5% of the average market value of its assets. The Endowment must make additional qualifying distributions of approximately \$336,000,000, before January 1, 2015, to meet the 2013 minimum distribution requirements.

## 3. 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.

#### 4. Fair Value of Financial Instruments

The Endowment determines fair values based on the framework for measuring fair value under ASC 820, *Fair Value Measurement*. The following table summarizes fair value information at December 31, 2013 and 2012.

Description	Cost	Quoted Prices in Active Markets for Identical Assets (Level 1)	Observable Inputs (Level 2)	Fair Value (Carrying Value)
<b>December 31, 2013</b>				
Cash equivalents	\$ 10,999,479	\$ 10,999,469	\$ -	\$ 10,999,469
Fixed income securities	50,054,553	10,005,000	39,933,712	49,938,712
Marketable securities	570,450,585	7,532,233,239	-	7,532,233,239
	631,504,617	7,553,237,708	39,933,712	7,593,171,420
Other receivables	-	5,775,989	26,199,434	31,975,423
	\$ 631,504,617	\$ 7,559,013,697	\$ 66,133,146	\$ 7,625,146,843
<b>December 31, 2012</b>				
Cash equivalents	\$ 5,999,265	\$ 5,999,985	\$ -	\$ 5,999,985
Fixed income securities	82,688,922	-	82,691,271	82,691,271
Marketable securities	558,299,943	7,167,755,398	-	7,167,755,398
	646,988,130	7,173,755,383	82,691,271	7,256,446,654
Other receivables	-	5,756,372	26,364,897	32,121,269
	\$ 646,988,130	\$ 7,179,511,755	\$ 109,056,168	\$ 7,288,567,923

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, 2013 and 2012.

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 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.

#### 5. 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 2% excise tax rate for the years ended December 31, 2013 and 2012. Federal excise tax paid on realized amounts was \$5,547,131 and \$5,542,538 for the years ended December 31, 2013 and 2012, respectively.

The Endowment recorded an additional liability of \$7,046,668 and \$22,133,513 for the years ended December 31, 2013 and 2012, 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 2010 due to the three-year statute of limitations.

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