Building a better working world

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Report of Independent Auditors

The Board of Directors
Lilly Endowment Inc.

We have audited the accompanying financial statements of Lilly Endowment Inc., which comprise the statements of financial position as of December 31, 2016 and 2015, and the related statements of activities and changes in unrestricted net assets and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Lilly Endowment Inc. at December 31, 2016 and 2015, and the changes in its unrestricted net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

March 16, 2017

Statements of Financial Position

As of December 31	2016	2015
Assets		
Cash and equivalents	$ 49,831,314	$ 53,153,768
Other receivables	14,361,093	18,873,326
Investments — at fair value:		
United States government and agency, bank, and corporate interest-bearing obligations	-	22,436,993
Eli Lilly and Company common stock (cost — $83,381,398 at December 31, 2016, and $83,702,131 at December 31, 2015)	9,236,100,384	10,773,551,345
Diversified equity investments	989,139,724	911,719,909
Other assets	4,398,884	5,213,469
	$ 10,293,831,399	$ 11,784,948,810
Liabilities		
Amounts appropriated for future grants	$ 46,167,500	$ 144,621,069
Deferred tax liability	180,331,317	209,606,228
	226,498,817	354,227,297
Unrestricted net assets	10,067,332,582	11,430,721,513
	$ 10,293,831,399	$ 11,784,948,810

See accompanying notes.

Statements of Activities and Changes in Unrestricted Net Assets

Year Ended December 31	**2016**	2015
Income:		
Dividends	$ 281,043,970	$ 280,923,758
Interest	644,970	566,913
Total income	281,688,940	281,490,671
Deductions:		
Grants approved	359,678,504	558,998,132
Expenses:		
Program support	7,028,602	6,861,265
Operational support	6,424,563	7,078,577
Federal excise tax related to realized gains	4,530,116	5,556,531
Federal excise tax related to unrealized gains	(29,274,911)	33,790,627
Total grants approved and expenses	348,386,874	612,285,132
Realized gain on sale of investments	179,240,996	286,032,772
Unrealized gain (loss) on investments	(1,473,400,413)	1,676,388,994
Other deductions	(2,531,580)	(2,128,665)
Increase (decrease) in unrestricted net assets	(1,363,388,931)	1,629,498,640
Unrestricted net assets:		
Balance at beginning of year	11,430,721,513	9,801,222,873
Increase (decrease) in unrestricted net assets	(1,363,388,931)	1,629,498,640
Balance at end of year	$ 10,067,332,582	$ 11,430,721,513

See accompanying notes.

Statements of Cash Flows

Year Ended December 31	2016	2015
Operating activities		
Increase (decrease) in unrestricted net assets	$ (1,363,388,931)	$ 1,629,498,640
Adjustments to reconcile change in unrestricted net assets to net cash used in operating activities:		
Investment expenses	279,517	288,490
Unrealized (gain) loss on investments	1,473,400,413	(1,676,388,994)
Realized gain on sale of investments	(179,240,996)	(286,032,772)
Changes in assets and liabilities:		
Other receivables	4,512,233	7,975,474
Other assets	814,585	(4,868,965)
Amounts appropriated for future grants	(98,453,569)	120,016,319
Deferred tax liability	(29,274,911)	33,790,627
Net cash used in operating activities	(191,351,659)	(175,721,181)
Investing activities		
Purchases of investments	(254,985,868)	(483,896,944)
Proceeds from sale and maturity of investments	443,294,590	583,902,217
Investment expenses	(279,517)	(288,490)
Net cash provided by investing activities	188,029,205	99,716,783
Net decrease in cash and equivalents	(3,322,454)	(76,004,398)
Cash and equivalents at beginning of year	53,153,768	129,158,166
Cash and equivalents at end of year	$ 49,831,314	$ 53,153,768

See accompanying notes.

Notes to Financial Statements

December 31, 2016

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 March 16, 2017, the date these financial statements were issued. There were no subsequent events that required recognition or disclosure in the financial statements.

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 incurred. The amounts expensed during 2016 and 2015, 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. Amounts appropriated for future grants at December 31, 2016, are expected to be paid to grantees as follows: $40,817,500 in 2017 and $5,350,000 in 2018.

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.

New Accounting Pronouncement

In August 2016, the FASB issued Accounting Standards Update 2016-14, *Not for Profit Entities* (Topic 958): *Presentation of Financial Statements of Not-for-Profit Entities*. This new standard on presentation of financial statements for not-for-profit entities makes targeted improvements to the current financial reporting model for not-for-profit entities. The standard imposes changes to net asset classification requirements and information about liquidity, financial performance and cash flows. The standard is effective for fiscal years beginning after December 15, 2017, and early adoption is permitted. The Endowment is evaluating the impact of the new guidance on the financial statements.

2. 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 $444,000,000, before January 1, 2018, to meet the 2016 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 agreement held by third parties. Amounts recorded are subject to subsequent changes in fair value, which are recorded in the statements of activities and changes in unrestricted net assets under other deductions. These changes totaled a deduction of $2,531,580 and $2,129,142 during 2016 and 2015, respectively.

4. 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, 2016 and 2015.

Description	Cost	Quoted Prices in Active Markets for Identical Assets (Level 1)	Observable Inputs (Level 2)	Unobservable Inputs (Level 3)	Fair Value (Carrying Value)
December 31, 2016					
Cash equivalents	$ 40,966,757	$ 40,974,552	$ –	$ –	$ 40,974,552
Marketable securities	883,669,565	10,225,240,108	–	–	10,225,240,108
	924,636,322	10,266,214,660	–	–	10,266,214,660
Other receivables	–	–	–	14,361,093	14,361,093
	$ 924,636,322	$ 10,266,214,660	$ –	$ 14,361,093	$ 10,280,575,753
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	–	–	–	18,873,326	18,873,326
	$ 941,825,628	$ 11,734,362,325	$ 22,436,993	$ 18,873,326	$ 11,775,672,644

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, 2016 and 2015.

The fair value for marketable securities is determined based on the regular trading session closing price on the exchange or market in which such securities are principally traded on the last business day of each period presented (Level 1).

For fixed income securities that are not based on quoted prices in active markets (Level 2), the fair value is determined by pricing models, quoted prices of securities with similar characteristics, or discounted cash flows. Fair values for these fixed income securities are obtained primarily from third-party pricing services.

Other receivables, which is a split-interest agreement, are valued using significant unobservable inputs (Level 3). The need to use unobservable inputs generally results from the lack of an active market or marketplace with respect to the split-interest agreement. The split-interest agreement is recorded at the estimated fair value based on the present value of the Endowment's future cash flows from the related trust. Future cash flows are based on an income approach (present value techniques), the inputs of which 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.

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 1% excise tax rate for the years ended December 31, 2016 and 2015. Federal excise tax expense on realized amounts was $4,530,116 and $5,556,531 for the years ended December 31, 2016 and 2015, respectively. The Endowment made estimated excise tax payments totaling $8,929,000 and $10,770,000 during 2016 and 2015, respectively. Due to estimated tax overpayments during these years, the Endowment recorded a receivable of $4,398,884 and $5,213,469 at December 31, 2016 and 2015, respectively.

The deferred tax liability recorded on the statements of financial position is for deferred federal excise taxes related to unrealized gains on investments. The Endowment recorded a decrease in the deferred tax liability of $29,274,911 for the year ended December 31, 2016, and an increase of $33,790,627 for the year ended December 31, 2015.

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 2013 due to three-year statute of limitations.

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