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International Accounting Standards Board
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7 March 2003

Dear Ms Crook,

RESPONSE TO ED2 SHARE-BASED PAYMENT

The Royal Dutch/Shell Group of Companies ("Shell") would like to take this opportunity to comment on the IAS exposure draft – ED2 on Share-Based Payments. We support the international harmonisation between the FAS and IAS and are concerned over the significant differences between the IAS exposure draft and existing US GAAP guidance in this area. We think that a stronger emphasis should be placed on reaching convergence in this area by both the IASB and the FASB in the United States in order to ensure a worldwide level playing field.

Whilst US GAAP allows non-recognition of certain options under APB 25, the IAS exposure draft requires recognition of expense related to all stock options. Beyond this significant and overarching difference, we have the following areas of specific concern:

- the credibility of a grant date model for valuation, particularly in the case of performance based options;
- the value of using a fair value model rather than an intrinsic value model for the valuation of options which are settled in cash;
- the proposed accounting treatment of tax.

Because of the specific features of employee stock options such as longevity, non-transferability and restrictions on exercise during "close" periods, we think that more work should be carried out to develop a valuation model for stock options that gives robust and reliable results.

Beyond this challenge, of particular concern are options that have complex vesting requirements based on performance. Arriving at an accurate assessment of the probabilities associated with this type of optionality will prove to be quite subjective and therefore will lead to issues of reliability and comparability. While we agree that requirements related to valuation in the standard should be principle based and not prescriptive, we would strongly encourage additional thought and discussions

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with experts in the field of valuation be undertaken by the IASB to determine if a modified grant date model (a model that contains a mechanism for truing up compensation cost for actual forfeitures) may be more appropriate given the issues of reliability and comparability. We prefer a model that will allow a true up of the estimate used in the valuation of the options for awards that do not ultimately vest. We are of the opinion that in this case, there is not an economic outflow associated with the unvested options and that it is inappropriate for an expense to be raised where the company assumes no liability.

Use of a fair value model for valuation of stock options which are settled in cash, while consistent with the measurement of other options, is quite burdensome given that revaluation must occur over the entire life of the option. Ultimately, these options will result in compensation cost being recognised on the intrinsic basis. We believe that while differences in recognition over time will occur in the two methods, an intrinsic method will be substantially less costly to administer and will ultimately lead to the same result and is therefore a more practical solution.

The suggested tax treatment in the exposure draft also raises issues of concern. The IASB's intent of charging an option's fair value to net income is to more accurately record the cost to an employer of receiving an employee's service (net of tax) over the vesting period. However, once granted, the risks and rewards arising on an option are transferred to the employee. It follows that any tax benefit that arises after an option is granted (commonly upon its exercise) should no longer be attributable to the cost of an employee's service and therefore, be recorded in equity rather than net income.

If you have any questions concerning this comment letter, please contact Simon Ingall, the head of our accounting research and development team, at 020-7934-2304.

Yours sincerely
Shell International Limited

Tim Morrison
Group Controller