160 Rio Robles San Jose, CA 95134

January 31, 2003

Letter of Comment No: 750 File Reference: 1102-001 Date Received: /-3/-/)3

Ms. Suzanne O. Bielstein Financial Accounting Standards Board 401 Merritt 7, P.O. Box 5116 Norwalk, Connecticut 06856-5116 director@fasb.org

Re: Invitation to Comment - Accounting for Stock Based Compensation

Dear Ms. Bielstein:

This letter and attachment address the Invitation to Comment issued on November 18, 2002 regarding Accounting for Stock-Based Compensation.

KLA-Tencor believes that the disclosure only rules within Statement 123 provide an appropriate mechanism to inform investors about a company's stock option plan. I am concerned that calls to change accounting for stock options by requiring expensing on the face of the income statement can have far reaching effects on the competitiveness of America's high tech industry. This is especially true because we compete for resources and talent with economies and nations around the world that do not have this restrictive treatment of employee stock options.

In addition the valuation models used with freely marketable stock options cannot be adjusted appropriately to present a reliable and consistent valuation for employee stock options due to the many restrictions and differences in terms in employee stock options. Adding this type of measure to the income statement will only reduce the transparency and usefulness of financial statements. This would be a disservice to our investors.

Please retain the disclosure only rules of Statement 123.

Sincerely yours,

Kenneth Schroeder Chief Executive Officer

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160 Rio Robles San Jose, CA 95134 January 31, 2003

Financial Accounting Standards Board 401 Merritt 7, P.O. Box 5116 Norwalk, Connecticut 06856-5116 director@fasb.org

Re: Invitation to Comment – Accounting for Stock Based Compensation: A Comparison of FASB Statement No. 123 and IASB Proposed IFRS, Share Based Payment – Issued November 18, 2002

To Whom It May Concern:

This letter addresses the Invitation to Comment issued on November 18, 2002 regarding Accounting for Stock-Based Compensation. While the invitation limits the area to be addressed by excluding certain issues, we note that the Board did not deliberate the issues and observations contained in the Invitation (Page 9, a-d). We consider this important because the issues excluded from consideration by the invitation are critical to the debate regarding expensing ESOs. This response will therefore cover both the issues for respondents in Appendix B of the Invitation to Comment and the issues excluded from consideration.

There is one basic issue that should be of primary consideration in any decision on how employee stock options (ESOs) should be treated for accounting purposes: what is important to investors to allow them to understand and interpret the financial information that is being presented. FASB issued Statement 123 with that goal in mind. At that time the FASB agreed with commentators who suggested that this new information was too complicated, too unproven, and too contentious to be placed within the financial statements. Therefore the information was included in the footnote disclosures to the financial statements. The situation is little changed today, as the standard requires computations that are still subject to disagreement within the corporate, accounting and investing community. It is clear that investors have not heeded the information on stock option expensing. Companies that adopted ESO expensing have not seen a large market reaction to this news.

Likewise companies that have asserted their belief that expensing is not appropriate did not see large changes in their market valuation. The fact that investors have made limited use of fair value accounting is not a valid reason to elevate this dubious valuation directly on the face of the financial statements.

The reasons for continuing the current disclosure standard as opposed to expensing ESOs can be broken down into two categories: 1) Accounting reasons that include consistency, valuation flaws and transparency. 2) Policy reasons that include competitiveness and fairness to our knowledge workers. While we understand that the FASB may not be interested in the policy reasons, we think those reasons are of importance to investors and

therefore they are included. We will first address the accounting reasons why ESO expensing is not appropriate, and therefore the current disclosure standard should be continued, we will then cover the policy issues that play an important part in this debate and finally the specific questions and issues for respondents from Appendix B of the Invitation to Comment are covered in detail.

Accounting Reasons Against Expensing ESOs:

Consistency - Accounting hallmark

Consistency has always been the watchword for accounting. Consistent treatment of an item between periods is essential to correctly reflect the financial condition and financial performance of the enterprise. Expensing of ESOs will not enhance comparability of financial periods. The Wall Street Journal reported on September 19, 2002 "...the options Cisco granted for the fiscal year ended July 2001 were valued at \$3.3 billion. Today, using the same statistical model, those options would be valued at \$131 million, because Cisco's stock price has dropped precipitously." These do not appear to be consistent results and in fact mislead investors. The current proposals for expensing do nothing to revalue ESOs, which have lost any portion of their value.

The current disclosure standard has been in effect for less than 10 years. There is no legitimate reason to abandon the standard, or aggressively push ESO expensing forward. The FASB appears intent on doing just that. FASB's most recent attempt to impose Statement 123 came about in the form of FAS 148. This Financial Accounting Statement forces companies to adopt Statement 123 within a specific timeframe or have the prospective-only method removed from the transition choices. Prospective-only was a natural course when Statement 123 was first introduced, but makes little sense to FASB now that the FAS 123 disclosures have been in place for several years. Many companies had announced their intention to expense their ESO plans and use the prospective-only method. In FAS 148 FASB kept prospective-only in place, but only for a limited time, benefiting only those companies willing to elect expensing of ESOs now. Discount stores have limited time offers, but financial standard setters should not. The allowance of prospective-only for companies that adopt ESO expensing now, appears to be FASB's effort to provide a benefit to those companies that support FASB's push for ESO expensing. The development and implementation of FAS 148 in our opinion adds no greater clarity or accuracy and in fact, only misleads investors. This is not consistent accounting, but is politically motivated by FASB to enforce their will on corporations and their investors.

Consistency between accounting standards between countries is an ambitious and worthy goal, however, no countries rushed to follow Statement 123 when it was originally adopted in the United States. In fact, some very large countries that are growing at very fast rates, like China, are not even within the accounting guidelines

of either the FASB or the IASB. Now the IASB is pushing for standards on ESO treatment. There is a great deal of work to be done before the IASB introduces their standard, therefore, the United States should not rush to ESO expensing. Investors will be better served by the maintenance of the current disclosure standard until it is clear what other standard setting boards adopt with regard to ESO accounting, and how broadly these standards are enacted and enforced.

Valuation Flaws

Both the FASB and the IASB call for companies to adjust their use of whichever option-pricing model they choose for factors that are distinctive to ESOs when compared to freely traded marketable options. The premise inherent in all option pricing models is that market participants are free to change their investment positions based on their interpretation of market data. This is not true with ESOs. Employees are not free to trade their options. This fact is the one basic flaw that is not considered in the FASB's work on the subject of ESO expensing. Options derive much of their value in option pricing models from free transferability which allows investors to trade in and out as their view of the market changes. In contrast an employee can only watch as the value of their options declines, having no recourse other than to leave their jobs and seek a new one. This is one reason why employees generally will exercise their options earlier than the final expiration date. Option theory can demonstrate that, in the absence of dividends, options should only be exercised on their last day of life. At any time prior to their expiration, the option has a value greater than could be obtained through exercise. Every option model created reaches this same conclusion concerning freely traded options. It should be instructive to FASB that employees most often exercise their options with many years remaining on the options, clearly indicating there are different metrics of valuation in use by employees. These different metrics are due to the restrictions, lack of transferability and other inherent differences of ESOs from freely traded options. For example, the chance that employment may be terminated, cutting off the opportunity to exercise at exactly the time that exercise is likely to have the lowest value, is something that each holder of an ESO must consider. No analysis has yet been put forward that can reasonably estimate that impact and consistently model how employees value a contract with these restrictions. In TechNet's comments to FASB, November 4, 2002, Rick White, CEO of TechNet, emphasized the difficulties of valuation models for ESOs. "There is a growing consensus that current option pricing models, when applied to ESOs, produce wide-ranging and therefore often misleading results. Quarterly disclosures based on a flawed valuation will not serve shareholders or investors."

Transparency

Another accounting issue within FASB's and IASB's approach to ESO accounting is how comparability will suffer due to the many choices that companies have in the implementation of the expensing standard. The fair

value approach has too many moving parts, each of which is subject to estimation and determination by the companies implementing the standard. These different choices create too much variability between the answers that derive from the fair value accounting method. Companies in similar industries, with similar capital structures, may choose different applicable interest rates, different expected option lives, and different volatility levels when applying their model to determine the "fair value" of ESOs. Increasing the lack of comparability are the adjustments to option pricing models required for ESOs. Transparency of financial statements will not be served by combining these inconsistent measures into a single figure for inclusion in an income statement, and this is not the appropriate approach to financial reporting. Instead these metrics should be retained in the footnote disclosure, with their details and explanations, so that investors can make their individual choices on how to use the information presented. Investors have generally chosen to ignore the disclosures, due to the inaccuracy that result from applying existing option models to ESOs. For this reason, stock option expensing should not be added to the financial statements.

Proponents of ESO expensing argue that expensing is needed to improve accuracy and reliability within financial statements. Expensing ESOs, however, would not have cured or prevented the fraud by corporate management in some spectacular bankruptcies that have recently shaken investor's confidence in financial reporting. Expensing ESOs will not eliminate the use of special purpose entities to hide significant risks and expenses. ESOs have been painted as the culprit in aiding and abetting management malfeasance. But ESOs were not the cause of the problems, and changing the accounting treatment does nothing but deflect attention away from the real issues of **consistency** and **transparency**. These accounting ideals are not served by moving a dubious computation from the footnotes to the face of the financial statements. As William Sahlman writes in "Expensing Options Solves Nothing," *Harvard Business Review*, December 2002, "...reporting an executive option as a cost item on the income statement does not add any information that 's not already included in the financial statements. If anything, expensing options may lead to an even more distorted picture of a company's economic condition and cash flows than financial statements currently paint."

Policy Reasons Against Expensing ESOs:

Competitiveness

Investors primary concern when allocating capital is the returns they can expect from that investment. Companies that issue stock options have had better returns over a long period of time. A recent study presented in the book, "In The Company Of Owners: The Truth About Stock Options and Why Every Employee Should Have Them", Blasi, Kruse, Bernstein, (Basic Books, 2003), reported "on average, companies and their investors

made a profit on partnership approaches including stock options, over and above any ownership they dished out to employees. They gave workers an 8 percent ownership stake, and in return enjoyed an average of a 2 percentage point higher return on the shares they still held." This study demonstrates that using broad based stock option plans to align the interests of employees and shareholder works. To expense ESOs would surely dampen the economic growth and innovation that this country has seen over the last 20 years. FASB seems more concerned that investors have not done more to reduce the stock prices of companies with broad based ESO plans. But the facts show that these companies have outperformed companies where options are less widely distributed, thereby justifying their higher stock prices. The current disclosure standard provides all the information that investors need to determine the impact of stock option plans and investors have consistently decided that broad based ESO plans can be an important part of the success of a company. We again refer to a study as presented in, the Blasi, Kruse and Bernstein book. (Page 109), "The High-Tech 100 handed out 7 percent of their total equity to employees and the top five officers that year. (2000). The top five executives in each firm received just 1 point. To put it another way, the High Tech 100 granted 1.5 billion options in 2000. The top five officers got 164 million of these, while everyone else split the remaining 1.36 billion." This is the type of additional information that investors need to determine the impact of stock option plans. We believe that this information is so important that we recently participated in efforts to improve stock option disclosures on grants to senior management, in order to help investors understand that our company's employee option plan really is broadly based. In November 2002 TechNet and AEA, along with 33 companies including KLA-Tencor, released an improved approach to disclosure of executive options, to be incorporated into quarterly filings. According to AeA Chairman Richard C. Cook, 'including the expanded disclosures in company quarterly SEC filings would be a significant improvement over the way the information is currently provided." We have reported, and intend to continue to report, this information on a quarterly basis.

It is notable that international standards did not move to provide greater disclosure or expensing of options immediately following the FASB's decision in 1995 to require disclosure of fair value accounting. This indicates not just the controversial nature of fair value accounting; it also indicates that other countries envy the success that the US has shown with its entrepreneurial spirit. At the European Council meeting in Lisbon in 2000, Member States of the European Union set the goal of "making Europe the most competitive and dynamic knowledge-based economy in the world." This goal was to be attained by promoting the entrepreneur approach within their employee base and business communities via increased use of ESOs. The EU called for all member countries to introduce laws to encourage ESO plans. This provides the reason, we believe, that EU member states will reject any attempt by the IASB to impose fair value accounting on the face of the financial statements. Taiwan has also made extensive use of ESOs to build their high-tech industry. "Taiwan company law stipulates that a percentage of company earnings must be shared among employees and that stock bonuses

are earnings distributions and not company expenses," *Tatpet Journal*, Taiwan December 5, 2002. Likewise China is expanding the use of ESOs in an effort to build alignment between workers and investors. According to *Business Week* December 9, 2002, China is encouraging "many U.S. based scientists, engineers and executives born in China to return home to found tech start-ups."

Fairness to our Knowledge Workers

"In Silicon Valley -- where as many as one in four households have ESOs -- companies are cutting back on the number of options they share with workers. The Rutgers' researchers say that would be the wrong solution to the problem." "It would be a sorry conclusion," Blasi said, "if the result of two years of horrible scandals in American corporations and an unprecedented public demand for corporate reform is that accountants persuade us to eliminate broad-based ownership for technology companies and other companies. ..." "Stock Options Profits Benefited Workers, Study Shows", Schwanhausser, San Jose Mercury News, California, January 10, 2003

KLA-Tencor utilizes a broad based ESO plan that we firmly believe aligns our employees with our shareholders. To expense ESOs through the financial statement will surely force us to re-think our use of broadbased ESOs. This could create detrimental effects for both our shareholders and our knowledge workers. Sarbanes-Oxley was designed and has been implemented to address the real issues that stemmed from lax corporate governance practices. Let's allow Sarbanes-Oxley to work for American companies and not throw out the mechanisms firms in the United States have used in building our best in class economy and world leadership role in entrepreneurial growth. Other countries, like China, are moving aggressively to encourage employee ownership and are recognizing the benefits of increased employee alignment with corporate goals. They will not make the mistake of stepping backwards by expensing ESOs.

Respectfully Submitted,

J. Peter Campagna

Vice President, Treasurer KLA-Tencor Corporation

408-875-9415

Issues for Respondents in Appendix B of the Invitation to Comment

Issue 1: Statement 123 provides a scope exclusion for ESOPs and certain ESPPs, and the Proposed IFRS does not. Which view do you support and why? (Refer to page 19.)

We support the exclusion of not just ESOPs and ESPPs, but all ESO plans from the requirements for mandatory expensing under the fair value approach. We do not find that there have been any improvements in the ability to consistently and reliably value an ESO, therefore the exclusions should be extended.

Issue 2: In measuring the fair value of stock options granted to employees, both Statement 123 and the Proposed IFRS require use of an option-pricing model that takes into account six specific assumptions. The standards provide supplemental guidance for use in selecting those assumptions. (Refer to page 20.)

Issue 2(a): Do you believe that an accounting standard should mandate the use of an option-pricing model for measurement purposes? If not, what other approaches do you believe would provide more consistent and reliable estimates of the fair value of employee stock options granted and why? (Refer to page 21.)

We believe that consistency within accounting would require the mandate of an appropriate measurement tool for all costs and expenses. But since no reasonable model exists to measure the value of ESOs, then no standard should be imposed which would require expensing of ESOs. We urge the board to review the numbers as reported by an article in Business Week Online, July 19, 2002. "Five ways to value options". In this article, the same hypothetical grant is valued using the Black-Scholes, Binomial, Minimum Value, Growth & Discount and Intrinsic Value methods for valuing an option. The results for each model are widely disparate. We would also urge the FASB and IASB to consider the numbers submitted by Dennis Powell, Controller, Cisco, as quoted by Scott Thurm in "Cisco says expensing options would reduce its net by 80%." The Wall Street Journal, September 19, 2002 "...the options Cisco granted for the fiscal year ended July 2001 were valued at \$3.3 billion. Today, using the same statistical model, those options would be valued at \$131 million, because Cisco's stock price has dropped precipitously." Consistent and reliable are not the words that come to mind when considering valuation models for ESOs.

Issue 2(b): If you agree that an accounting standard should mandate the use of an option-pricing model, do you believe that a particular model should be mandated? If so, which model should be required to be used and why? (Refer to page 21.)

We believe that no model created to date accurately reflects the true value of ESOs, and that no adjustments of currently existing models adequately correct for the various restrictions within ESOs that severely limit their value compared to free-market options. Therefore no hypothetical valuation should be imposed on the financial statements. The standard should continue to require disclosure only so that investors can make their own decisions on the merits of the model and assumptions used.

Issue 2(c): If you agree that an accounting standard should not mandate the use of a particular option-pricing model, do you believe that additional disclosures should be made to improve the user's ability to compare the reported financial results of different enterprises? If so, what types of additional information should be required to be disclosed? (Refer to page 21.)

Since no model can accurately estimate the value of an ESO, accounting rules should continue to provide disclosure information on the number of outstanding options and their terms, and then provide sample assumptions that investors can utilize to measure the impact of the ESO program. Therefore, we support the additional disclosures required by the Proposed IFRS.

Issue 2(d): Statement 123 and the Proposed IFRS require that certain modifications be made to the outcome of an option-pricing model to address certain features of employee stock options. If you believe that other modifications should be made to improve the consistency and reliability of those outcomes, please describe those modifications and why they should be required. (Refer to page 21.)

Although both the FASB and IASB concludes that adjustments can be made to option pricing models to account for the unique features of ESOs, neither entity presents any evidence to support this conclusion. In fact the factors that make ESOs different from freely transferable options are not the subject of the extensive studies that have been done on open market options. The lack of a market for ESOs is the reason that they cannot be valued using the same approaches and models that work for market traded options. No amount of study will produce any different answer, because there is not a way to directly measure ESOs perceived value to the employee. According to William Margrabe, Ph.D. from the University of Chicago and Fischer Black's research assistant during development of the Black-Scholes option valuation model, [Bloomberg, July 23, 2002] "As a result of these differences, an employee option must be worth less than an option of the type the Black-Scholes was meant to value. So any result obtained by using this method would need a 'haircut' or a discount to a lower

figure. Nobody knows how much of a haircut to take and nobody will probably ever know." If the research assistant to one of the developers of the Black-Scholes model is not confident in the discount amount to be applied, how can the IASB, FASB, or others presume to know what the correct adjustments might be? If individual companies adjust option-pricing models for the different terms and conditions of ESOs, this will be an additional area where comparability between companies' presentations will suffer.

Issue 2(e): Do you believe that additional guidance for selecting the factors used in option-pricing models is necessary to provide added consistency and comparability of reported results? If so, what types of guidance should be provided and in which areas? (Refer to page 21.)

Since the pricing models that are used today are flawed when applied to pricing ESOs, no amount of guidance offered would improve the consistency or accuracy of the estimates produced.

Issue 3: Do you believe that employee and non-employee transactions are distinct and, therefore, warrant different measurement dates for determining the fair value of equity instruments granted? If so, why? If not, why not? (Refer to page 24.)

We do not agree that non-employee stock option transactions are distinct from employee stock option transactions.

Issue 4: Do you believe that the fair value of equity awards granted to non-employees that include performance conditions can be measured with sufficient reliability to justify a grant-date measurement method? If so, why? If not, why not? (Refer to page 24.)

We believe there is no model that can accurately ascertain the value of an employee equity award, and therefore the value of a non-employee award where there are performance conditions cannot be measured reliably until said performance has been accomplished. Otherwise the contract obligations may never be fulfilled, and the award would have no value.

Issue 5: Do you believe the notion of issuance is conceptually of importance in the design of a standard on stock-based compensation? If so, why? If not, why not? (Refer to page 25.)

No, we do not believe the notion of issuance is conceptually of importance in this discussion. Issuance simply represents to the optionee that the company is willing to allow the purchase of stock at a specific price, within a specific time period and by virtue of completing specific requirements. If all conditions go unmet, then the "contract" is cancelled for both parties.

Issue 6: Do you believe an equity instrument subject to vesting or other performance conditions is issued, as defined by Statement 123, at the grant date? If so, why? If not, why not? (Refer to page 25.)

Yes, we agree the ESO is issued at the grant date. (See our response to Issue 5)

Issue 7: Do you believe that the effect of forfeiture should be incorporated into the estimate of fair value per equity instrument (IASB approach)? If so, why? If not, why not? (Refer to page 28.)

Yes, the effect of forfeitures must be taken into account in measuring the fair value of ESOs.

Unfortunately there is no accurate or reliable way in which to measure the impact of forfeitures until the forfeiture actually happens. Any valuation model that attempts to value ESOs at grant date must include an adjustment for possible forfeitures. We can offer no guidance on how any option valuation model can accurately or reliably make such adjustments.

Issue 8: Should failure of an award holder to satisfy the conditions that entitle the holder to retain or receive the promised benefits affect the amount of compensation expense that should be recognized related to that award? If so, why? If not, why not? (Refer to page 28.)

If the conditions of the agreement are not met, the agreement becomes null and void. The same principle is used in contract law, where the parties do not adhere to the terms of the agreement. In this situation there clearly should be no compensation expense. Any model that purports to value options at grant date would need to adjust for the possibility that the conditions were not met, and the promised benefit thereby not attained. We can offer no guidance on how any option valuation model can accurately or reliably make such adjustments.

Issue 9: Do you agree that the result of the IASB's approach to calculate the fair value of equity instruments of nonpublic entities would be closer to fair value than minimum value? If so, why? If not, why not? (Refer to page 29.)

This question is tantamount to asking which estimate is less egregious. We believe that no model created to date accurately reflects the true value or cost of ESOs, and that no adjustments of currently existing models adequately correct for the various restrictions within ESOs that severely limit their value compared to free-market options. Therefore both approaches fall short of the consistency and reliability required for imposition of an accounting standard requiring ESO expensing on the financial statements.

Issue 10: Which of the two attribution methods described by the standards do you believe is more representationally faithful of the economics of stock-based compensation arrangements and why? (Refer to page 35.)

In our opinion Statement 123 depicts the time factor associated with the award more accurately. Statement 123 also recognizes that the award or contract may never be fulfilled.

Issue 11: Statement 123 does not ascribe value to services received in exchange for equity instruments that are later forfeited (that is, recognized compensation expense is reversed upon forfeiture), whereas the Proposed IFRS ascribes value to such services through its units-of-service attribution method (that is, recognized compensation expense is not reversed upon forfeiture). If you support the Proposed IFRS's view, do you believe the units-of-service method ascribes an appropriate value to services received prior to forfeiture? If so, why? If not, why not? (Refer to page 35.)

We do not support the view of the IFRS that compensation expense should be recognized using the valuation models available today. However if an option is forfeited, then that option clearly cannot create any compensation charge and if any compensation charge was already recorded, the charge should be reversed.

Issue 12: Do you believe that the actual outcome of performance awards should affect the total compensation expense incurred by an enterprise? If so, why? If not, why not? (Refer to page 38.)

We do not accept the position that compensation expense can be recognized for awards using the valuation models available today. Therefore, those awards should not affect the total compensation expense incurred by an enterprise. In fact, this view is also supported publicly, and most recently in the book titled "In the Company of Owners", Blasi, Kruse and Bernstein, 2003, Basic Books. "But as we've said, options, at least for non-executives, in fact aren't compensation at all. Instead they represent risk-sharing profits that workers receive on top of their normal market wages and benefits. Unlike wages, which companies must pay out in cash,

options require no expenditure by the corporation. Instead, they come out of the pockets of the company's shareholders, in the form of dilution." (Page 240) In the same book, (page 157), the authors' research shows that shareholders investing in companies with broad based ESO plans, (risk sharing), enjoyed an average of a 2-percentage point higher return on the diluted shares that they still held.

Issue 13: Do you believe that this issue is important in considering an attribution model's validity? If so, why? If not, why not? (Refer to page 40.)

The issue is important because the position taken by both Statement 123 and the IFRS have a critical flaw. Both assume that there is a readily ascertainable value or market for ESOs. In fact, ESOs have no market and therefore cannot be valued using option models developed for marketable options.

Issue 14: Do you believe that the measurement-date criteria in Issue 96-18 accurately reflect the economics of transactions with non-employees? If not, why not? (Refer to page 43.)

Unless there are differences in their terms, we do not believe that there is a fundamental difference between employee and non-employee stock option. For that reason the measurement-date criteria in Issue 96-18 would not accurately reflect the economics of transactions with non-employees.

Issue 15: Do you believe that all of the tax benefits derived from stock-based compensation arrangements should be recognized in the income statement? If so, why? If not, why not? (Refer to page 46.)

Tax regulations related to stock options vary widely between jurisdictions, and most often produce benefits only after exercise of the option. The formulae upon which these tax benefits are computed bear no relationship to either FASB's or IASB's notion of an ESOs fair value computed on the grant date. Most often the tax regulations provide an additional cash flow benefit to companies using ESOs. Relegating this cash flow benefit away from the income statement, while imposing non-cash ESO expense computations on the income statement, would only further exacerbate the problems that ESO expensing would create if imposed on the face of the financial statements. Reconciliation of the book tax differences for ESOs would span several financial statement periods, and would be subject to additional estimations and projections that do not belong on the face of the financial statements.

Issue 16: As discussed in paragraph 83 of this Invitation to Comment, the Proposed IFRS expands on the disclosure requirements in Statement 123. Do you believe that those expanded disclosures would be more informative to users of financial

statements? If so, why? If not, why not? (Which of the disclosure requirements should be eliminated or modified in that case?) (Refer to pages 47 and 48.)

We have voluntarily provided enhanced stock option disclosures to depict the quarterly activity surrounding ESOs. This enhancement includes; grants, exercises and cancellations that have occurred over the quarter. We also added a disclosure to show the grant amounts and exercise amounts for each of the top five executives in the company. KLA-Tencor welcomes enhanced disclosures providing that the additional disclosures include accurate information to help the investment community.

Issue 17: Please describe any additional disclosures that you believe should be required in order to inform a user of financial statements about the economics of stock-based compensation arrangements. (Refer to page 48.)

KLA-Tencor believes the investment community values disclosure of where stock options were awarded and other quarterly ESO activity. This table was in included in our 10-Q filed November 13, 2002, and similar disclosures will be made in future filings.

| KLA-Tencor Grant Allocation Disclosure | | | | |
|--|---------|---------|---------|---------|
| (Shares in millions) | Q1 2003 | 2002 | 2001 | 2000 |
| Weighted average number of shares outstanding | 189,279 | 187,677 | 185,860 | 182,177 |
| Total Options Granted During the period | 353 | 9,915 | 10,274 | 8,166 |
| Less Options Forfeited | (512) | (1,786) | (2,418) | (1,484) |
| Net Options Granted | (159) | 8,129 | 7,856 | 6,682 |
| Net grants during the period as % of total shares outstanding | -0.1% | 4.3% | 4.2% | 3.7% |
| Grants to top 5 officers during the period as a % of total options granted | 0% | 6% | 4% | 5% |
| Grants to top 5 officers during the period as a % of total | | | | |
| shares outstanding | 0.0% | 0.3% | 0.2% | 0.2% |

This table clearly demonstrates the broad based aspect of the KLA-Tencor plan. We believe that our shareholders value this type of disclosure.

SECONDARY SIMILARITIES AND DIFFERENCES FROM APPENDIX A

Issue A1: Statement 123 distinguishes between a principal stockholder and a stockholder for certain transactions, and the Proposed IFRS does not. Which view do you support and why? (Refer to page 52.)

As a public company with no principal shareholder, we do not have a position on this issue.

Issue A2: Do you believe that a probability-weighted average amount of the range should be used when no amount in the range is better than any other? If so, why? If not, what other amount within the range would you propose when no amount in the range is better than any other? Why? (Refer to page 56.)

We believe that the probability-weighted average amount of the range better reflects the statistical probability of occurrences.

Issue A3: Do you agree that option-pricing techniques have sufficiently evolved since Statement 123 was issued to address reload features and, if so, should Statement 123's requirements be changed? If not, why not? (Refer to page 57.)

We believe that since the issuance of Statement 123, option pricing models have **not** evolved with respect to pricing ESOs. Therefore we do not think the requirements of Statement 123 should be changed, either with respect to expensing options on the face of the financial statements, or with respect to the methods of addressing reload features.

Issue A4: Do you believe there are circumstances in which an entity may not be able to reasonably estimate the fair value of equity instruments at the grant date? If so, please provide examples of such circumstances and describe how those equity instruments should be accounted for until a reasonable estimate is determinable. (Refer to page 57.)

We are not aware of any circumstances in which an entity is able to estimate the fair value of equity instruments at the grant date with any degree of confidence, consistency or reliability. That is the main reason for our position that expensing ESOs should not be imposed.

Issue A5: Do you believe there is a single grant date or multiple grant dates for the preceding example? Why? (Refer to page 58.)

This example demonstrates the issuance concept, which is not relevant to the measurement date. This example seems to have more than one grant date.

Issue A6: Should SARs be measured at fair value rather than intrinsic value? If so, why? If not, why not? (Refer to page 58.)

We believe that SARs should be measured at intrinsic value. As stated in Statement 123, the liability will be settled at its intrinsic value. SAR's represent a call on the assets of the issuer, unlike ESOs, which require a cash payment to the issuer from the holder upon completion of the terms of the agreement.

Issue A7: In accounting for equity award modifications, should the fair value of the original award be calculated using (a) the shorter of the remaining expected life of

the original award or the expected life of the modified award or (b) the remaining expected life of the original award? Why? (Refer to page 61.)

Using the shorter of the remaining life of the original award or the expected life of the modified award reflects the obligation with greater consistency and accuracy.

Issue A8: Do you believe that an accounting standard on stock-based compensation should include provisions for distinguishing between repricing and other modification events? Why? (Refer to page 61.)

We believe that there need to be provisions distinguishing ESO repricings from other modifications. For example where ESO terms are modified in favor of the company and its shareholders, and do not result in better terms for the optionee, we believe there should be standards that exclude this event from repricing treatment.

Issue A9: Which method of accounting for settlements of unvested awards do you believe is more representationally faithful and why? (Refer to page 62.)

We agree with current Statement 123 treatment of settlements of unvested awards.

Issue A10: The Proposed IFRS considers certain factors, including past practice or a stated policy of settling in cash, in evaluating how an entity should account for certain contracts that can be settled in cash or equity, at the entity's option. Do you agree with this view? If so, why? If not, why not? (Refer to page 63.)

We believe that use of past practice can be appropriate in evaluating accounting treatment, but we note that this opens the door to reduced comparability between similarly situated entities. Although their intended future practices may be similar, one company may have history to support their position while another may not.