

REPORT OF THE COMPENSATION AND GOVERNANCE COMMITTEE OF THE BOARD OF DIRECTORS

The current Compensation and Governance Committee members are Jerry K. Pearlman (Chairman), James A. Henderson, and Donald S. Perkins. The objectives of the Compensation and Governance Committee in determining the levels and components of executive compensation are to (1) attract, motivate and retain talented and dedicated executive officers, (2) provide executive officers with both cash and equity incentives to further the interests of the Company and its stockholders, and (3) compensate executive officers at levels comparable to those of executive officers at other comparable high technology companies. In setting compensation, the Compensation and Governance Committee reviews the achievement of corporate goals and individual contributions of particular executives. Generally, the compensation of the Company's executive officers is composed of base annual compensation, in the form of salary and other benefits, incentives in the form of fiscal year-end bonuses, and long-term compensation consisting of stock options awarded under the Company's stock option plan.

Base Salaries

In determining the base salaries of the executive officers in 2002, the Compensation and Governance Committee considered the performance of each executive, the nature of the executive's responsibilities, the salary levels of executives at comparable high technology companies, including other publicly-held advanced materials and advanced technologies companies, and the Company's general compensation practices.

Cash Bonuses

Discretionary cash bonuses for executive officers are directly tied to achievement of specified goals of the Company and are a function of the criteria which the Compensation and Governance Committee believes appropriately take into account the specific areas of responsibility of the particular officer.

Stock Options

Periodically, the Compensation and Governance Committee also grants stock options to executive officers in order to provide a long-term incentive which is directly tied to the performance of the Company's stock. These options provide an incentive to maximize stockholder value because they reward option holders only if stockholders also benefit. The exercise price of these stock options is the fair market of the Common Stock on the date of grant. In general, the options vest in equal annual installments over a three-year period beginning one year after the date of grant, in certain instances the Board of Directors (or the Compensation and Governance Committee) can adjust the vesting period for performance-based options. Vesting periods are used to retain key employees and to emphasize the long-term aspect of contribution and performance. In making stock option grants to executives, including Mr. Cross, in 2002, the Compensation and Governance Committee considered a number of factors, including the performance of such persons, the Company's performance in 2001, achievement of specific delineated goals, the responsibilities and the relative position of such persons within the Company, the compensation of executives in comparable high technology companies and the number of stock options each such person currently possesses.

Compliance with Section 162(m)

The Compensation and Governance Committee currently intends for all compensation paid to the Named Officers to be tax deductible to the Company pursuant to Section 162(m) of the Internal Revenue Code of 1986, as amended ("Section 162(m)"). Section 162(m) provides that compensation paid to the Named Officers in excess of \$1,000,000 cannot be deducted by

the Company for Federal income tax purposes unless, in general, (1) such compensation is performance-based, established by a committee of outside directors and objective, and (2) the plan or agreement providing for such performance-based compensation has been approved in advance by stockholders. The Compensation and Governance Committee believes that the requirements of Section 162(m) are uncertain at this time and may arbitrarily impact the Company. In the future, the Compensation and Governance Committee may determine to adopt a compensation program that does not satisfy the conditions of Section 162(m) if in its judgment, after considering the additional costs of not satisfying Section 162(m), such program is appropriate.

Compensation and Governance Committee Interlocks and Insider Participation

Pursuant to a consulting agreement effective as of October 29, 1998, and prior to his appointment as Chairman of the Board of Directors, Donald S. Perkins, who is Chairman of the Compensation and Governance Committee, was engaged by the Company to provide additional services in connection with the Company's organizational restructuring and refocusing. In consideration for such services, Mr. Perkins was granted options to purchase 25,000 shares of Common Stock at an exercise price of \$3.50 per share. Such options vest in five equal annual installments beginning on October 29, 1999; provided, however, that unvested options will expire upon Mr. Perkins no longer providing such services to the Company.

Equity Compensation Plan Information

The following table gives information about our common stock that may be issued upon the exercise of options, warrants, and rights under all of our existing compensation plans as of December 31, 2002, including the 1992 Amended and Restated Stock Option Plan and the 2001 Equity Compensation Plan.

Plan Category	(a) Number of Securities to be Issued Upon Exercise of Outstanding Options, Warrants and Rights	(b) Weighted Average Exercise Price of Outstanding Options, Warrants, and Rights	(c) Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column (a))	(d) Total of Securities Reflected in Columns (a) and (c)
Plans Approved by Shareholders	2,089,350 (1)	\$5.49	588,000 (2)	2,677,350
Plans Not Approved by Shareholders	None	\$ -	None	-

(1) Consists of the 1992 Amended and Restated Stock Option Plan, the 2001 Equity Compensation Plan, and shares of authorized but unissued Preferred Stock

(2) Consists of shares available for future issuance under the 2001 Equity Compensation Plan.

REPORT OF THE AUDIT AND FINANCE COMMITTEE OF THE BOARD OF DIRECTORS

All members of the Audit and Finance Committee are independent, as that term is defined in the applicable National Association of Securities Dealers' listing standards. Each member of the Audit and Finance Committee is also financially literate, as that qualification is interpreted by the Company's Board of Directors in its business judgment. The Audit and Finance Committee currently consists of James A. McClung, Ph.D. (Chairman), James A. Henderson, Jerry K. Pearlman and Donald S. Perkins.

Policies and Mission

The Audit and Finance Committee recommends the independent certified public accountants for Board of Director approval, engages in a discussion with the independent accountants regarding the objectivity and independence of the accountants, reviews the adequacy of the Audit and Finance Committee Charter, reviews certain of the Company's Securities and Exchange Commission filings, reviews significant financial reporting issues with the Company's chief financial officer, reviews risk management and internal audit procedures with the Company's chief financial officer, and engages in any necessary private sessions with the Company's chief financial officer and independent accountants.

Audit and Finance Committee Statement

The Audit and Finance Committee, consistent with its policies and mission, has adopted a charter, which was included as Exhibit A to the Company's proxy statement for the 2002 Annual Meeting. The Audit and Finance Committee has reviewed and discussed the audited financial statements with Company management; discussed with the independent auditors the matters required to be discussed by SAS 61 (Codification of Statements on Auditing Standards), as modified or supplemented; received a written disclosure letter from the Company's independent certified public accountants as required by Independence Standards Board Standard No. 1 (Independence Standards Board Standard No. 1, Independence Discussions with Audit Committees), as modified and supplemented, and has discussed with the independent certified public accountants the independent accountant's independence; and based on the preceding review and discussions contained in this paragraph, recommended to the Board of Directors that the audited financial statements be included in the Company's Annual Report on Form 10?K for the 2002 fiscal year for filing with the Securities and Exchange Commission.

Recommendations Ratified at the June 26, 2003 Annual Meeting of Stockholders

The Board of Directors, upon the recommendation of the Audit and Finance Committee, has appointed McGladrey and Pullen, LLP, independent certified public accountants, as auditors of the Company's financial statements for the year ended December 31, 2003. McGladrey and Pullen, LLP has been engaged as auditors for the Company beginning in November 2001. The Board of Directors has determined to afford stockholders the opportunity to express their opinions on the matter of auditors and, accordingly, was submitting to the stockholders at the Annual Meeting a proposal to ratify the Board of Directors' appointment of McGladrey & Pullen, LLP. In addition to audit services, McGladrey & Pullen, LLP also provided certain non-audit services to Nanophase Technologies Corporation in relation to the 2002 fiscal year. The Audit and Finance Committee has considered whether the provision of these additional services is compatible with maintaining the independence of McGladrey & Pullen, LLP. The following table sets forth fees incurred by Nanophase Technologies Corporation for the services of both Ernst & Young, LLP and McGladrey & Pullen, LLP in relation to the 2002 fiscal year.

<u>Audit Fees</u>	<u>All Other Fees</u>
\$60,260	\$20,949*

* Consists primarily of fees in connection with tax and Securities and Exchange Commission compliance matters.

It is expected that representatives of McGladrey & Pullen will be present at the meeting and will be available to respond to questions. They will be given an opportunity to make a statement if they desire to do so.