

THE PROSPECT JAPAN FUND LIMITED

ANNUAL REPORT AND AUDITED FINANCIAL STATEMENTS

For the year ended 31 December, 2012

THE PROSPECT JAPAN FUND LIMITED

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THE PROSPECT JAPAN FUND LIMITED

MANAGEMENT AND ADVISORS

Directors

John A. Hawkins (Chairman)
Richard J. Battey
Rupert A. R. Evans
Christopher W. Sherwell

Registered Office

PO Box 255
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St Peter Port,
Guernsey, GY1 3QL
Channel Islands

Custodian

Northern Trust (Guernsey) Limited,
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Les Banques,
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Channel Islands

Manager

Prospect Asset Management (Channel Islands)
Limited,
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Channel Islands

Secretary, Registrar and Administrator

Northern Trust International Fund Administration
Services (Guernsey) Limited,
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Investment Advisor

Prospect Asset Management, Inc.,
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Corporate Broker

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CREST Agent

Computershare Investor Services
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Channel Islands

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Mourant Ozannes,
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Independent Auditor

Ernst & Young LLP,
Royal Chambers,
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Channel Islands

THE PROSPECT JAPAN FUND LIMITED

CHAIRMAN'S REPORT

for the year ended 31 December, 2012

The Fund has shown a return of 20.24 per cent for the year ended 31 December 2012, strongly outperforming the Topix Small Index of 8.76 per cent and its peers. Your Manager's strategy and skills and beliefs in both stock picking and sectors have yielded very satisfactory results. The Japanese economy continued the improvement witnessed at the end of the preceding year, with corporate earnings sustaining the recovery post the earthquake aided by the weakening of the Yen, which has boosted exports.

Japanese corporations have continued to build their cash reserves for acquisition of both foreign and also domestic companies and also for buy out opportunities which have become a more frequent feature.

Perhaps the most significant event of the year was the win by The Liberal Democratic Party on the 16th December of The Diet Lower House and the appointment of Shinzo Abe as Prime Minister. Significantly the coalition won a supermajority in the Lower House, with power to override the Upper House. The LDP are committed to reflation and growth with policies which include a depreciation of the Yen and a 2 per cent inflation target to be adopted and implemented by The Bank of Japan, under a new governor. The changes are generating additional investment opportunities and in the process attracting international investors and, to a lesser but significant extent, domestic investors.

The Fund's share price discount to the Net Asset Value at the end of the year was 14.85 per cent which was 3.13 percentage points lower compared with the end of the previous year.

The Investment Advisor reports in considerable detail on the portfolio in its report within these Financial Statements. The Board remains fully supportive of the strategy pursued by the Investment Advisor. The next Annual General Meeting of the Company is scheduled to be held on 21 June 2013.

John Hawkins
Chairman
19 April 2013

THE PROSPECT JAPAN FUND LIMITED

INVESTMENT ADVISOR'S REPORT

for the year ended 31 December, 2012

Market Performance (%), US\$ NAV

	1 Year	3 Year	5 Year
Prospect Japan Fund	20.24	32.89	(43.58)
Topix Small	8.76	27.62	13.25

Prospect Japan Fund inception date is 20 December 1994. Topix Small is a capitalization-weighted index designed to measure the stocks not included in the Topix 500 Index that are listed on the First Section of the Tokyo Stock Exchange. As of August 2003, the benchmark of the Prospect Japan Fund changed from TSE2 to Topix Small since its characteristics with respect to average market capitalization more closely resemble the investment strategy pursued by the portfolio. The above performance of the Fund is net of fees and expenses and includes reinvestment of dividends and capital gains.

Source: Prospect Asset Management, Inc. Index Performance Source: Bloomberg.

Summary

The Prospect Japan Fund Limited (the “Company”) returned 20.24% in 2012 well ahead of the Topix Small Index’s 8.76% gain.

The seminal event of 2012 took place in the waning weeks of December, as the landslide election of the Liberal Democratic Party (“LDP”) after three years in the wilderness fuelled reflation expectations, drove the Yen to a 28-month low, and lifted equities higher. Former Prime Minister Shinzo Abe returned to power on a platform to launch a full-scale war on Japan’s entrenched deflation, weakening the currency and seeking to achieve 3% nominal GDP growth via short-term stimulus spending on public works and economic growth centered legislation.

The 16 December election gained the LDP and its coalition partner New Komeito 68% of the lower house seats, establishing a super majority capable of pushing through much of the new administration’s ambitious goals. The coalition came out swinging, calling for an approximately ¥10 trillion supplementary budget centered on public works. Key to Abe’s vision is closer ties between the government and the Bank of Japan (“BoJ”), pressuring the BoJ to further expand its efforts on the monetary stimulus by publicly pushing for unlimited monetary easing and the adoption of a 2% inflation target, as opposed to the current 1% “goal” announced in February 2012. Abe has gone so far as to consider revising the law governing the BoJ if it does not meet expectations. The development of policies for economic growth will now rest with a new economic revitalization council.

The election was preceded by months of political gridlock during which time the only major political achievement was passage of a sales tax increase bill proposed by then Prime Minister Yoshihiko Noda, calling for a doubling of the 5% tax by 2015. The measure was seen as a vital first step towards dealing with Japan’s government debt burden. The law calls for the tax to increase from 5% up to 8% in 2014, then to 10% in 2015, though there is a clause allowing for a suspension of implementation based on economic conditions. This followed a downgrading of Japan’s sovereign credit rating to ‘A+’ by Fitch Ratings in May, maintaining a negative outlook stating that Japan continues to struggle with reining in its dire fiscal balance. According to Fitch, ‘the downgrades and negative outlook reflect growing risks for Japan’s sovereign credit profile as a result of a high and rising public debt ratio.’ Implementation of the tax hike under the new administration is unclear.

Japan recorded its first annual trade deficit in 31 years for 2011, mainly due to soaring imports of oil and liquid natural gas following the 11 March 2011 earthquake/tsunami. Reliance on foreign oil will remain high, but should show a moderate decrease as more nuclear reactors go online. On 1 July, Japan ended a two-month period without nuclear power after Kansai Electric Power restarted the Oi Nuclear Power Plant in western Japan. The decision to restart the reactor came from Prime Minister Noda due to concerns of energy shortages despite a swell of protestors.

THE PROSPECT JAPAN FUND LIMITED

INVESTMENT ADVISOR'S REPORT

for the year ended 31 December, 2012

Continued

Japan posted a record current account deficit in January 2012 amid flagging exports and soaring energy imports. The shortfall in the current account stood at ¥437.3 billion in January before seasonal adjustment, the data showed. That was the first deficit since January 2009, when Japan registered its previous record shortfall of ¥132.7 billion at the height of the global financial crisis.

Japan has entered a technical recession after maintaining an annualized 3.5% GDP decline for Q3, its 3rd recession since the global financial crisis. Sluggish exports and dampened domestic demand have dragged on the economy. Industrial production declined year-on-year for the 6th consecutive month in November, falling 5.8% and cementing the case for enhanced stimulus efforts supported by the incoming Abe administration.

Attempted economic stimulus fell primarily to the BoJ, where attempts to weaken the Yen included an announced inflation goal of 1% on 14 February, 2012. The BoJ also announced that it would review raising its 1% inflation “goal” to a more concrete 2% inflation “target”, as demanded by the new Prime Minister Abe, at its January 2013 policy board meeting.

In December, the BoJ expanded its asset purchase program for the third time in 2012, this time by ¥10 trillion, increasing allocations for Japanese Government Bonds and short-dated T-Bills by ¥5 trillion each. The program has now been expanded to ¥66 trillion, including an increase in the J-REIT allotment to ¥130 billion from ¥120 billion. More aggressive BoJ action can be expected with the appointment of a new governor from April 2013, and there is also the possibility of additional fiscal stimulus when the 2013 budget is drafted.

A bright spot has been a recovery in the Tokyo office market, with Miki Shoji reporting that the average office vacancy in Tokyo’s Central Business District has fallen 25 bps through the November end to 8.76% as a glut of new supply has been absorbed.

At the year’s end, the Yen was trading at ¥86.6 to the US dollar, overshooting Bloomberg’s top rated analysts’ estimates of 82 by June 2013. On 14 December the quarterly Tankan survey of large manufacturers showed an average forecast of 78.3 through March 2013.

FUND PERFORMANCE 2012

OUTPERFORMANCE

The biggest contributor to 2012 performance was Yasuragi (8919). Yasuragi, a real estate brokerage firm that focuses on refurbishing and selling of second-hand single-family homes was acquired by private equity firm Advantage Partners. Advantage Partners offered ¥627 a share, a 61% premium to the last traded price on 26 January. Advantage Partners took the company private.

Welcia Holdings (3141) a drug store chain, performed strongly through the first half of 2012, announcing solid first half results on 13 April with sales growth of 9.7% year-on-year and operating profit growth of 18.3% accompanied by same-store-sales of +4.2%, outpaced estimates. Welcia completed the move to the First Section of the Tokyo Stock Exchange in April.

Shaklee Global Group (8205), a seller of nutrition and personal care products, was quiet for most of the year, before rallying to a 5-year high on a very positive November results announcement. The company experienced double digit growth in revenues and profits during the first half of its fiscal year, exceeding estimates on expansion in Asian markets.

THE PROSPECT JAPAN FUND LIMITED

INVESTMENT ADVISOR'S REPORT

for the year ended 31 December, 2012

Continued

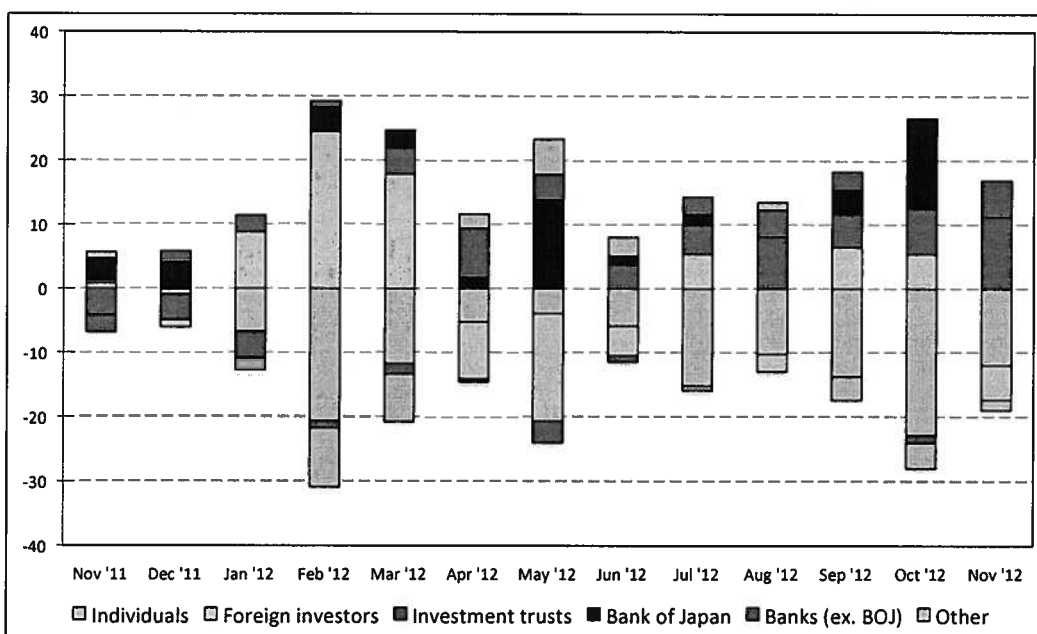
UNDERPERFORMANCE

Invincible Investment Corporation (8963), a J-REIT with a diversified portfolio, saw its unit price trend downward for much of the year despite improved operational performance under new sponsor, Fortress. The J-REIT continues to struggle under the burden of the sector's highest borrowing costs, and so has missed the benefits of lower rates permitting dividend expansion.

Tomoe Corporation (1921) constructs steel structures and school facilities, long-span projects, bridges, electric pylons and gymnasiums. The company fell as weak H1 performance from higher than expected input costs on steel projects and large impairment losses on investment securities resulted a downward revision of full-year forecasts.

J-REIT MARKET 2012

Tokyo Stock Exchange Market Data (Net Buyers/Sellers of J-REITs)



The TSEREIT index gained 26.00% during 2012, outperforming the Nikkei 225's +12.22% year-on-year performance.

J-REITs gained strongly on the back of improved fundamentals, decreasing cost of debt financing and strong public policy support. The market has seen a full-scale recovery in demand for secondary issues, along with 4 successful J-REIT Initial Public Offerings ("IPO's"), the first since 2007.

J-REITs raised approximately ¥211 billion through 11 new equity issues during the year, along with 4 IPOs for about ¥264 billion, supporting the almost ¥1 trillion in property acquisitions announced during the year. ¥89.0 billion in new corporate bonds were issued during the year, with an average 0.910% interest rate and 5.1 year maturity.

THE PROSPECT JAPAN FUND LIMITED

INVESTMENT ADVISOR'S REPORT

for the year ended 31 December, 2012

Continued

As of year-end, the BoJ has purchased ¥111.1 billion in J-REIT units under its asset purchase program (85.5% of total allotment). The BoJ refrained from any unit purchases during the last two months of the year.

The Financial Services Agency working group concluded its 13th and final meeting with a final report on suggested revisions to the Investment Trust Act. The changes will be drafted and voted on by the incoming Diet, with expected implementation in 2013. Changes to regulations effecting J-REITs are as follows:

- 1) Lifting certain bans on overseas acquisition of real estate.
- 2) Diversification of fund procurement channels, including rights offerings, unit buy backs, and reduction of capital without compensation. The issue of convertible bond issuance was discussed, but shelved for the time being.
- 3) Establishing rules to strengthen corporate governance, specifically in regards to transactions with related entities and allowing existing unit holders to petition against the issuance of new shares.

OUTLOOK FOR THE COMPANY 2013

Revenues of Japanese companies are expected to grow 2.7% and profits to grow 7% in the year to March 2013. For the year to March 2014, sales are forecast to grow 3.3% and profits to grow 22.7%. This recovery is fully discounted in the recent market rally. Therefore, gains for the company are expected from stock picking those companies most likely to see a change of control at a significant premium. The market saw 10 management buyouts, 21 take over bids and buying full ownership of listed subsidiaries, and 29 mergers between listed companies in 2012, for a total of 60 change of control transactions. An even greater number of deals is expected this year due to real estate reflation. About 75 similar transactions out of 3700 listed companies in Japan would not be surprising in 2013.

RECENT DEVELOPMENTS

The Bank of Japan, under new governor Kuroda, has terminated the Asset Purchase Program in favor of "Quantitative and Qualitative" monetary easing, aimed at lowering long-term interest rates and supporting asset prices in pursuit of reaching its 2% inflation target within the next two years. The bank will now target up to an annual ¥60-70 trillion expansion of the monetary base, achieved by 1) annual purchases of ¥50 billion of Japanese Government Bonds ("JGB") with maturities up to 40 years, 2) annual purchases of ETF and J-REIT units of ¥1 trillion and ¥30 billion respectively. JGB purchasing operations have been consolidated under the new program, and the bank has suspended the "banknote principle" under which the BoJ was prohibited from buying more banknotes than in circulation.

The BoJ action benefits J-REITs through the direct purchases providing floor, lowering long-term interest rates, and by widening the yield-spread as JGB yields decline. Higher unit prices also provide more opportunity for J-REITs to issue new equity and grow through AUM expansion.

The announcement reassured markets of the bank's seriousness in ending persistent deflation, and the yen resumed its weakening trend, nearing JPY/USD 100, from 92.87 the day before the announcement.

PRINCIPAL RISKS AND UNCERTAINTIES

Continuing sovereign debt concerns in Japan, Europe and the USA could cause 2013 to be turbulent. The Yen could also continue to fluctuate wildly, increasing uncertainty over corporate profits in Japan. Merger and MBO financing could dry up if banks were to suffer losses on Japan Government Bond holdings. 2013 is expected to be a very eventful year, with increasing volatility.

Prospect Asset Management, Inc.
19 April, 2013

THE PROSPECT JAPAN FUND LIMITED

DISCLOSURE OF DIRECTORSHIPS IN PUBLIC COMPANIES LISTED ON RECOGNISED STOCK EXCHANGES

for the year ended 31 December, 2012

The following summarises the Directors' directorships in other public companies

Directorships Company Name	Stock Exchange
Richard Battey	
AcenciA Debt Strategies Limited	London
Northwood Capital Enhanced European Fund Limited	Irish
Juridica Investments Limited	London
Princess Private Equity Holding Limited	London
Better Capital PCC Limited	London
NB Global Floating Rate Income Fund Limited	London
Rupert Evans	
El Oro Limited	Channel Islands
Oryx International Growth Fund Limited	London
The Red Fort Partnership Limited	Channel Islands
FF&P Alternative Strategy PCC Limited	Channel Islands
FF&P Enhanced Opportunities Limited	Channel Islands
FF&P Global Property Fund PCC Limited	Channel Islands
FF&P Ventures Fund PCC Limited	Channel Islands
Master Capital Fund Limited	Irish
John Hawkins	
Advance Developing Markets Fund Limited	London
Low Carbon Accelerator Limited	London
M W Japan Fund Limited	Irish
P D Star Fund Limited	Irish
SR Global Fund Inc.	Irish
The Greater China Fund, Inc.	New York
Real Estate Credit Investments PCC Limited	London
Christopher Sherwell	
Baker Steel Resources Trust Limited	London
Goldman Sachs Dynamic Opportunities Limited (in voluntary liquidation)	London
F&C UK Real Estate Investments Limited (Formerly IRP Property Investments Limited)	London and Channel Islands
NB Private Equity Partners Limited	Euronext, Amsterdam and SFM London
NB Distressed Debt Investment Fund Limited	London and Channel Islands
Raven Russia Limited	London
Rufford & Ralston PCC Limited (formerly Saltus European Debt Strategies Limited)	Channel Islands
Alternative Liquidity Solutions Limited	London
Schroder Oriental Income Fund Limited	London

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

The Directors present their Annual Report and the Audited Financial Statements of Prospect Japan Fund Limited (the "Company") for the year ended 31 December, 2012.

The Company's Business

The Company was registered under the laws of Guernsey on 18 November, 1994 as a Limited Company with a premium listing on the London Stock Exchange. It is a closed-ended investment company established to achieve long-term capital growth from an actively managed portfolio of securities primarily of smaller Japanese companies listed or traded on Japanese Stock Markets.

Results and Dividend

The results for the year are set out in the Statement of Comprehensive Income on page 19. The Directors do not recommend the payment of a dividend for the year.

In the year to 31 December, 2012 Net Asset Value per Ordinary Share increased by 20.24%.

Performance

The Board considers that Prospect Asset Management (Channel Islands) Limited, the Manager to the Company, is managing the Company's investments in a manner that is most likely to achieve the objective of long term capital appreciation for its shareholders.

Statement of Directors' Responsibilities

The Directors are responsible for preparing the Financial Statements in accordance with applicable Guernsey Law and Generally Accepted Accounting Principles. The Directors are required to prepare Financial Statements for each financial year which give a true and fair view of the state of the affairs of the Company and of the total return of the Company for that year and in accordance with the applicable laws. In preparing those Financial Statements the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the Financial Statements; and
- prepare the Financial Statements on a going concern basis unless it is inappropriate to presume that the company will continue in business.

The Directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the Financial Statements have been properly prepared in accordance with The Companies (Guernsey) Law, 2008. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud, error and non-compliance with law or regulations.

The Directors confirm that they have complied with the above requirements in preparing the Financial Statements.

The Directors confirm that to the best of their knowledge

(a) The Annual Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and give a true and fair view of the financial position and profit or loss of the Company as at and for the year ended 31 December, 2012.

(b) The Annual Financial Report includes information detailed in the Chairman's Report, Investment Advisor's and Directors' Reports and Notes to the Annual Financial Statements which provides a fair review of the information required by:

(i) DTR 4.1.8 of the Disclosure and Transparency Rules, being a fair review of the Company business and a description of the principal risks and uncertainties facing the Company; and

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

Continued

Statement of Directors' Responsibilities

Continued

(ii) DTR 4.1.11 of the Disclosure and Transparency Rules, being an indication of important events that have occurred since the end of the financial year and the likely future development of the Company.

Directors' Statement

So far as each of the Directors is aware, there is no relevant audit information of which the Company's auditor is unaware, and each Director has taken all the steps he ought to have taken as a Director to make himself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

Ongoing Charges

During the year, the Association of Investment Companies ("AIC") recommended that Ongoing Charges disclosure should replace the Total Expense Ratio which has traditionally been calculated by investment companies. Ongoing charges for the year ended 31 December, 2012 and 31 December, 2011 have been prepared in accordance with the AIC's recommended methodology and replaced the previously used Total Expense Ratios. The Ongoing charges for the year ended 31 December, 2012 was 2.21 per cent (31.12.11: 2.20 per cent). No performance fees were charged during the year.

Corporate Governance

Application of the AIC Code

The Board of Prospect Japan Fund Limited has considered the principles and recommendations of the AIC's Code of Corporate Governance (the "AIC Code") by reference to the AIC Corporate Governance Guide for Investment Companies (the "AIC Guide"). The AIC Code as explained by the AIC Guide, addresses all the principles set out in Section 1 of the The UK Corporate Governance Code ("The Code"), as well as setting out additional principles and recommendations on issues which are of specific relevance to investment companies. The Board considers that reporting against the principles and recommendations of the AIC Code, and by reference to the AIC Guide (which incorporates The Code), will provide better information to shareholders.

The Board is accountable to the Company's shareholders for good governance and this statement describes how the principles identified in the AIC Code have been applied to the Company. Save for the exception noted below, the Company has complied with the provisions set out in the AIC Code and the relevant provisions of The Code throughout the year ended 31 December 2012. The Code includes provisions relating to; the role of the chief executive, executive director's remuneration and, the need for an internal audit function. For the reasons set out in the AIC Guide, and in the preamble to the AIC Code, the Board considers these provisions are not relevant to the position of the Company, being an externally managed investment company with no employees. The Company has therefore not reported further in respect of these provisions.

The new Guernsey Financial Services Commission ("GFSC") Code of Corporate Governance (the "GFSC Code") came into effect on 1 January 2012. The GFSC Code replaces the existing GFSC guidance, "Guidance on Corporate Governance in the Finance Sector". The GFSC Code provides a framework that applies to all entities licensed by the GFSC or which are registered or authorised as a collective investment scheme. The Company complies with the AIC Code and as such also complies with the GFSC Code.

The Board

The Board comprises four non-executive directors. All members of the Board other than Rupert Evans are independent of the Manager. None of the Directors have a contract of service with the Company.

The Chairman of the Board is John Hawkins. Biographies for Mr Hawkins and all other Directors can be found on page 39. In considering the independence of the Chairman, the Board has taken note of the provisions of The Code relating to independence and has determined that Mr Hawkins is an Independent Director. As the Chairman is an Independent Director, no appointment of a senior Independent Director has been made. The Company has no employees and therefore there is no requirement for a chief executive.

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

Continued

The Board

Continued

The Board meets on at least four occasions each year, at which time the Directors review the investment management of the Company's assets and all other significant matters so as to ensure that the Directors maintain overall control and supervision of the Company's affairs. The Board is responsible for the appointment and monitoring of all service providers to the Company.

Attendance at the Board, Audit Committee and Management Engagement Committee meetings during the year was as follows;

	Board Meetings		Management Engagement Committee Meetings		Ad hoc Committee Meetings		Audit Committee Meetings	
	Held	Attended	Held	Attended	Held	Attended	Held	Attended
Rupert Evans	4	3	NA	NA	-	-	NA	NA
John Hawkins	4	4	2	2	-	-	2	2
Christopher Sherwell	4	4	2	2	-	-	2	2
Richard Battey	4	4	2	2	-	-	2	2

Re-election

In accordance with the Company's Articles of Association, all newly appointed Directors stand for election by the shareholders at the next Annual General Meeting ("AGM") following their appointment. The Directors retire by rotation and offer themselves for re-election every three years. Directors who have served on the Board for more than nine years are subject to annual re-election. Mr Rupert Evans is considered a non-independent Director due to being a Director of the Manager. Non-independent Directors are subject to annual re-election.

Board Performance

The company conducted a review of the effectiveness of the Board during the year. The review concluded that the members of the Board had the right mix of skills and functioned effectively as a Board.

Supply of Information

The quarterly board meetings are the principal source of regular information for the Board enabling it to determine policy and to monitor performance and compliance. The Manager attends each Board meeting either in person or by telephone thus enabling the Board to fully discuss and review the Company's operation and performance. Each Director has direct access to the Company Secretary, and may, at the expense of the Company, seek independent professional advice on any matter that concerns them in the furtherance of their duties.

Nomination Committee

The Board as a whole fulfils the function of a Nomination Committee. Whilst the independent Directors take the lead in the appointment of new Directors, any proposal for a new Director will be discussed and approved by all of the Board.

Directors' Remuneration

The level of Directors' fees is determined by the whole Board on an annual basis and therefore a separate Remuneration Committee has not been appointed. When considering the level of Directors' remuneration the Board considers the industry standard and the level of work that is undertaken.

During the year ended 31 December, 2012, the Directors were entitled to receive an annual fee of £20,000, the Chairman of the Audit Committee £22,500 and the Chairman of the Board £25,000.

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

Continued

Going Concern

The Directors believe that it is appropriate to continue to adopt the going concern basis in preparing the Financial Statements because the assets of the Company consist mainly of securities that are readily realisable and, whilst the liquidity of these needs to be managed, the Company has adequate financial resources to meet its liabilities as they fall due.

Audit Committee

An audit committee has been appointed comprising the independent Directors. The Audit Committee operates within clearly defined terms of reference which have been approved by the Board and provides a forum through which the Company's external Auditors report to the Board. The Board is satisfied that the Audit Committee contains members with sufficient recent and relevant financial reporting experience.

The Audit Committee has considered the requirement for an annual internal audit of the Company. On the basis that the Company is an investment company with no employees, the Audit Committee believes that an internal audit function is not necessary for the Company.

Management and Engagement Committee

At a Board Meeting held on 12 November, 2012 it was resolved that a Management and Engagement Committee be appointed comprising the independent Directors. The Management and Engagement Committee operates within clearly defined terms of reference which have been approved by the Board.

The purpose of this Committee is to review the performance of the Investment Advisor, Investment Manager and the third party service providers to the Company. The Committee is satisfied with their performance.

Dialogue with Shareholders

The Investment Advisor maintains a regular dialogue with institutional shareholders, feedback from which is reported to the Board. In addition, Board members and representatives of the Manager are available to answer shareholders' questions at the Annual General Meeting. The Company Secretary is available to answer general shareholders' queries at any time during the year.

Internal Control

The Board is responsible for establishing and maintaining the Company's system of internal control and for maintaining and reviewing its effectiveness. The system of internal controls is designed to manage rather than to eliminate the risk of failure to achieve business objectives and as such can only provide reasonable, but not absolute assurance against material misstatement or loss.

The Board considers on an ongoing basis the process for identifying, evaluating and managing any significant risks faced by the Company. The process includes reviewing reports from the Company Secretary on risk control and compliance, in conjunction with the Manager's regular reports which cover investment performance.

The Board has contractually delegated to external parties various functions as listed below. The duties of investment management, accounting and custody are segregated. Each of the contracts entered into with the parties was entered into after full and proper consideration by the Board of the quality and cost of services offered, including the control systems in operation as far as they relate to the affairs of the Company.

The key terms of the Investment Management Agreement and specifically the fee charged by the Manager are set out in Note 4 to the Financial Statements.

* Management is provided by Prospect Asset Management (Channel Islands) Limited, a company licensed and regulated by the Guernsey Financial Services Commission.

* Investment Advisory Services are provided by Prospect Asset Management Inc., a company registered with the SEC.

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

Continued

Internal Control

Continued

- * Administration, Registrar and Company Secretarial duties are performed by Northern Trust International Fund Administration Services (Guernsey) Limited, a company licensed and regulated by the Guernsey Financial Services Commission.
- * CREST agency functions are performed by Computershare (CI) Limited, a company licensed and regulated by the Jersey Financial Services Commission.
- * Custody of assets is undertaken by Northern Trust (Guernsey) Limited, a company licensed and regulated by the Guernsey Financial Services Commission.

Directors' and Other Interests

At 31 December, 2012 Chris Sherwell had beneficial interests of 9,940 (2011: 9,940) Ordinary Shares respectively of the Company. No other Directors holding office at 31 December, 2012, or their associates, had any beneficial interest in the Company's Shares. There have been no changes in these interests between the end of the year and the date of this report.

Rupert Evans is a Director of the Manager and a former partner in the firm of the Guernsey legal advisors, Mourant Ozannes. John Hawkins, Chris Sherwell and Richard Battey are Directors of a range of funds.

Substantial Shareholdings

At 31 December, 2012 the following interests in the share capital of the Company exceeded 3% of the issued share capital:

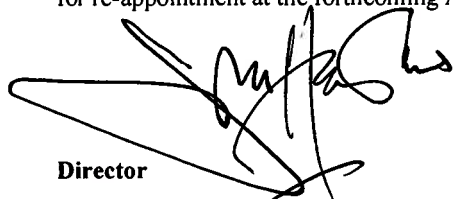
	Number of shares	Percentage of issued share capital
CG Asset Management	14,997,936.00	15.72%
Clearstream, Luxembourg	7,192,629.00	7.54%
Lazard Asset Management	16,440,066.00	17.23%
Permal Asset Management	21,694,907.00	22.74%
Ruffer	4,020,185.00	4.21%
South Yorkshire Pension Authority	4,140,000.00	4.34%
SVM Asset Management	6,070,000.00	6.36%
1607 Capital Partners	15,316,200.00	16.06%

Share buybacks

As approved at the AGM on 24 August, 2012, the Company may purchase, subject to various terms as set out in the Articles, a maximum of 14,577,865 Ordinary Shares. During the year, the Company purchased shares as detailed in Note 9 on page 28 of the Financial Statements. Post year end transactions are detailed in Note 15 on pages 37 of the Financial Statements.

Auditors

The Auditors, Ernst & Young LLP have indicated their willingness to continue in office and offer themselves for re-appointment at the forthcoming AGM.



Director

19 April 2013



Director

THE PROSPECT JAPAN FUND LIMITED

INVESTMENT POLICY

for the year ended 31 December, 2012

The Company will invest mainly in shares, but may also invest in equity related instruments such as convertible bonds or warrants issued by smaller Japanese companies and debt instruments.

The Company may invest not more than 10% of the Net Asset Value of the Company in unlisted securities which are not recognised for trading on or quoted on any of the Japanese Stock Markets. It is the intention of the Directors that such investments should only be made where either a listing or an alternative form of realising the investment can be expected within a reasonable period of time. Within these parameters, the assets of the Company may be used to provide "venture" or "start-up" capital (but no investment will carry unlimited liability). The balance of the assets of the Company not invested in securities will normally be invested in short-term debt securities and money market instruments or placed on deposit.

The assets of the Company will be denominated principally in Japanese Yen. It is not the present intention of the Directors to hedge the currency exposure of the Company, but the Directors reserve the right to do so in the future if they consider this to be desirable.

It is intended that the principal investment objective and policies of the Company as set out above will remain in force until determined by the Directors and any material change in the policies will only be made with shareholder approval.

While overall control of investment policy will be retained by the Directors, day-to-day investment management is the responsibility of the Manager. The Manager will have the benefit of advice from the Investment Advisor.

THE PROSPECT JAPAN FUND LIMITED

PORTFOLIO OF INVESTMENTS

as at 31 December, 2012

Number of Securities	Investments	Fair Value in U.S. Dollars	Percentage of Net Asset Value
	<i>Listed investments</i>		
	Advertising		
739,100	Tri-stage Inc	9,855,809	10.29
		<u>9,855,809</u>	<u>10.29</u>
	Automobile		
38,000	Nikki Co Ltd	110,598	0.12
		<u>110,598</u>	<u>0.12</u>
	Beverages		
1,926,000	Oenon Holdings Inc	4,421,939	4.62
		<u>4,421,939</u>	<u>4.62</u>
	Diversified Financial Services		
309,700	Ace Koeki Co Ltd	840,327	0.88
		<u>840,327</u>	<u>0.88</u>
	Engineering and Construction		
870,000	Toyo Engineering works Ltd	1,886,480	1.97
3,128,600	Tomoe Corp	10,448,015	10.91
		<u>12,334,495</u>	<u>12.88</u>
	Internet		
409,600	OPT Inc	3,182,189	3.32
		<u>3,182,189</u>	<u>3.32</u>
	Media		
2,938,000	Seven Seas Holdings Co Ltd	511,016	0.53
		<u>511,016</u>	<u>0.53</u>
	Pharmaceuticals		
1,048,400	Katakura Industries Co Ltd	9,299,930	9.71
		<u>9,299,930</u>	<u>9.71</u>
	Real Estate		
6,539,000	Gro-Bels Co Ltd +	3,487,872	3.64
435	Sunwood Corp	228,748	0.24
		<u>3,716,620</u>	<u>3.88</u>

+ Mr. Curtis Freeze, Director of Prospect Asset Management (Channel Islands) Limited, the Manager of The Prospect Japan Fund Limited is President of Gro-Bels Co Ltd.

THE PROSPECT JAPAN FUND LIMITED

PORTFOLIO OF INVESTMENTS

as at 31 December, 2012

Continued

Number of Securities	Investments	in U.S. Dollars	Net Asset Value
	REITs		
105,226	Invincible Investment Corp	7,516,143	7.85
7,898,895	Prospect Epicure J-REIT Value Fund*#	-	-
		<u>7,516,143</u>	<u>7.85</u>
	Retail		
266,000	Sekichu Co Ltd	1,360,227	1.42
842,000	Shaklee Global Group Inc	7,703,363	8.04
		<u>9,063,590</u>	<u>9.46</u>
	Transportation		
3,096,000	Shibusawa Warehouse Co Ltd	9,621,150	10.04
		<u>9,621,150</u>	<u>10.04</u>
	Total listed investments	<u>70,473,806</u>	<u>73.55</u>
	Unlisted investments		
	Corporate bond		
5,150,000	Godo Kaisha Taiheiyo Jisho	5,150,000	5.38
150,000,000	Kidoh Construction	1,739,332	1.82
315,700,000	Takefuji Corp	178,084	0.19
		<u>7,067,416</u>	<u>7.39</u>
	Total unlisted investments	<u>7,067,416</u>	<u>7.39</u>
	Total investments	<u>77,541,222</u>	<u>80.94</u>
	Net current assets	<u>18,258,324</u>	<u>19.06</u>
	NET ASSETS	<u><u>95,799,546</u></u>	<u><u>100.00</u></u>

* Prospect Epicure JREIT Value Fund is classed as a related party as the fund shares the same Investment Advisor as the Company

Currently in liquidation.

THE PROSPECT JAPAN FUND LIMITED

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF THE PROSPECT JAPAN FUND LIMITED

We have audited the Financial Statements of The Prospect Japan Fund Limited the (the "Company") for the year ended 31 December 2012 which comprise the Statement of Comprehensive Income, Statement of Financial Position, Statement of Changes in Equity, Statement of Cash Flows and the related notes 1 to 15. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the Company's members, as a body, in accordance with Section 262 of the Companies (Guernsey) Law, 2008. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Statement of Directors' Responsibilities set out on pages 9 and 10, the directors are responsible for the preparation of the Financial Statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the Financial Statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the Financial Statements

An audit involves obtaining evidence about the amounts and disclosures in the Financial Statements sufficient to give reasonable assurance that the Financial Statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the Financial Statements. In addition, we read all the financial and non-financial information in the Annual Report to identify material inconsistencies with the audited Financial Statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on Financial Statements

In our opinion the Financial Statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2012 and of its gain for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies (Guernsey) Law, 2008.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters:

Under the Companies (Guernsey) Law, 2008 we are required to report to you if, in our opinion:


- Proper accounting records have not been kept; or
- The Financial Statements are not in agreement with the accounting records; or
- We have not received all the information and explanations we require for our audit.

THE PROSPECT JAPAN FUND LIMITED

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF THE PROSPECT JAPAN FUND LIMITED (CONTINUED)

Under the Listing Rules we are required to review the part of the Corporate Governance Statement relating to the Company's compliance with the nine provisions of the UK Corporate Governance Code specified for our review.



Christopher James Matthews, FCA
for and on behalf of Ernst & Young LLP
Guernsey, Channel Islands
19 April, 2013

The Financial Statements are published on websites maintained by the Investment Manager.

The maintenance and integrity of these websites are the responsibility of the Investment Manager; the work carried out by the Auditors does not involve consideration of these matters and, accordingly, the Auditors accept no responsibility for any changes that may have occurred to the Financial Statements since they were initially presented on the website.

Legislation in Guernsey governing the preparation and dissemination of Financial Statements may differ from legislation in other jurisdictions.

THE PROSPECT JAPAN FUND LIMITED

STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December, 2012

Notes	Revenue	Capital	Total	Revenue	Capital	Total
	01.01.2012 to 31.12.2012 In U.S. Dollars	01.01.2012 to 31.12.2012 In U.S. Dollars	01.01.2012 to 31.12.2012 In U.S. Dollars	01.01.2011 to 31.12.2011 In U.S. Dollars	01.01.2011 to 31.12.2011 In U.S. Dollars	01.01.2011 to 31.12.2011 In U.S. Dollars
Investment income	1,658,400	-	1,658,400	2,182,612	-	2,182,612
Interest income	439,355	-	439,355	-	-	-
Foreign exchange movements	(896,118)	536,762	(359,356)	(332,777)	577,539	244,762
Gain/(loss) on financial assets at fair value through profit or loss	-	16,749,969	16,749,969	-	(5,618,627)	(5,618,627)
Total income	1,201,637	17,286,731	18,488,368	1,849,835	(5,041,088)	(3,191,253)
4 Management fee	(1,410,894)	-	(1,410,894)	(1,318,200)	-	(1,318,200)
5 Other expenses	(664,351)	-	(664,351)	(673,260)	-	(673,260)
Transaction costs	-	(320,563)	(320,563)	-	(261,557)	(261,557)
Total expenses	(2,075,245)	(320,563)	(2,395,808)	(1,991,460)	(261,557)	(2,253,017)
Gain/(loss) for the period before tax	(873,608)	16,966,168	16,092,560	(141,625)	(5,302,645)	(5,444,270)
3 Withholding tax	(116,088)	-	(116,088)	(152,783)	-	(152,783)
Gain/(loss) for the period after tax	(989,696)	16,966,168	15,976,472	(294,408)	(5,302,645)	(5,597,053)
Total comprehensive income/ (deficit) for the period	(989,696)	16,966,168	15,976,472	(294,408)	(5,302,645)	(5,597,053)
2 Gain per Ordinary Share - Basic & Diluted	(0.010)	0.175	0.165	(0.003)	(0.053)	0.028

The 'Total' column of this statement represents the Company's Statement of Comprehensive Income, prepared in accordance with IFRS. The supplementary 'Revenue' and 'Capital' columns are both prepared under guidance published by the Association of Investment Companies.

All items in the above statement derive from continuing operations.

The notes on pages 23 to 37 form an integral part of the Financial Statements.

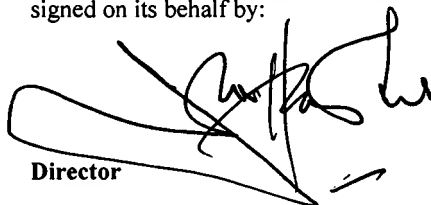
THE PROSPECT JAPAN FUND LIMITED

STATEMENT OF FINANCIAL POSITION

as at 31 December, 2012

Notes	31.12.2012 In U.S. Dollars	31.12.2011 In U.S. Dollars	
Non-current assets			
6	Financial assets at fair value through profit or loss	77,541,222	81,179,926
Current assets			
7	Receivables	1,737,922	1,058,870
	Cash and cash equivalents	16,945,485	486,833
	Total current assets	18,683,407	1,545,703
Current liabilities			
8	Payables	425,083	520,839
	Net current assets	18,258,324	1,024,864
	Net assets	95,799,546	82,204,790
Equity			
9	Share capital account	95,278	98,198
9	Redemption reserve	88,581,476	90,963,192
9	Capital redemption reserve	320,231	317,311
	Other reserves	6,802,561	(9,173,911)
	Total equity	95,799,546	82,204,790
	Ordinary Shares in issue	95,278,602	98,198,602
2	Net Asset Value per Ordinary Share	1.01	0.84

The Financial Statements on pages 19 to 37 were approved by the Board of Directors on 19 April, 2013 and signed on its behalf by:


Director


Director

The notes on pages 23 to 37 form an integral part of the Financial Statements.

THE PROSPECT JAPAN FUND LIMITED

STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December, 2012

	Share Capital Account In U.S. Dollars	Capital Redemption Reserve In U.S. Dollars	Redemption Reserve In U.S. Dollars	Revenue Reserve In U.S. Dollars	Capital Reserve/ Realised In U.S. Dollars	Capital Reserve/ Unrealised In U.S. Dollars	Capital Reserve/ Exchange Differences In U.S. Dollars	Total In U.S. Dollars
Balances at 1 January, 2012	98,198	317,311	90,963,192	(11,302,434)	22,472,199	(23,861,300)	3,517,624	82,204,790
Total comprehensive income/(expense) for the period								
(Loss)/gain for the period after tax	-	-	-	(989,696)	4,430,933	11,998,473	536,762	15,976,472
Capital activities								
Repurchase of shares	(2,920)	2,920	(2,381,716)	-	-	-	-	(2,381,716)
Balances at 31 December, 2012	<u>95,278</u>	<u>320,231</u>	<u>88,581,476</u>	<u>(12,292,130)</u>	<u>26,903,132</u>	<u>(11,862,827)</u>	<u>4,054,386</u>	<u>95,799,546</u>
Balances at 1 January, 2011	99,634	315,875	92,027,074	(11,008,026)	27,619,116	(23,128,033)	2,940,085	88,865,725
Total comprehensive income/(expense) for the period								
(Loss)/gain for the period after tax	-	-	-	(294,408)	(5,146,917)	(733,267)	577,539	(5,597,053)
Capital activities								
Repurchase of shares	(1,436)	1,436	(1,063,882)	-	-	-	-	(1,063,882)
Balances at 31 December, 2012	<u>98,198</u>	<u>317,311</u>	<u>90,963,192</u>	<u>(11,302,434)</u>	<u>22,472,199</u>	<u>(23,861,300)</u>	<u>3,517,624</u>	<u>82,204,790</u>

The notes on pages 23 to 37 form an integral part of the Financial Statements.

THE PROSPECT JAPAN FUND LIMITED

STATEMENT OF CASH FLOWS

for the year ended 31 December, 2012

Notes	01.01.2012 to 31.12.2012 In U.S. Dollars	01.01.2011 to 31.12.2011 In U.S. Dollars
Cash flows from operating activities		
10 Net cash inflow from operating activities	418,906	228,029
Cash flows from investing activities		
Purchase of investments	(76,663,344)	(77,118,552)
Sale of investments	96,022,694	76,894,388
Net cash inflow/(outflow) from investing activities	19,359,350	(224,164)
Net cash inflow before financing activities	19,778,256	3,865
Cash flows from financing activities		
Repurchase of shares	(2,381,716)	(1,063,882)
Net cash outflow from financing activities	(2,381,716)	(1,063,882)
Increase/(decrease) in cash and cash equivalents	17,396,540	(1,060,017)
Reconciliation of net cash flow to movement in net funds		
Net cash inflow/(outflow)	17,396,540	(1,060,017)
Effects of foreign exchange rate changes	(937,888)	(40,878)
Cash and cash equivalents at beginning of period	486,833	1,587,728
Cash and cash equivalents at end of period	16,945,485	486,833

The notes on pages 23 to 37 form an integral part of the Financial Statements.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December, 2012

Note 1 Principal Accounting Policies

The following accounting policies have been applied consistently in dealing with items which are considered to be material in relation to the Company's Financial Statements:

Basis of preparation

The Financial Statements are prepared in accordance with International Financial Reporting Standards ("IFRS") adopted for use in the European Union, which comprise standards and interpretations approved by the International Accounting Standards Board (IASB) and are in compliance with The Companies (Guernsey) Law, 2008. The Financial Statements have been prepared on a going concern basis under the historical cost convention, as modified by the revaluation of financial assets at fair value through profit or loss.

Going concern

The Directors believe that it is appropriate to continue to adopt the going concern basis in preparing the Financial Statements because the assets of the Company consist mainly of securities that are readily realisable and, whilst the liquidity of these needs to be managed, the Company has adequate financial resources to meet its liabilities as they fall due.

In accordance with the Company's Articles, the Board is required every three years to include in the business to be considered by shareholders at the Annual General Meeting a Special Resolution that the Company should be wound up. This resolution requires 75% of votes in favour for it to be passed. The next such resolution will be tabled at the Eighteenth Annual General Meeting to be held in 2014.

Presentation of information

Where presentational guidance set out in the Statement of Recommended Practice ("SORP") for Investment Companies issued by the Association of Investment Companies ("AIC") in January 2009 is consistent with the requirements of IFRS, the Directors have sought to prepare the Financial Statements on a basis compliant with the SORP. Supplementary information which analyses the Statement of Comprehensive Income between items of a revenue and capital nature has been presented within the Statement of Comprehensive Income.

Standards, amendments and interpretations effective during the year

The following interpretations were applicable for the first time this year but had no impact on the financial position or performance of the Company.

- IAS 12 Income Taxes – Limited scope amendment – (effective 1 January, 2012);

Standards, amendments and interpretations issued but not yet effective

The following interpretations are mandatory for accounting periods beginning on or after 1st January, 2013.

- IFRS 1 (Amendments) – Borrowing Costs – (effective 1 January, 2013)
- IAS 1 Presentation of items of Other Comprehensive Income (effective 1 July, 2012)
- IFRS 7 (Amendments), Financial Instruments : Disclosures – (effective 1 January, 2013 and 1 January, 2015);
- IFRS 9 Financial Instruments: Classification and Measurement – (effective 1 January, 2015);

IFRS 9 will change the way the Company classifies and measures certain of its financial assets. The Company is currently in the process of evaluating the potential effect of this standard. The standard is not expected to have a significant impact on the Financial Statements since the majority of the Company's financial assets are designated at fair value through profit and loss.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 1 Principal Accounting Policies

Continued

Standards, amendments and interpretations issued but not yet effective

Continued

- IFRS 10 Consolidated Financial Statements – (effective 1 January, 2013);
- IFRS 11 Joint Arrangements – (effective 1 January, 2013);
- IFRS 12 Disclosure of Interests in Other Entities – (effective 1 January, 2013);
- IFRS 13 Fair Value Measurement – (effective 1 January, 2013);

IFRS 13 aims to improve consistency and reduce complexity by providing a precise definition of fair value and a single source of fair value measurement and disclosure requirements. The Company is yet to assess the full impact of IFRS 13 and does not intend to early-adopt the standard.

The European Union has not yet endorsed the amendments to IFRS 10 “Consolidated Financial Statements” and IFRS 9 “Financial Instruments: Classification and Measurement” for investment entities. The application of IFRS 10 “Consolidated Financial Statements” is due to be endorsed on 1 January, 2014.

There are no other standards, amendments or interpretations that are not yet effective that would be expected to have a material impact on the Company.

The Board anticipate that the adoption of these standards and interpretations in a future period will not have a material impact on the Financial Statements of the Company.

Improvements to IFRSs

In May 2012 the IASB issued improvements to IFRS, an omnibus of amendments to its IFRS standards. The amendments have not been adopted as they become effective for annual periods on or after 1 January, 2013. The Company expects no impact from the adoption of the amendments on its financial position or performance.

Significant accounting judgements, estimates and assumptions

The preparation of the Financial Statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and the reported amounts of assets and liabilities, income and expense. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from those estimates.

The financial information in these Financial Statements has been prepared on the basis of standards applicable as at 31 December, 2012.

Financial instruments

Financial assets and financial liabilities are recognised in the Company's Statement of Financial Position when the Company becomes a party to the contractual provisions of the instrument. Financial assets and liabilities, other than those shown at fair value through profit or loss, are measured at amortised cost using the effective interest rate method.

Financial assets at fair value through profit or loss (“investments”)

All “regular way” purchases and sales of investments are recognised on the trade date, that is the date on which the Company commits to purchase or sell the investment). “Regular way” purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame generally established by regulation or convention in the market place.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 1 Principal Accounting Policies

Continued

Financial assets at fair value through profit or loss (“investments”)

Continued

All of the Company's investments are recorded at fair value through profit or loss at the time of acquisition. Investments are initially recognised at fair value, normally being the cost incurred in their acquisition. Any transaction costs are expensed in the Statement of Comprehensive Income. After initial recognition, investments are measured at fair value. Gains and losses arising from changes in fair value are presented in the Statement of Comprehensive Income in the period in which they arise.

Investments are designated at fair value through profit or loss at inception because they are managed and their performance evaluated on a fair value basis and information thereon is evaluated by the management of the Company on a fair value basis.

Other financial instruments

For other financial instruments, including other receivables, other payables and unrealised gains or losses on open forward foreign currency contracts, the carrying amounts as shown in the Statement of Financial Position approximate to fair values due to the short term nature of these financial instruments.

Offsetting of financial instruments

Financial assets and financial liabilities are offset and the net amount reported in the Statement of Financial Position, if and only if, there is a currently enforceable legal right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise assets and settle the liabilities simultaneously.

Fair value

The Company's investments consist of equity and equity-related investments in smaller companies in Japan and unlisted convertible and corporate bonds.

Listed investments held at the statement of financial position date are valued at bid prices quoted on the principal stock exchange on which the investments are traded. Gains and losses arising from changes in fair value are presented in the Statement of Comprehensive Income in the period in which they arise.

Unlisted investments are valued at the Directors' estimate of their fair value in accordance with the requirements of IAS 39 'Financial Instruments: Recognition and Measurement'. The Directors estimates are based on available price data or comparisons with the valuations of comparable convertible and corporate bonds.

Derecognition of financial instruments

A financial asset is derecognised when the Company has transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled.

Income

Income arising on the investments is recognised when the right to receive it has been met and is recorded gross of withholding tax. Bank interest is accounted for on an accruals basis.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 1 Principal Accounting Policies

Continued

Expenses

Expenses are accounted for on an accruals basis. Expenses incurred on the acquisition of investments at fair value through profit or loss are charged to the Statement of Comprehensive Income in capital. All other expenses are charged to the Statement of Comprehensive Income in revenue.

Cash and Cash equivalents

Cash and cash equivalents are defined as cash in hand, demand deposits and highly liquid investments readily convertible to known amounts of cash and subject to insignificant risk of change in value. Cash and cash equivalents at the year end constituted demand deposits.

Capital Reserves

Gains and losses recorded on the realisation of investments and realised exchange differences of a capital nature are transferred to the realised capital reserve. Unrealised gains and losses recorded on the revaluation of investments held at a period end and unrealised exchange differences of a capital nature are transferred to the unrealised capital reserve.

Foreign Currencies

(i) Functional and presentation currency

The Company's shares are denominated in United States Dollar and accordingly the Board have determined that the Company's functional and presentation currency is United States Dollar, despite the fact that the investments are in Japanese Yen.

(ii) Foreign currency transactions

Monetary assets and liabilities and investments at fair value through profit or loss are translated into United States Dollars at the rate of exchange ruling at the Statement of Financial Position date. Investment transactions and income and expenditure items are translated at the rate of exchange ruling at the date of the transactions. Gains and losses on foreign exchange are included in the Statement of Comprehensive Income.

Note 2 Gain/(loss) per Ordinary Share - Basic & Diluted and Net Asset Value per Ordinary Share - Basic & Diluted

The gain per Ordinary Share - Basic and Diluted has been calculated based on the weighted average number of Ordinary Shares of 97,028,307 and a net gain of US\$15,976,472 (2011: 99,056,113 Ordinary Shares and a net loss of US\$5,597,053).

There were no dilutive elements to shares issued or repurchased during the year.

The Net Asset Value per Ordinary Share - Basic and Diluted has been calculated based on the number of shares in existence at the year end date of 95,278,602 (2011: 98,198,602) and shareholders' funds attributable to equity interests of US\$95,799,546 (2011: US\$82,204,790).

Note 3 Taxation

The Company has been granted Exempt Status under the terms of The Income Tax (Exempt Bodies) (Guernsey) Ordinance, 1989 to income tax in Guernsey. Its liability is an annual fee of £600.

The amount disclosed as withholding tax in the Statement of Comprehensive Income relates solely to withholding tax suffered at source, on income in the investing country, Japan.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 4 Management Fees

The management fee is payable to the Manager, Prospect Asset Management (Channel Islands) Limited ("PAM(CI)Ltd"), monthly in arrears at a rate of 1.5% per annum of the Net Asset Value, which is calculated as of the last business day of each month. Total management fees for the year amounted to US\$1,410,894 (2011: US\$1,318,200) of which US\$110,087 (2011: US\$102,458) is due and payable at the year end. The Management Agreement dated 1 December, 1994 remains in force until determined by the Company or by the Manager giving the other party not less than three months' notice in writing, subject to additional provisions included in the agreement regarding a breach by either party.

Note 5 Other Expenses

	01.01.2012 to 31.12.2012 In U.S. Dollars	01.01.2011 to 31.12.2011 In U.S. Dollars
Administration and secretarial fees*	235,149	219,700
Custodian's fees and charges**	116,173	122,043
General expenses	121,668	147,134
Directors' remuneration	141,236	119,922
Non-audit fees	19,516	27,644
Auditors' fees	30,609	36,817
	<u>664,351</u>	<u>673,260</u>

*The administration and secretarial fees are payable to Northern Trust International Fund Administration Services (Guernsey) Limited monthly in arrears at a rate of 0.25% of the Net Asset Value of the Company as at the last business day of the month. Total administration and secretarial fees for the year amounted to US\$235,149 (2011: US\$219,700) of which US\$18,348 (2011: US\$17,076) is due and payable at the year end.

** The custodian's fees and charges are payable to Northern Trust (Guernsey) Limited monthly in arrears at a rate of 0.08% of the value of the portfolio of the Company as at the last business day of the month. Total custodian's fees and charges for the year amounted to US\$116,173 (2011: US\$122,043) of which US\$13,969 (2011: US\$5,380) is due and payable at the year end.

Note 6 Financial Assets at Fair Value through Profit or Loss

	01.01.2012 to 31.12.2012 In U.S. Dollars	01.01.2011 to 31.12.2011 In U.S. Dollars
Opening book cost	105,041,226	110,330,155
Purchases at cost	76,435,294	76,703,583
Proceeds on sale	(96,823,967)	(77,107,152)
Realised gain/(loss) on sale	4,751,496	(4,885,360)
Closing book cost	89,404,049	105,041,226
Unrealised loss	(11,862,827)	(23,861,300)
Fair value	<u>77,541,222</u>	<u>81,179,926</u>

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 7 Receivables

	31.12.2012	31.12.2011
	In U.S. Dollars	In U.S. Dollars
Amounts due from brokers	884,904	278,868
Interest receivable	399,513	-
Dividends receivable	453,505	780,002
	<u>1,737,922</u>	<u>1,058,870</u>

Note 8 Payables

	31.12.2012	31.12.2011
	In U.S. Dollars	In U.S. Dollars
Amounts due to brokers	169,656	272,380
Other creditors	255,427	248,459
	<u>425,083</u>	<u>520,839</u>

Note 9 Share Capital, Redemption Reserve & Capital Redemption Reserve

Authorised Share Capital		31.12.2012	31.12.2011
Number of shares		In U.S. Dollars	In U.S. Dollars
150,000,000	Ordinary Shares of US\$0.001 each	<u>150,000</u>	<u>150,000</u>
60,000,000	"C" Ordinary Shares of US\$0.01 each	<u>600,000</u>	<u>600,000</u>

As approved at the AGM on 24 August, 2012, the Company may purchase a maximum of 14,577,865 Ordinary Shares, equivalent to 14.99% of the Issued share capital of the Company as at the date of the AGM. During the year, shares were purchased and cancelled as follows:-

Ordinary Shares		Share Capital	Redemption Reserve	Capital Redemption Reserve
Number of shares		In U.S. Dollars	In U.S. Dollars	In U.S. Dollars
98,198,602	Balance at 1 January, 2012	98,198	90,963,192	317,311
(2,920,000)	Shares repurchased and cancelled during the period	(2,920)	(2,381,716)	2,920
<u>95,278,602</u>	Balance at 31 December, 2012	<u>95,278</u>	<u>88,581,476</u>	<u>320,231</u>

The Redemption Reserve account is a distributable reserve account which can be used for among other things, the payment of dividends, if any. The Directors do not recommend the payment of a dividend for the year.

The Capital Redemption Reserve is used to cancel the nominal shares of the Company when they are redeemed or there is a share buy back.

Ordinary Shares carry the right to vote at general meetings of the Company and to receive dividends and, in a winding-up will participate in any surplus assets remaining after settlement of any outstanding liabilities of the Company.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 10 Reconciliation of Deficit on Ordinary Activities to Net Cash Inflow from Operating Activities

	31.12.2012	31.12.2011
	In U.S. Dollars	In U.S. Dollars
Revenue loss on ordinary activities for the period	(989,696)	(294,408)
Decrease in dividends receivable and other receivables	(73,016)	(90,155)
Increase/(decrease) in other creditors	6,968	(5,825)
Foreign exchange gain	1,474,650	618,417
	<u>418,906</u>	<u>228,029</u>
Net cash inflow from operating activities	<u><u>418,906</u></u>	<u><u>228,029</u></u>

Note 11 Analysis of Financial Assets and Liabilities by Measurement Basis

	Investments at fair value	Net current assets	Total
	In U.S. Dollars	In U.S. Dollars	In U.S. Dollars
As at 31 December, 2012			
Financial assets			
Investments at fair value through profit or loss	77,541,222	-	77,541,222
Cash and cash equivalents	-	16,945,485	16,945,485
Receivables	-	1,737,922	1,737,922
	<u>77,541,222</u>	<u>18,683,407</u>	<u>96,224,629</u>
Financial liabilities			
Payables	-	425,083	425,083
	<u>-</u>	<u>425,083</u>	<u>425,083</u>
As at 31 December, 2011			
Financial assets			
Investments at fair value through profit or loss	81,179,926	-	81,179,926
Cash and cash equivalents	-	486,833	486,833
Receivables	-	1,058,870	1,058,870
	<u>81,179,926</u>	<u>1,545,703</u>	<u>82,725,629</u>
Financial liabilities			
Payables	-	520,839	520,839
	<u>-</u>	<u>520,839</u>	<u>520,839</u>

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 12 Related Party Transactions

Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operational decisions.

The Directors are responsible for the determination of the investment policy of the Company and have overall responsibility for the Company's activities. The Company's investment portfolio is managed by PAM(CI) Ltd whose parent company is Prospect Company Limited (Kabushiki Kaisha Prospect, a Japanese Company).

Mr Rupert Evans is a Director of the Manager.

Directors' fees are disclosed in Note 5. The basic fee payable to Directors in 2012 was £20,000, the Chairman of the Audit Committee £22,500 and the Chairman of the Board £25,000 per annum.

Prospect Epicure JREIT Value Fund is classed as a related party as the fund shares the same Investment Advisor as the Company. The Company did not receive income (2011: Nil) during the year from Prospect Epicure JREIT Value Fund.

Note 13 Financial Risk Management Objectives and Policies

Financial Instruments

In accordance with its investment objectives and policies, the Company holds financial instruments which at any one time may comprise the following:

- * securities held in accordance with the investment objectives and policies
- * cash and short-term debtors and creditors arising directly from operations
- * borrowing used to finance investment activity
- * derivative transactions including investment in warrants and forward currency contracts
- * options or futures for hedging purposes

The financial instruments held by the Company principally comprise equities listed on the stock market in Japan. The specific risks arising from the Company's exposure to these instruments, and the Manager/Investment Advisor's policies for managing these risks, which have been applied throughout the year, are summarised below.

Market Price Risk

The Company's investment portfolio - particularly its equity investments - is exposed to market price fluctuations, which are monitored by the Manager/Investment Advisor in pursuance of the investment objectives and policies.

Exceptional risks associated with investment in Japanese smaller companies may include:

- a) greater price volatility, substantially less liquidity and significantly smaller market capitalisation, and
- b) more substantial government intervention in the economy, including restrictions on investing in companies or in industries deemed sensitive to relevant national interests.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 13 Financial Risk Management Objectives and Policies

Continued

Market price sensitivity analysis

The sensitivity of the Company to market price risk can be approximated by measuring the impact that a movement in the Topix Small Index would have on the percentage of funds invested. Topix Small Index is the capitalization-weighted index designed to measure the stocks not included in the Topix 500 Index that are listed on the First Section of the Tokyo Stock Exchange. Topix Small Index provides an indicator of the effect of market price risk on the Company's portfolio since its characteristics with respect to average market capitalization more closely resemble the investment strategy pursued by the Company. However, the Company's investments do not reflect the full array of companies on the index. At 31 December, 2012 a 1% positive/negative movement in the index would produce a positive/negative movement in the net assets of the Company of US\$217,115 (2011: US\$389,663) for equity related securities. This relationship between the movement in the value of the assets of the Company and the Index is of a linear nature.

As the intrinsic value of the corporate bonds is affected by the movements in interest rates, an increase in the interest rate would decrease the value of the bonds and a decrease would have an opposite effect.

Foreign Currency Risk

The Company principally invests in securities denominated in Yen rather than United States Dollar, the functional currency of the Company. Therefore, the Statement of Financial Position may be affected by movements in the exchange rates of such currencies against the US Dollar. The Manager/Investment Advisor has the power to manage exposure to currency movements by using forward currency contracts. The Company was not party to any such instruments at the date of these Financial Statements.

It is not the present intention of the Directors to hedge the currency exposure of the Company, but the Directors reserve the right to do so in the future if they consider this to be desirable.

The treatment of currency transactions other than in US Dollars is set out in Note 1 to the Financial Statements under "Foreign Currencies".

The Company's currency exposure is as follows:

	31.12.2012	31.12.2011
	In US Dollars	In US Dollars
Investments		
Japanese Yen (¥6,687,154,985, 2011:¥6,300,779,956)	77,541,222	81,179,926
	<u>77,541,222</u>	<u>81,179,926</u>
Other (Liabilities)/Assets		
US Dollars	140,752	(130,237)
Sterling (£48,267, 2011:£40,938)	(77,973)	(63,622)
Japanese Yen (¥1,600,966,518, 2011:¥94,591,186)	18,195,545	1,218,723
	<u>18,258,324</u>	<u>1,024,864</u>

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 13 Financial risk management objectives and policies

Continued

Foreign Currency Risk

Continued

The below details the Company's sensitivity to a 10% (31 December 2011: 10%) change in the Yen exchange rates against the US Dollar.

	31.12.2012 In US Dollars	31.12.2011 In US Dollars
Impact on Statement of Comprehensive Income and Equity in response to a		
- 10% increase	<u>8,711,139</u>	<u>7,497,147</u>
- 10% decrease	<u>(10,645,216)</u>	<u>(9,161,768)</u>
Impact on Equity in response to a		
- 10% increase	<u>8,711,139</u>	<u>7,497,147</u>
- 10% decrease	<u>(10,645,216)</u>	<u>(9,161,768)</u>

Interest Rate Risk

The Company may invest in fixed and floating rate securities. The income of the Company may be affected by changes to interest rates relevant to particular securities or as a result of the Manager/Investment Advisor being unable to secure similar returns on the expiry of contracts or sale of securities.

The value of fixed interest securities may be affected by interest rate movements in the future however, in the Directors' opinion no material impact is expected. Interest receivable on bank deposits or payable on bank overdraft positions will be affected by fluctuations in interest rates, however the value of the underlying cash positions will not be affected.

The direct effect of movements in interest rates are not material on cash and cash equivalent as the Company predominately keeps its surplus cash in Japanese Yen on which it does not earn interest.

Interest rate sensitivity analysis

As the intrinsic value of the corporate bonds is affected by the movements in interest rates, an increase in the interest rate would decrease the value of the corporate bonds and a decrease would have an opposite effect.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 13 Financial risk management objectives and policies

Continued

Fair Value

All assets and liabilities are carried at fair value or at carrying value which equates to fair value.

IFRS 7 requires the Company to classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy has the following levels:

- (i) Quoted prices (unadjusted) in active markets for identical assets or liabilities (level 1).
- (ii) Inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (that is, as prices) or indirectly (that is, derived from prices) (level 2).
- (iii) Inputs for the asset or liability that are not based on observable market data (that is, unobservable inputs) (level 3).

The following table analyses within the fair value hierarchy the Company's financial assets and liabilities (by class) measured at fair value for the year ended 31 December 2012.

	Level 1 In US Dollars	Level 2 In US Dollars	Level 3 In US Dollars	Total In US Dollars
Assets				
Financial assets at fair value through profit and loss:				
-Equity Securities	70,473,806	-	-	70,473,806
-Debt Securities		-	7,067,416	7,067,416
Total assets as at 31 December, 2012	70,473,806	-	7,067,416	77,541,222

The following table presents the movement in level 3 instruments for the year ended 31 December, 2012 by class of financial instrument.

	Debt	
	Securities In US Dollars	Total In US Dollars
Opening balance	134,228	134,228
Purchases	8,283,617	8,283,617
Unrealised losses during the period	(1,350,429)	(1,350,429)
Closing balance	7,067,416	7,067,416
Net unrealised gain for the period included in the Statement of Comprehensive Income for level 3 Investments held at 31 December, 2012	624,230	624,230

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 13 Financial risk management objectives and policies

Continued

Fair Value

Continued

The following table analyses within the fair value hierarchy the Company's financial assets and liabilities (by class) measured at fair value for the year ended 31 December 2011.

	Level 1	Level 2	Level 3	Total
	In US Dollars	In US Dollars	In US Dollars	In US Dollars
Assets				
Financial assets at fair value through profit and loss:				
-Equity Securities	81,045,698	-	-	81,045,698
-Debt Securities	-	-	134,228	134,228
Total assets as at 31 December, 2011	81,045,698	-	134,228	81,179,926

	Debt Securities	Total
	In US Dollars	In US Dollars
Opening balance	502,454	502,454
Sales	(3,340,292)	(3,340,292)
Gains recognised in profit and loss	2,972,066	2,972,066
Closing balance	<u>134,228</u>	<u>134,228</u>
Net unrealised loss for the year included in the Statement of Comprehensive Income for level 3 Investments held at 31 December, 2011	<u>(8,519,824)</u>	<u>(8,519,824)</u>

Level 3 investments, consisting of corporate bonds, are valued at the Directors' estimate of their fair value in accordance with the requirements of IAS 39 'Financial Instruments: Recognition and Measurement'. The Directors estimates are based on available traded prices or comparisons with the valuations of comparable convertible bonds.

There were no transfers between level 1 and level 3 during the financial year 2012 or 2011.

On 20 December, 2012 the Company signed a ¥300,000,000 purchase agreement for an unlisted bond. The purchase was settled on 7 January, 2013 at a cost of \$3,419,796.

Short term Debtors and Creditors

Trade and other receivables do not carry interest and are short term in nature. They are stated at nominal value as reduced by appropriate allowances for irrecoverable amounts in the case of receivables.

Liquidity Risk

Liquidity risk is the risk that the Company will encounter in realising assets or otherwise raising funds to meet financial commitments.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 13 Financial risk management objectives and policies

Continued

Liquidity risk

Continued

The Company invests primarily in listed securities. The tables below analyse liquidity of the Company's securities based on trading volumes in the period after the statement of financial position date and maturity of other financial assets and liabilities.

The Investment Manager considers expected cash flows from financial assets in assessing and managing liquidity risk, in particular its cash resources and trade receivables. Cash flows from trade and other receivables are all contractually due within twelve months.

As at 31 December 2012	Up to 1 week In US Dollars	1 week to 1 month In US Dollars	1-6 months In US Dollars	6-12 months In US Dollars	Total In US Dollars
Financial assets					
Financial assets at fair value through profit or loss	11,806,843	17,788,151	38,302,729	9,643,499	77,541,222
Dividends receivable	-	-	453,504	-	453,504
Interest receivable	-	-	30,976	368,538	399,514
Cash and cash equivalents	16,945,485	-	-	-	16,945,485
Securities sold receivable	884,904	-	-	-	884,904
Financial liabilities					
Amounts due to brokers	(169,656)	-	-	-	(169,656)
Other creditors	-	(186,182)	(69,245)	-	(255,427)
Total	29,467,576	17,601,969	38,717,964	10,012,037	95,799,546
As at 31 December 2011	Up to 1 week In US Dollars	1 week to 1 month In US Dollars	1-6 months In US Dollars	6-12 months In US Dollars	Total In US Dollars
Financial assets					
Financial assets at fair value through profit or loss	12,832,997	25,601,895	34,057,649	8,687,385	81,179,926
Dividends receivable	-	-	780,002	-	780,002
Cash and cash equivalents	486,833	-	-	-	486,833
Securities sold receivable	278,868	-	-	-	278,868
Financial liabilities					
Amounts due to brokers	(272,380)	-	-	-	(272,380)
Other creditors	-	(169,309)	(79,150)	-	(248,459)
Total	13,326,318	25,432,586	34,758,501	8,687,385	82,204,790

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 13 Financial risk management objectives and policies

Continued

Credit Risk

Credit risk is the risk that an issuer or counterparty will be unable or unwilling to meet a commitment that it has entered into with the Company. The Company's principal sources of credit risk arise on amounts due from brokers for settlement of outstanding investments transactions, dividends and interest receivable, corporate bonds and cash and cash equivalents.

The Company utilizes 18 executing brokers setting allocation targets for each broker so as to not to place excessive concentration on any one counterparty.

The investment advisor performs a quarterly review of executing brokers as part of its "Best Execution" analysis, which is part of the advisor's compliance program. The investment team reviews the quality of broker research, execution and service, and sets targets for each broker based on brokers' overall performance.

Currently all cash is placed with Northern Trust (Guernsey) Limited ("NTGL"). NTGL is also custodian of the majority of the Company's investments. NTGL is a wholly owned subsidiary of The Northern Trust Corporation ("TNTC"). TNTC is publicly traded and a constituent of the S&P 500. TNTC has a credit rating of A+.

All transactions in listed securities are settled/paid upon delivery using approved brokers. The risk of default is considered minimal, as delivery of securities sold is only made once the broker has received payment. Payment is made on a purchase once the securities have been received by the broker. The trade will fail if either party fails to meet their obligation.

When purchasing unlisted securities including OTC bonds, the Investment Advisor prepares an evaluation on the company issuing these securities and monitors and reviews the Company's quality and performance over time. These unlisted investments are issued by the companies themselves and by their nature are either not rated or have a higher credit rating.

It is the opinion of the Board of Directors that the carrying amounts of these financial assets, excluding equities, represent the maximum credit risk exposure as at the statement of financial position date.

Capital Management

The Company is a closed-ended investment company, and thus has a fixed capital. The Company's capital is represented by Ordinary Shares and each share carries one vote. They are entitled to dividends when declared.

As approved at the AGM on 24 August, 2012, the Company may purchase a maximum of 14,577,865 Ordinary Shares, equivalent to 14.99% of the Issued share capital of the Company as at the date of the AGM provided that;

- The minimum price to be paid (exclusive of expenses) be US\$0.01;
- The maximum price to be paid (exclusive of expenses) be 105% of the average mid-market valuation for five days preceding the purchase; and
- If the shares are trading on the London Stock Exchange at a discount to the lower of the undiluted or diluted Net Asset Value;

The Board also considers from time to time whether it may be appropriate to raise new capital by a further issue of shares. The raising of new capital would however be dependent on there being genuine market demand.

The Company is not subject to externally imposed capital requirements.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 14 Segmental Reporting

The Board is responsible for reviewing the Company's entire portfolio and considers the business to have a single operating segment. The Board's asset allocation decisions are based on a single, integrated investment strategy, and the Company's performance is evaluated on an overall basis.

The Company invests in a diversified portfolio of Japanese investments. The total fair value of the financial instruments held by the Company and the equivalent percentages of the total value of the Company, are reported in the Portfolio Statement.

Revenue earned is reported separately on the face of the Statement of Comprehensive Income as investment income being dividend income received from equities, and interest income being interest earned from convertible and corporate bonds.

Note 15 Subsequent Events

These Financial Statements were approved for issuance by the Board on 19 April, 2013. Subsequent events have been evaluated until this date.

The Company has made the following share buybacks subsequent to the year end, up to the date up to the date of these Financial Statements:

Date	Shares	Price per Share In U.S. Dollars	Percentage of share capital
30 January, 2013	5,000	0.885	0.01%
25 February, 2013	5,000	0.840	0.01%
26 February, 2013	25,000	0.840	0.03%
27 February, 2013	10,000	0.840	0.02%
4 April, 2013	10,000	0.990	0.02%
	<u>55,000</u>		<u>0.09%</u>

THE PROSPECT JAPAN FUND LIMITED

GENERAL INFORMATION

General

The Company is a closed-ended investment company incorporated in Guernsey in November 1994 and was launched in December 1994 with an initial asset value of US\$70 million. There are 95,278,602 Ordinary Shares in issue as at 31 December, 2012. The Company's Ordinary Shares are listed on the London Stock Exchange.

The Ordinary Shares of the Company have not been registered under the United States Securities Act of 1933 or the United States Investment Companies Act of 1940. Accordingly, none of the Ordinary Shares may be offered or sold directly or indirectly in the United States or to any United States persons (as defined in Regulation 'S' under the 1933 Act) other than in accordance with certain exemptions. Investment in the Company is suitable only for sophisticated investors and should be regarded as long-term. Past performance is no indication of future results.

Investment Objective

The Company was established to invest substantially all of its assets in securities issued by smaller Japanese companies. The objective of the Company is to achieve long-term capital growth from an actively managed portfolio of securities primarily of smaller Japanese companies listed or traded on Japanese Stock Markets.

Investment Restrictions

The following investment restrictions have been adopted:

- (i) the Company may not invest in securities carrying unlimited liability; or
- (ii) the Company may not deal short in securities; or
- (iii) the Company may not take legal or management control in investments in its portfolio; or
- (iv) the Company may not invest in any commodities, land or interests in land; or
- (v) the Company may not invest or lend more than 10% of its assets in securities of any one company or single issuer (other than obligations of the Japanese Government or its agencies or of the US Government or its agencies); or
- (vi) the Company may not invest more than 10% of its assets in non-corporate investments or securities not listed or quoted on any recognised stock exchange, for which purpose securities quoted on any of the Japanese Stock Markets will be treated as securities quoted on a recognised stock exchange; or
- (vii) the Company may not invest more than 5% of its assets in unit trusts, shares or other forms of participation in managed open-ended investment vehicles; or
- (viii) the Company may not commit its assets in the purchase of foreign exchange contracts, financial futures contracts, put or call options or in the purchase of securities on margin other than in connection with or for the purpose of hedging transactions effected on behalf of the Company.

NAV and Information

The prices of Ordinary Shares and the latest NAV are published daily in the Financial Times. Prices (in Sterling terms) of the Ordinary Shares appear within the section of the London Share Service entitled "Investment Companies".

Life of the Company

From inception the Directors have believed that Shareholders should be able to review the progress of the Company so that a decision can be taken as to whether Shareholders should have an opportunity of realising the Company's underlying investments. Accordingly, at the fifteenth Annual General Meeting of the Company held on 22 August 2011, the Board included in the business to be considered by Shareholders a Special Resolution that the Company should be wound up. As the resolution was not passed, the Board will include a similar resolution in the business to be considered at every third Annual General Meeting held. The next such resolution will be tabled at the Annual General Meeting to be held in 2014.

THE PROSPECT JAPAN FUND LIMITED

GENERAL INFORMATION

Continued

Directors

Brief biographical details of the Directors are as follows:

Rupert Evans, age 74, is a Guernsey advocate and former partner in the firm of the Guernsey legal advisors, Mourant Ozannes. He is now a consultant to Mourant Ozannes. He is a non-executive director of the Manager and of a number of investment companies. Mr Evans is resident in Guernsey. Mr Evans was appointed to the Board on 18 November, 1994.

John Hawkins, age 70, is a Fellow of the Institute of Chartered Accountants in England and Wales. He was formerly Executive Vice President and a member of the Corporate Office of The Bank of Bermuda Limited, with whom he spent many years in Asia. He retired from the Bank of Bermuda in 2001 after 25 years with the Group. He is a director of a range of funds which include hedge funds and equity funds investing in Japan and Asia. Mr Hawkins was appointed to the Board on 4 April, 2004.

Christopher Sherwell, age 65, was Managing Director of Schroders (C.I.) Limited from 2000 to 2003, and was Investment Director with Schroders (C.I.) Limited from 1993 to 2000. Prior to joining Schroders (C.I.) Limited, Mr Sherwell was Far East Regional Strategist with Smith New Court Securities, and from 1977 to 1990 worked as a journalist on the Financial Times, including seven years as a foreign correspondent in the Far East and Australia from 1983 to 1990. Mr Sherwell was appointed to the Board on 27 September, 2004.

Richard Battey, age 61, is a qualified chartered accountant. He is a non-executive director of a number of investment companies and funds. Mr Battey joined the Schroder Group in December 1977 and was a director of Schroders (C.I.) Limited from April 1994 to December 2004, where he served as Finance Director and Chief Operating Officer, and was a director of Schroder Group Guernsey companies before retiring from his last Schroder directorship in December 2008. Mr Battey was appointed to the Board on 10 February, 2010.

Taxation Status

The Company has obtained exemption from Guernsey Income Tax under The Income Tax (Exempt Bodies) (Guernsey) Ordinance, 1989. There is no capital gains tax in Guernsey.