

THE PROSPECT JAPAN FUND LIMITED

ANNUAL REPORT AND AUDITED FINANCIAL STATEMENTS

For the year ended 31 December, 2013

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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Les Banques,
St Peter Port,
Guernsey, GY1 3QL
Channel Islands

Custodian

Northern Trust (Guernsey) Limited,
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Les Banques,
St Peter Port,
Guernsey, GY1 3DA
Channel Islands

Manager

Prospect Asset Management (Channel Islands)
Limited,
PO Box 255
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Les Banques,
St Peter Port,
Guernsey, GY1 3QL
Channel Islands

Secretary, Registrar and Administrator

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

Prospect Asset Management, Inc.,
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United States of America

Corporate Broker

Westhouse Securities Limited,
Heron Tower,
110 Bishopsgate,
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Legal Advisors

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CREST Agent

Computershare Investor Services
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Channel Islands

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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, 2013

The performance of the fund was highly satisfactory during the year with an increase in the net asset value of 27.72% as against the Topix small index of 21.10%. The share price increased from US\$0.861 at 31 December, 2012 to US\$1.05 at 31 December, 2013.

Following his election victory in December 2012 Prime Minister Abe introduced a bold new economic program, known as Abenomics. It has three parts or "Arrows". The first arrow is monetary policy, the second arrow is fiscal policy and the third arrow is structural reform. The first arrow, expansionary monetary policy to overcome deflation, is probably the most important in the short term. The new Bank of Japan Governor, Mr. Kuroda, announced a radical change of monetary policy in April and recent inflation figures continue to show improvement towards the Bank's target rate of 2%. Underlying inflation, excluding food and energy prices, hit its highest rate of growth for 15 years and wages appear to be increasing across the board.

The outlook for corporate earnings is good, helped partly by the weaker yen, and profits are forecast to grow strongly to reach record levels. Dividends are being raised and are also forecast to reach record levels, while share buybacks are once again increasing. The property market is also showing signs of recovery, with more housing construction taking place and property prices now starting to rise in major cities.

The end of deflation would have implications for companies and households, which both have huge savings. The introduction of Nippon Individual Savings Accounts on 1 January, 2014, which give tax advantages for individuals, may help encourage households to invest in riskier assets including equities. The Tokyo Olympics in 2020 should also boost domestic sentiment. However, in the shorter term investors will focus on the risks to the economy from an increase in the consumption tax from 5% to 8% in April, any further deterioration in Sino-Japanese relations and whether there is any meaningful progress with Abe's "Third Arrow" structural reforms, such as progress with the Trans-Pacific Partnership ("TPP"), introduction of special Economic Zones, corporate tax and labour reforms.

There remain risks with the implementation of Abenomics, the impact of the increase of the consumption tax and external relations with China. With the Bank of Japan and government policy tending toward the increase of risk the question now is whether the major domestic pension funds will become more confident and start increasing their exposure to equities.

At the EGM on 5 March, 2014 changes to the investment policy were approved by the Shareholders to enable the investment advisor to invest up to 25% of the Fund's assets at the time of Investment in the securities of any single company. This is designed to give the investment advisor flexibility and is not expected to lead to undue concentration, but to enable the investment advisor to do what he is good at.

The Board of directors has taken legal advice on the impact of the rules recently published by the Financial Conduct Authority ("FCA") which restrict the marketing and distribution of Non-Mainstream Pooled Investment Products. Due to the underlying nature of the Fund's assets the Board has been advised that its shares are excluded from these restrictions and accordingly the retail distribution of the Fund's shares is unaffected by the new FCA rules.

Your Investment Advisor has reported in considerable detail, on the performance of your Company, covering the positives, the opportunities and the issues. The Directors have reviewed the prospects for your Company and believe that the revised investment powers should provide for an interesting year for shareholders given the changes being pursued by the Government.

John Hawkins
Chairman
15 April, 2014

THE PROSPECT JAPAN FUND LIMITED

INVESTMENT ADVISOR'S REPORT

for the year ended 31 December, 2013

Market Performance (%), US\$ NAV

	1 Year	3 Year	5 Year
The Prospect Japan Fund Limited	26.73	44.94	130.36
Topix Small	21.10	31.79	58.64

The Prospect Japan Fund Limited inception date is 20 December 1994. Topix Small is capitalization-weighted index designed to measure the stocks that are listed on the First Section of the Tokyo Stock Exchange but not included in the Topix 500 Index. As of August 2003, the benchmark of The Prospect Japan Fund Limited 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.

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

Summary

The Prospect Japan Fund Limited (the “Company”) returned 26.73% in 2013 solidly ahead of the Topix Small Index’s 21.10% gain.

2013 may go down as the year Japan awoke from its “lost” two decades of post-Bubble low growth and deflation. The year saw a small but meaningful move to inflation, soaring profits on the back of a weaker Yen and the TOPIX at 5-year highs.

Following the Liberal Democratic Party’s (“LDP”) return to power under Prime Minister Shinzo Abe in the December 2012 election, and subsequent securing of a ruling majority in both houses of the Diet through a decisive victory in the July upper house elections, Japan saw a rapid progression of expansionary policies known collectively as “Abenomics”, with the goal of ending persistent deflation and spurring economic revitalization through 1) expanded monetary easing by the Bank of Japan (“BoJ”), 2) a ¥13.1 trillion fiscal stimulus package and 3) structural economic reform through regulation change and incentives to investment and hiring.

The government approved a ¥92.6 trillion draft budget for fiscal year 2013, to complement the ¥13.1 trillion supplementary budget for the current fiscal year. As expected, public works spending will serve as the key stimulus measure, with ¥5.3 trillion allotted to infrastructure repair spending (+¥700 billion year-on-year), with the cost offset by a reduction in grants to local governments.

The administration joined US-led TPP negotiations as Japan looks for ways to spur growth. The government estimates that Japan’s participation could boost GDP by as much as ¥3.2 trillion (0.66 percentage points), assuming elimination of all tariffs, though this outcome is unlikely considering pushback from Japanese farmers and American auto-makers. Other participants include the US, Canada, Mexico, Australia, New Zealand, Vietnam, Singapore, Malaysia, Brunei, Peru and Chile.

Former Asian Development Bank President Haruhiko Kuroda was confirmed as the new BoJ governor in March 2013, with the stated intention to reach a 2% inflation goal within the next two years by engaging in bold monetary easing in terms of both the quantity and quality. Under its new governor, the BoJ terminated the Asset Purchase Program in favour of “Quantitative and Qualitative” monetary easing, aimed at lowering long-term interest rates and supporting asset prices. 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 Exchange Traded Funds (“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 PROSPECT JAPAN FUND LIMITED

INVESTMENT ADVISOR'S REPORT

for the year ended 31 December, 2013

Continued

Summary

Continued

Emboldened by strong economic data in the first half, the administration announced that the consumption tax increase from 5% to 8% will go ahead as scheduled in April 2014, along with a ¥5 trillion stimulus package of infrastructure investment and corporate tax incentives aimed at lessening the economic impact of the increase.

Recovery in the Tokyo office market was strong, with Miki Shoji reporting that the average office vacancy in Tokyo's Central Business District has fallen 167 basis points ("bps") through the year end to 7.34%. This marks its lowest reading since June 2009.

The market performed well during the year, with a particularly strong rally during the first half, as the Yen declined sharply, raising the profitability of exports. Real Estate names performed strongly as interest rates declined broadly for most of the year, office vacancies declined and transaction numbers soared. The return of inflation expectations, low interest rates and confirmation of the 2014 consumption tax increase also supported demand for condominiums, which saw strong year on year growth in supply and sales during the year. The announcement of Tokyo as the host city for the 2020 Olympic Games provided an additional boost to market sentiment, with strong gains to construction and real estate related names expected to benefit from investments in the venues.

Fund Performance 2013

Outperformance

The largest contributor to 2013 performance was Shaklee Global Group (8205), a seller of nutrition and personal care products. Shaklee Global Group contributed 15.4 percentage points to total performance, as shares in the company outperformed for most of the year. Share prices reached 18 year highs following the November announcement of triple-digit H1 profit growth on expansion in Asian markets. Shaklee Global returned 159.5% during 2013, far outperforming the Topix Small's 47.8% total return.

Tomoe Corp (1921), a steel frame construction company, performed strongly following the September announcement of Tokyo's winning bid to host the 2020 Olympic Games. The company contributed 8.6 percentage points to total annual performance. Tomoe Corp has multiple real estate holdings around Tokyo Bay, near the proposed Olympic Village site. The company has ¥14.8 billion in unrealized gains on its property holdings.

Shibusawa Warehouse (9304), which operates in logistics and real estate, gained sharply on the market's bullish stance on Tokyo real estate. Shibusawa Warehouse contributed 6.6 percentage points to total performance. The company gained on positive sentiment towards real estate, as 71% of FY 2012 Shibusawa Warehouse's operating profit was from real estate leasing activities, and the company has ¥36.5 billion in unrealized gains on its holdings.

Underperformance

Endo Lighting Corp (6932), a maker of LED light fixtures, declined sharply following a downward revision to full year earnings forecasts due to an unexpected lack of commercial customer demand for energy saving investments, the strengthening yen squeezing profit margins and large inventory write-offs. The company's underperformance resulted in a negative 1.5 percentage point impact on annual performance.

MID REIT (3227), an Osaka office focused J-REIT, underperformed for much of 2013 suffering from declining revenue and profits caused by large tenant departures and limited growth paths in the relatively weak Osaka market. The J-REIT contributed a negative 0.4 percentage point impact on annual performance.

THE PROSPECT JAPAN FUND LIMITED

INVESTMENT ADVISOR'S REPORT

for the year ended 31 December, 2013

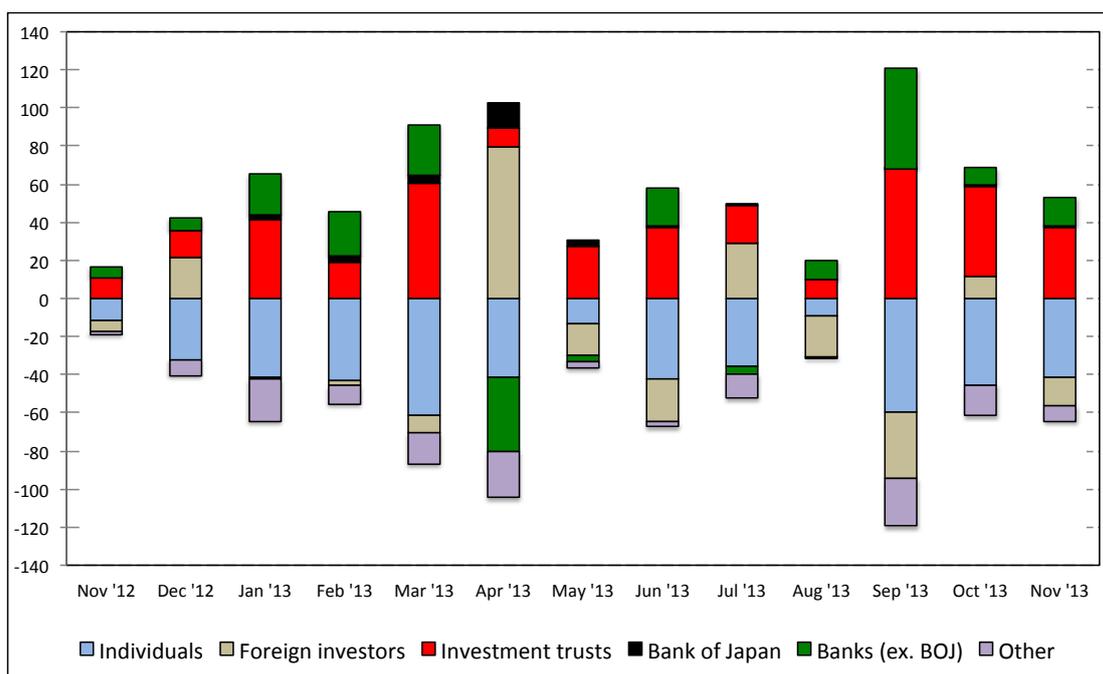
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J-REIT Market 2013

In USD the TSEREIT index has gained 15.44% in the year, versus the Nikkei 225's +30.49% performance. The TSEREIT index rose ferociously through the first quarter of the calendar year, and received a boost from the announcement of the Tokyo Olympic Games in mid-September. Through most of the year however, performance was held in check by increased supply as the pace of new equity issuances remained brisk throughout 2013.

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

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



Source: Tokyo Stock Exchange, Prospect Asset Management, Inc.

J-REITs account for 18.93% of portfolio assets. We believe that J-REITs have and will directly benefit from the asset price reflation that is a cornerstone to Prime Minister Abe's economic strategy.

J-REITs gained strongly on the back of improved fundamentals, a revitalized virtuous cycle of equity issuances and property acquisitions, along with expectations of improving office occupancy and a return to rising rents in the current year 2014.

J-REITs raised a record ¥1.1 trillion through 44 equity issuances during the year, including 6 Initial Public Offerings ("IPO's") for about ¥414.6 billion, supporting the ¥2.2 trillion in property acquisitions announced during the year. ¥108.3 billion in new corporate bonds were issued during the year, with an average 0.80% interest rate and 6.4 year maturity.

As of year-end, the total amount of J-REIT units purchased by the BoJ stands at ¥141 billion, ¥1 billion over the ¥140 billion originally allotted for through 2013 end. The annual target for 2014 direct purchases is ¥30 billion.

The outlook for 2014 remains strong, with the expected launch of Health Care related J-REIT IPO's, continued property price appreciation and rising rents for centrally located office properties being key factors.

THE PROSPECT JAPAN FUND LIMITED

INVESTMENT ADVISOR'S REPORT

for the year ended 31 December, 2013

Continued

Outlook for the Company 2014

The outlook for 2014 remains positive, with the weakening trend for the Japanese Yen, strong Bank of Japan easing support and expected wage increases poised to offset much of the economic impact of higher consumption taxes set to go into effect in April. We see recovery being 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.

Positive impact from the choice of Tokyo to host the 2020 Summer Olympic Games can be expected. The Mori Memorial Foundation projects economic impact of the games to be as much as ¥20 trillion between now and 2020, generating over a million jobs.

Principal Risks and Uncertainties

Japan remains vulnerable to a slowdown in the global economy, particularly in major trading partners.

While the Abe administration has consolidated political power and is engaged in ongoing free-trade negotiations, there has been internal pushback on deregulation that are key to the sustainability of Japanese economic recovery once fiscal and monetary stimulus runs its course. The coming legislative session will reveal if the administration has the wherewithal to push through reform.

Prospect Asset Management, Inc.

15 April 2014

THE PROSPECT JAPAN FUND LIMITED

DISCLOSURE OF DIRECTORSHIPS IN PUBLIC COMPANIES LISTED ON RECOGNISED STOCK EXCHANGES

for the year ended 31 December, 2013

The following summarises the Directors' directorships in other public companies

Directorships Company Name	Stock Exchange
Richard Battey	
AcenciA Debt Strategies Limited	London
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 Global Property Fund PCC Limited	Channel Islands
FF&P Ventures Fund PCC Limited	Channel Islands
Master Capital Fund Limited	Irish
John Hawkins	
Low Carbon Accelerator Limited	London
M W Japan Fund Limited	Irish
The Greater China Fund, Inc.	New York
Christopher Sherwell	
Baker Steel Resources Trust Limited	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
Heritage Diversified Investments PCC Limited (formerly Rufford & Ralston PCC Limited)	Channel Islands
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 The Prospect Japan Fund Limited (the "Company") for the year ended 31 December, 2013.

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 25. The Directors do not recommend the payment of a dividend for the year.

In the year to 31 December, 2013 Net Asset Value per Ordinary Share increased by 26.73%.

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 and Declarations

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. The Directors are responsible for ensuring that the Financial Statements include information required by the Rules of the UK Listing Authority. The Directors are also responsible for ensuring that the Company complies with the provisions of the Listing Rules and the Disclosure Rules and Transparency Rules of the UK Listing Authority. With regard to corporate governance the Company is required to disclose how it has applied the principles and complied with the provisions of the Corporate Governance code applicable to the Company. 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 of the Company as at and for the year ended 31 December, 2013.

(b) The Annual Financial Report includes information detailed in the Chairman's Report, Investment Advisor's, Investment Manager's and Directors' Reports, Audit Committee Report and Notes to the Annual Financial Statements required by:

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

Continued

Statement of Directors' Responsibilities and Declarations

Continued

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

(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. In the opinion of the Board, the Annual Report and Accounts taken as a whole, are fair, balanced and understandable and provide the information necessary to assess the Company's performance, business model and strategy.

Ongoing Charges

Ongoing charges are the recurring expenses incurred by the fund excluding one off expenses. Ongoing charges for the year ended 31 December, 2013 and 31 December, 2012 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, 2013 was 2.24 per cent (31.12.12: 2.21 per cent). No performance fees were charged during the year.

Corporate Governance

The AIC Corporate Governance Guide for Investment Companies ("AIC Guide") came into effect from 1 February 2013. The AIC guide brings together the recommendations of the UK Corporate Governance Code ("UK Code") and the AIC Code of Corporate Governance ("AIC Code") into a single document.

The Board of The Prospect Japan Fund Limited has considered the principles and recommendations of the AIC Code by reference to the AIC Guide. The AIC Code addresses all the principles set out in Section 1 of the 2012 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 more relevant 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, 2013. 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 Company complies with the AIC Code and as such also complies with the Guernsey Financial Services Commission ("GFSC") Code of Corporate Governance (the "GFSC Code"). 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 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 has a contract of service with the Company.

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

Continued

The Board

Continued

The Chairman of the Board is John Hawkins. Biographies for Mr Hawkins and all other Directors can be found on page 51. 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 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 formal 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	4	NA	NA	-	-	NA	NA
John Hawkins	4	4	-	-	-	-	2	2
Christopher Sherwell	4	4	-	-	-	-	2	2
Richard Battey	4	4	-	-	-	-	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. At the AGM on 21 June, 2013, Rupert Evans, John Hawkins and Christopher Sherwell retired as Directors, and being eligible offered themselves for re-election. Rupert Evans, John Hawkins and Christopher Sherwell were re-elected as Directors of the Company.

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.

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

Continued

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. During the year, Christopher Sherwell advised he will be retiring at the Annual General Meeting. A succession plan has been discussed and is in place. A number of suitable candidates are being reviewed.

The Board has also given careful consideration to the recommendations of the Davies Report on "Women on Boards". As recommended in the Davies Report, the Board has reviewed its composition and believes that the current appointments provide an appropriate range of skills, experience and diversity. The Board will take into account the recommendations of the Davies Report as part of its succession planning over future years.

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, 2013, 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.

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. The next such resolution will be tabled at the Eighteenth Annual General Meeting to be held in 2014. The impact of this vote and other factors regarding the going concern basis are discussed in note 1 of the Financial Statements.

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.

The table on page 11 sets out the number of Audit Committee Meetings held during the year ended 31 December, 2013 and the number of such meetings attended by each Committee member.

A report of the Audit Committee detailing responsibilities and activities is presented on pages 15 – 17.

Management and Engagement Committee

The Management and Engagement Committee comprises 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. As the Board has evaluated their performance during the course of their regular meetings, the Management Engagement Committee did not need to meet during the year. The Board agreed to appoint Westhouse Securities Limited as the new Corporate Broker of the fund from the 6 December, 2013.

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

Continued

Dialogue with Shareholders

The Investment Advisor and the Corporate Broker maintain 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 deal with 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.
- * 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, 2013 Christopher Sherwell had beneficial interests of 9,940 (2012: 9,940) Ordinary Shares respectively of the Company. No other Directors holding office at 31 December, 2013, 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, Christopher Sherwell and Richard Battey are Directors of a range of funds.

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

Continued

Substantial Shareholdings

At 31 December, 2013 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	15.80%
Clearstream, Luxembourg	6,860,447	7.23%
Henderson Global Investors	7,000,000	7.38%
Lazard Asset Management	17,338,872	18.27%
Permal Asset Management	18,957,907	19.97%
Ruffer	3,274,052	3.45%
South Yorkshire Pension Authority	4,140,000	4.36%
1607 Capital Partners	17,481,200	18.42%

On 14 April, 2014 Permal Asset Management declared that their Shareholding was 9,396,072 which is 9.97% of issued share capital. There have been no other notifications of significant changes to the substantial shareholdings at 15 April 2014.

Share buybacks

As approved at the AGM on 21 June, 2013, the Company may purchase, subject to various terms as set out in the Articles, a maximum of 14,275,516 Ordinary Shares under the Company's discount control mechanism. During the year, the Company purchased shares as detailed in Note 9 on page 35 and 36 of the Financial Statements. Post year end transactions are detailed in Note 16 on page 48 and 49 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.

John Hawkins

Richard Battey

15 April 2014

THE PROSPECT JAPAN FUND LIMITED

AUDIT COMMITTEE REPORT

On the following pages, we present the Audit Committee (the “Committee”) Report for 2013, setting out the Committee’s structure and composition, principal duties and key activities during the year. As in previous years, the Committee has reviewed the Company's financial reporting, the independence and effectiveness of the independent auditor and the internal control and risk management systems of service providers.

Role and responsibilities

The function of the Audit Committee (the “Committee”) is to ensure that the Company maintains the highest standards of integrity of its financial reporting and internal control.

The responsibilities of the Committee are:

- To review and make recommendations on the appointment of the Company’s Auditors, the scope of the audit, the audit fee, and any questions of the resignation or dismissal of the Auditors;
- To discuss with the Auditors the nature and scope of the audit and to keep under review such scope and its cost-effectiveness;
- To receive and review a Report from the Company’s Auditors and to discuss any matters arising from the audit and recommendations made by them;
- To review the Company’s half-year and Annual Accounts and any other financial information published by the Company, in each case before issue or publication, prior to their submission to the Board, having particular regard to:-
 - the accounting policies and whether they continue to be appropriate to the business;
 - any changes in accounting policies or practice and whether they are appropriate to the business;
 - any important areas where judgement must be exercised e.g. valuation of unquoted investments;
 - any significant adjustments arising from the audit;
 - the going concern assumption;
 - other legal, UK Listing Authority or recognised investment exchange requirements;
- To advise the Board on whether the annual report and accounts, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders to assess the Company’s performance, business model and strategy.
- To ensure that the internal control systems of the service providers are adequate. To receive reports from the Company’s service providers covering internal control systems and procedures supported either by SSAE 16, ISAE 3402 or AAF Reports. In light of the above, to review the Company’s statement on internal controls prior to endorsement by the Board;
- To monitor the Company’s procedures for ensuring compliance with statutory, regulatory and other financial reporting requirements i.e. the Guernsey Financial Services Commission and the London Stock Exchange (which includes the UK Listing Authority);
- To review significant transactions outside the Company’s normal business (e.g. Company share buy backs);
- To consider any other topics referred to it by the Board.

Membership

The members of the Committee are Richard Battey (Chairman), Christopher Sherwell and John Hawkins. Full biographical details of each member can be found on page 51. All members attended the formal Audit Committee meetings held during the year. In addition a number of ad hoc meetings were held with the auditors to discuss financial reporting issues.

THE PROSPECT JAPAN FUND LIMITED

AUDIT COMMITTEE REPORT

Continued

Significant issues related to the financial statements

The Committee's review of the interim and annual financial statements focused on the following areas:

- Going concern. As detailed in the Chairman's Report a Resolution to wind up the Company is required to be put to the Shareholders at the 2014 AGM. The Committee has considered the positive response of the Shareholders to support the changes in investment policy at the EGM on 5 March, 2014 and take that as a strong indication that they would not wish to wind up the Company. The Committee also consider that the Company has the ability to meet its obligations as they fall due over a period greater than a year and accordingly have recommended to the Board that it remains appropriate for these financial statements to be prepared on a going concern basis.
- The Committee has concentrated on the investment issues of value, existence and title in respect of the Company's portfolio holdings. Over 86% by value of the investments are quoted investments and are held in a designated account at the Custodian. The remaining 14% of investments are unlisted and dealt with in more detail below. Some 20% of the total assets of the Company is in cash at A+ rated banks.

Key activities and significant risks

The investment manager has built a concentrated portfolio of small and medium sized enterprises and the Committee appreciates that there are significant risks inherent in that investment policy compared with a wider spread in larger quoted companies. There is also a material exposure to property at the year-end given an 11% direct exposure to property companies and a 19% exposure to REITs.

The Company holds four unlisted investments. Following advice from the Investment Manager, the Committee considers the valuation of each of these investments in detail. For further details on the Investment policies and the valuation of unlisted investments, please see note 13 of the Financial Statements.

The Committee has also considered the existence and valuation of a registered non-custodial bond in Kidoh Capital Growth. The Committee is satisfied that the Bond exists and is duly owned and correctly registered to the Company and that the carrying amount of the bond represents fair value.

The external auditor reported to the Committee it had found no material misstatements. Likewise, the Manager and Administrator confirmed to the Committee that they were not aware of any material misstatements including matters relating to presentation. The Committee advised the Board that this annual report and accounts, taken as a whole, is fair, balanced and understandable.

Following a review of the presentations and reports from the Administrator and after consulting where necessary with the external auditor, the Committee is satisfied that the financial statements appropriately address the critical judgements and key estimates (both in respect to the amounts reported and the disclosures). The Committee is also satisfied that the significant assumptions used for determining the value of assets have been appropriately scrutinised, challenged and are sufficiently robust. Further details on the significant assumptions used for determining the value of assets can be found in note 13 of the Financial Statements.

THE PROSPECT JAPAN FUND LIMITED

AUDIT COMMITTEE REPORT

Continued

External Audit

Ernst & Young LLP were appointed as external auditor to the Company on 28 June 2001. In accordance with the normal rotation requirements, Chris Matthews replaced Mike Bane as the audit engagement partner and opinion signatory after the conclusion of the 2011 audit. The Company does not have a policy on putting the audit services contract out to tender. There are no contractual obligations which would act to restrict the Committee's choice of external auditor. The Committee reviews and agrees the engagement letter issued by the external auditor at the start of each audit, ensuring that it has been updated to reflect changes in circumstances arising since the previous year. The Committee also considers if the auditor's work plan, including levels of materiality and resources to execute the plan are consistent with the scope of the audit engagement.

The Committee has performed a review of the audit process, the effectiveness and performance of the audit team, and the quality and cost-effectiveness of the audit, and confirms that it is satisfied that the external auditor has fulfilled its responsibilities with diligence and professional scepticism and that the scope of the audit is appropriate. The Committee has come to that conclusion after having met with the auditors both formally and informally through the year to discuss changes in audit and corporate governance reporting, valuation issues, significant risks related to the financial statements and the audit process. The Committee has also received feedback from the Administrator. Following this review of the independence and effectiveness of the Company's external auditors, the Committee has recommended to the Board that Ernst & Young LLP be reappointed as auditors, which the Board will submit for approval to the Company's Members.

Risk Management

After consultation with the Manager and external auditor, the Committee considers the key risk of misstatement in the Company's financial statements to be the override of controls by its service providers, the Manager and Administrator.

The Committee reviews and examines externally prepared assessments of the control environment in place at the Manager and the Administrator, with the Manager and Administrator providing a SOC1 report covering internal control systems and procedures supported either by SSAE 16, ISAE 3402 or AAF Reports, on an annual basis and a bi-annual basis respectively. No significant failings or weaknesses were identified in these reports by the Committee. There were no changes in risk management or internal control systems during the year.

The 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.

Fraud, Bribery and Corruption

The Audit Committee continues to monitor the fraud, bribery and corruption policies of the Company. The Board receives a confirmation from all service providers that there have been no instances of fraud or bribery.

Richard Battey
Chairman, Audit Committee
15 April 2014

THE PROSPECT JAPAN FUND LIMITED

INVESTMENT POLICY

for the year ended 31 December, 2013

The Company announced the approval of an amendment to the Company's Investment Objective, Policy and Restrictions at the Extraordinary General Meeting on the 5 March, 2014. Further details on the amendments to the Company's investment restrictions can be found in note 16 of the Financial Statements.

Prior to this change, and for the period under review, the investment policy was as follows;

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% at the time of acquisition 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, 2013

Number of Securities	Investments	Fair Value in U.S. Dollars	Percentage of Net Asset Value
	<i>Listed investments</i>		
	Advertising		
756,800	Tri-stage Inc	9,420,031	7.75
		9,420,031	7.75
	Building Materials		
153,600	Endo Lighting Corp	3,050,854	2.51
		3,050,854	2.51
	Distribution/Wholesale		
177,100	Kamei Corp	1,388,888	1.14
		1,388,888	1.14
	Diversified Financial Services		
2,108,000	The Daito Bank	2,301,638	1.89
253,000	Yutaka Shoji Co Ltd	711,018	0.58
		3,012,656	2.47
	Engineering and Construction		
68,000	Sanyo Engineering & Construction Inc	313,126	0.26
1,375,300	Tomoe Corp	6,568,012	5.40
		6,881,138	5.66
	Machinery		
80,000	Nikki Co Ltd	240,779	0.20
426,000	Showa Aircraft Industry Co Ltd	4,995,110	4.10
1,124,000	Tokyo Kikai Seisakusho Ltd	1,227,249	1.01
		6,463,138	5.31

THE PROSPECT JAPAN FUND LIMITED

PORTFOLIO OF INVESTMENTS

as at 31 December, 2013

Continued

Number of Securities	Investments	in U.S. Dollars	Net Asset Value
	<i>Listed investments</i>		
	Real Estate		
794,000	Gro-Bels Co Ltd +	452,315	0.37
916,000	Katakura Industries Co Ltd	10,401,481	8.56
562,200	Keihanshin Building Co Ltd	2,994,486	2.46
		13,848,282	11.39
	REITs		
6,916	Heiwa Real Estate REIT Inc.	5,279,339	4.34
1,972	Ichigo Real Estate Investment Corp	1,202,016	0.99
3,882	Invincible Investment Corp	716,138	0.59
11,880	Japan Rental Housing Investments Inc	7,263,917	5.97
3,843	MID Reit Inc	8,559,864	7.04
7,898,895	Prospect Epicure J-REIT Value Fund*#	-	-
		23,021,274	18.93
	Retail		
58,700	Matsuya Co Ltd	623,644	0.51
169,000	Sekichu Co Ltd	746,119	0.61
392,000	Shaklee Global Group Inc	7,611,110	6.26
		8,980,873	7.38
	Storage/warehousing		
109,400	Inui Warehouse Co Ltd	1,067,773	0.88
452,000	Maruhachi Warehouse Co Ltd	1,287,444	1.06
321,895	Yasuda Warehouse Co Ltd	3,542,144	2.91
		5,897,361	4.85
	Transportation		
587,000	Daiwa Motor Transportation Co Ltd	2,034,227	1.68
18,000	Hokkaido Chuo Bus Co Ltd	50,074	0.04
3,500	Tohbu Network Co Ltd	25,920	0.02
		2,110,221	1.74
	Total listed investments	84,074,716	69.13

+ Mr. Curtis Freeze, Director of Prospect Asset Management (Channel Islands) Limited (“PAM(CI)”), the Manager of The Prospect Japan Fund Limited is President of Gro-Bels Co Ltd (“Gro-Bels”). Gro-Bels owns the entire share capital of PAM(CI) and Prospect Asset Management Inc (“PAMI”), the Investment Advisor of The Prospect Japan Fund Limited.

* 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

PORTFOLIO OF INVESTMENTS

as at 31 December, 2013

Continued

Number of Securities	Investments	in U.S. Dollars	Net Asset Value
	<i>Unlisted investments</i>		
	Corporate bond		
5,150,000	Godō Kaisha Taiheiyo Jisho	6,102,173	5.01
615,000,000	Gro-Bels Co Ltd +	5,879,384	4.83
300,000,000	Kidoh Capital Growth	2,985,671	2.47
315,700,000	Takefuji Corp	145,814	0.12
		<hr/>	<hr/>
		15,113,042	12.43
		<hr/>	<hr/>
	Total unlisted investments	15,113,042	12.43
		<hr/>	<hr/>
	Total investments	99,187,758	81.56
	Net current assets	22,424,311	18.44
		<hr/>	<hr/>
	NET ASSETS	121,612,069	100.00
		<hr/> <hr/>	<hr/> <hr/>

+ Mr. Curtis Freeze, Director of Prospect Asset Management (Channel Islands) Limited (“PAM(CI)”), the Manager of The Prospect Japan Fund Limited is President of Gro-Bels Co Ltd (“Gro-Bels”). Gro-Bels owns the entire share capital of PAM(CI) and Prospect Asset Management Inc (“PAMI”), the Investment Advisor of The Prospect Japan Fund Limited.

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 "Company") for the year ended 31 December, 2013 which comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity, the Statement of Cash Flow and the related notes 1 to 16. 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 Directors' Responsibilities Statement set out on pages 9 and 10 of the Annual Report, 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 and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. 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, 2013 and of its profit for the year then ended;
- have been properly prepared in accordance with International Financial Reporting Standards as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies (Guernsey) Law 2008.

Our assessment of risks of material misstatement

We identified the following risks of material misstatement that we believed would have the greatest impact on our overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team:

- valuation of the Company's investments; and
- existence and ownership of the Company's investments.

THE PROSPECT JAPAN FUND LIMITED

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF THE PROSPECT JAPAN FUND LIMITED

Continued

Our application of materiality

We apply the concept of materiality to the individual account or balance level through our determination of performance materiality, which is set to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality.

We determined materiality for the Company to be £1.1 million, which is 1% of total equity. This provided a basis for determining the nature, timing and extent of risk assessment procedures, identifying and assessing the risk of material misstatement and determining the nature, timing and extent of further audit procedures.

On the basis of our risk assessments, together with our assessment of the Company's overall control environment, our judgement was that overall performance materiality (i.e. our tolerance for misstatement in an individual account or balance) for the Company should be 75% of materiality, namely £0.8 million. Our objective in adopting this approach was to ensure that total uncorrected and undetected audit differences in all accounts did not exceed our materiality level.

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.06 million, as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

An overview of the scope of our audit

Our response to the risks identified above was as follows;

- we considered the appropriateness of the valuation techniques applied to unquoted investments, and obtained evidence to corroborate the inputs into the valuation model;
- we agreed year end prices for quoted investments to an independent source;
- we obtained independent confirmation from the custodian of the Company's investments and agreed this to the records of the Company; and
- for the single investment not held by the Company's custodian, we obtained independent confirmation from the bond issuer evidencing the ownership and agreed this to the Company's records.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the ISAs (UK and Ireland), we are required to report to you if, in our opinion, information in the annual report is:

- materially inconsistent with the information in the audited financial statements; or
- apparently materially incorrect based on, or materially inconsistent with, our knowledge of the Company acquired in the course of performing our audit; or
- is otherwise misleading.

In particular we are required to consider whether we have identified any inconsistencies between our knowledge acquired during the audit and the Directors' statement that they consider the annual report is fair, balanced and understandable and whether the annual report appropriately discloses those matters that we communicated to the audit committee which we consider should have been disclosed.

THE PROSPECT JAPAN FUND LIMITED

INDEPENDENT AUDITOR'S REPORT

TO THE MEMBERS OF THE PROSPECT JAPAN FUND LIMITED

Continued

Matters on which we are required to report by exception

Continued

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

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
15 April, 2014

The Financial Statements are published on websites maintained by the Investment Manager. The maintenance and integrity of the The Prospect Japan Fund Limited web site is the responsibility of the directors; 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 web site.

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, 2013

Notes	Revenue	Capital	Total	Revenue	Capital	Total
	01.01.2013 to	01.01.2013 to	01.01.2013 to	01.01.2012 to	01.01.2012 to	01.01.2012 to
	31.12.2013	31.12.2013	31.12.2013	31.12.2012	31.12.2012	31.12.2012
	In U.S. Dollars	In U.S. Dollars	In U.S. Dollars	In U.S. Dollars	In U.S. Dollars	In U.S. Dollars
Investment income	1,398,250	-	1,398,250	1,658,400	-	1,658,400
Interest income	55,176	-	55,176	439,355	-	439,355
Foreign exchange movements	(579,475)	(4,298,624)	(4,878,099)	(896,118)	536,762	(359,356)
Gain on financial assets at fair value through profit or loss	-	33,388,135	33,388,135	-	16,749,969	16,749,969
Total income	873,951	29,089,511	29,963,462	1,201,637	17,286,731	18,488,368
4 Management fee	(1,706,635)	-	(1,706,635)	(1,410,894)	-	(1,410,894)
5 Other expenses	(840,538)	-	(840,538)	(664,351)	-	(664,351)
Transaction costs	-	(1,078,749)	(1,078,749)	-	(320,563)	(320,563)
Total expenses	(2,547,173)	(1,078,749)	(3,625,922)	(2,075,245)	(320,563)	(2,395,808)
Gain for the year before tax	(1,673,222)	28,010,762	26,337,540	(873,608)	16,966,168	16,092,560
3 Withholding tax	(140,744)	-	(140,744)	(116,088)	-	(116,088)
Gain for the year after tax	(1,813,966)	28,010,762	26,196,796	(989,696)	16,966,168	15,976,472
Total comprehensive income for the year	(1,813,966)	28,010,762	26,196,796	(989,696)	16,966,168	15,976,472
2 Gain per Ordinary Share - Basic & Diluted	(0.019)	0.295	0.276	(0.010)	0.175	0.165

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 29 to 49 form an integral part of the Financial Statements.

THE PROSPECT JAPAN FUND LIMITED

STATEMENT OF FINANCIAL POSITION

as at 31 December, 2013

Notes	31.12.2013 In U.S. Dollars	31.12.2012 In U.S. Dollars
Non-current assets		
6	99,187,758	77,541,222
Current assets		
7	3,162,181	1,737,922
	21,309,724	16,945,485
	24,471,905	18,683,407
Current liabilities		
8	2,047,594	425,083
	22,424,311	18,258,324
	121,612,069	95,799,546
Equity		
9	94,878	95,278
9	88,197,203	88,581,476
9	320,631	320,231
	32,999,357	6,802,561
	121,612,069	95,799,546
	94,878,602	95,278,602
2	1.28	1.01

The Financial Statements on pages 25 to 49 were approved by the Board of Directors on 15 April, 2014 and signed on its behalf by:

John Hawkins

Richard Battey

The notes on pages 29 to 49 form an integral part of the Financial Statements.

THE PROSPECT JAPAN FUND LIMITED

STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December, 2013

	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, 2013	95,278	320,231	88,581,476	(12,292,130)	26,903,132	(11,862,827)	4,054,386	95,799,546
Total comprehensive income/(expense) for the period								
(Loss)/gain for the period after tax	-	-	-	(1,813,966)	22,835,699	9,473,687	(4,298,624)	26,196,796
Capital activities								
Repurchase of shares	(400)	400	(384,273)	-	-	-	-	(384,273)
Balances at 31 December, 2013	<u>94,878</u>	<u>320,631</u>	<u>88,197,203</u>	<u>(14,106,096)</u>	<u>49,738,831</u>	<u>(2,389,140)</u>	<u>(244,238)</u>	<u>121,612,069</u>

	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>

The notes on pages 29 to 49 form an integral part of the Financial Statements.

THE PROSPECT JAPAN FUND LIMITED

STATEMENT OF CASH FLOWS

for the year ended 31 December, 2013

Notes	01.01.2013 to 31.12.2013 In U.S. Dollars	01.01.2012 to 31.12.2012 In U.S. Dollars
Cash flows from operating activities		
10 Net cash (outflow)/inflow from operating activities	(7,822,325)	418,906
Cash flows from investing activities		
Purchase of investments	(240,847,025)	(76,663,344)
Sale of investments	253,973,582	96,022,694
Net cash inflow from investing activities	13,126,557	19,359,350
Net cash inflow before financing activities	5,304,232	19,778,256
Cash flows from financing activities		
Repurchase of shares	(384,273)	(2,381,716)
Net cash outflow from financing activities	(384,273)	(2,381,716)
Increase in cash and cash equivalents	4,919,959	17,396,540
Reconciliation of net cash flow to movement in net funds		
Net cash inflow	4,919,959	17,396,540
Effects of foreign exchange rate changes	(555,720)	(937,888)
Cash and cash equivalents at beginning of the year	16,945,485	486,833
Cash and cash equivalents at end of the year	21,309,724	16,945,485

The notes on pages 29 to 49 form an integral part of the Financial Statements.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December, 2013

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. The future outcome of this vote represents uncertainty as to the likelihood of the Company continuing as a going concern, however the Directors are of the opinion that Shareholders will react positively to their recommendation to vote against the resolution, and in favour of the continuation of the Company and that it is therefore appropriate for the Financial Statements to be prepared on a going concern basis.

On the 5 March, 2014, 87% of the Company's Shareholders voted in favour of an amendment to the Company's Investment Objective, Policy and Restrictions. This provides support for the appropriateness of the going concern basis used in preparing the Financial Statements.

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.

- IFRS 7 (Amendments) - Financial Instruments: Disclosures – (effective 1 January, 2013);
- IFRS 10 (Amendments) - Consolidated Financial Statements (effective 1 July, 2013)
- IFRS 12 (Amendments) - Disclosure of Interests in Other Entities (effective 1 January, 2013)
- IFRS 13 - Fair Value Measurement - (effective 1 January, 2013)

Interpretations which are relevant to the Financial Statements are discussed below. The remaining interpretations are not considered to be applicable to the Financial Statements.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 1 Principal Accounting Policies

Continued

Standards, amendments and interpretations effective during the year

IFRS 7, 'Financial Instruments: Disclosures', adds certain new disclosures about financial instruments to those currently required by IAS 32. It replaces the disclosures previously required by IAS 30 and puts all the financial instruments disclosures together into a new standard. IFRS 7 requires certain disclosures to be presented by category of instrument based on the IAS 39 measurement categories and certain other disclosures by class of financial instrument. The two main categories of disclosures required by IFRS 7 are information about the significance of financial instruments and information about the nature and extent of risks arising from financial instruments.

IFRS 10, 'Consolidated Financial Statements', replaces guidance within IAS 27, 'Consolidated and Separate Financial Statements'. The standard establishes principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities. IFRS 10 requires entities to consolidate entities it controls. Control requires exposure or rights to variable returns and the ability to affect those returns through power over an investee. The Company does not control any entities.

IFRS 13, 'Fair Value Measurement', establishes a single source of guidance under IFRS for all fair value measurements. IFRS 13 does not change when an entity is required to use fair value, but rather provides guidance on how to measure fair value under IFRS. IFRS 13 defines fair value as an exit price and requires additional disclosures. Application of IFRS 13 has not materially impacted the fair value measurements of the Company. Additional disclosures where required, are provided in the individual notes relating to the assets and liabilities whose fair values were determined. In accordance with the provisions of IFRS 13, the Company has applied IFRS 13 prospectively and has not provided comparative information for new disclosures. The Company provides these disclosures in Note 13 of the Financial Statements.

Standards, amendments and interpretations issued but not yet effective

- IAS 32 Financial Instruments: Presentation – (effective 1 January, 2014)
- IFRS 9 Financial Instruments – (effective 1 January, 2018)
- IFRS 10 (Amendments) - Consolidated Financial Statements (effective 1 January, 2014)
- IFRS 12 (Amendments) - Disclosure of Interests in Other Entities (effective 1 January, 2014)
- IAS 27 (Amendments) - Separate Financial Statements (effective 1 January, 2014)

IFRS 9, 'Financial Instruments', as issued reflects the first phase of the IASB's work on the replacement of IAS 39 and applies to classification and measurement of financial assets and financial liabilities as defined in IAS 39. The standard was initially effective for annual periods beginning on or after 1 January, 2013. At its meeting in November 2013, the IASB tentatively decided that the mandatory effective date will be no earlier than annual periods beginning on or after 1 January, 2018.

IFRS 10 (Amendments) includes an exception from consolidation for entities which meet the definition of an investment entity, and requires such entities to recognise all investments at fair value through profit or loss. The Company meets the definition of an investment entity but does not control any entities as defined under IFRS 10.

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

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.

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 and disclosure of contingent assets. 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.

Fair value of securities not quoted in an active market

In the process of applying the Company's accounting policies, management has made the following judgements, which have the most significant effect on the amounts recognised in the financial statements:

The Company carries its investments at fair value, with changes in value being recognised in the Statement of Comprehensive Income. In cases of unlisted investments where prices of investments are not quoted in an active market, estimates are based on available traded prices or comparisons with the valuations of comparable convertible bonds. The carrying amount of the bond represents fair value.

The Investment Manager would exercise judgement on the valuation of unlisted investments. As the level 3 investments are unlisted corporate bonds, valuation techniques are based on the value of comparable convertible bonds for which market prices are available and adjusted for interest rate yield, credit risk and other factors. Further details on the valuation techniques applied to level 3 investments can be found in note 13 of the Financial Statements.

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.

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”)

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.

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 and other payables, 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.

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 IFRS 13 'Fair Value 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.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 1 Principal Accounting Policies

Continued

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.

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 95,073,601 and a net gain of US\$26,196,796 (2012: 97,028,307 Ordinary Shares and a net gain of US\$15,976,472).

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 94,878,602 (2012: 95,278,602) and shareholders' funds attributable to equity interests of US\$121,612,069 (2012: US\$95,799,546).

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

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.

Note 4 Management Fees

The management fee is payable to the Manager, PAM(CI), 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\$1,706,635 (2012: US\$1,410,894) of which US\$156,315 (2012: US\$110,087) 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

	01.01.2013 to 31.12.2013	01.01.2012 to 31.12.2012
	In U.S. Dollars	In U.S. Dollars
Administration and secretarial fees*	284,439	235,149
Custodian's fees and charges**	149,240	116,173
General expenses	204,246	121,668
Directors' remuneration	133,595	141,236
Auditors' fees	43,074	30,609
Non-audit fees	25,944	19,516
	<u>840,538</u>	<u>664,351</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\$284,439 (2012: US\$235,149) of which US\$26,053 (2012: US\$18,348) 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\$149,240 (2012: US\$116,173) of which US\$23,235 (2012: US\$13,969) is due and payable at the year end.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 6 Financial Assets at Fair Value through Profit or Loss

	01.01.2013 to 31.12.2013 In U.S. Dollars	01.01.2012 to 31.12.2012 In U.S. Dollars
Opening book cost	89,404,049	105,041,226
Purchases at cost	241,863,287	76,435,294
Proceeds on sale	(253,604,885)	(96,823,967)
Realised gain on sale	23,914,447	4,751,496
	<hr/>	<hr/>
Closing book cost	101,576,898	89,404,049
Unrealised loss	(2,389,140)	(11,862,827)
	<hr/>	<hr/>
Fair value	99,187,758	77,541,222

Note 7 Receivables

	31.12.2013 In U.S. Dollars	31.12.2012 In U.S. Dollars
Amounts due from brokers	-	884,904
Interest receivable	-	399,513
Dividends receivable	319,454	453,505
Other receivables*	2,842,727	-
	<hr/>	<hr/>
	3,162,181	1,737,922

*Other receivables are amounts due from the custodian caused by duplicate trades.

Note 8 Payables

	31.12.2013 In U.S. Dollars	31.12.2012 In U.S. Dollars
Amounts due to brokers	1,748,459	169,656
Other creditors	299,135	255,427
	<hr/>	<hr/>
	2,047,594	425,083

Note 9 Share Capital, Redemption Reserve & Capital Redemption Reserve

Authorised Share Capital Number of shares		31.12.2013 In U.S. Dollars	31.12.2012 In U.S. Dollars
150,000,000	Ordinary Shares of US\$0.001 each	150,000	150,000
<hr/>		<hr/>	<hr/>
60,000,000	"C" Ordinary Shares of US\$0.01 each	600,000	600,000
<hr/>		<hr/>	<hr/>

As approved at the AGM on 21 June, 2013, the Company may purchase a maximum of 14,275,516 Ordinary Shares, equivalent to 14.99% of the Issued share capital of the Company as at the date of the AGM.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 9 Share Capital, Redemption Reserve & Capital Redemption Reserve

Continued

During the year, shares were purchased and cancelled as follows:-

Ordinary Shares Number of shares		Share Capital In U.S. Dollars	Redemption Reserve In U.S. Dollars	Capital Redemption Reserve In U.S. Dollars
95,278,602	Balance at 1 January, 2013	95,278	88,581,476	320,231
(400,000)	Shares repurchased and cancelled during the year	(400)	(384,273)	400
<u>94,878,602</u>	Balance at 31 December, 2013	<u>94,878</u>	<u>88,197,203</u>	<u>320,631</u>

Ordinary Shares Number of shares		Share Capital In U.S. Dollars	Redemption Reserve In U.S. Dollars	Capital Redemption Reserve 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 year	(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 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.

“C” Ordinary Shares do not carry the right to attend or to vote at general meetings of the Company or to receive dividends and, in a winding up will participate in any “C” Ordinary Share surplus assets remaining after the settlement of any outstanding liabilities of the Company.

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

	31.12.2013 In U.S. Dollars	31.12.2012 In U.S. Dollars
Revenue loss on ordinary activities for the year	(1,813,966)	(989,696)
Increase in dividends receivable and other receivables	(2,309,163)	(73,016)
Increase in other creditors	43,708	6,968
Foreign exchange (loss)/gain	(3,742,904)	1,474,650
Net cash outflow from operating activities	<u>(7,822,325)</u>	<u>418,906</u>

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 11 Analysis of Financial Assets and Liabilities by Measurement Basis

	Investments at fair value In U.S. Dollars	Net current assets In U.S. Dollars	Total In U.S. Dollars
As at 31 December, 2013			
Financial assets			
Investments at fair value through profit or loss	99,187,758	-	99,187,758
Cash and cash equivalents	-	21,309,724	21,309,724
Receivables	-	3,162,181	3,162,181
	<u>99,187,758</u>	<u>24,471,905</u>	<u>123,659,663</u>
Financial liabilities			
Payables	-	2,047,594	2,047,594
	<u>-</u>	<u>2,047,594</u>	<u>2,047,594</u>

	Investments at fair value In U.S. Dollars	Net current assets In U.S. Dollars	Total 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>

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) whose parent company is Prospect Co., Ltd (Kabushiki Kaisha Prospect ("KKP"), a Japanese Company) and the ultimate parent is Gro-Bels Co Ltd. ("Gro-Bels").

Mr Rupert Evans is a Director of the Manager.

Directors' fees are disclosed in Note 5. The basic fee payable to Directors in 2013 is £20,000, the Chairman of the Audit Committee £22,500 and the Chairman of the Board £25,000 per annum.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 12 Related Party Transactions

Continued

At 31 December, 2013 Christopher Sherwell held beneficial interests of 9,940 (2012: 9,940) Ordinary Shares in the Company. No other Directors holding office at 31 December, 2013, 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 period and up to the date of this report.

Mr. Curtis Freeze is a Director of PAM(CI), the Manager of The Prospect Japan Fund Limited, and is the President of Gro-Bels. Effective 1 August, 2013, Gro-Bels acquired the entire issued share capital of KKP, the owner of PAMI, the Investment Advisor to The Prospect Japan Fund Limited and PAM(CI), the Manager of The Prospect Japan Fund Limited.

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 (2012: 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, 2013 a 1% positive/negative movement in the index would produce a positive/negative movement in the net assets of the Company of US\$509,825 (2012: US\$217,115) 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.

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 balance sheet date.

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:

	31.12.2013	31.12.2012
	In US Dollars	In US Dollars
Investments		
Japanese Yen (¥10,428,237,572, 2012:¥6,687,154,985)	99,187,758	77,541,222
	<u>99,187,758</u>	<u>77,541,222</u>
Other (Liabilities)/Assets		
US Dollars	(185,346)	140,752
Sterling (£49,548, 2012:£48,267)	(81,886)	(77,973)
Japanese Yen (¥2,408,698,490, 2012:¥1,600,966,518)	22,691,543	18,195,545
	<u>22,424,311</u>	<u>18,258,324</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 2012: 10%) change in exchange rates against the US Dollar.

	31.12.2013	31.12.2012
	In US Dollars	In US Dollars
Impact on Statement of Comprehensive Income and Equity in response to a		
- 10% increase in the US Dollar against other currencies	<u>11,093,472</u>	<u>8,711,139</u>
- 10% decrease in the US Dollar against other currencies	<u>(13,555,679)</u>	<u>(10,645,216)</u>
Impact on Equity in response to a		
- 10% increase in the US Dollar against other currencies	<u>11,093,472</u>	<u>8,711,139</u>
- 10% decrease in the US Dollar against other currencies	<u>(13,555,679)</u>	<u>(10,645,216)</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.

If the risk-free rate of return increased/decreased by 1%, the impact on the net asset value and profit for the year would be a decrease/increase of US\$10,895.

Interest rate sensitivity analysis

As the intrinsic value of the corporate bonds could potentially be 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.

Fair Value

Financial assets at fair value through profit or loss are carried at fair value. The valuation techniques for valuing unlisted corporate bonds are described below. Other assets and liabilities are carried at amortised cost which approximate fair value.

IFRS 13 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 PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 13 Financial risk management objectives and policies

Continued

Fair Value

Continued

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement is based on the presumption that the transaction to sell the asset or transfer the liability takes place either:

- (i) In the principal market for the asset or liability, or
- (ii) In the absence of a principal market, in the most advantageous market for the asset or liability

The principal or the most advantageous market must be accessible by the Company.

The fair value of an asset or a liability is measured using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest.

The Company uses valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

All financial instruments for which fair value is recognised or disclosed are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

Level 1 — Quoted market prices (unadjusted) in an active market for identical assets or liabilities

Level 2 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is directly or indirectly observable

Level 3 — Valuation techniques for which the lowest level input that is significant to the fair value measurement is unobservable

For financial instruments that are recognised at fair value on a recurring basis, the Company determines whether transfers have occurred between Levels in the hierarchy by re-assessing categorisation, based on the lowest level input that is significant to the fair value measurement as a whole, at the end of each reporting period.

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 2013.

	Quoted prices in active markets Level 1 In US Dollars	Significant observable inputs Level 2 In US Dollars	Significant unobservable inputs Level 3 In US Dollars	Total In US Dollars
Financial assets at fair value through profit or loss:				
-Equity Securities	84,074,716	-	-	84,074,716
-Debt Securities				
Corporate bonds	-	-	15,113,042	15,113,042
Total as at 31 December, 2013	84,074,716	-	15,113,042	99,187,758

The following table presents the movement in level 3 instruments for the year ended 31 December, 2013 by class of Financial Instrument.

	Debt Securities In US Dollars	Total In US Dollars
Opening balance	7,067,416	7,067,416
Purchases	20,324,858	20,324,858
Sales	(11,245,782)	(11,245,782)
Realised losses during the year	(1,297,697)	(1,297,697)
Unrealised gains during the year	264,247	264,247
Closing balance	15,113,042	15,113,042
Net unrealised gain for the year included in the Statement of Comprehensive Income for level 3 Investments held at 31 December, 2013	264,245	264,245

There were no transfers between levels for the year ended 31 December, 2013.

Valuation techniques

Listed investments

Securities valued based on quoted market prices, in an active market for identical assets without any adjustments, are included within Level 1 of the hierarchy and are valued at bid price.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 13 Financial risk management objectives and policies

Continued

Fair Value

Continued

Valuation techniques

Continued

Unlisted Investments

The Company invests in debt securities which are not quoted in an active market. Transactions in such investments do not occur on a regular basis. These positions are valued at the Directors estimate of their fair value in accordance with IFRS 13.

Level 3 valuations are monitored closely by the Investment Manager who reports to the Board of Directors on a quarterly basis. Valuations are based on the most appropriate method for each level 3 investment as described below.

The Company holds a bond in Taiheyo Jisho (GK) a Japanese partnership set up to invest in real estate ventures at a fixed interest rate of 10%. Taiheyo Jisho currently invests in SCD ML II, LLC, which is developing a project on the island of Hawaii. The assessed value of the land was over \$7 million at the time of the bond issuance, there is also a title insurance policy issued for \$5 million. Projections show that equity in the project, after liabilities and interest payments which include the bond, to be almost \$12 million which is in line with expectations. Projections are carried out based on weekly performance reports of the construction project and regular review of the financial statements. The bond was issued to fund the development project which is developing as expected. The Company bought the entire issuance of the bond which it still holds and there have been no further issues, therefore a secondary market does not exist. The issuer does not have a credit rating to monitor and the credit rating of the insurer remains unchanged.

Kidoh Capital Growth Bond is issued by a Japanese partnership set up to invest in Kidoh Construction. The proceeds from the bond were used by Kidoh to finance a management buyout. The construction company produces around \$60 million of sales a year. There is a large amount of equity in the company and the Company has placed a KKP employee on the board of the construction company to monitor the progress of the company and the financial statements are regularly reviewed. The construction company is doing well, and is on plan to sell itself and pay off the bond. Kidoh Construction has no liabilities other than the bond to the Company.

Based on the above and the means by which management monitors the valuation of the investments, there is little likelihood of a change in the fair value of the bonds as they are fixed interest, fixed maturity debt securities and are therefore not subject to fluctuations in interest rates or market movements.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 13 Financial risk management objectives and policies

Continued

Fair Value

Continued

Valuation techniques

Continued

Unlisted Investments

Continued

During the year Toho Real Estate was the subject of a tender offer and was delisted. The Investment Adviser believed that the true value was considerably higher and recommended that the tender was declined and the Company seek arbitration. The results of that arbitration are uncertain, and for the Committee, valuation of the investment for the purposes of the Interim Financial Statements was challenging. After full discussion with the Board, and taking into account (i) the risks and uncertainties of the arbitration process (ii) discounts for the fact that the holding was delisted and therefore no longer tradable and (iii) the time value of money, we believed that a price 10% higher than the tender offer was an appropriate fair value for this holding. The Company received the tender offer price for the investment, yet still believes that the arbitration will result in a further payment to the Company. The Committee therefore recommended to the Board that a contingent asset of the suggested 10% uplift be disclosed in the Annual Financial Statements. Please see note 15 of the Financial Statements for this disclosure.

The Gro-Bels bond was converted into shares on 1 January, 2014 and the Shares were received on 24 January, 2014. Based on the conversion price of the Shares, the carrying amount of the bond in the Financial Statements is at fair value.

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 as required by IFRS 7.

	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	70,473,806	-	-	70,473,806
-Debt Securities				
Corporate bonds	-	-	7,067,416	7,067,416
Total assets as at 31 December, 2012	70,473,806	-	7,067,416	77,541,222

There were no transfers between levels for the year ended 31 December, 2012.

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

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 13 Financial risk management objectives and policies

Continued

	Debt	
	Securities In US Dollars	Total In US Dollars
Opening balance	134,228	134,228
Purchases	8,283,617	8,283,617
Gains recognised in profit and loss	(1,350,429)	(1,350,429)
Closing balance	<u>7,067,416</u>	<u>7,067,416</u>
Net unrealised loss for the year included in the Statement of Comprehensive Income for level 3 Investments held at 31 December, 2012	<u>624,230</u>	<u>624,230</u>

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 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. Liquidity risk is not deemed to be significant.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 13 Financial risk management objectives and policies

Continued

Liquidity risk

Continued

As at 31 December, 2013

	Up to 1 week	1 week to 1 month	1-6 months	6-12 months	Greater than 12 months	Total
	In US Dollars	In US Dollars	In US Dollars	In US Dollars	In US Dollars	In US Dollars
Financial assets						
Financial assets at fair value through profit or loss	57,944,388	18,407,477	7,725,266	-	15,110,627	99,187,758
Dividends receivable	-	-	319,454	-	-	319,454
Other receivables	2,834,528	-	8,199	-	-	2,842,727
Cash and cash equivalents	21,309,724	-	-	-	-	21,309,724
Financial liabilities						
Amounts due to brokers	(1,748,459)	-	-	-	-	(1,748,459)
Other creditors	-	(239,294)	(59,841)	-	-	(299,135)
Total	80,340,181	18,168,183	7,993,078	-	15,110,627	121,612,069

As at 31 December, 2012

	Up to 1 week	1 week to 1 month	1-6 months	6-12 months	Total
	In US Dollars	In US Dollars	In US Dollars	In US Dollars	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

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 21 June, 2013, the Company may purchase a maximum of 14,275,516 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\$0.001;
- 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 Contingent asset

The Company declined to tender its shares for Toho Real Estate, as the Company believed the true value to be considerably higher, and entered into an arbitration process. The results of arbitration are uncertain and placing a value of future receipts was challenging however the Board estimated that the true value of Toho Real Estate to be 10 per cent. in excess of the tender offer price. As the tender offer price has now been received, this results in a contingent asset of \$898,120, 10 per cent of the tender offer price of Toho Real Estate. The Board has taken into account the risks and uncertainties of the arbitration process, applied discounts for the fact that the holding was delisted and therefore no longer tradable and the time value of money in reaching the estimated uplift.

Note 16 Subsequent Events

These Financial Statements were approved for issuance by the Board on 15 April, 2014. Subsequent events have been evaluated until this date.

Amendment of Investment Objective, Policy and Restrictions

The Company announced the approval of an amendment to the Company's Investment Objective, Policy and Restrictions at the Extraordinary General Meeting on the 5 March, 2014.

The amendment of the Company's investment restrictions increase the amount that the Company may invest or lend 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) from up to 10 per cent. of its assets to up to 25 per cent. of its assets at the time the investment is made.

In addition the following restrictions were removed in their entirety:

- (a) the amount the Company may invest 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; and
- (b) the Company investing where the investment would result in the Company holding more than 10 per cent of the issued share capital of that company or of any class of that company's share capital, unless that company constitutes a trading company (for the purposes of the relevant United Kingdom legislation) where the investment would result in the Company holding 50 per cent or more of the issued share capital of that company or of any class of that company's share capital.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 16 Subsequent Events

Continued

New investment restrictions were introduced in relation to investment in other closed end investment funds listed on the Official List and to formalise the Company's gearing policy. The new investment restrictions provide:

- The Company may not enter into borrowings in excess of 20 per cent. of the Company's net asset value at the time the borrowings are drawn down.
- The Company may not invest more than 10 per cent. of its assets at the time the investment is made in closed-end investment funds which are listed on the Official List maintained by the FCA (except to the extent that those investment funds have stated investment policies to invest no more than 15 per cent. of their total assets in other investment funds which are listed on the Official List) and the Company will not invest more than 15 per cent. of its assets at the time the investment is made in such funds.

Finally, since the Company's portfolio is not managed to a benchmark, it was approved that the investment objective be amended to state that performance be measured against the MSCI Japan Small Cap Index (Total Return) for comparison purposes only.

Shares in public hands

The Company has recently become aware that it is currently in breach of Listing Rule 6.1.19R which states that at least 25 per cent. of a listed company's issued share capital must be held in public hands and that shares held by any person or persons in the same group or persons acting in concert who have an interest in 5 per cent. or more of the shares are not deemed to be in public hands. In accordance with Listing Rule 9.2.16R, the Company has informed the FCA that, given the size of the combined shareholdings of its top Shareholders, the Company is currently not able to comply with the shares in public hands requirement and it remains in consultation with the FCA regarding this issue.

The Board, in conjunction with its financial adviser and broker, Westhouse Securities Limited, is currently considering all possible and appropriate options for redressing the Company's current position. The 25% threshold, as a result of recent share trades, is close to being met. The Company intends to keep the FCA and its Shareholders regularly apprised of the issue.

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 94,878,602 Ordinary Shares in issue as at 31 December, 2013. 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 were approved on the 5 March, 2014:

- (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 25 per cent of its assets at the time the investment is made 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) invest more than 10 per cent of its assets at the time the investment is made in closed-end investment funds which are listed on the Official List maintained by the Financial Conduct Authority (except to the extent that those investment funds have state investment policies to invest no more than 15 per cent of their total assets in other investment funds which are listed on the Official List) and the Company will not invest more than 15 per cent of its assets at the time the investment is made in such funds; or
- (vii) the Company may not invest more than 5% of its assets at the time the investment is made 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; or
- (ix) enter into borrowings in excess of 20 per cent. of net assets at the time the borrowings are drawn down.

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. 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 71, 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 66, 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 62, 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.