

THE PROSPECT JAPAN FUND LIMITED

ANNUAL REPORT AND AUDITED FINANCIAL STATEMENTS

For the year ended 31 December, 2014

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 (retired 27 August, 2014)

Registered Office

PO Box 255
Trafalgar Court,
Les Banques,
St Peter Port,
Guernsey, GY1 3QL
Channel Islands

Manager

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

Investment Advisor

Prospect Asset Management, Inc.,
410 Atkinson Drive,
Suite 434,
Honolulu,
Hawaii 96814
United States of America

Legal Advisors

England
Herbert Smith Freehills LLP,
Exchange House,
Primrose Street,
London, EC2A 2EG

Guernsey

Mourant Ozannes,
1 Le Marchant Street,
St Peter Port,
Guernsey, GY1 4HP
Channel Islands

Custodian

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

Secretary, Registrar and Administrator

Northern Trust International Fund Administration
Services (Guernsey) Limited,
Trafalgar Court,
Les Banques,
St Peter Port,
Guernsey, GY1 3QL
Channel Islands

Corporate Broker

Westhouse Securities Limited,
110 Bishopsgate,
London, EC2N 4AY
United Kingdom

CREST Agent

Computershare Investor Services (Jersey) Limited,
(resigned 7 January, 2015)
Queensway House,
Hilgrove Street,
St Helier,
Jersey, JE4 9XY
Channel Islands

Computershare Investor Services (Guernsey) Limited,
(appointed 7 January, 2015)
1st Floor Tudor House,
Le Bordage
St Peter Port,
Guernsey, GY1 1DB
Channel Islands

Independent Auditor

Ernst & Young LLP,
Royal Chambers,
St Julian's Avenue,
St Peter Port,
Guernsey, GY1 4AF
Channel Islands

THE PROSPECT JAPAN FUND LIMITED

CHAIRMAN'S REPORT

for the year ended 31 December, 2014

Whilst over the previous three year period the Company's return was 36.90% compared with 31.71% for the MSCI Japan Small Cap Index, the last year's performance based on valuations produced in accordance with International Financial Reporting Standards ("IFRS") was +9.21% compared with MSCI Japan Small Cap Index performance of (0.12%) ((10.85%) based on published NAV).

The Investment Advisor writes in considerable detail about performance and strategy particularly in light of the changes in investment policy approved by shareholders earlier in the year.

The significant event has been the change of investment policy permitting, inter alia, the investment of up to 25 per cent of the Company's portfolio into a single stock, which was approved by the shareholders at the EGM held on 5 March 2014. This change was made to facilitate the opportunity to realise value for shareholders through the initiation of a corporate transaction or other corporate action. One of the investments during the year to take advantage of the change of investment policy was the purchase of ¥3 billion (US\$25.3 million) Convertible Bond in Prospect Co, a real estate developer in Japan, formerly known as Gro-bels. The Convertible Bond has a coupon of 4% and is convertible into shares of Prospect Co at a price of ¥60 per share. The proceeds provided Prospect Co. with a significant pool of funds to extend its corporate activity through taking positions in Japanese listed companies, some of which may be companies held directly by the Company. Prospect Co is the ultimate parent of the manager of the Company (PAM(CI)L) and therefore the investment constituted a related party transaction.

In the Investment Advisor's monthly review for December 2014 published on the Company's website (www.prospectjapan.com), they note that the largest individual holding of the Company (the ¥3 billion convertible bond noted above) has been valued at cost vis \$25 million. For the purposes of the Financial Statements, these bonds have to be valued in accordance with IFRS. The effect of this IFRS adjustment is to increase the value of the holding by \$26 million to \$51 million. This was a major factor which turned the comprehensive income for the year from what would have been a loss (as indicated by the published NAV) into a gain for the year of \$10.48million. For further details of the differences between published NAV and IFRS adjusted NAV please see note 16. At the end of December, 2014 Prospect Co shares traded at ¥83, a 38.3% premium to par value of ¥60. Since the year end, 1,800,000,000 have been converted to 30,000,000 shares of which 27,404,000 have been sold at an average rate of ¥81.

In light of the Company's investment in the corporate bond issued by Godo Kaisha Taiheiyo Jisho becoming non performing during the year, the Company is pleased to have sold the investment after the year end to Prospect Co. for an amount equal to the face value of the bond plus all accrued interest to 31 December 2014. In light of Prospect Co.'s real estate business, Prospect Co. is much better placed to manage this investment than the Company.

As widely expected the ruling LDP coalition won a convincing victory in the Lower House election and Prime Minister Abe lost no time in announcing new tax reforms, including additional cuts in corporation tax. From April 2015 corporation tax will be cut from 34.6% to 32.1%, followed by a further reduction to 31.3% in April 2016.

A draft of the Japanese Corporate Governance Code, which is due to be implemented in June 2015, was also announced. The code follows a number of other shareholder-friendly measures in 2014, including the Stewardship Code and the Ito Review, and is designed to stimulate corporate entrepreneurship and increase corporate value.

Japanese companies remain financially strong and as at the end of September aggregate cash levels reached ¥233trn. In addition to cash flow being used for increased shareholder returns, total M&A activity also rose in 2014 and in the second half of the year there was a noticeable increase in the number of domestic deals.

So far Abenomics has had a degree of success such as weakening the yen, higher stock prices and better performance by businesses. It is quite possible that Abe will use the public support gained in the election in December 2014 as a driving force for implementing reforms especially for the third arrow of "growth strategies" where so far there has been slower progress. There is a clearly a need for structural reform so that the benefits of Abenomics spread outside from the main urban areas and to small and mid-sized companies.

Risks and uncertainties remain but the Directors have reviewed the outlook for your Company and believe the opportunities remain exciting in Japan and continue to have every confidence in the strategy and ability of your manager.

John Hawkins
Chairman

27 April, 2015

THE PROSPECT JAPAN FUND LIMITED

INVESTMENT ADVISOR'S REPORT

for the year ended 31 December, 2014

Market Performance (%), US\$ NAV

	1 Year	3 Year	5 Year
Prospect Japan Fund	9.21/(10.85)*	65.66	84.20
MSCI Japan Small Cap Index	(0.12)	31.71	52.47

The Prospect Japan Fund Limited inception date is 20 December 1994. The above performance of the Fund is net of fees and expenses and includes reinvestment of dividends and capital gains. (Source: Prospect Asset Management, Inc.) Although the Company is not managed to a benchmark, it measures its performance against the MSCI Japan Small Cap Index (Total Return) for comparison purposes only. The MSCI Developed Markets Small Cap Indices offer an exhaustive representation of this size segment by targeting companies that are in the Investable Market Index but not in the Standard Index in a particular developed market. The indices include Value and Growth style indices and industry indices based on the Global Industry Classification Standard (GICS®). (Source: Bloomberg)

* Refers to performance based on published NAV

Summary

The Prospect Japan Fund Limited (the "Company") NAV performance based on valuations produced in accordance with International Financial Reporting Standards ("IFRS") increased 9.21% in 2014, outperforming the MSCI Japan Small Cap Index which declined 0.12%. NAV performance based on the published NAV showed a decrease of 10.85%. The broader Japan market performed poorly in 2014, weighed down by domestic issues such as a higher import bill, disappointing export numbers and the consumption tax hike. These were compounded by external shocks from emerging market volatility and the Russian incursion into Crimea.

The effects of April's consumption tax increase proved longer lasting than anticipated, driving the Japanese economy into technical recession as consumer spending remained depressed during Q2 and Q3.

US economic growth (+4.6% in Q2, the fastest growth in 3 years) and strong employment numbers fuelled speculation of US Fed interest rates hike timing, resulting in a strengthening dollar H2 2014. The dollar rose to ¥119.8 by year end, helping the TOPIX index end the year near annual highs, up 25.3% from 2014 lows in April.

Perhaps the largest story of the year was the surprise expansion of the Bank of Japan ("BoJ") monetary easing program in October 2014, and simultaneous release of the Government Pension Investment Fund ("GPIF") new investment weightings.

Bank of Japan Expanded Quantitative & Qualitative Monetary Easing

	2013-end (Actual)	2014-end (Projected)	Annual Increase	Increase from QQE1
Japanese Government bonds	142	200	80	30
Commercial paper	2.2	2.2	0	–
Corp bonds	3.2	3.2	0	–
ETFs	2.5	3.8	3	2
J-REITs	0.14	0.18	0.09	0.06
Total Assets	224	297	–	

The Government Pension Investment Fund (GPIF) investment weightings

Asset Type	Previous		New	
	Median	Range	Median	Range
Japanese bonds	60%	± 8%	35%	±10%
Japanese equities	12%	± 6%	25%	± 9%
Foreign bonds	11%	± 5%	15%	± 4%
Foreign equities	12%	± 5%	25%	± 8%
Short-term assets	5%	–	–	–

THE PROSPECT JAPAN FUND LIMITED

INVESTMENT ADVISOR'S REPORT

for the year ended 31 December, 2014

Continued

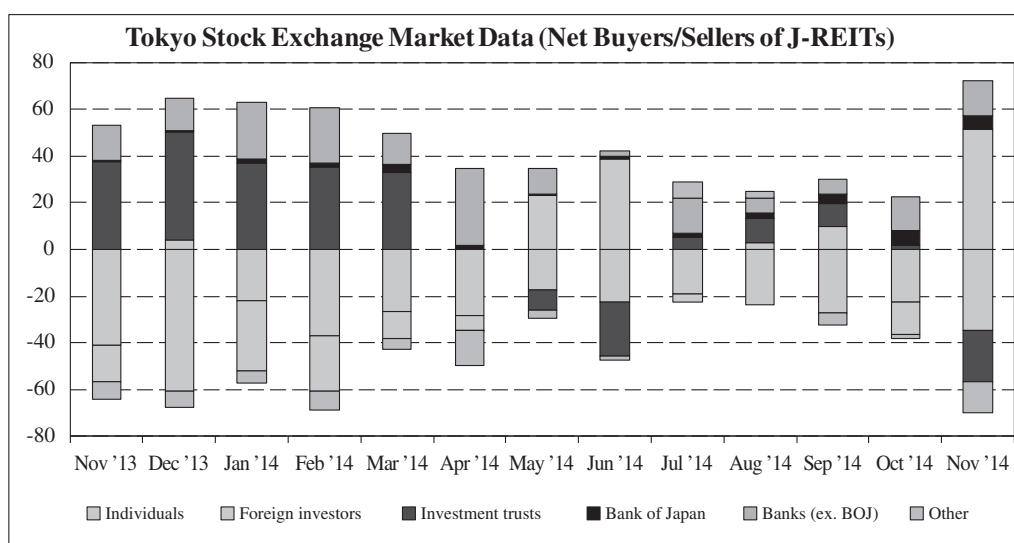
Despite the support from the BoJ, GDP contraction and ongoing sluggish consumer spending prompted Prime Minister Shinzo Abe to delay the upcoming additional 2 basis point increase in consumption tax by 18 months and call for snap elections to renew his mandate to govern. The ruling coalition easily retained its super majority following the December snap elections, returning the focus to economic growth policies. These include expected reforms to the Japanese corporate tax code and labour regulations in 2015. The administration has also announced new stimulus spending totalling ¥3.5 trillion with focus on revitalization of regional economies, including ¥1.7 trillion in additional post-disaster reconstruction.

Company holdings, with strong weightings towards Real Estate (31.8%), Retail (8.2%) and Financial Services (8.1%), are direct beneficiaries of the continued support for fiscal and monetary stimulus by the Abe administration and BoJ. Support for asset inflation and domestic consumption can be seen through additional stimulus government spending, delay of the next consumption tax increase and the additional easing enacted by the BoJ. Real Estate prices are supported by an expectation of stable near to mid-term low government bond yields via BoJ purchases.

Strong recovery in the Tokyo office market continues, due to low new office supply. Miki Shoji reporting that the average office vacancy in Tokyo's Central Business District has fallen 187 bps through the year end to 5.47%. This marks its lowest reading since January 2009.

While the Company did not have direct exposure to J-REITs at year end, they serve as a bellwether for the overall Japanese real estate market, and BoJ commitment to asset reflation via direct purchase of investment units. In 2014, the BoJ purchased a total of ¥ 37.2 billion in J-REIT units, bringing total purchases to date to ¥178.2 billion of ¥180 billion target for direct purchases by 2014 end. The annual purchase allocation for 2015 stands at ¥90 billion.

The TSEREIT index rallied to a seven year high at year end, supported by a decline in JGB yields to as low as 0.31%.



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

UNDERPERFORMANCE

Underperformance was led by Shaklee Global Group (8205), a seller of nutrition and personal care products, with a high percentage of overseas sales which fell sharply during November, following weaker than expected H1 results and a downward revision to full year forecasts. Shaklee was also the subject of social media speculation on potential regulatory investigations into its Chinese operations, though these concerns remain unsubstantiated. Accordingly, shares in the company surrendered most of the gains made earlier in the year.

Tomoe Corp (1921), a steel frame construction company that derives 82% of its operating profit from real estate leasing, underperformed along with the real estate index, following strong outperformance during 2013. The company maintains ¥14.7 billion in unrealized gains on rental real estate assets (vs a market cap of ¥18.5 billion), with an adjusted price to book ratio of 0.55x. While share performance during the year disappointed, Tomoe Corp announced strong H1 results, along with a large upward revision to full year 2015 guidance. H1 profits rose sharply thanks to contribution of a ¥2.5 billion government bridge construction order with an exceptional 20% profit margin.

THE PROSPECT JAPAN FUND LIMITED

INVESTMENT ADVISOR'S REPORT

for the year ended 31 December, 2014

Continued

OUTPERFORMANCE

The largest contributor to 2014 performance was Daiwa Motor Transportation (9082), a taxi and limousine service provider. The company rallied strongly towards year-end following its November announcement of H1 results. Daiwa Motor reported net income 28.7% above company guidance, aided by a resurgence in its real estate business. The steep drop in oil prices into year-end also likely played a part in turning sentiment.

The Company's largest position, Prospect Co. Ltd (3528), rallied into December, following a ¥3 billion convertible bond issuance to the Company and the announced tender offer bid ("TOB") for control of Yutaka Shoji (8747), a commodity futures trader (1.4% of the Company). Outperformance of Prospect was not reflected in Company's published NAV performance at end December, Prospect shares traded at ¥83, a 38.3% premium to par value of ¥60. This fact has been reported in the annual accounts.

The Tokyo District Court advised the results of the case involving the Toho (9602) TOB of Toho Real Estate in March 2015, with the court ordering the price raised 13.6% to ¥835. While an improvement, the price is still significantly discounted to book value of Toho Real Estate when adjusted for unrealised gains on its real estate holdings. The Company is currently appealing the ruling.

OUTLOOK FOR THE COMPANY 2015

The outlook for 2015 remains positive, as BoJ easing, a weaker Yen, and potential for a second year of wage increases provide tailwinds for the economy. We see high probability for outperformance of asset rich companies due to demand from J-REITs for sources of additional property acquisitions. J-REITs acquired over ¥1.5 trillion in property during 2014. We expect demand for attractive property, as well as sites for redevelopment to be healthy going forward. Accordingly, gains for the company are expected from stock picking among companies with undervalued real estate portfolios.

The Company believes that activism plays a key role in unlocking value from Japanese companies. To help in these activist endeavors, in November 2014 the fund bought 100% of a \$25.3 million convertible bond from the Investment Advisor's parent, Prospect Co., Ltd. The activism has helped the Prospect Co., Ltd. share price which, as of the beginning of April this year, has allowed the Company to convert half of the bond and sell the shares for a 35% gain.

Prospect Asset Management, Inc.

27 April 2015

THE PROSPECT JAPAN FUND LIMITED

DISCLOSURE OF DIRECTORSHIPS IN PUBLIC COMPANIES LISTED ON RECOGNISED STOCK EXCHANGES

for the year ended 31 December, 2014

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
Pershing Square Holdings Limited	Euronext
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
Aberdeen Greater China Fund, Inc.	New York
Advance Developing Markets Fund	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, 2014.

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 close-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. The Company is a FATCA compliant organisation with FATCA entity classification FFI and GIIN L0Q9R3.99999.SL.831.

Results and Dividend

The results for the year are set out in the Statement of Comprehensive Income on page 24.

Whilst over the last three year period the Company's return was 36.90% compared with 31.71% for the MSCI Japan Small Cap Index, the last year's performance based on valuations produced in accordance with International Financial Reporting Standards ("IFRS") was +9.21% compared with MSCI Japan Small Cap Index performance of (0.12%) ((10.85%) based on published NAV).

In the Investment Advisor's monthly review for December 2014 published on the Company's website (www.prospectjapan.com), they note that the largest individual holding of the Company (the ¥3 billion convertible bond noted above) has been valued at cost vis \$25 million. For the purposes of the Financial Statements, these bonds have to be valued in accordance with IFRS. The effect of this IFRS adjustment is to increase the value of the holding by \$26 million to \$51 million. This was a major factor which turned the comprehensive income for the year from what would have been a loss (as indicated by the published NAV) into a gain for the year of \$10.48million. At the end of December, 2014 Prospect Co shares traded at ¥83, a 38.3% premium to par value of ¥60. For further details of the differences between published NAV and IFRS adjusted NAV please see note 16.

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

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.

Principal Risks and Uncertainties

The Company's assets consist mainly of listed and quoted securities and its principal risks are therefore market related or currency related. A more detailed explanation of these risks and the way they are managed is contained in note 13 to the accounts. Other risks faced by the Company include the following:

(i) *Investment objective and strategy*

The Company's strategy may not be successful in achieving its investment objective.

(ii) *Investment risk*

To achieve the objective of delivering long-term performance, the Company invests in Japanese growth as well as cyclical companies with strong management teams that possess a clear vision and focus on profitability and shareholders' interests. The investment process is driven by proprietary fundamental research identifying companies with below average valuations and above average earnings growth and return on equity.

The Company also invests in companies that have undervalued assets where it identifies a realistic catalyst for positive change. This represents an enhancement of the overall investment process reflecting what the Manager believes are exciting new opportunities in the Japanese equity market. The Manager believes that these types of companies compliment the Company's overall stock picking expertise, enabling the Company to identify the best opportunities for long term capital appreciation in Japan caused by ongoing consolidation.

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

Continued

Principal Risks and Uncertainties

Continued

Risk management is an integral part of the investment management process. Core to the process is that risks taken are not incidental but are fully understood and accounted for. In-depth proprietary fundamental research provides the Manager with a deep understanding of each stock in the Company's portfolio and the associated risks. The Board considers the risks facing the Company on an on-going basis. All Board meetings are also attended by the Manager, either in person or by telephone, where reports on portfolio performance and strategy are provided.

Portfolio performance will be dependent on the performance of Japanese equities and such stocks will be influenced by the general health of the country. The largest risk for Japan continues to be a slowdown in the global economy, particularly in major trading partners. Japan remains sensitive to economic and geopolitical uncertainty abroad, as seen during disruptive developments in Russia and elsewhere in 2014. Within Japan, there continues to be uncertainty with regard to sustainable inflation expectations leading to a positive feedback cycle of increased consumption and wage growth. The Bank of Japan is currently acquiring the majority of newly issued government debt in pursuit of reaching its 2% inflation target and questions remain as to the need, timing and method of further stimulus measures.

(iii) *Foreign exchange risk*

The movement of exchange rates may have an unfavourable or favourable impact on returns as the majority of the Company's assets are denominated in Yen, rather than US Dollar, the reporting currency of the Company.

(iv) *Ordinary shares*

The market value of the shares in the Company may not reflect the underlying Net Asset Value and may trade at a discount to it. The Board actively monitors the discount of the Company and, where appropriate, may implement share buybacks to help reduce the discount and/or discount volatility.

(v) *Borrowing*

The Investment Policy restricts the Company from entering into borrowings in excess of 20 per cent. of net assets at the time the borrowings are drawn down. Whilst such borrowings may enhance the return on the shares where the underlying Company performance is positive, the opposite is also true and any borrowing will enhance the negative performance of the Company.

(vi) *Third party service providers*

The Company has no employees and the Board comprises three non-executive directors. The Company is reliant on the Manager, the Investment Advisor and the Secretary, Registrar and Administrator to perform its executive function. The most significant of these third party service providers is the Manager to whom the management of the Company's investments has been delegated. Failure by any of these third party service providers to perform the services in accordance with the terms of the relevant service contracts represents a risk to the operations of the Company and the performance of the Company. Termination of the Investment Management Contract by the Manager or loss of key staff by the Manager could materially affect the ability of the Company to operate and detract from the performance of the Company until a suitable replacement could be found.

The Board has segregated the duties of investment management, accounting and custody. Each of the contracts with third party service providers has been entered into after full and proper consideration of the quality and cost of the services provided and the control systems in place. The Board reviews the performance of the Investment Advisor and the Manager on a regular basis.

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

Continued

Statement of Directors' Responsibilities and Declarations

The Directors are responsible for preparing the Financial Statements in accordance with applicable Guernsey Law and International Financial Reporting Standards as adopted by the EU. 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 Annual Report includes 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 and performance 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 and International Financial Reporting Standards as adopted by the EU ("IFRS"). 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 IFRS as adopted by the European Union and give a true and fair view of the financial position and performance of the Company as at and for the year ended 31 December, 2014.
- (b) The Chairman's Report, Investment Advisor's and Directors' Reports include 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.

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 Financial Statements 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 years ended 31 December, 2014 and 31 December, 2013 have been prepared in accordance with the AIC's recommended methodology. The ongoing charges for the year ended 31 December, 2014 was 2.28 per cent (31 December, 2013: 2.24 per cent). No performance fees were charged during the year.

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

Continued

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 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, 2014. The Code includes provisions relating to; the role of the chief executive, executive directors' 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 that 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 three 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 Chairman of the Board is John Hawkins. Biographies for Mr Hawkins and all other Directors can be found on page 46. In considering the independence of the Chairman, the Board has taken note of the provisions of the AIC 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	3	2	NA	NA
John Hawkins	4	4	–	–	3	3	3	3
Richard Battey	4	4	–	–	3	1	3	3
Christopher Sherwell	4	2	–	–	3	2	3	2

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

Continued

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 27 August, 2014, Rupert Evans, John Hawkins, Richard Battey and Christopher Sherwell retired as Directors, and being eligible, Rupert Evans, John Hawkins and Richard Battey offered themselves for re-election. Rupert Evans, John Hawkins and Richard Battey were re-elected as Directors of the Company.

Board Performance

The Company conducted a review of the effectiveness of the Board during the year by way of self-evaluation questionnaires. The review concluded that the members of the Board had the right mix of skills and functioned effectively as a Board.

Supply of Information

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

Nomination Committee

The Board as a whole fulfils the function of a Nomination Committee. Whilst the independent Directors take the lead in the appointment of new Directors, any proposal for a new Director will be discussed and approved by the entire Board. Christopher Sherwell retired 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 not engaged an external search consultancy, nor is it advertising openly.

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, 2014 and 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

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 last such resolution was tabled at the eighteenth Annual General Meeting held in 2014. The Shareholders voted against the resolution, and in favour of the continuation of the Company. Based on this vote and the fact that the assets of the Company consist mainly of securities that are readily realisable, whilst the Directors acknowledge that the liquidity of these assets needs to be managed, the Directors believe that the Company has adequate financial resources to meet its liabilities as they fall due and that it is appropriate for the Financial Statements to be prepared on a going concern basis. Factors regarding the going concern basis are also discussed in note 1 of the Financial Statements.

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

Continued

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, 2014 and the number of such meetings attended by each Committee member.

The Audit Committee Report detailing responsibilities and activities is presented on pages 15 – 17.

Management and Engagement Committee

The Management and Engagement Committee comprise the Independent Directors. The Management and Engagement Committee operate 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 and found it satisfactory, the Management Engagement Committee did not need to meet during the year.

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 systems of internal control and for maintaining and reviewing its effectiveness. The systems of internal controls are 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 relevant third party 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.

THE PROSPECT JAPAN FUND LIMITED

DIRECTORS' REPORT

Continued

Internal Control

Continued

- CREST agency functions are performed by Computershare (CI) Limited, a company licensed and regulated by the Guernsey 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

No Directors holding office at 31 December, 2014, or their associates, had any beneficial interest in the Company's Shares (2013: Christopher Sherwell had beneficial interest in 9,940 shares). There has been no change in this position 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 and Richard Battey are Directors of a range of funds.

Substantial Shareholdings

As at the date of this report, the Company has been notified of 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
Lazard Asset Management	20,525,944	22.20%
1607 Capital Partners	17,493,887	19.19%
CG Asset Management	15,105,436	16.30%
Weiss Asset Management	6,979,265	7.55%
Wells Capital Management	4,684,888	5.07%
Permal Asset Management	4,482,907	4.85%

Share buybacks

As approved at the AGM on 27 August, 2014, the Company may purchase, subject to various terms as set out in the Articles, a maximum of 14,013,191 Ordinary Shares under the Company's discount control mechanism. During the year, the Company purchased shares as detailed in Note 9 on page 33 and 34 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

27 April 2015

THE PROSPECT JAPAN FUND LIMITED

AUDIT COMMITTEE REPORT

On the following pages, we present the Audit Committee (the “Committee”) Report for 2014, 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 Report and Financial Statements and any other financial information published by the Company, in each case before issue or publication, prior to submission to the Board, having particular regard to:-
 - the accounting policies and whether they continue to be appropriate for the business;
 - any changes in accounting policies or practices and whether they are appropriate for 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 Financial Statements, 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); and
- To consider any other topics referred to it by the Board.

Membership

The members of the Committee are Richard Battey (Chairman) and John Hawkins. Full biographical details of each member can be found on page 46. 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 matters.

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 was required to be put to the Shareholders at the 2014 AGM. The Shareholders voted against winding up the Company. The Committee 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 55% by value of the investments are quoted investments and are held in a designated account at the Custodian. The remaining 45% of investments are unlisted and dealt with in more detail below.

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 a 7% direct exposure to property companies (2013: 19%).

The Company holds three unlisted investments. Following advice from the Investment Manager and per requirements under IFRS, 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 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 Financial Statements, 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.

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.

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. 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 the engagement letter that was issued by the external Auditor at the start of each audit, ensuring that it reflects any changes in circumstances 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.

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

27 April, 2015

THE PROSPECT JAPAN FUND LIMITED

INVESTMENT POLICY

for the year ended 31 December, 2014

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

Following 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 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;

- (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) the Company may not enter into borrowings in excess of 20 per cent. of net assets at the time the borrowings are drawn down.

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, 2014

Number of Securities	Investments	Fair Value in U.S. Dollars	Percentage of Net Asset Value
	<i>Listed investments</i>		
	Advertising		
985,800	Tri-stage Inc	12,621,540	9.75
		<u>12,621,540</u>	<u>9.75</u>
	Banks		
8,369,000	The Daito Bank	9,874,720	7.63
		<u>9,874,720</u>	<u>7.63</u>
	Diversified Financial Services		
337,060	Akatsuki Financial Group Inc	1,881,331	1.45
438,000	Yutaka Shoji Co Ltd	1,469,774	1.14
		<u>3,351,105</u>	<u>2.59</u>
	Engineering and Construction		
2,090,600	Tomoe Corp	7,907,541	6.11
		<u>7,907,541</u>	<u>6.11</u>
	Machinery		
577,600	Showa Aircraft Industry Co Ltd	5,490,825	4.24
		<u>5,490,825</u>	<u>4.24</u>
	Real Estate		
743,400	Katakura Industries Co Ltd	7,857,022	6.07
		<u>7,857,022</u>	<u>6.07</u>
	Retail		
467,000	Shaklee Global Group Inc	8,683,464	6.71
		<u>8,683,464</u>	<u>6.71</u>
	REITs		
7,898,895	Prospect Epicure J-REIT Value Fund*#	—	—
		<u>—</u>	<u>—</u>
	Storage/warehousing		
1,509,000	Maruhachi Warehouse Co Ltd	4,545,941	3.51
446,695	Yasuda Logistics Corp	3,981,006	3.08
		<u>8,526,947</u>	<u>6.59</u>
	Transportation		
914,000	Daiwa Motor Transportation Co Ltd	3,671,297	2.84
3,000	Hokkaido Chuo Bus Co Ltd	9,063	0.01
		<u>3,680,360</u>	<u>2.85</u>
	Total listed investments	<u>67,993,524</u>	<u>52.54</u>

THE PROSPECT JAPAN FUND LIMITED

PORTFOLIO OF INVESTMENTS

as at 31 December, 2014

Continued

Number of Securities	Investments	Fair Value in U.S. Dollars	Percentage of Net Asset Value
	<i>Unlisted investments</i>		
	Corporate bonds		
5,150,000	Godo Kaisha Taiheiyo Jisho	4,681,865	3.62
3,000,000,000	Prospect Co Ltd 2nd Series Unsecured Convertible Bond +	51,198,143	39.56
315,700,000	Takefuji Corp	128,518	0.10
		<u>56,008,526</u>	<u>43.28</u>
	Total unlisted investments	<u>56,008,526</u>	<u>43.28</u>
	Total investments	124,002,050	95.82
	Net current assets	<u>5,421,387</u>	<u>4.18</u>
	NET ASSETS	<u><u>129,423,437</u></u>	<u><u>100.00</u></u>

* Prospect Epicure J-REIT Value Fund is classed as a related party as the fund shares the same Investment Advisor as the Company.

Currently in liquidation.

+ Mr. Curtis Freeze, Director of Prospect Asset Management (Channel Islands) Limited ("PAM(CI)"), the Manager of The Prospect Japan Fund Limited is President of Prospect Co Ltd which owns the majority 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

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of The Prospect Japan Fund Limited's ("the Company") affairs as at 31 December 2014 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 ("IFRS"); and
- have been prepared in accordance with the requirements of the Companies (Guernsey) Law, 2008.

What we have audited

We have audited the financial statements of The Prospect Japan Fund Limited for the year ended 31 December 2014 which comprise the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity, the Statement of Cash Flows and related notes 1 to 17. The financial reporting framework that has been applied in their preparation is applicable law and IFRS.

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

Respective responsibilities of Directors and Auditor

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

Scope of the audit of the financial statements

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

Our assessment of risks of material misstatement

We identified the following risk that we believed would have the greatest effect on the overall audit strategy, the allocation of resources and directing the efforts of the engagement team:

- valuation of the Company's unquoted investments whose valuations are subjective and require the use of estimation and judgement

THE PROSPECT JAPAN FUND LIMITED

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF THE PROSPECT JAPAN FUND LIMITED

Continued

Our application of materiality

We determined planning materiality for the Company to be US\$1.29 million (2013: US\$1.1 million), which is 1% of Net Asset Value. 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. We used equity as a basis for determining planning materiality because the Company's primary performance measures for internal and external reporting are based on net asset value.

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 US\$968k (2013: US\$0.8 million). Our objective in adopting this approach was to ensure that total uncorrected and undetected audit differences in the financial statements did not exceed our materiality level.

We agreed with the Audit Committee that we would report to them all audit differences in excess of US\$65k (2013: US\$ 0.06 million), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds.

We evaluated any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations.

An overview of the scope of our audit

We adopted a risk-based approach in determining our audit strategy. This approach focuses audit effort towards higher risk areas, such as management judgments and estimates.

Our response to the risk of incorrect valuation of the Company's unquoted investments was as follows:

- We confirmed our understanding of the Company's processes, methodologies and policies for valuing unquoted investments;
- We determined and challenged the appropriateness of the valuation techniques applied to unquoted investments, and obtained evidence to corroborate the inputs into the valuation model;
- We agreed valuation inputs that did not require specialist knowledge to supporting documentation and we tested the arithmetical accuracy of the Company's calculations;
- We engaged our own derivatives valuation experts, in relation to the valuation of the Prospect Co Ltd unsecured convertible bond, to:
 - (a) assist us to determine whether the methodology used to value the investment was appropriate; and
 - (b) corroborate and challenge management's judgements and valuation inputs utilised in the valuation calculation.

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

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; 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.

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
27 April, 2015

The maintenance and integrity of the Company's website is the sole responsibility of the Directors; the work carried out by the auditors does not involve consideration of these matters and, accordingly, the auditor accepts no responsibility for any changes that may have occurred to the Financial Statements since they were initially presented on the website.

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

THE PROSPECT JAPAN FUND LIMITED

STATEMENT OF COMPREHENSIVE INCOME

for the year ended 31 December, 2014

Notes	Revenue	Capital	Total	Revenue	Capital	Total
	01.01.2014 to 31.12.2014	01.01.2014 to 31.12.2014	01.01.2014 to 31.12.2014	01.01.2013 to 31.12.2013	01.01.2013 to 31.12.2013	01.01.2013 to 31.12.2013
	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	1,104,378	–	1,104,378	1,398,250	–	1,398,250
Interest income	23,738	–	23,738	55,176	–	55,176
Foreign exchange movements	1,275,048	(4,364,984)	(3,089,936)	(579,475)	(4,298,624)	(4,878,099)
Gain on financial assets at fair value through profit or loss	–	16,037,689	16,037,689	–	33,388,135	33,388,135
Total income	<u>2,403,164</u>	<u>11,672,705</u>	<u>14,075,869</u>	<u>873,951</u>	<u>29,089,511</u>	<u>29,963,462</u>
4 Management fee	(1,827,971)	–	(1,827,971)	(1,706,635)	–	(1,706,635)
5 Other expenses	(1,147,024)	–	(1,147,024)	(840,538)	–	(840,538)
Transaction costs	–	(397,717)	(397,717)	–	(1,078,749)	(1,078,749)
Total expenses	<u>(2,974,995)</u>	<u>(397,717)</u>	<u>(3,372,712)</u>	<u>(2,547,173)</u>	<u>(1,078,749)</u>	<u>(3,625,922)</u>
(Loss)/gain for the year before tax	(571,831)	11,274,988	10,703,157	(1,673,222)	28,010,762	26,337,540
3 Withholding tax	(227,663)	–	(227,663)	(140,744)	–	(140,744)
(Loss)/gain for the year after tax	<u>(799,494)</u>	<u>11,274,988</u>	<u>10,475,494</u>	<u>(1,813,966)</u>	<u>28,010,762</u>	<u>26,196,796</u>
(Loss)/gain for the year	<u>(799,494)</u>	<u>11,274,988</u>	<u>10,475,494</u>	<u>(1,813,966)</u>	<u>28,010,762</u>	<u>26,196,796</u>
2 (Loss)/gain per Ordinary Share – Basic & Diluted (in Cents)	<u>(0.85)</u>	<u>12.06</u>	<u>11.20</u>	<u>(1.90)</u>	<u>29.50</u>	<u>27.60</u>

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. There was no comprehensive income other than the (loss)/gain for the year.

All items in the above statement derive from continuing operations.

The notes on pages 28 to 44 form an integral part of the Financial Statements.

THE PROSPECT JAPAN FUND LIMITED

STATEMENT OF FINANCIAL POSITION

as at 31 December, 2014

Notes	31.12.2014 In U.S. Dollars	31.12.2013 In U.S. Dollars
Non-current assets		
6 Financial assets at fair value through profit or loss	124,002,050	99,187,758
Current assets		
7 Receivables	749,055	3,162,181
Cash and cash equivalents	5,404,636	21,309,724
Total current assets	<u>6,153,691</u>	<u>24,471,905</u>
Current liabilities		
8 Payables	732,304	2,047,594
Net current assets	<u>5,421,387</u>	<u>22,424,311</u>
Net assets	<u>129,423,437</u>	<u>121,612,069</u>
Equity		
9 Share capital account	92,452	94,878
9 Redemption reserve	85,533,077	88,197,203
9 Capital redemption reserve	323,057	320,631
Other reserves	43,474,851	32,999,357
Total equity	<u>129,423,437</u>	<u>121,612,069</u>
Ordinary Shares in issue	<u>92,452,602</u>	<u>94,878,602</u>
2 Net Asset Value per Ordinary Share (in cents)	<u>139.99</u>	<u>128.18</u>

The Financial Statements on pages 25 to 44 were approved by the Board of Directors on 27 April, 2015 and signed on its behalf by:

John Hawkins
Director

Richard Battey
Director

The notes on pages 28 to 44 form an integral part of the Financial Statements.

THE PROSPECT JAPAN FUND LIMITED

STATEMENT OF CHANGES IN EQUITY

for the year ended 31 December, 2014

	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, 2014	94,878	320,631	88,197,203	(14,106,096)	49,738,831	(2,389,140)	(244,238)	121,612,069
Total comprehensive income/ (expense) for the period								
(Loss)/gain for the period after tax	–	–	–	(799,494)	4,134,299	11,505,673	(4,364,984)	10,475,494
Capital activities								
Repurchase of shares	(2,426)	2,426	(2,664,126)	–	–	–	–	(2,664,126)
Balances at 31 December, 2014	92,452	323,057	85,533,077	(14,905,590)	53,873,130	9,116,533	(4,609,222)	129,423,437
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	94,878	320,631	88,197,203	(14,106,096)	49,738,831	(2,389,140)	(244,238)	121,612,069

The notes on pages 28 to 44 form an integral part of the Financial Statements.

THE PROSPECT JAPAN FUND LIMITED

STATEMENT OF CASH FLOWS

for the year ended 31 December, 2014

Notes	01.01.2014 to 31.12.2014 In U.S. Dollars	01.01.2013 to 31.12.2013 In U.S. Dollars
Cash flows from operating activities		
10 Net cash inflow/(outflow) from operating activities	2,269,678	(4,079,421)
Cash flows from investing activities		
Purchase of investments	(105,284,182)	(240,847,025)
Sale of investments	94,138,526	253,973,582
Net cash (outflow)/inflow from investing activities	(11,145,656)	13,126,557
Net cash (outflow)/inflow before financing activities	(8,875,978)	9,047,136
Cash flows from financing activities		
9 Repurchase of shares	(2,664,126)	(384,273)
Net cash outflow from financing activities	(2,664,126)	(384,273)
(Decrease)/increase in cash and cash equivalents	<u>(11,540,104)</u>	<u>8,662,863</u>
Reconciliation of net cash flow to movement in net funds		
Net cash (outflow)/inflow	(11,540,104)	8,662,863
Effects of foreign exchange rate changes	(4,364,984)	(4,298,624)
Cash and cash equivalents at beginning of the year	21,309,724	16,945,485
Cash and cash equivalents at end of the year	<u>5,404,636</u>	<u>21,309,724</u>

Foreign exchange translation amounts arising in 2013 have been presented in the comparative column on the face of the statement of cash flows, and not as a reconciling item in Note 10, to align with the current period presentation, with no net impact on the net cash (outflow)/inflow.

The notes on pages 28 to 44 form an integral part of the Financial Statements.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

for the year ended 31 December, 2014

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 by 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 assets 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 Annual General Meeting to be held in 2017.

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

- 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)
- IAS 28 (Amendments) – Investments in Associates and Joint Ventures (effective 1 January, 2014)

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

Standards, amendments and interpretations issued but not yet effective

- IFRS 9 Financial Instruments – (effective 1 January, 2018) (not yet EU endorsed)
- IFRS 10 (Amendments) – Consolidated Financial Statements (effective 1 January, 2016)
- IFRS 12 (Amendments) – Disclosure of Interests in Other Entities (effective 1 January, 2016)
- IFRS 13 (Amendments) – Fair Value Measurement (effective 1 July, 2014)
- IFRS 14 – Regulatory Deferral Accounts (effective 1 January, 2016)
- IFRS 15 – Revenue from Contracts with Customers (effective 1 January, 2017) (not yet EU endorsed)
- IAS 1 (Amendments) – Presentation of Financial Statements (effective 1 January, 2016)

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 1 Principal Accounting Policies

Continued

– IAS 27 (Amendments) – Separate Financial Statements (effective 1 January, 2016)

– IAS 28 (Amendments) – Investments in Associates and Joint Ventures (effective 1 January, 2016)

Investment Entities, Applying the Consolidation Exception

Narrow-scope amendments to IFRS 10, IFRS 12 and IAS 28 introduce clarifications to the requirements when accounting for investment entities. The amendments also provide relief in particular circumstances, which will reduce the costs of applying the Standards.

IFRS 9, Financial Instruments

In July 2014, the IASB issued the final version of IFRS 9 Financial Instruments which reflects all phases of the financial instruments project and replaces IAS 39 Financial Instruments: Recognition and Measurement and all previous versions of IFRS 9. The standard introduces new requirements for classification and measurement, impairment, and hedge accounting. IFRS 9 is effective for annual periods beginning on or after 1 January 2018, with early application permitted. Retrospective application is required, but comparative information is not compulsory. Early application of previous versions of IFRS 9 (2009, 2010 and 2013) is permitted if the date of initial application is before 1 February 2015. The adoption of IFRS 9 will have an effect on the classification and measurement of the Company's financial assets, but no impact on the classification and measurement of the Company's financial liabilities.

IFRS 13, Fair Value Measurement

The amendment is applied prospectively and clarifies that the portfolio exception in IFRS 13 can be applied not only to financial assets and financial liabilities, but also to other contracts within the scope of IFRS 9 (or IAS 39, as applicable).

IFRS 14, Regulatory Deferral Accounts

An optional standard that allows an entity, whose activities are subject to rate-regulation, to continue applying most of its existing accounting policies for regulatory deferral account balances upon its first-time adoption of IFRS. Entities that adopt IFRS 14 must present the regulatory deferral accounts as separate line items on the statement of financial position and present movements in these account balances as separate line items in the statement of profit or loss and other comprehensive income. The standard requires disclosures on the nature of, and risks associated with, the entity's rate-regulation and the effects of that rate-regulation on its financial statements. IFRS 14 is effective for annual periods beginning on or after 1 January 2016. Since the Company is an existing IFRS preparer, this standard would not apply.

IFRS 15, Revenue from Contracts with Customers

This standard was issued in May 2014 and establishes a new five-step model that will apply to revenue arising from contracts with customers. Under IFRS 15 revenue is recognised at an amount that reflects the consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The principles in IFRS 15 provide a more structured approach to measuring and recognising revenue. The new revenue standard is applicable to all entities and will supersede all current revenue recognition requirements under IFRS. Either a full or modified retrospective application is required for annual periods beginning on or after 1 January, 2017 with early adoption permitted. The Company is currently assessing the impact of IFRS 15.

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.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 1 Principal Accounting Policies

Continued

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, comparisons with the valuations of comparable instruments or by using valuation techniques, such as the Black Scholes model. The carrying amounts of the instruments approximate fair value.

The Investment Manager exercises 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.

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.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 1 Principal Accounting Policies

Continued

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, comparisons with the valuations of comparable convertible and corporate bonds or by using appropriate valuation techniques, such as the Black Scholes model.

Derecognition of financial instruments

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

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

Income

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

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 Dollars and accordingly the Board have determined that the Company's functional and presentation currency is United States Dollars, 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.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

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

The gain/(loss) per Ordinary Share – Basic and Diluted has been calculated based on the weighted average number of Ordinary Shares of 93,521,466 and a net gain of US\$10,475,494 (2013: 95,073,601 Ordinary Shares and a net gain of US\$26,196,796).

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 92,452,602 (2013: 94,878,602) and shareholders' funds attributable to equity interests of US\$129,423,437 (2013: US\$121,612,069).

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 (£1,200 with effect from 1 January 2015).

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, Prospect Asset Management (Channel Islands) ("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\$1,827,971 (2013: US\$1,706,635) of which US\$140,024 (2013: US\$156,315) 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

	01.01.2014 to 31.12.2014 In U.S. Dollars	01.01.2013 to 31.12.2013 In U.S. Dollars
Administration and secretarial fees*	304,662	284,439
Custodian's fees and charges**	125,556	149,240
General expenses	523,776	204,246
Directors' remuneration	138,280	133,595
Auditors' fees	38,000	43,074
Non-audit fees	16,750	25,944
	<u>1,147,024</u>	<u>840,538</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\$304,662 (2013: US\$284,439) of which US\$23,337 (2013: US\$26,053) 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\$125,556 (2013: US\$149,240) of which US\$10,006 (2013: US\$23,235) 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

	01.01.2014 to 31.12.2014 In U.S. Dollars	01.01.2013 to 31.12.2013 In U.S. Dollars
Opening book cost	101,576,898	89,404,049
Purchases at cost	103,729,025	241,863,287
Proceeds on sale	(94,952,422)	(253,604,885)
Realised gain on sale	4,532,016	23,914,447
Closing book cost	114,885,517	101,576,898
Unrealised gain/(loss)	9,116,533	(2,389,140)
Fair value	<u>124,002,050</u>	<u>99,187,758</u>

Note 7 Receivables

	31.12.2014 In U.S. Dollars	31.12.2013 In U.S. Dollars
Amounts due from brokers	605,775	–
Dividends receivable	143,280	319,454
Other receivables*	–	2,842,727
	<u>749,055</u>	<u>3,162,181</u>

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

Note 8 Payables

	31.12.2014 In U.S. Dollars	31.12.2013 In U.S. Dollars
Amounts due to brokers	382,899	1,748,459
Other creditors	349,405	299,135
	<u>732,304</u>	<u>2,047,594</u>

Note 9 Share Capital, Redemption Reserve & Capital Redemption Reserve

Authorised Share Capital Number of shares		31.12.2014 In U.S. Dollars	31.12.2013 In U.S. Dollars
<u>150,000,000</u>	Ordinary Shares of US\$0.001 each	<u>150,000</u>	<u>150,000</u>
<u>60,000,000</u>	“C” Ordinary Shares of US\$0.01 each	<u>600,000</u>	<u>600,000</u>

As approved at the AGM on 27 August, 2014, the Company may purchase a maximum of 14,013,191 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
94,878,602	Balance at 1 January, 2014	94,878	88,197,203	320,631
(2,426,000)	Shares repurchased and cancelled during the year	(2,426)	(2,664,126)	2,426
<u>92,452,602</u>	Balance at 31 December, 2014	<u>92,452</u>	<u>85,533,077</u>	<u>323,057</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
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>

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. There were no “C” Ordinary Shares in issue during the year (2013: Nil)

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

	31.12.2014 In U.S. Dollars	31.12.2013 In U.S. Dollars
Revenue loss on ordinary activities for the year	(799,494)	(1,813,966)
Decrease/(increase) in dividends receivable and other receivables	3,018,902	(2,309,163)
Increase in other creditors	50,270	43,708
Net cash inflow/(outflow) from operating activities	<u>2,269,678</u>	<u>(4,079,421)</u>

Foreign exchange translation amounts arising in 2013 have been presented in the comparative column on the face of the statement of cash flows, and not as a reconciling item the above note, to align with the current period presentation, with no net impact on the net cash (outflow)/inflow.

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, 2014			
Financial assets			
Investments at fair value through profit or loss	124,002,050	–	124,002,050
Cash and cash equivalents	–	5,404,636	5,404,636
Receivables	–	749,055	749,055
	<u>124,002,050</u>	<u>6,153,691</u>	<u>130,155,741</u>
Financial liabilities			
Payables	–	732,304	732,304
	<u>–</u>	<u>732,304</u>	<u>732,304</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, 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>

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) (the "Manager") whose parent company is Prospect Co., Ltd (Kabushiki Kaisha Prospect ("KKP"), a Japanese Company). During the year, the Company purchased a convertible bond issued by Prospect Co., Ltd. As Prospect Co., Ltd is the ultimate parent of the Manager and therefore a related party, the Company was required to seek Shareholder approval at an EGM held on 20 November, 2014. The resolution to purchase the investment was duly passed. See the Chairman's report on page 3 for further details of the transaction.

Mr Rupert Evans is a Director of the Manager.

Directors' fees are disclosed in Note 5. The basic fee payable to Directors in 2014 and 2013 is £20,000, the Chairman of the Audit Committee £22,500 and the Chairman of the Board £25,000 per annum.

No Directors holding office at 31 December, 2014, 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.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 12 Related Party Transactions

Continued

Mr. Curtis Freeze is a Director of PAM(CI), the Manager of The Prospect Japan Fund Limited, and is the President of Prospect Co Ltd., 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 J-REIT 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 (2013: Nil) during the year from Prospect Epicure J-REIT 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.

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 MSCI Japan Small Cap Index would have on the percentage of funds invested. The MSCI Developed Markets Small Cap Indices offer an exhaustive representation of the size segment by targeting companies that are in the Investable Market Index but not in the Standard Index in a particular developed market. The indices include Value and Growth style indices and industry indices based on the Global Industry Classification Standard. The MSCI Japan Small Cap 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, 2014 a 1% positive/negative movement in the index would produce a positive/negative movement in the net assets of the Company of US\$493,103 (2013:\$354,100) 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.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 13 Financial Risk Management Objectives and Policies

Continued

Foreign Currency Risk

The Company principally invests in securities denominated in Japanese Yen rather than United States Dollars, 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 in either the current or prior year.

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:

	31.12.2014 In US Dollars	31.12.2013 In US Dollars
Investments		
Japanese Yen (¥14,258,762,107; 2013:¥10,428,237,572)	119,320,185	99,187,758
	<u>119,320,185</u>	<u>99,187,758</u>
Other (Liabilities)/Assets		
US Dollars	(199,947)	(185,346)
Sterling (£80,232, 2013:£49,548)	(124,683)	(81,886)
Japanese Yen (¥686,649,031; 2013:¥2,408,698,490)	5,746,017	22,691,543
	<u>5,421,387</u>	<u>22,424,311</u>

The below details the Company's sensitivity to a 10% (31 December 2013: 10%) change in Japanese Yen exchange rates against the US Dollar.

	31.12.2014 In US Dollars	31.12.2013 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>(11,382,120)</u>	<u>(11,093,472)</u>
– 10% decrease in the US Dollar against other currencies	<u>13,908,709</u>	<u>13,555,679</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 equivalents as the Company predominantly 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 the profit and loss for the year would be a decrease/increase of US\$614,132 (2013: US\$364,228).

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 13 Financial Risk Management Objectives and Policies

Continued

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 approximates 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.

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 is 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 2014.

	Level 1 In US Dollars	Level 2 In US Dollars	Level 3 In US Dollars	Total In US Dollars
Financial assets at fair value through profit or loss:				
– Equity Securities	67,993,524	–	–	67,993,524
– Debt Securities				
Corporate bonds	–	–	56,008,526	56,008,526
Total as at 31 December, 2014	<u>67,993,524</u>	<u>–</u>	<u>56,008,526</u>	<u>124,002,050</u>

The following table presents the movement in level 3 instruments for the year ended 31 December, 2014 by class of Financial Instrument.

	Debt Securities In US Dollars	Total In US Dollars
Opening balance	15,113,042	15,113,042
Purchases	25,456,088	25,456,088
Sales	(9,166,872)	(9,166,872)
Realised losses during the year	(494,679)	(494,679)
Unrealised gains during the year	25,100,947	25,100,947
Closing balance	<u>56,008,526</u>	<u>56,008,526</u>
Net unrealised gain for the year included in the Statement of Comprehensive Income	<u>25,100,947</u>	<u>25,100,947</u>

There were no transfers between levels for the year ended 31 December, 2014.

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 as required by IFRS 7.

	Level 1 In US Dollars	Level 2 In US Dollars	Level 3 In US Dollars	Total In US Dollars
Assets				
Financial assets at fair value through profit and loss:				
– Equity Securities	84,074,716	–	–	84,074,716
– Debt Securities				
Corporate bonds	–	–	15,113,042	15,113,042
Total assets as at 31 December, 2013	<u>84,074,716</u>	<u>–</u>	<u>15,113,042</u>	<u>99,187,758</u>

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 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	<u>15,113,042</u>	<u>15,113,042</u>
Net unrealised loss for the year included in the Statement of Comprehensive Income for level 3 Investments held at 31 December, 2013	<u>264,245</u>	<u>264,245</u>

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.

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 Taiheiyō Jisho (GK) a Japanese partnership set up to invest in real estate ventures at a fixed interest rate of 10%. Taiheiyō Jisho currently invests in SCD ML II, LLC, which is developing a project on the island of Hawaii. The project is currently behind target and SCD ML II, LLC have issued a revised completion date. As such, there is doubt that they will be able to pay all the interest on the bond on maturity. Due to the increased credit risk as a result of the non-performance of the bond, the Directors believe that this results in a reduction in the fair value. The value of the bond has therefore been written down by \$2 million to \$4.7 million in the Financial Statements. The unobservable input used in arriving at this valuation is the discount rate and estimated repayment date which is dependent on the pace of progress of the project.

The Company holds a convertible bond in Prospect Co. Ltd (formerly Gro-Bels). As stated above, the bond is valued at the Directors' estimate of its fair value in accordance with IFRS 13 using appropriate techniques. As the bond contains an embedded derivative, the Directors believe that the valuation produced using the Black-Scholes model approximates fair value for accounting purposes. The model uses both observable and non-observable data. Observable inputs include the face value and coupon rate of the bond, the conversion period, the shares received for each bond converted and the maturity date. The significant unobservable input is the volatility rate used. Using the Black Scholes model to value the bond has resulted in a \$26 million uplift in the valuation of the bond in the financial statements from the published NAV. A reconciliation of published to accounting NAV can be found in note 16.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 13 Financial Risk Management Objectives and Policies

Continued

Valuation techniques

Continued

The significant unobservable inputs used in the fair value measurement categorised within Level 3 of the fair value hierarchy together with a quantitative sensitivity analysis as at 31 December, 2014 are as shown below:

Description	Significant unobservable input	Sensitivity used	Effect on fair value In US Dollars
Godo Kaisha Taiheiyo Jisho Prospect Co Ltd 2nd Series Unsecured Convertible Bond	Current period market rate	+1%/-1%	(390,370)/468,135
	Volatility	+1%/-1%	107,974/(115,282)

Short term Debtors and Creditors

Trade and other receivables and creditors 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 may 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. Although market values are low in comparison to the Company's shareholding for some securities, there is sufficient volume to demonstrate an active market.

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.

As at 31 December, 2014

	Up to 1 week In US Dollars	1 week to 1 month In US Dollars	1-6 months In US Dollars	6-12 months In US Dollars	Greater than 12 months In US Dollars	Total In US Dollars
Financial assets						
Financial assets at fair value through profit or loss	27,270,006	24,387,570	16,340,361	–	56,004,113	124,002,050
Dividends receivable	–	–	143,279	–	–	143,279
Cash and cash equivalents	5,404,636	–	–	–	–	5,404,636
Securities sold receivable	605,776	–	–	–	–	605,776
Financial liabilities						
Amounts due to brokers	(382,899)	–	–	–	–	(382,899)
Other creditors	(29,695)	(253,367)	(66,343)	–	–	(349,405)
Total	<u>32,867,824</u>	<u>24,134,203</u>	<u>16,417,297</u>	<u>–</u>	<u>56,004,113</u>	<u>129,423,437</u>

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 In US Dollars	1 week to 1 month In US Dollars	1-6 months In US Dollars	6-12 months In US Dollars	Greater than 12 months In US Dollars	Total 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	<u>80,340,181</u>	<u>18,168,183</u>	<u>7,993,078</u>	<u>–</u>	<u>15,110,627</u>	<u>121,612,069</u>

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 investment 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 in 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 the 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 over-the-counter 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.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 13 Financial Risk Management Objectives and Policies

Continued

Capital Management

The Company is a close-ended investment company, and thus has a fixed capital. The Company's capital is represented by Ordinary Shares and each share carries one vote. Each share has an entitlement to dividends if declared.

As approved at the AGM on 27 August, 2014, the Company may purchase a maximum of 14,013,191 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) is US\$0.001;
- the maximum price to be paid (exclusive of expenses) is 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.

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 than that stated in the tender offer, and entered into an arbitration process. At the year end, the court had not yet made a ruling. Refer to note 17 for further detail.

THE PROSPECT JAPAN FUND LIMITED

NOTES TO THE FINANCIAL STATEMENTS

Continued

Note 16 Reconciliation of Published Valuation to Financial Statements

	31.12.2014
	In US Dollars
Net assets per Financial Statements	129,423,437
Buy back effective 30 December 2014 after valuation point	29,695
Writeback of prior year uplift on Toho Real Estate	791,587
Adjustment in value of financial assets at fair value through profit and loss:	
Godo Kaisha Taiheiyo Jisho	2,061,986
Prospect Co Ltd 2nd Series Unsecured Convertible Bond	(26,000,000)
Net assets per published valuation	<u><u>106,306,705</u></u>

Note 17 Subsequent Events

These Financial Statements were approved for issuance by the Board on 27 April, 2015. Subsequent events have been evaluated until this date.

On 7 January, 2015, the Company appointed Computershare Investor Services (Guernsey) Limited as Crest agent.

On 2 April, 2015 the Board agreed the sale of the bond in Taiheiyo Jisho to Prospect Co., Ltd the parent company of the Company's Manager, at the face value of the bond plus accrued interest to 31 December, 2014 amounting to \$6.7 million, approximately \$2 million in excess of the year end carrying amount.

As mentioned in note 15 above, the Company has been involved in court proceedings with Toho Real Estate arising from the tender offer. In March, 2015 the Company received notice from the court presiding over its petition that it had ruled in its favour. The court awarded the Company an aggregate amount of ¥121,610,000 (\$1.03 million). Although an improvement, this is still significantly discounted to the book value of Toho Real Estate and as such, on 9 April, 2015 the Company filed an appeal against the ruling.

THE PROSPECT JAPAN FUND LIMITED

GENERAL INFORMATION

General

The Company is a close-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 92,452,602 Ordinary Shares in issue as at 31 December, 2014. 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.

The Company is a FATCA compliant organisation with FATCA entity classification FFI and GIIN L0Q9R3.99999.SL.831.

Investment Objective

The Company's investment objective is to achieve long-term capital growth from a portfolio of securities primarily of smaller Japanese companies listed or traded on Japanese Stock Markets. The aim will be to achieve a long-term capital return on the Company's portfolio and dividend income will be a secondary consideration in making investment decisions. Although the Company is not managed to a benchmark, it measures its performance against the MSCI Japan Small Cap Index (Total Return) for comparison purposes only.

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) the Company may not 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. The price of the Ordinary Shares appears within the section of the London Share Service entitled "Investment Companies".

THE PROSPECT JAPAN FUND LIMITED

GENERAL INFORMATION

Continued

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 eighteenth Annual General Meeting of the Company held on 27 August 2014, 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 2017.

Directors

Brief biographical details of the Directors are as follows:

Rupert Evans, age 76, 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 72, 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 67 (retired 27 August, 2014) 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 63, 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.

