Notes to the Financial Statements

1. General

JF Japan OTC Fund Inc. (the "Company") is an exempted company incorporated in the Cayman Islands with unlimited life. The investment objective of the Company is to secure long-term capital appreciation through investment primarily in equity securities in companies whose shares are traded on the Japan OTC market, the Mothers Market and NASDAQ Japan market. The Company is listed on the Stock Exchange of Hong Kong Limited.

2. Principal Accounting Policies

The principal accounting policies adopted in the preparation of the financial statements are set out below:

(a) Basis of preparation
The financial statements have been prepared in accordance with and comply with International Accounting Standards. The financial statements are prepared under the historical cost convention as modified by the revaluation of available-for-sale securities and derivative contracts. In view of the geographical location of the Company's investments, the amounts shown in these financial statements are presented in Japanese Yen.

(b) Investments
At 1 January 2001 the Company adopted International Accounting Standards 39 ("IAS 39"). Investments intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices are classified as available-for-sale securities. Management determines the appropriate classification of its investments at the time of the purchase and re-evaluates such designation on a regular basis.

Available-for-sale securities are initially recognized at cost (which includes transaction costs). Listed securities and securities with prices quoted in over-the-counter markets or by market makers are subsequently re-measured at fair value based on the last traded price of the relevant stock exchanges or over-the-counter markets at the close of the business on the valuation day. The Board of Directors consider that last traded prices better represent the fair values of securities traded in the Japan OTC market, the Mothers Market and NASDAQ Japan market, as compared to bid prices which is the normal basis ascribed under IAS 39. When trading in the securities of an investee company is thin or suspended, the investment is valued at the Board's estimate of its net realizable value.

Purchases and sales of investments are accounted for on the trade date basis. Realized and unrealized gains and losses on investments are initially recognised in the Statement of Operations and thereafter transferred to the Capital Reserve. In accordance with the Company's Placing Memorandum dated 11 January 1990, such gains are not distributable.

Notes to the Financial Statements (continued)

The effect of adopting IAS 39 at 1 January 2001 is not material.

(c) Dividend and interest income
Dividend receivable on quoted equity shares are brought into account on the ex-dividend date.

Fixed returns on non-equity shares are recognised on a time apportionment basis so as to reflect the effective yield on the shares. Other returns on non-equity shares are recognised when the right to the return is established.

Interest income on bank deposits is recognised on a time proportion basis, taking into account the principal amounts outstanding and the interest rate applicable.

(d) Translation of foreign currencies
Monetary assets and liabilities expressed in foreign currencies at the year end are translated into Japanese Yen at the following rates of exchange ruling at the balance sheet date:

CHF1 = JPY78.9375	HK$1 = JPY16.8071
GBP1 = JPY190.7447	US$1 = JPY131.0600

Transactions in foreign currencies during the year are translated into Japanese Yen at the rate of exchange ruling at the transaction dates. Realized and unrealized gains and losses on translation of transactions and balances denominated in foreign currencies are initially recognised in the Statement of Operations and thereafter transferred to the Capital Reserve.

(e) Borrowing costs and expenses
Borrowing costs and expenses are accounted for on an accruals basis. Expenses are charged to the Statement of Operations except for expenses incurred on the acquisition of an investment which are included within the cost of that investment. Expenses arising on the disposal of investments are deducted from the disposal proceeds.

(f) Derivative financial instruments
At 1 January 2001 the Company adopted IAS 39. Derivative financial instruments which comprise interest rate swaps are initially recognised in the balance sheet at cost and subsequently are remeasured at their fair value. Fair values are obtained from quoted market prices. All derivatives are carried in assets when amounts are receivable by the Company and in liabilities when amounts are payable by the Company. Changes in fair values of derivative financial instruments are included in the Statement of Operations.

Prior to 1 January 2001, interest rate swaps were not included in the Balance Sheet. Any differential to be paid or received on an interest rate swap agreement was recognised as a component of interest revenue or expense over the period of the agreement. Gains and losses on early termination of interest rate swaps or on repayment of the borrowing were taken to the Statement of Operations. The effect of adopting IAS 39 at 1 January 2001 is not material.

Disclosures about financial instruments to which the Company is a party are provided in Note 13.

(g) Cash and cash equivalents
For the purpose of the cash flow statement, cash and cash equivalents comprise cash at banks and bank deposits with maturity of three months or less from the date of placing the deposit, net of short-term bank loans and overdrafts.

(h) Related parties
Parties are considered related if one party has the ability to control the other party or exercise significant influence over the other party in making financial or operating decisions.

(i) Capital reserve
Capital reserve represents accumulated realised and unrealised gains/losses on investments and exchange differences.

3. Taxation

No provision for Hong Kong profits tax has been made as the Company has no assessable income for the year (2000: Nil). The Company is not subject to taxation in the Cayman Islands.

Overseas withholding tax was charged on certain dividend income received during the year.

4. Management Fee

JF Japan OTC Management Limited, the Company's Manager, is entitled to receive a fee calculated at the rate of 1.3% per annum of the Company's total assets less current liabilities (being amounts due to creditors and short-term borrowings with an initial maturity of less than one year) ("TA-CL") on the last business day of the relevant month, but if "TA-CL" exceeds 125% of the net asset value, the rate applicable to such excess would be 1.3% per annum for invested assets e.g. shares, warrants, and 0.25% per annum for uninvested assets e.g. cash at banks and short term deposits.

The Management fee is calculated daily and payable monthly in arrears.

5. Directors' Remuneration

The aggregate amounts of fees paid and payable to the Directors and the Chairman of the Company are as follows:

	2001	2000
	JPY	JPY
As Directors and Chairman	**11,960,499**	9,602,938
As Audit Committee Members	**314,750**	278,100
	12,275,249	9,881,038

Directors' remuneration included JPY9,040,501 (2000: JPY6,228,780) payable to Independent Non-Executive Directors.

No Director waived emoluments in respect of the years ended 31 December 2001 and 31 December 2000.

The number of Directors whose emoluments fell within the following bands are as follows:

Directors' Fees	No. of Directors	
	2001	2000
	JPY	JPY
Nil - HK$1,000,000 (equivalent to JPY16,807,100)	**5**	5
Over HK$1,000,000 (equivalent to JPY16,807,100)	**–**	–
	5	5

Pursuant to the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, the above disclosure of payment includes payment to the five highest paid individuals in the Company during the year.

6. Net Loss Per Share

The calculation of net loss per share is based on net loss for the year of JPY792,203,160 (2000: JPY16,651,474,986) and the weighted average of 21,426,084 shares in issue during the year (2000: 22,009,205).

7. Investments

	2001	2000
	JPY	JPY
Available-for-sale securities		
Quoted securities, at fair value	**5,222,097,190**	6,099,215,290
Cost of investments	**6,024,113,941**	7,944,578,953

8. Accounts Receivable and Payable

As at 31 December 2001, dividend and other accounts receivable, accounts payable and amount due from/to brokers were either current or due for less than 30 days.

Notes to the Financial Statements (continued)

9. Long-term Bank Loan

The Company entered into a long-term loan agreement in 1996. The loan is unsecured and interest is charged on the outstanding balance at a rate of 0.6% per annum over JPY LIBOR. The maturity date of the loan was in June 2001 with early repayment option on any interest payment date one year after the facility was granted. The loan was fully repaid during the year.

The interest rate swap agreement detailed in Note 13 was entered into in order to hedge the interest rate risks on the above long-term loan.

10. Share Capital

	2001	2000
	US$	US$
Authorised:		
48,000,000 shares of US$0.25 each	**12,000,000**	12,000,000

	2001	2000
	JPY	JPY
Issued and fully paid:		
21,411,400 (2000: 21,470,200) shares of nominal value US$0.25 each	**656,613,168**	663,885,851

During the year, the Company repurchased, for cancellation, 58,800 shares of nominal value US$0.25 each (2000: 252,000 shares of nominal value US$1.00 each; 293,800 shares of nominal value US$0.25 each), which represented 0.3% of the issued share capital, through the market makers, at a total consideration of US$135,070 (equivalent to JPY17,067,881) (2000: US$7,030,996 and equivalent to JPY754,318,829).

11. Net Asset Value Per Share

The calculation of net asset value per share is based on the net assets of JPY6,123,113,276 (2000: JPY6,932,384,317) and the number of shares in issue 21,411,400 at 31 December 2001 (2000: 21,470,200).

12. Related Party Transactions

In addition to the transactions disclosed in Note 4, the Company had entered into the following transactions with related parties. All such transactions were entered into in the ordinary course of business and on normal commercial terms.

Notes to the Financial Statements (continued)

(a) Brokerage commissions in relation to transactions dealt through related parties were as follows:

	Brokerage commission paid JPY	% of the Company's total commission paid in the year
Year ended 31 December 2001		
Jardine Fleming Securities Limited	**794,441**	**5.20**
Year ended 31 December 2000		
Jardine Fleming Securities Limited	2,294,511	6.38

(b) The Company had stock lending arrangements with Robert Fleming & Co. Limited ("RF"), a related party of the Manager. The stock lending arrangement was terminated in December 2001. Details of stock lending transactions with RF during the year were as follows:

	2001 **JPY**	2000 JPY
Aggregate value of securities on loan at year end	**–**	–
Maximum aggregate value of securities on loan during the year	**–**	66,014,400

The Company held no collateral in respect of stock lending activities as at 31 December 2001 (2000: Nil).

(c) The Company utilises the brokerages, agency and banking services of fellow subsidiaries in the JPMorgan Chase group. Interest income and expenses during the year and balances outstanding at year end were as follows:

	Interest income for the year JPY	Interest expenses for the year JPY	Deposits as at 31 December JPY	Borrowings as at 31 December JPY
2001				
Nil	**–**	**–**	**–**	**–**
2000				
Jardine Fleming Bank Limited	193,408	4,977,400	–	–
Robert Fleming & Co. Limited	–	596,857	–	–

Notes to the Financial Statements (continued)

(d) Other balances with related parties as at 31 December 2001

	2001 JPY	2000 JPY
Amounts payable	**7,296,127**	10,258,293

13. Financial Instruments

Credit risk

Financial assets which potentially subject the Company to concentrations of credit risk consist principally of equities, cash at bank, short-term deposits and amounts due from/to brokers. The exposure to credit risk in respect of equities is controlled by the limits set by the Company on its investment holding in a single issuer.

Derivative instruments and stock lending arrangements are entered into with, and cash at bank and short-term deposits are placed with substantial financial institutions. The exposure to credit risk in respect of amounts due from/to brokers is monitored by way of identifying and transacting only with approved brokers. Exposure limits are also set and reviewed on a periodical basis. Furthermore, in respect of stocks on loan at any particular point in time, collateral equivalent to at least 105% of the stocks on loan at the time the loan is provided, is obtained.

Accordingly, the Company has no significant concentration of credit risk.

Interest rate risk

The Company entered into an interest rate swap agreement that entitles it to receive interest at floating rates on the notional principal amount and oblige it to pay interest at fixed rates on the same amount. The fixed interest rate was 2.75% p.a. and the floating rate was linked to JPY LIBOR, with a floating rate reset every 6 months. During the year, the interest rate swap agreement matured. The Company's short-term deposits, short-term bank loans and overdrafts at balance sheet date carried interest at the following rates per annum:

	2001	2000
Short-term deposits	**0.01%**	0.01% -1.00%
Bank overdrafts	**Nil**	n/a

Currency risk

The Company has no significant currency risk because substantially all assets and liabilities are denominated in Japanese Yen.

Fair values

The carrying amounts of investments, dividend and other accounts receivable, amounts due from/ to brokers, short-term deposits, cash at bank, accounts payable and short-term bank loans and overdrafts approximate their fair value.