



Solution 121.1

Component	Investment entities
Index	Principles/concepts
Short title	Functional currency of investment fund

Attention: This guidance is based on the revised standards and interpretations that are mandatory for accounting periods commencing 1 January 2005. A company may early adopt an individual revised standard, but only in its entirety. Guidance based on the previous version of the standards is included in the “Applying IFRS 2004” guidance.

Issue

Functional currency is the currency of the primary economic environment in which the entity operates [IAS21R.8].

What is the appropriate functional currency for an investment fund?

Background

The investment strategy of fund X, a Luxembourg fund, which operates in a strong regulatory environment, is to invest primarily in securities of companies operating in Japan and to offer a high return to investors. The majority of the fund’s investment assets are the securities of Japanese issuers traded on Japanese Stock Markets. All subscription/redemption transactions are processed in euro. The fund is marketed to European investors. All investors are based in the Euro zone. The fund’s management and service providers are remunerated in euro. The fund’s asset manager is based in Luxembourg. The performance of the fund is reported to the investors in euro. The financial statements are prepared using the euro as presentation currency.

Solution

In determining the functional currency management has to consider the following factors:

- (a) the economic environment(s) in which the financial assets are invested (Japan);
- (b) the economic environment(s) of the investors (Euro zone);
- (c) the regulatory environment (Luxembourg, part of Euro zone);
- (d) the competitive environment (the fund gives a Euro return, the fund is competing with other investment funds distributed in Europe);
- (e) the fee structure (euro;) and
- (f) the denomination of subscriptions / redemptions (euro).

The factors are mixed. The functional currency is not obvious and thus according to IAS 21R.12 management has to use its judgement to determine the functional currency that most faithfully represents the economic effect of the underlying transactions, events and conditions. Although the fund invests



in Japanese Yen assets, its primary objective is to provide a euro return in competition with other European investment funds. Consequently it is likely that management will conclude that the functional currency is euro. This is consistent with management's decision to report to investors using a euro presentation currency.