



Solution 121.2

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

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 is embedded in a strong regulatory environment, is to invest primarily in securities of companies operating in Japan and to offer a high return linked to the economic performance of Japan. 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 Japanese yen. The fund is marketed to investors in Europe. Investors are based in Switzerland, the United Kingdom and the Euro zone. The fund's management and service providers are remunerated in euro. The fund's asset manager is based in Luxembourg. All reporting to the globally based investors is provided in Japanese yen. The financial statements are prepared using the Japanese yen as presentation currency.

Solution

Management will consider the following facts:

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



The factors are mixed. The functional currency is not obvious and thus 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 (IAS 21R.12). Since the fund is investing in Japanese yen asset, gives a Japanese yen return and competes with other funds investing in Japan, it is likely that management will conclude that the functional currency is Japanese yen. This is consistent with management's decision to report to investors using a Japanese yen presentation currency.