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# Flash – ASPE

# Cryptocurrencies

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The popularity of cryptocurrencies, such as Bitcoin, has soared in recent years. Accounting standards for private enterprises (ASPE) do not contain explicit guidance on how to account for holdings of cryptocurrencies or cryptocurrency mining activity. This edition of *Flash* provides a summary of some of the main accounting issues and, in the absence of specific guidance, our views on the issues.

## Overview

Cryptocurrency is digital or "virtual" money, which uses cryptography to secure its transactions, control the creation of additional currency units, and verify the transfer of assets. In contrast to traditional forms of money which are controlled using centralized banking systems, cryptocurrencies use decentralized control. The decentralized control of a cryptocurrency works through a "blockchain", which is a public transaction database, functioning as a distributed ledger. This has advantages in that two parties can transact with each other directly without the need for an intermediary, thereby saving time and cost.

More and more entities, including private enterprises, are entering into transactions in which they obtain cryptocurrencies. The following are examples of situations in which an entity may obtain cryptocurrencies:

- An entity may accept cryptocurrency in exchange for goods or services sold in the ordinary course of its business;
- An entity may purchase cryptocurrency with the intention to hold it for investment purposes (i.e., to benefit from increases in value);
- An entity may act as a broker-trader of cryptocurrencies and purchase cryptocurrencies with the purpose of selling it in the near future in order to generate a profit from fluctuations in price or broker-traders' margin; or
- An entity may be involved in cryptocurrency mining activities.

Cryptocurrency mining describes the process in which transactions for various forms of cryptocurrency are verified and added to the blockchain digital ledger. Those that perform cryptocurrency mining are generally referred to as "miners". Cryptocurrency miners use large amounts of computing power to solve blockchain algorithms. Once a block has been solved by the miner, he may, depending on the mining algorithm, be entitled to transaction fees as consideration for verifying cryptocurrency transactions and entering them in the blockchain ledger. Such transaction fees are specified by the original transacting parties. Depending on the mining algorithm, the miner may also receive a reward of newly minted cryptocurrency for solving the block, with the amount of the reward being determined by the underlying blockchain software.

ASPE do not contain explicit guidance on how to account for holdings of cryptocurrencies or cryptocurrency mining activity. Furthermore, neither International Financial Reporting Standards (IFRS) nor generally accepted accounting principles in the United States (US GAAP) provide guidance which is appropriate for entities applying ASPE to analogize to in accordance with Section 1100, Generally Accepted Accounting Principles. The following is a summary of some of the main accounting issues and, in the absence of specific guidance, our views on the issues.

## Holdings of cryptocurrency

Given that cryptocurrency is often held for investment purposes, the value of many cryptocurrencies is volatile and financial statement users are interested in knowing current values, one approach to accounting for holdings of cryptocurrencies is at fair value through profit or loss. Although this approach may seem intuitive, it is incompatible with the requirements of ASPE in most circumstances. There is consensus that cryptocurrency does not satisfy the definitions of "cash and cash equivalents" or "financial assets". In addition, given that cryptocurrency is not a tangible asset, it would not be considered as "property, plant and equipment". Therefore, the three views that are currently held in practice are as follows:

1. Cryptocurrency is an indefinite life intangible asset within the scope of Section 3064, Goodwill and Intangible Assets. Consequently, it would be initially and subsequently measured at cost, less impairment (if any). Any impairment would not be subsequently reversed;

2. Cryptocurrency is a non-financial instrument investment and, like works of art and tangible assets held for investment purposes, is within the scope of Section 3051, Investments. Such investments are initially and subsequently measured at cost, less impairment (if any). All or part of any impairment would be subsequently reversed if events and circumstances dictate;

3. In limited circumstances, it may be appropriate for an entity to account for cryptocurrency assets in accordance with the guidance set out in Section 3031, Inventories, for commodity broker-traders. The default measurement approach in Section 3031 is to recognize inventories at the lower of cost and net realizable value; however, commodity broker-traders are required to measure their inventories at fair value less costs to sell, with changes in fair value less costs to sell being recognized in net income in the period of the change.

**Our thoughts**

Only the third view outlined above results in the cryptocurrency being accounted for at fair value through profit or loss, which many stakeholders believe it provides the most relevant information to financial statement users. However, in our view, the third accounting view outlined above would only be appropriate in narrow circumstances where cryptocurrency assets are acquired by the reporting entity for the purpose of selling them in the near future and generating a profit from fluctuations in price or broker-traders' margin.

## Cryptocurrency mining

Questions arise as to whether the transaction fees in the form of cryptocurrency earned by cryptocurrency miners, and the reward of newly created cryptocurrency, can be recognized as revenue. Section 3400, Revenue, defines revenue as "the inflow of cash, receivables or other consideration arising in the course of the ordinary activities of an enterprise, normally from the sale of goods, the rendering of services, and the use by others of enterprise resources yielding interest, royalties and dividends". Based on this definition, it may seem clear that the transaction fees would be considered revenue; however, there are differing views in practice regarding the treatment of the newly created cryptocurrency:

1. The newly created cryptocurrency is received as consideration for the miner's activity in maintaining the blockchain and, as such, is revenue;

2. The mining of cryptocurrency represents the creation of an internally generated intangible asset and the requirements of Section 3064 must be considered. The miner is inputting computing power, electricity and staff cost to build, or mine, an internally generated intangible asset (i.e., the cryptocurrency); therefore, no revenue or gain is recognized until the resulting cryptocurrency is subsequently sold.

**Our thoughts**

With the current lack of clear guidance, there is likely to be a large amount of diversity in practice as to what alternative accounting treatments may be acceptable for cryptocurrencies. Furthermore, as the use of blockchain technology evolves, more specific guidance is issued and more standardized industry practice is established. There may be changes in the current thinking around acceptable accounting treatments.

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