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How should **cryptocurrencies** be accounted for in the financial statements?

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Bitcoin, one of the best known crypto-currency, has stunned the world lately with its skyrocketing rises and precipitous drops in recent months.

While most trading activity is confined to individuals and some speculative funds, it will not be surprising if Bitcoin starts appearing in the balance sheets of companies.

How should Bitcoins be treated from the accounting perspective? Is it an intangible asset, cash balance or something else? Our analysis in this article will shed some light on this somewhat mysterious phenomenon.

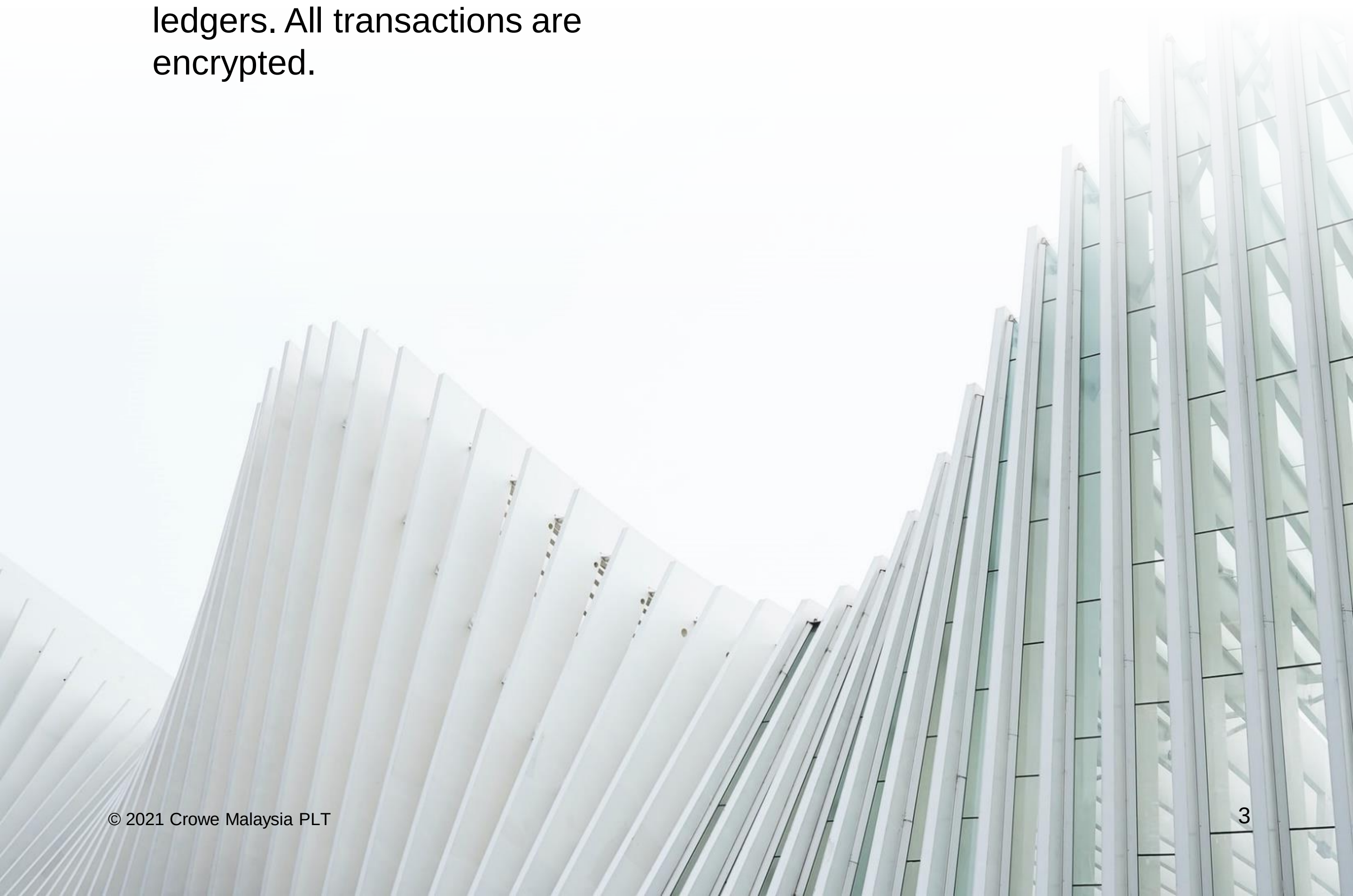
What is a crypto-currency?

“Crypto” means secret or concealed, hence, a crypto-currency is actually a secret currency! The modern version of a crypto-currency is in its digital form and usage. In technical terms, a cryptocurrency is a decentralised digital currency with no physical form.

Decentralised means the currency does not have a central monitoring authority after it is issued. Instead, transactions are recorded using ‘blockchain’ technology which makes use of distributed ledgers i.e accounting ledgers that record transactions in several computers in contrast to one computer for conventional ledgers. All transactions are encrypted.

Examples of popular cryptocurrencies are Bitcoin, Ethereum, Bulldog and Litecoin.

Even Facebook is going to launch its own cryptocurrency, Diem or previously known as Libra, in 2021.



Nature of crypto-assets for accounting purposes

Generally, investors record their investment in cryptocurrencies as an asset because it is a resource controlled by them and the investors can obtain future economic benefits from the consumption or realisation of the cryptocurrency held.

Crypto-assets which generally refer to crypto-currencies and related assets, have various terms and conditions. Some crypto-assets entitle the holders to receive goods or services upon their redemption, while others may allow the holders to trade the crypto-assets online using a designated platform.

The accounting treatment of the crypto-assets depends greatly on the purpose for holding the crypto-assets. The purpose can differ for different parties. For example, the issuer of the crypto-currency who has created the crypto-currency through its efforts, may view their crypto-currency created as inventory. Subsequent to the issue, the holders of crypto-assets who make use of these assets as a currency for purchase of goods or services, or for trading may treat it as cash.

Is crypto-currency cash?

Cryptocurrencies are mainly used as a medium of exchange for goods and services, to some extent like a currency. Unlike transitional currencies, cryptocurrencies are not issued and backed by any government and involve no central repository or central bank; hence, they are not recognised as legal tender (fiat money).
As a result, cryptocurrencies are not considered as cash.

Possible classifications of cryptocurrencies by holders

In June 2019, the IFRS Interpretations Committee published an agenda decision which clarified the appropriate accounting classification of the crypto-assets in the balance sheet of the holders. The table below summarises the possible classifications:-

Cash equivalents	MFRS 107 defines cash equivalents as ‘short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value’. Investment in cryptocurrencies are not cash equivalents because they are often subject to significant price volatility.
Financial asset	A financial asset is a liquid asset that gets its value from a contractual right or ownership claim eg bonds. Hence, a contractual relationship must exist when applying the definition of financial asset to cryptocurrencies. Crypto-assets are not financial assets because they do not give the holder a contractual right to receive cash or another financial asset. Also, they do not represent equity instrument of another entity like ordinary shares.
Prepayment	A prepayment is an advance payment of a debt or an expense. In this regard, a crypto-asset that entitles the holder to future goods or services rather than a right to receive cash or another financial asset is akin to a prepaid expense. However, if the holder does not intend to take delivery of the underlying goods or services, the classification as a prepayment may not be appropriate. In this case, the holder should consider the intangible asset guide below.
Intangible asset	An intangible asset is an identifiable non-monetary asset without physical substance. Generally, crypto-assets meet the definition of an intangible asset in MFRS 138 on the grounds that they are capable of being separated from the holder and sold or transferred individually; and they do not give the holder a right to receive a fixed or determinable number of units of currency due to variation in value.
Inventory	Inventories do not need to be in a physical form. Crypto-assets could be classified as inventory if they are held for resale and are actively traded in the ordinary course of business; for instance, broker-traders who buy or sell cryptocurrencies on their own account.

Subsequent measurement of crypto-assets

Intangible assets

We observed that most holders apply the revaluation model of MFRS 138 to their crypto-assets when they are held for investment purposes – by using their quoted market price in an active market. If there is no active market, the holder will need to apply the cost model to record the crypto-assets.

Under the revaluation model, any revaluation gain is reported in other comprehensive income and accumulated in equity and not profit or loss. When a revaluation deficit exists, the deficit will reverse the gain accumulated in the equity with any excess going to profit or loss. Upon disposal of the crypto-assets, any gain accumulated in the equity will be transferred to retained profits directly without passing through the income statement.

This would make the revaluation model unattractive for most entities. As a result, some argue that the existing intangible asset accounting does not work for cryptocurrencies and they are of the view that crypto-assets should be reported at their current fair value with changes in value going to profit or loss regardless why the assets are being held and their timing of realisation.

Inventories

When the crypto-assets are treated as inventory, the holders may apply the commodity broker-trader exception in MFRS 102 to measure them at fair value less cost to sell, with changes in fair value recognised in profit or loss rather at the lower of cost and net realisable value.

Possible classification of cryptocurrencies by issuers

It is common that cryptocurrencies are launched by issuers through an initial coin offering (“ICO”) fund raising exercise. Unlike share offerings, the issuer allocates cryptocurrency instead of shares to the investors or subscribers in an ICO.

In September 2018, the IFRS Interpretations Committee discussed the application of existing IFRS standards in accounting for cryptocurrencies issued in an ICO. The accounting of cryptocurrency issued is derived by the rights and obligations attached to the cryptocurrency and the guidance of the relevant accounting standards. The classification considerations of any cryptocurrency issued are analysed in the following page.

Possible classification of cryptocurrencies by issuers (cont.)

Cash equivalents

When an issuer is obligated to deliver cash or other financial asset to the crypto-currency holder in specific circumstances, then the issuer applies MFRS 9 “Financial Instruments” to account for that financial liability.

Equity instruments

A cryptocurrency issued can be an equity instrument when the crypto-currency holder is entitled to distributions paid by the issuer from its distribution reserves.

Prepayment received by issuer for goods and services to be delivered

When the issuer is contractually obligated to deliver goods or services to the crypto-currency holder at a future date either free-of-charge or at a discounted price, the proceeds received are to be accounted for under MFRS 15 as a contract liability (commonly known as deferred revenue).

Others

If the crypto-currency issued does not fall into any of the above categories, the issuer should apply the requirements of MFRS 108 in developing its own accounting policy that provides users of financial statements with the most relevant and reliable information.

Future Developments

Although the accounting for crypto-currency is not simple and varies between transactions, the standard setters are unlikely to develop a separate accounting standard to fit all situations when it comes to crypto-currency.

Meanwhile, IASB does not consider standard-setting for holdings of cryptocurrencies or for ICOs because these matters are not prevalent among the IFRS financial statement preparers. Nevertheless, the guidance published by the IFRS Interpretations Committee above, to a limited extent, helps entities to apply appropriate accounting treatment for the cryptocurrencies held under MFRS.

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