

Overview on EFRAG Research: Accounting for Crypto-Assets (Liabilities)

Crypto-assets came into existence with the launch of bitcoin in 2009. This was in the aftermath of the global financial crisis, where some market actors sought to disrupt the financial system by providing alternatives to fiat currencies and aimed to avoid the dependence on intermediaries.

Crypto-assets are a by-product of innovation in technology and finance and are based on cryptography, distributed ledger technology and decentralised networks. Cryptography allows the creation of unique digital signatures for every transaction and avoids the “double spend” problem. It enables the digital representation of value and digital scarcity.

Spiking interest

Since the early days over a decade ago when two pizzas were bought for 10,000 units of bitcoin (equal to USD 35 at the time and USD 600 million as at March 2021), there has been a rapid evolution in the crypto-asset market. There have also been booms, busts and recoveries in the related market capitalisation levels. In 2020 and 2021, several high-profile large corporations, institutional investors and financial institutions initiated or increased their individual holdings in bitcoin as a store of value or as a hedge. In addition to bitcoin, there is diversity in types of crypto-assets (currently 6000+)- many being similar to bitcoin, but there are also new and diverse economic use cases.

Besides the economic use cases attracting a growing number of market participants, the unique and risky nature and growth potential of crypto-assets has also drawn the attention of National Standard Setters (NSS), and policymakers (EC, IMF, FSB, OECD, EBA, ESMA, IOSCO, ECB). There is a wealth of publications from these stakeholders addressing related questions including on investor and consumer protection and on necessary accounting requirements.

There are also ongoing initiatives to enhance regulation across the globe including proposals at an EU level through the Markets in Crypto Assets (MiCA) regulation. Accounting requirements can be seen as part of the overall regime of regulation as they enable the transparency of companies that buy, issue or hold crypto-assets. In 2019, the IFRS Interpretation Committee (IFRS IC) issued an agenda decision that clarified the accounting requirements for a subset of crypto-assets (i.e., cryptocurrencies where there is no claim on the issuer such as bitcoin) ought to be classified as either intangible assets or inventories if held in the course of normal business and fall within the scope of IAS 38 *Intangible Assets* or IAS 2 *Inventories*. In addition, several NSS, accounting professional bodies, audit firms, academics have published papers highlighting various areas where there are challenges in the accounting for crypto-assets transactions.

EFRAG Discussion Paper

To contribute to the debate on related accounting requirements, in July 2020, EFRAG published a Discussion Paper on Accounting for Crypto-Assets (Liabilities) (DP) that was developed as part of the EFRAG proactive research agenda. The DP is intended to inform the forthcoming IASB agenda consultation process. It has a broader scope than the aforementioned IFRS IC agenda decision and it covers holders, issuers accounting and valuation considerations.

The DP addresses three common categories of crypto-assets, namely: payment tokens or cryptocurrencies, which are used as a means of exchanges; utility tokens, which grant rights to access or consume network goods or services, and investment tokens, which are comparable to securities. It also includes hybrid tokens that combine the features of payment, utility or investment tokens; and stable coins, which are designed to minimise the price volatility associated with different crypto-assets. The DP encompasses a problem definition by providing an analysis of the crypto-ecosystem (economic characteristics, rights and obligations, and regulatory regimes) and an in-depth analysis of the current gaps in accounting requirements for both holders and issuers.

The DP points to the accounting challenge arising from the unique characteristics and multi-purpose use of different crypto-assets. While primarily meant to be a means of exchange (payment tokens), cryptocurrencies such as bitcoin have volatile prices and are often held as a *de facto* trading asset (i.e., for capital gains). Yet the measurement requirements under IAS 38 do not allow Fair Value through Profit or Loss (FVPL) and IAS 2 only allows FVPL if these are held in the ordinary course of business (e.g., by brokerages). As such, entities can fail to reflect price movements of their holdings in reported performance. Of note is that IAS 38 and IAS 2 were not written with crypto-assets in mind. The DP highlights the broader challenge arising from the lack of guidance whenever non-financial assets other than property or other digitised rights are held as investments (e.g., commodities, emission trading rights). The DP also identifies challenges with classification of crypto-assets as financial assets and the need to consider the IFRS definition of cash or cash equivalents in light of the emergence of central bank digital currencies (CBDCs) and fiat-currency-pegged stable coins.

For issuers, the DP identifies areas that need clarification including IFRS 9 *Financial Instruments*; IAS 32; IFRS 15 *Revenue from Contracts with Customers*; and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. It also identifies the need for clarification of IFRS 13 *Fair Value Measurement* guidance for the valuation of crypto-assets.

As a way forward, the DP proposes three overall approaches for addressing IFRS related requirements, namely:

- do nothing, with preparers relying on existing IFRS requirements;
- update existing requirements - amend or clarify existing applicable requirements for holders and issuers;
- develop a new Standard with explicit requirements for the accounting for crypto-assets (liabilities).

The DP also proposes an emphasis on economic substance while thinking of the accounting requirements regardless of the rapid pace of technological innovation within the crypto-market (i.e., there is a need to consider what is in the container rather than the container).

Outreach on EFRAG DP

From Q4 2020, EFRAG has been undertaking an ongoing outreach to seek stakeholders' views on the DP's proposals for possibly developing IFRS requirements and for feedback on the identified areas for possible amendment or clarification of existing IFRS requirements. The outreach is being targeted across key markets and is being conducted through interviews, questionnaires and presentations (e.g., IFASS, ASAF, IMA Conference in France, EACB, European Accounting Congress virtual workshops). The DP has also been translated into Japanese by the Accounting Standard Board of Japan (ASBJ).