IFRS Issues presented by Crypto-Assets

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IFRS Issues

- Digital currencies and tokens – classification and measurement
- Crypto miners – revenue recognition, classification of costs, estimates
- Initial coin offerings (ICO's) – revenue recognition
- Ability to audit – Exchanges are often start-ups themselves without the systems to provide transaction records similar to banks

New issues are being identified constantly as the technology evolves. Today we will primarily discuss digital currencies.

Potential Classification for Digital Currencies

- Cash and cash equivalents (IAS 7)
- Financial instruments other than cash (IAS 32)
- Intangible assets (IAS 38)
- Inventory (IAS 2)
- None of the above (IAS 1, paragraph 19) – CPA Canada has indicated application of this standard is not appropriate in accounting for cryptocurrencies

Digital Currency Classification – Cash or other Financial Instrument?

Cash and Cash Equivalents

- Demonstrates characteristics of a medium of exchange, however lacks broad acceptance (at present)
- Enables users to buy goods or services
- Observable markets for the major crypto currencies (Bitcoin, Etherium, Litecoin)
- Not issued by a central bank
- Not a cash equivalent because the value is exposed to significant changes in market value

Digital Currency Classification – Cash or other Financial Instrument? cont'd

Does not meet definition as Financial Instrument under IAS 32

- Lack of contractual relationship that results in a financial asset for one party and a financial liability for another.

Neither classification appears to be appropriate.

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Digital Currency Classification – Intangible Asset (IAS 38)

- Meets the definition as an Intangible Asset because a digital currency is an identifiable non-monetary asset without physical substance
- Cost Model – Carried at cost less any accumulated amortization and any accumulated impairment losses
- Revaluation Model – Carried at fair value (provided there is an active market)
  - Specific guidance provided under IAS 38 as to whether gains/losses go through OCI or P&L (generally gains go to OCI and losses to P&L, with the exception to offset amounts that have already been recognized due to prior gains and losses)

However, there is an exception! Paragraph 3 of IAS 38 has a scope exception for intangible assets held for sale in the ordinary course of business. Such intangibles are subject to IAS 2 Inventories…

Digital Currency Classification – Inventory (IAS 2)

- Questions surrounding how "held in the ordinary course of business" should be applied. I.e.: Accepting digital currencies as a payment form is not necessarily meeting the standard
- Inventory is carried at lower of cost and net realizable value
- Scope exception for broker-traders who measure inventories at fair value less costs to sell, with changes in fair value recognized in profit or loss
- Broker-traders are those who buy or sell commodities for others or on their own account. There remains debate as to whether digital currencies are commodities

For now Digital Currencies should be classified as either Intangible Assets or Inventory depending on the business model.

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Other Accounting Issues Currently under Debate

- How to classify tokens?
- When should revenue be recognized for an ICO?
- When should revenue be recognized for a crypto miner?
- Capitalization of costs up until mining rigs reach intended production levels
- Amortization of mining rigs and useful life

Auditing Issues

Crypto Miners

- Verification that digital currencies received from mining were actually the result of mining and not illegal activity

Digital Currency Trading

- Valuation of thinly traded crypto assets
- Availability of source documents from exchanges
- Lack of ability to send confirmations to exchanges/custodians
- Completeness of reporting