

# point of *view*

## *Cryptocurrencies* Time to consider plan B



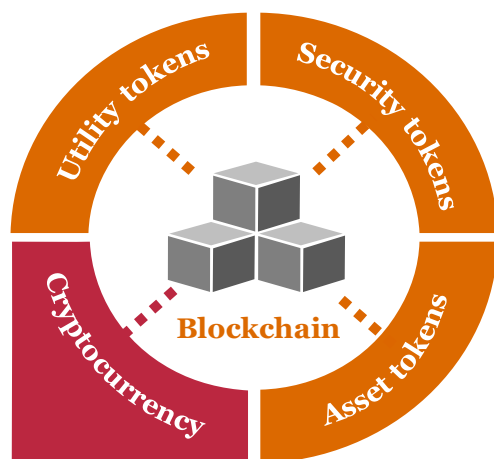
### **Cryptocurrency – despite its name – is not accounted for as currency**

- Digital tokens are built on a distributed ledger infrastructure often referred to as a “blockchain.” These tokens can provide various rights. Cryptocurrency is a type of digital token, and is designed as a medium of exchange. Other digital tokens provide rights to use assets or services, or in some cases represent ownership interests.
- Cryptocurrencies, including Bitcoin, are generating a significant amount of press given their rapid increases in value and extreme volatility. Because of this volatility, the value of Bitcoin in circulation has recently fluctuated between \$100 and \$300 billion. While investment activity in cryptocurrency is relatively small when compared to the overall financial markets, it has attracted significant regulatory scrutiny across multiple jurisdictions.
- Under the current US accounting framework, cryptocurrency is not cash, currency, or a financial asset; rather, it should likely be accounted for as an indefinite-lived intangible asset. The implication of this model is that declines in the market price of cryptocurrencies would be included in earnings, while increases in value beyond the original cost or recoveries of previous declines in value would not be captured.
- We believe that measuring cryptocurrencies at fair value, with changes in fair value recognized in earnings, better reflects their economics. We applaud the FASB for researching this topic in consideration of potential standard-setting and encourage them to undertake a project to consider the accounting for cryptocurrencies.

# Overview of tokens, cryptocurrencies and blockchain

## What are digital tokens?

Digital tokens come in a variety of forms, and new tokens are emerging almost daily. The function of these digital tokens vary. Some are designed to function as a digital medium of exchange. These are commonly referred to as “digital currency” or “cryptocurrency.” Others provide a right to use a product or service and may be referred to as “utility tokens;” whereas “asset tokens” provide for rights to obtain assets. Still others, known as “security tokens,” may entitle holders to voting rights and/or rights to profits/losses. However, the distinction between types of tokens can oftentimes be blurry.



Digital tokens are built on a common distributed ledger infrastructure, often referred to as a “[blockchain](#),” that allows the transfer of tokens to be validated by members of the token network.

**Blockchain and cryptocurrency, such as Bitcoin, are not synonymous.** Rather, blockchain is the underlying technology that facilitates the creation and transfers of digital tokens, including cryptocurrency.

## Regulation of digital tokens

Digital tokens can be initially funded through offerings, referred to as “[initial coin offerings](#)” (ICOs). ICOs are attracting regulatory scrutiny. The SEC has stated that initial issuances of certain tokens may be required to be registered under securities law and that regulatory matters related to ICOs will be an enforcement priority for 2018.

**History also has proved that transparency, investor protection and market integrity are critical to ensuring that innovation continues. But today we are seeing substantial [distributed ledger technology]-related market activity that shows little or no regard to our proven regulatory approach. This concerns us.**

Jay Clayton, SEC Chairman

The US and other international governments have also raised concerns regarding cryptocurrencies. Given the recent volatility, governments around the world continue to consider if and how cryptocurrencies can be regulated.

## How are cryptocurrencies obtained?

There are two general methods by which cryptocurrency is obtained:

- Purchased or received from a counterparty directly or through an unregulated exchange; or
- Created through a process called mining. “Miners” are rewarded with cryptocurrency units when they successfully solve complex mathematical problems that allow for the addition of a group of valid transactions (i.e., a “block”) to the distributed ledger (i.e., the blockchain).

# The accounting possibilities for cryptocurrency

Mining can generate new units of cryptocurrencies. However, this method of cryptocurrency creation continues to evolve. This type of mining also requires significant energy consumption (creating environmental concerns), and transaction fees, and requires substantial processing capacity, among other concerns.

## *Is the accounting for all digital token types the same?*

The rights and preferences of the different types of digital tokens vary widely. Accordingly, a one-size-fits-all accounting model is not practical.

It's fair to say that current accounting standards did not contemplate digital tokens. However, given the relative similarities among cryptocurrencies, it may be possible to fit them into an existing accounting model. Notwithstanding this, such models may not result in the best representation of the unique economics of cryptocurrency.

## *Fitting cryptocurrency into today's GAAP*

1

### *Cash, cash equivalents, and foreign currency*

Because cryptocurrencies are generally not accepted as legal tender, and are not backed by a government, they do not qualify as cash.

Cryptocurrencies are also not cash equivalents because they are not investments that are either (1) readily convertible to cash or (2) so near their maturity that they have insignificant risk.

Similarly, cryptocurrencies do not meet the definition of foreign currency as they are not cash.

2

### *Financial instrument*

Because cryptocurrencies do not represent the contractual right to receive or exchange cash or a financial instrument, they are not financial instruments.

3

### *Commodity*

"Commodity," while used throughout the accounting standards, is neither a defined term, nor does it have special accounting treatment. Rather, commodities are generally accounted for as inventory.

4

### *Inventory*

Cryptocurrencies are often purchased or mined with the intent to sell them. Thus, cryptocurrencies may meet some of the characteristics of inventory. However, as cryptocurrencies are not tangible assets, they may not meet the definition of inventory.

5

### *Intangible asset*

This is the widest of the definitions. Intangible assets are those that lack physical substance. Cryptocurrencies inherently lack physical substance and, therefore, fall within this definition. Further, as cryptocurrencies have no prescribed life, they would be classified as indefinite-lived.

## *Accounting considerations*

Cryptocurrencies meet the definition of an intangible asset. This model results in holdings of cryptocurrencies being recorded at the cost of acquisition, subject to impairment. That is, the model will only capture declines in the value of the cryptocurrency, not increases.

When cryptocurrency is purchased, the intangible asset would be measured at the price paid or consideration given to obtain the cryptocurrency. However, the question for miners is more complicated. Unlike a direct purchase, miners are awarded units, but they incur costs of computing equipment, electricity, and other expenses. At issue for the miners is whether the associated costs should be capitalized as an intangible asset or expensed.

# What are the implications of the current accounting model?

There is not a lot of guidance on accounting for the costs incurred to internally-develop intangible assets, but it generally limits capitalization. Notwithstanding, existing guidance may not preclude capitalization for certain costs incurred by miners to obtain cryptocurrencies. Miners may need to analogize to other areas of US GAAP where explicit guidance exists (e.g., internal-use software or film production).

Further challenges associated with the intangible asset model relate to post-acquisition or creation accounting, including when to test for impairment. As the prices of many cryptocurrencies are currently driven by speculative interests, there is significant volatility in cryptocurrency markets. Given these rapid changes in value, practical challenges loom over judgments associated with when the intangible assets are “more likely than not” to be impaired.

## *Our proposal*

While it is possible to fit cryptocurrency into the existing accounting model for intangible assets, this model does not best reflect the economics of these unique assets. Unlike other intangible assets that are measured at cost (unless impaired), the fundamental nature of cryptocurrencies is different. While these assets have no physical substance, many are traded on exchanges (unlike other intangibles), are designed to be accepted as payment for other goods and services (which is infrequent for intangibles), and subject to significant volatility.

We believe that a fair value measurement model, with both realized and unrealized changes reflected currently in the income statement, will best represent the economics associated with holding cryptocurrencies.

Further, we believe that the disclosures that accompany fair value measurements will provide useful information to stakeholders. This will allow financial statement users with current information to monitor cryptocurrency holdings, including the valuation techniques and observable and unobservable inputs used to derive fair value.

## *A call to action*

Given the current accounting and reporting framework did not contemplate cryptocurrencies, US standard setters and regulators have an opportunity to proactively provide guidance on a potentially transformative issue. Given the relative similarities found among cryptocurrencies, we encourage standard setters to tackle this issue and develop an accounting framework for cryptocurrency holdings, including the costs related to “mining” efforts.

## *In the meantime...*

We encourage entities with material cryptocurrency holdings to provide transparent disclosures concerning the reporting of cryptocurrencies and the entity’s risk exposure to such assets. If an impairment occurs and the asset is remeasured to fair value, robust fair value disclosures should be included. For entities that file with the SEC, additional non-financial statement disclosures should be considered, such as the impact of cryptocurrency holdings on capital resources and liquidity and related risk factors.

### Contact Information

To have a deeper discussion about our point of view on cryptocurrency, please contact:

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