Hot Topic: Digital assets

Constituents to FASB: Crypto asset accounting guidance urgently needed

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Investors, preparers and practitioners suggest fair value measurement and other changes to US GAAP for crypto assets

Introduction and background

There is presently no explicit US GAAP for 'crypto assets' or other digital assets. KPMG Executive Summary, *Accounting for crypto assets – entities that are not broker-dealers or investment companies* (the KPMG Executive Summary), defines 'crypto asset' within the larger realm of digital assets and provides a high-level overview of the accounting for crypto assets that meet the definition of an intangible asset under US GAAP.

In July 2021, the FASB issued its Invitation to Comment, *Agenda Consultation* (the ITC). The comment period ended in September 2021. More than 500 comment letters were received. With respect to crypto and other digital assets, the ITC asked respondents three questions specifically about digital assets (summarized).

— The first (Question 10 in the ITC) asked investors to provide information about the significance of digital assets to the companies they analyze. It further asked them about the information they receive from companies concerning these assets and the usefulness of that information. Lastly, it asked them what other information would be decision useful to them, and why.

— The second (Question 11 in the ITC) asked preparers and practitioners whether they or their clients hold significant amounts of digital assets, and if so, for what purpose(s).

— The final question (Question 12 in the ITC) asked all stakeholders what improvements should be made to US GAAP with respect to the accounting and reporting for digital assets, and of those, which were most important.

In addition to those questions, the ITC invited respondents to comment on which new or existing projects should take priority for the FASB (Question 2 in the ITC).

This Hot Topic summarizes the feedback received by the FASB to these questions and provides example comments furnished by ITC respondents. Our summary is not exhaustive to every comment provided to the FASB related to crypto or other digital assets.

In a snapshot

Accounting for and reporting of crypto and other digital assets received the most comments of any topic by respondents to the ITC. Of the more than 500 comment letters received by the FASB, over 400 solely commented on the accounting for crypto assets. However, nearly three-quarters of those who solely commented on crypto asset accounting expressed their views by reference to the comments of a single US public company significantly invested in bitcoin.

Nearly all the ~500 digital asset commenters suggested the FASB undertake a project to require or permit crypto assets with a 'readily determinable fair value'[1] like bitcoin to be measured on a recurring basis at fair value, with realized and unrealized gains and losses recognized in current period earnings. Principally, these respondents commented that the ASC 350-30 indefinite-lived intangible asset accounting model results in accounting and reporting that is not decision-useful to investors and other users of the financial statements because it does not reflect the economic nature of these assets or companies' reasons for investing in them.

Opinions differed about whether fair value measurement should be required or optional for those crypto assets. In addition, there was diversity in views about how the FASB should enact fair value measurement. For example, some suggested amending ASC 350-30, and thus implicitly retaining crypto assets in its scope, while others suggested either (1) creating a new ASC Topic or Subtopic for crypto assets or (2) scoping crypto assets into existing financial assets or financial instruments guidance.

Most digital asset commenters suggested the FASB undertake a narrow, initial project, focused on crypto assets currently accounted for under ASC 350-30, and in particular their subsequent measurement, before tackling the accounting for other types of digital assets. Many of those respondents stated that they believe this would permit the FASB to tackle the most pressing issues in a timely manner.

While respondents generally suggested that the FASB collaborate with the IASB on the accounting for crypto assets, and digital assets more broadly, many suggested that the FASB should move forward timely on improving US GAAP accounting and reporting for crypto assets *with or without* the IASB.

KPMG observation: KPMG's digital asset comments were generally aligned with the positions summarized above. In those areas of diverse opinion, we (1) suggested that recurring fair value measurement of crypto assets with a readily determinable fair value should be required, and (2) expressed our view that the simplest and quickest path to accomplish this, without unintended consequences, is to continue to classify these assets as intangible assets, treating them as a subset for which fair value measurement is required. We encourage the FASB to work closely with the IASB to develop a converged crypto asset accounting model if possible, but believe the FASB should proceed with its own improvements if it cannot expeditiously convince the IASB to follow.

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[1] FASB ASC Section 321-10-20.

ITC Comments – while you hold a crypto intangible asset

The 'While you hold a crypto intangible asset' section of the KPMG Executive Summary summarizes the accounting for crypto intangible assets while an entity holds them under current US GAAP.

It appears that *all* the ITC respondents who commented on digital assets commented on the accounting that should be applied to crypto assets while they are held by an entity. This section summarizes that feedback.

Unsatisfactory current 'while you hold' model

Respondents expressed almost universal dissatisfaction with the cost-less-impairment measurement model generally applied to crypto intangible assets presently. Respondents noted this asymmetric subsequent measurement model does not provide decision-useful information to investors, or appropriately reflect the economics of a holder's investment in crypto assets like bitcoin or ether.

"…the existing indefinite-lived intangible accounting model being applied to digital assets does not provide investors, analysts, or the general public with the information they need to make an informed assessment of an entity's current and future prospects. As outlined above, the current accounting model required by ASC 350 can create a significant disconnect between the carrying value of an entity's digital asset holdings presented on its balance sheet and the economic reality of the entity's financial condition and can provide a contradictory view of an entity's business operations to investors."

—Public company preparer with significant crypto asset holding

"Accounting for digital assets as an intangible under ASC 350…does not appropriately reflect the true underlying economics of the instrument – as a form of currency…Investors must look to a company's Non-GAAP disclosures to understand the impact these digital assets have on their results of operations.

—Parent of, and investor in, crypto asset companies

KPMG comments: "For crypto assets, such as bitcoin and ether, we believe there is an emerging consensus that the present accounting does not provide decision-useful information to investors, or appropriately reflect the effect of these assets on the holder's financial position."

Respondents further observed that crypto intangible assets like bitcoin or ether are fungible, and do not generate cash flows other than through their sale or exchange for goods, services or other assets. In many cases, that rate of exchange is observable in the marketplace and subject to significant volatility – up *and* down. These factors make fair value the most relevant and faithful measurement attribute for those assets and differentiate them from other intangible assets for which the indefinite-lived intangible asset model was designed.

Some respondents noted that the absence of fair value reporting for crypto assets has been met in the short run by investor requests for non-GAAP financial measures and disclosure. However, they further noted that those disclosures do not rectify the misleading economic picture created in the financial statements by the current cost-less-impairment measurement model.

"For example, there are already multiple public companies that are not allowed to measure their digital assets at fair value and therefore continuously write down to [sic] the asset to its lowest reported price in each reporting period. These entities have GAAP reporting that does not accurately capture the performance of their investment and investors must look to their Non-GAAP disclosures to understand the impact these investments have on their results of operations."

—*Digital currency asset manager*

KPMG comments: "Companies with material holdings of crypto assets generally provide significant non-GAAP disclosures (e.g. of balance sheet date/current market value, and income measures exclusive of crypto asset impairment losses or inclusive of unrecognized gains) to help investors understand the true, economic effect of their crypto asset holdings on their financial position and performance. The extent of these non-GAAP disclosures, often at the request of the Company's investors, indicates that the current GAAP accounting may not result in decision-useful information nor reflect the economic substance of digital assets."

Fair value measurement

Nearly all of the more than 500 digital asset commenters suggested the FASB undertake a project to either require or permit crypto intangible assets like bitcoin or ether – i.e. those crypto intangible assets with a 'readily determinable fair value' (or similar)[2] – to be measured on a recurring basis at fair value, with realized and unrealized gains/losses recorded in current period earnings. Many of those respondents suggested that the current cost-less-impairment model is appropriate, and therefore should remain, for crypto assets that do not have a readily determinable fair value.

"We believe that a fair value measurement model, with both realized and unrealized changes reflected in the income statement, would best represent the economics associated with holding digital assets for which there is an active market… Alternatively, the intangibles model could be amended to more closely align with IFRS. Under IFRS, intangible assets are initially measured at cost. However, a company may elect to subsequently measure an intangible asset at fair value when fair value can be determined by reference to an active market."

—*Public accounting firm*

"…the Association urges FASB to develop an accounting standard that allows entities the option to elect to mark digital assets to fair value"

—*Industry trade group*

"For crypto assets that do not meet the criteria for having a fair value that is readily determinable, the measurement should be cost less any impairment."

—*Public accounting firm*

"For all other crypto assets (i.e., those without a "readily determinable fair value"), the Board could consider no change to the existing accounting

[2] Some respondents suggested that, for purposes of crypto assets, 'readily determinable fair value' could include prices for crypto assets as quoted on exchanges that have a significant breadth and scope.

model. These crypto assets could continue to be subject to the current impairment model under ASC 350."

—Public company digital asset industry preparer

KPMG comments: "It is our view that these assets [digital assets with a 'readily determinable fair value'] should be measured on a recurring basis at fair value, with realized and unrealized gains/losses recognized in current period earnings… We are not in favor of this proposed accounting being optional because we believe (1) optionality creates a lack of comparability that puts financial statement users at a disadvantage and (2) fair value measurement is the appropriate measurement basis for crypto assets."

Recovering impairment losses

A few respondents, including KPMG, suggested that if the FASB does not require or permit fair value measurement of crypto assets with a readily determinable fair value that it should, at least, permit entities to recover previously recognized impairment losses. We observed that IFRS Standards (IAS 36 (asset impairment)) require recoveries of an impaired intangible asset to be recognized.

Classifying crypto assets

Respondents offered varied suggestions about how crypto assets should be classified. Suggestions included:

- **Cash or cash equivalent.** Adopt fair value measurement for crypto assets on the basis that they are used in the same manner as other fiat currencies (e.g. USD, EUR).
- **Financial asset or financial instrument.** Scope crypto assets into the existing financial assets/instruments guidance; this would make them eligible for the fair value measurement option in ASC 825 (financial instruments).
- **'Special' (or subset of) intangible assets.** Enacting recurring fair value measurement but leaving most crypto assets classified as intangible assets means entities would not have to revisit other accounting conclusions unrelated to subsequent measurement (e.g. the model to apply to sales of crypto assets).
- **New, unique asset class.** Designating crypto assets as its own unique asset class may avoid unintended consequences that could result from trying to wedge crypto assets into any of the existing asset classes some have suggested (e.g. cash, cash equivalents, financial instruments).

"Digital assets with readily determinable fair values are used as currencies and as such, companies who hold digital assets with a readily determinable fair value should fair value those assets at the end of each reporting period akin to other currencies…If a currency conclusion cannot be reached, then at a minimum, digital assets, such as Bitcoin and Ethereum, should be considered financial instruments or financial assets…"

—Parent of, and investor in, crypto asset companies

"We recommend the Board consider following a path similar to Japanese GAAP by declaring these assets a separate asset class, that would follow its own accounting rules for recognition, derecognition, measurement, etc."

—Accounting consultancy

> “Digital assets are a novel and unique asset-type and we believe it will require a novel approach to accounting. The accounting for digital assets should be stand-alone and not apply to nonfinancial assets, in our view.”
>
> —*Credit rating agency*

KPMG comments: “We are aware that some believe that this proposed accounting should be accomplished by treating these assets as a special type of intangible asset, while others would suggest treating crypto assets as their own class of asset or some type of financial asset. While arguments can be made for different approaches, we believe it may be most practical to treat these assets as a subset of intangible assets for which fair value measurement is required.”

Financial statement presentation and disclosure

While not a significant area of comment, a few respondents specifically commented on financial statement presentation and disclosure. The following comments reflect feedback we have also heard from stakeholders in different forums.

— Impairment losses and sales gains on crypto assets held by commercial entities for investment purposes should be presented as nonoperating income (loss) items in the income statement.

— The presentation and disclosure of crypto assets and crypto asset transactions should follow the entity’s purpose and intent for acquiring and holding the crypto assets.

ITC comments on prioritization

In urging the FASB to make crypto asset accounting a *priority* project, some respondents highlighted that, beyond accounting for crypto assets, diversity in accounting practice tends to broaden the longer there is no governing, authoritative guidance. In addition, many noted that the transition to new, authoritative guidance – if the new guidance does not codify a *prevailing* practice – becomes more costly and difficult for preparers (and investors) as practices that differ from the new guidance become more entrenched and/or widespread.

> “the longer that there is no formal guidance, the more difficult the transition for financial statement preparers and users. We encourage the FASB to address the following topics as priority projects.”
>
> —*Public accounting firm*

Other respondents directly addressed the notion that crypto asset accounting issues should not be a priority because they are not yet ‘pervasive’, citing that it is important to establish US GAAP in this new area *before* significant issues with respect to application and diversity become pervasive.

> “We recommend that the FASB begin a project on accounting for digital assets immediately; waiting until they become pervasive in financial reporting may put the FASB so far behind, they may never catch up.”
>
> —*Investor group*

Meanwhile, some respondents looked to preempt any conclusion that crypto asset transactions are not yet pervasive enough to warrant FASB action. These respondents noted that crypto asset transactions and adoption are prevalent *now*, and also much more so than when the FASB last debated undertaking a project on crypto asset accounting (Fall 2020). At least one respondent specifically cited a number of statistics in support of this assertion.

"**Pervasiveness of crypto assets**

Crypto assets (and digital assets, more broadly) have become much more prevalent since the Board considered a targeted project in late 2020 as evidenced by the following observations:"

— *Public company digital asset industry preparer*

"With the rapid growth and adoption of digital assets, it is crucial that entities apply accounting guidance that better reflects the economic realities and provides more accurate and meaningful information to investors and users of financial statements."

— *Private company digital asset industry preparer*

KPMG comments: KPMG identified the accounting for crypto and other digital assets as one of the four projects the FASB should prioritize, citing, principally, the lack of decision-useful information provided to investors and other financial statement users by the current accounting for crypto assets.

Other ITC comments on crypto asset accounting

Comments on the accounting that should apply to held crypto assets, and the priority nature of such a project, were by far the most pervasive of the ITC comments on crypto asset accounting. Nevertheless, many respondents commented on other aspects of crypto asset accounting. The following are examples of other ITC comments.

Sale/derecognition of crypto assets

The 'When you sell a crypto intangible asset' section of the KPMG Executive Summary summarizes the accounting for sales of crypto intangible assets under current US GAAP.

Comments about the accounting for the sale (or other transfer – e.g. in a lending scenario) of crypto assets included the following (not exhaustive).

— The sale and derecognition model in ASC 606 (revenue from contracts with customers) and ASC 610-20 (gains and losses from the derecognition of nonfinancial assets) presently applied to sales (transfers) of most crypto assets may not be appropriate to crypto sales or rapidly proliferating crypto asset lending and borrowing transactions. The FASB should consider whether another model – e.g. that in ASC 860-20 (sales of financial assets) – would be more appropriate, even if crypto assets are not classified as financial assets or instruments.

— An average costing method when calculating the gain or loss on the sale of a crypto asset should be permitted. In suggesting this, one respondent articulated the view that tracking the cost basis of each unit (or fractional unit) is onerous and that using an average costing method would better reflect the economics of a sale of only a portion of an entity's overall holdings of a fungible crypto asset like bitcoin. This respondent further noted that this would enhance consistency for crypto trusts with its commodity trusts, which use an average costing method to record gains and losses on commodity investments.

— Whatever model the FASB adopts should mandate accounting symmetry between the buyer (transferee) and seller (transferor). That is, the sale/derecognition model should not permit a buyer (transferee) to recognize a sold (transferred) crypto asset if the seller (transferor) does not derecognize that crypto asset.

Initial recognition and measurement

While not a frequent area of comment, a few respondents identified *initial* recognition and measurement of crypto assets in certain scenarios as an issue area for the FASB to address. For example, one respondent suggested the FASB should address whether the creator of a crypto asset should measure its holdings of that crypto asset at fair value.

We have observed this question arise, without a clear answer in US GAAP or in practice, for the creator of a decentralized blockchain network that has substantial holdings of the blockchain's native token.

Expanding the scope of ASC 940 on broker-dealers

Some entities' crypto asset activities are akin to that of a broker-dealer for crypto assets. However, they often cannot apply ASC 940 (brokers and dealers) because they are not registered (i.e. with the SEC or FINRA[3]) broker-dealers and the relevant crypto assets do not meet the definition of a 'security' under applicable securities laws.[4] This results in accounting that often does not reflect the entities' broker-dealer-like activities with respect to crypto assets.

Permitting these entities to apply ASC 940 may result in more economically reflective and comparable (to securities broker-dealers) accounting than that applied by these entities currently.

> "The industry-specific guidance reflects how broker-dealers typically operate and provides accounting and reporting that better portrays the financial results of these entities. For example, the specialized guidance for broker-dealers provides, among other items, (1) subsequent measurement of a broker-dealer's proprietary inventory at fair value, (2) accounting for commissions and agency transactions, (3) accounting for certain broker-dealer liabilities, such as fails to receive and sold but not purchase, (4) accounting for assets held for customers in a custody relationship and (5) specific financial statement presentation requirements."
>
> — *Public company digital asset industry preparer*

ITC comments – digital assets other than crypto assets

Many respondents suggested that the FASB focus on the accounting for crypto assets before attempting to craft guidance for other digital assets. In their view, a project encompassing digital assets beyond 'crypto assets' could be more difficult to scope and complete than a narrowly tailored project to improve the accounting for crypto assets. It may also give rise to unintended consequences should some of the digital assets meet the definitions of asset classes for which there is extensive,

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3 Financial Industry Regulatory Authority (FINRA)

4 FASB ASC paragraph 940-10-15-2 states that ASC 940 "provides guidance for all entities that are brokers and dealers in securities."

existing US GAAP (e.g. financial assets or instruments). These respondents did not want a broader digital assets project to delay or scuttle a crypto asset project.

That said, most suggested the FASB should still undertake a broader digital assets project on a separate track from one focused on crypto assets. Such a project might address issues around non-fungible tokens (NFTs), stablecoins and central bank digital currencies (CBDCs), and any others that might arise between now and such project's completion. Some respondents further suggested that issues around the accounting for NFTs may also apply to other intangible assets like renewable energy credits and emission allowances/credits that are actively traded or held for investment purposes; therefore, the FASB might consider tackling those issues together.

For further information

See KPMG Executive Summary, *Accounting for crypto assets – entities that are not broker-dealers or investment companies*, and other digital asset Hot Topics.

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