HOT TOPIC

Digital assets

Lenders' accounting for crypto intangible asset loans

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KPMG summarizes recent views expressed by the SEC staff about how lenders should account for crypto intangible asset loans.

Two KPMG Executive Summaries provide a high-level overview of the accounting for 'crypto assets' that meet the definition of an intangible asset under US GAAP (crypto intangible assets):

- Accounting for crypto assets – entities that are not broker-dealers or investment companies; and
- Accounting for crypto assets – investment companies.

There is currently no explicit US GAAP that directly addresses the accounting for digital assets, including crypto asset lending. However, there was *nonauthoritative* guidance in Question 25 of the AICPA Practice Aid, Accounting for and auditing of digital assets (the AICPA Guide)[1] around lenders' accounting for crypto intangible assets (e.g. bitcoin, ether) loans that many lenders have applied to date in the absence of authoritative guidance.

In this Hot Topic, we summarize recent guidance provided by the SEC staff about lender accounting for loans of crypto intangible assets. The SEC staff's views differ from the guidance previously included in the AICPA Guide in important respects.

The consultations with the SEC staff of which we are aware explicitly related to crypto intangible asset lending scenarios. Therefore, the views and analysis explained in this Hot Topic do not attempt to address SEC staff views in any other scenario, including loans of crypto assets not accounted for as intangible assets under US GAAP.

Background

Question 25 of the AICPA Guide presents a crypto intangible asset loan fact pattern (the Question 25 example). The following are the key facts presented.

- Lender lends 100 units of crypto asset ABC to Borrower for a fixed term of six months, at the end of which Borrower is required to deliver 100 units of crypto asset ABC back to Lender.
- Borrower is required to pay a loan fee in arrears of one unit of crypto asset ABC for each month the loan is outstanding.

[1] The interpretive response to Question 25 was removed in the December 31, 2022 edition of the AICPA Guide in light of the SEC staff guidance. Question 25 may be further updated to reflect the SEC staff's views in the future.

- Ownership of the loaned ABC units transfers to Borrower at loan commencement, and Borrower has the right to transfer, encumber or pledge those ABC units as it sees fit during the loan period.

The response to Question 25 concluded the following in respect of Lender's accounting for the loan. Lender should:

- continue to recognize the loaned units of crypto asset ABC. The derecognition requirements in Topic 606 (revenue from contracts with customers) and Subtopic 610-20 (gains and losses from the derecognition of nonfinancial assets) were not met for those loaned crypto assets because the requirement for Borrower to return the loaned assets (or fungibly equivalent units thereof) at the end of six months fails the repurchase agreements guidance in Topic 606.[2] That guidance states that a customer (or other transferee) does not obtain control of an asset if the seller (transferor) has an obligation or a right to repurchase the asset (a forward or call option);
- continue to account for the loaned 100 units of crypto asset ABC in the same manner as before the loan – i.e. under Subtopic 350-30 (intangible assets other than goodwill). See KPMG Executive Summary, Accounting for crypto assets – entities that are not broker-dealers or investment companies, for details on the accounting for held crypto intangible assets;
- reclassify the loaned units of crypto asset ABC to an appropriately titled balance sheet caption such as 'Crypto Asset ABC loaned'; and
- recognize the loan fees on a generally straight-line basis over the six-month loan period.

Question 26 of the AICPA Guide addresses Borrower's accounting for the same fact pattern. Recent interactions with the SEC staff have not addressed borrower accounting for crypto intangible asset loans, so we do not believe Question 26 is affected thereby.

SEC staff views on lenders' accounting for crypto intangible asset loans

This section of the Hot Topic outlines the views provided by the SEC staff, presented in the following subsections:

- At loan commencement
- During the loan period
- Disclosures
- Adoption and transition

Question 25 of the AICPA Guide illustrates a crypto intangible asset loan with a stated maturity. It is our understanding that the SEC staff also considered otherwise similar crypto intangible asset loans without a stated maturity date. Under those loans, the lender has the right to call, and the borrower the right to repay, the loan at any time without penalty.

At loan commencement

In contrast to the conclusion reached in Question 25 of the AICPA Guide, the SEC staff expressed the view that the nature of crypto intangible asset lending arrangements is different than that of a repurchase agreement as described in Topic 606 for a fact pattern in which a borrower can deploy the assets at its discretion, bears the risk of loss or theft of those assets and otherwise has the ability to direct the use of the crypto assets transferred under such a lending arrangement. That is, a crypto intangible asset loan borrower's right or obligation to return the loaned crypto assets, on-demand (i.e. in a callable loan) or at the end of a fixed loan period (i.e. in a fixed term loan), is *not* akin to a call option or forward under

[2] See ASC paragraphs 606-10-55-66 – 55-68. Section 7.5.60 of KPMG Handbook, Revenue recognition, discusses call options and forwards.

Topic 606 (see footnote 2). Therefore, the lender should evaluate whether to derecognize the loaned crypto assets based on an evaluation of all relevant control and asset derecognition considerations, which would generally include (not exhaustive) whether:

- the lender has transferred the present rights to the economic benefits associated with the crypto asset for a different right to receive crypto assets in the future;
- the lender cannot sell, pledge, loan, or otherwise use the lent crypto assets while the loan is outstanding, as those rights have been transferred to the borrower;
- inherent in the realization of the economic benefits associated with the crypto asset loan receivable is exposure to credit risk of the borrower; and
- the borrower of the crypto assets can deploy those assets at its discretion for the duration of the lending arrangement and bears the risk of loss or theft of those assets, and otherwise has the ability to direct the use of the assets transferred.

If the lender concludes derecognition is appropriate, the lender should:

- derecognize the loaned crypto assets it no longer controls; and
- recognize a right to receive back in the future the loaned crypto assets (hereafter, a 'crypto asset loan receivable').

The crypto asset loan receivable should be recorded at the then-current (i.e. time of transfer) fair value of the loaned crypto assets. Any difference between the fair value of the loaned crypto assets and their pre-transfer carrying amount should be recognized as a gain in the income statement. Revenue (and related cost of goods sold) should not be recorded on this exchange.

At loan commencement and throughout the loan period, the lender should consider and account for credit risk of the borrower (i.e. risk the borrower will not return the loaned crypto assets), using the principles in Topic 326 (financial instruments—credit losses) to measure any credit impairment. The crypto asset loan receivable should be presented net of any allowance for credit losses on the lender's balance sheet. KPMG Handbook, Credit impairment, provides guidance on applying Topic 326.

During the loan period

While the crypto intangible asset loan is outstanding, in addition to considering and accounting for credit risk of the borrower (see above), the lender should:

- continue to measure its crypto asset loan receivable at the fair value of the loaned crypto assets, recognizing gains or losses therefrom as a component of current period earnings each period the loan remains outstanding. We believe, to be consistent with the presentation of initial gains, gains or losses from changes in fair value should similarly be reflected in operating income (loss); and
- separately present and disclose (see below) any crypto intangible asset loans with related parties.

Disclosures

Lenders should provide clear disclosures about their crypto intangible asset lending activities. Those disclosures should include all of the following (not exhaustive):

- the nature and risks of crypto intangible assets lending, including how credit risk is monitored and how the lender manages its credit risk exposure;
- information about the type and amount of collateral held in relation to outstanding loans, change in collateral fair value, and any requirements for borrowers to post additional collateral;
- information about collateral management, including the lender's ability to request (and the logistics around doing so) additional collateral and/or liquidate collateral to recover loan receivables; and

- to the extent applicable:
  - other relevant disclosures considering the principles in Topic 326 (see chapter 24 of KPMG Handbook, Credit impairment), including factors the lender considers in evaluating and managing credit risk, factors and assumptions influencing the lender's estimated expected credit losses, changes in the allowance for credit losses, and information about crypto intangible asset loans past due (including how past due status is determined);
  - borrower concentration risks using the principles in Topic 275 (risks and uncertainties);
  - disclosures about loans with related parties as required by Topic 850 (related party disclosures) and Regulation S-X; and
  - fair value disclosures required by Topic 820 (fair value measurement) around measuring the crypto asset loan receivable.[3]

Adoption and transition

The SEC staff stated that they would not object to a lender that applies their views described herein as the adoption of a new accounting principle under Topic 250 (accounting changes and error corrections), with retrospective application to all periods presented in its financial statements, unless impracticable to do so. Section 3.3 of KPMG Handbook, Accounting changes and error corrections, discusses the accounting for a change in accounting principle in further detail. [250-10-05-2]

Other lender accounting considerations

In this section of the Hot Topic, we discuss complementary issues to those discussed in the preceding section about which the SEC staff did not provide views:

- end of loan accounting;
- the accounting for the loan fees earned by the lender for providing the loan (e.g. the one unit of crypto asset ABC earned by Lender each month the loan is outstanding in the Question 25 example); and
- certain lender financial statement presentation matters.

End of loan accounting

At the end of the loan and repayment of the crypto asset loan receivable, we believe the lender should derecognize the receivable and re-record the loaned crypto assets at the final, pre-derecognition carrying amount of the crypto asset loan receivable. Because the crypto asset loan receivable is marked to the fair value of the loaned crypto assets until repayment, no gain or loss results from this end-of-loan accounting entry. Assuming the loan is repaid in full, any credit loss allowance related to the loan is also derecognized with a corresponding reduction to bad debt expense.

After re-recording the loaned crypto assets, the lender resumes accounting for those crypto intangible assets in the same manner as those it holds not subject to loan. See the 'While you hold a crypto intangible asset' section of KPMG Executive Summary, Accounting for crypto assets – entities that are not broker-dealers or investment companies.

Loan fee accounting

While the SEC staff did not provide views on the accounting for loan fees, based on public remarks[4] and other discussions with the SEC staff, we believe one acceptable approach to the accounting for loan fees

[3] Chapter N of KPMG Handbook, Fair value measurement, provides detailed guidance on fair value disclosures required by Topic 820.
[4] At the December 2022 AICPA & CIMA Conference on Current SEC and PCAOB Developments.

is to respect the stated nature of the arrangement as a loan for purposes of loan fee recognition. Therefore, the loan fees would be accounted for in a similar manner to interest on a cash loan, even though the loan is of (and the loan fees will be paid in) nonfinancial crypto intangible assets. In the Question 25 example, this approach results in recognizing the one crypto asset ABC loan fee each month as it becomes due.

Because the SEC staff have not provided official views on loan fee accounting, and crypto intangible (nonfinancial) asset lending arrangements differ from financial asset loans, other views about the appropriate or acceptable accounting for crypto intangible asset loan fees may exist. Lenders should consult with their auditors or other accounting advisors about the approach they intend to take.

Financial statement presentation

The SEC staff also did not, in general, provide views on financial statement presentation; however, based on the staff's other expressed views, we believe the following conclusions are appropriate.

- **Balance sheet:** The lender's crypto asset loan receivable (net of allowance for credit losses) should be presented separately from the lender's recognized crypto intangible assets on the lender's balance sheet.
- **Income statement:**
  - Any gain from the transfer of the loaned crypto assets should be included within operating income (loss). This is because Topic 360 (property, plant, and equipment) states that the gain or loss recognized on the disposal of a long-lived asset shall be presented within operating income (loss). In addition, if the lender presents its crypto intangible asset impairment losses within operating income (loss), we believe it would be misleading to present these gains as nonoperating items. [360-10-45-5]
  - Income stemming from loan fees should be presented in the same manner as the lender presents (or would present) interest income in its income statement.
- **Statement of cash flows:** The exchange of the loaned crypto assets for the crypto asset loan receivable should be disclosed as a noncash activity. Any gain on the exchange should be presented as a reconciling item in the reconciliation of net income to net cash flows from operating activities (see section 3.2 of KPMG Handbook, Statement of cash flows, for guidance on the reconciliation). [230-10-50-3 – 50-4]

For further information

See KPMG Cryptocurrencies and other digital assets resource page, which includes (not exhaustive) KPMG Executive Summaries, Accounting for crypto assets – entities that are not broker-dealers or investment companies and Accounting for crypto assets – investment companies, and other digital assets Hot Topics.

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