

Financial Reporting Alert 18-9 — Classification of cryptocurrency holdings

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Background

Cryptocurrency is a new type of value and payment method that is distinctly different from fiat currency (e.g., U.S. dollars and foreign currencies). Instead of possessing a physical form, cryptocurrency exists as immutable distributed ledgers maintained on public blockchains. (For Deloitte's perspectives on blockchain technology, including a discussion of cryptocurrency, see [Blockchain Technology and Its Potential Impact on the Audit and Assurance Profession](#).)

Cryptocurrency should not be confused with electronic instances of cash (e.g., an online bank account with a consumer banking institution), which are linked to physical currency. An online bank account shows the amount of, for example, U.S. dollars held in a specified account. By contrast, cryptocurrency refers to a form of exchange that only exists digitally and is not linked to any physical currency. Entities should therefore exercise care when referring to cryptocurrency as "currency" since most governments do not currently consider it to meet the legal definition of a currency. In certain circumstances, cryptocurrencies may be considered securities by the Securities and Exchange Commission (SEC) and commodities by the Commodities Futures Trading Commission, as defined by those institutions. For taxation and other regulatory purposes, cryptocurrency can be considered and taxed as a property, prepaid good or service, or equity in the United States.

Other terms, such as "digital currency," "virtual currency," "tokens," or "coins," may be used to describe cryptocurrency. However, it is important to distinguish between cryptocurrency and tokens, which are often interchanged in media coverage. This *Financial Reporting Alert* focuses only on what the SEC considers cryptocurrencies and not tokens.



Connecting the Dots — Cryptocurrency Versus Token

Cryptocurrency is a unit of value that is native to a blockchain. It is a means of exchange within the blockchain to incentivize the network of participants to use the blockchain. The cryptocurrencies Bitcoin, Ether, Ripple, and Litecoin are all examples of native cryptocurrencies. The sole purpose of a cryptocurrency is for exchange of value, and it has limited functionality beyond that.

A **token** is a piece of business logic (i.e., "smart contract") coded into an existing blockchain. A token can have a functionality beyond an exchange of value — it can represent any asset or functionality desired by the developer for use on a platform. Most tokens are created on the Ethereum blockchain by using ERC-20 smart contracts, such as Tron and VeChain.

The best known example of a cryptocurrency is Bitcoin. However, today there are many types of cryptocurrency at different stages of maturity. The prices of cryptocurrencies as traded on exchanges or elsewhere are always represented in some other fiat currency (e.g., U.S. dollars, euros), although such prices are usually just the average of the buy/sell spread on the particular exchanges. In addition, prices for the same cryptocurrency often vary by small amounts on the various exchanges.

Cryptocurrencies have the following characteristics:

- They are created by "mining" (i.e., using computer power to solve complex cryptographic algorithms), often with a maximum number of coins that can exist (e.g., there can never be more than 21 million Bitcoins in existence).
- No single party (government or otherwise) regulates their use. Although values for a cryptocurrency may sometimes be quoted in a particular fiat currency, a coin in one country is indistinguishable from a coin in another.
- Their value is supported only by the laws of supply and demand.
- Their general purpose is to be used in exchange for goods or services (provided that both parties agree to such an exchange).

Cryptocurrencies can also be obtained by purchasing or receiving them on a peer-to-peer basis.

Accounting for Cryptocurrencies

The guidance in U.S. GAAP does not currently directly address the accounting for cryptocurrencies. For the reasons explained below, we believe that cryptocurrencies should generally be accounted for as indefinite-lived intangible assets under ASC 350;¹ however, there may be limited circumstances in which cryptocurrencies are (1) held for sale in the ordinary course of business and thus considered inventory (as in the case of a broker) or (2) accounted for as an investment by an investment company.

The ASC master glossary defines intangible assets as "[a]ssets (not including financial assets) that lack physical substance. (The term intangible assets is used to refer to intangible assets other than goodwill.)" Cryptocurrencies are not financial assets because they are not cash, an ownership interest in an entity, or a contract establishing a right or obligation to deliver or receive cash or another financial instrument. Since they lack physical substance, they are generally considered intangible assets.



Connecting the Dots — Cryptocurrencies Are Not Cash or Cash Equivalents

The ASC master glossary states that cash "includes not only currency on hand but demand deposits with banks or other financial institutions." While the ASC master glossary includes currency in the definition of cash, it does not define currency.

Cryptocurrencies can be used as a medium of exchange if both parties agree to the exchange; however, cryptocurrencies are not backed by a sovereign government and do not represent legal tender that must be accepted as a form of payment. Therefore,

we do not believe that cryptocurrencies are cash.

Further, they are not cash equivalents. The ASC master glossary defines “cash equivalents” as “short-term, highly liquid investments” that are “[r]eadily convertible to known amounts of cash” and “[s]o near their maturity that they present insignificant risk of changes in value because of changes in interest rates.” Cryptocurrencies are not readily convertible to known amounts of cash and have more than an insignificant risk of change in value.

ASC 350 requires entities to initially record intangible assets at cost (e.g., consideration transferred). As intangible assets, cryptocurrencies have indefinite lives and therefore must be tested for impairment at least annually and more frequently if events or changes in circumstances indicate that it is more likely than not that they are impaired. A decline below cost in a quoted price on an exchange may be an event indicating that it is more likely than not that a cryptocurrency is impaired.

Cryptocurrencies used as a medium of exchange or for speculative purposes are not “inventory,” which the ASC master glossary defines, in part, as “[t]he aggregate of those items of tangible personal property that [are held for sale] in the ordinary course of business.” Some cryptocurrencies may be held for sale in the ordinary course of business as part of a primary business model in a manner similar to how commodity inventories are held by brokers. We believe that in the absence of future standard setting by the FASB, it may be acceptable in certain circumstances for entities to account for cryptocurrencies as inventory if part of their primary business is to hold such cryptocurrencies in a manner similar to how brokers hold inventories. However, entities should carefully consider their facts and circumstances and consult with their accounting advisers before concluding that accounting for cryptocurrencies as inventory is appropriate.

Entities within the scope of ASC 946² (i.e., investment companies) that hold cryptocurrencies as investments should account for them as they would any other investment that they measure initially and subsequently at fair value.

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¹ FASB Accounting Standards Codification Topic 350, *Intangibles — Goodwill and Other*.

² FASB Accounting Standards Codification Topic 946, *Financial Services — Investment Companies*.

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