Accounting for the Lending of Crypto Assets

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The Group discussed factors a crypto-asset lender might consider when determining the accounting for such transactions. In the fact pattern discussed, the underlying crypto asset lent is a cryptocurrency, such as bitcoin. It is understood that views on this subject are diverse. The purpose of the Group's discussion, therefore, is to raise awareness of factors a crypto-asset lender might consider when determining the accounting under IFRS Accounting Standards. Group members were not asked to provide their views on the appropriate accounting for these arrangements. This issue does not currently meet the criteria for an IFRS Accounting Standards-setting project. Therefore, the Group will not be asked whether to recommend that the AcSB discuss the issue to determine if it should be raised with the IASB or the IFRS Interpretations Committee (the Interpretations Committee).

Background on accounting for crypto assets

- In June 2019, the Interpretations Committee published an agenda decision on the holdings of cryptocurrencies. This agenda decision concluded that an entity applies:
  (a) IAS 2 *Inventories* to cryptocurrencies held for sale in the ordinary course of business; and
  (b) IAS 38 *Intangible Assets* to cryptocurrencies not held for sale in the ordinary course of business.
- Pursuant to the Interpretations Committee's June 2019 agenda decision, the derecognition guidance in IAS 2 or IAS 38 applies to crypto assets lent. However, the lending of intangible assets or inventory is not clearly captured within the scope of any IFRS Accounting Standard.
- One might also consider analogizing crypto-asset lending to commodity loans. However, a March 2017 Interpretations Committee agenda decision concluded that commodity-loan transactions are not clearly captured within the scope of any IFRS Accounting Standard. In the absence of a standard that specifically applies to the lending of non-financial assets, an entity would likely apply paragraphs 10-11 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* in developing and applying an accounting policy to the accounting for commodity loans. Analogizing crypto-asset lending to commodity loans is challenging. Although these arrangements share similar characteristics, it is unlikely that the accounting for commodity loans would have been considered in the context of intangible assets.

Fact pattern

The following fact pattern describes a simple crypto-asset lending arrangement.

- Entity A lends 1,000 units of a crypto asset (bitcoin or BTC) for a six-month term to Entity B.
- Entity B will pay a fee in total of six units of BTC for borrowing the 1,000 units of BTC during the six-month term, paying one unit of BTC each month in arrears during the term (this is typically referred to as an "interest payment" in the agreement). At the end of six months, Entity B is required to return 1,000 units of BTC to Entity A. Entity A may request the BTC lent on demand.

Doing so results in a proration of the interest payments.

- The loaned BTC is transferred to Entity B upon initiation of the loan term. Entity B has the right to use the BTC lent to pledge, repledge, hypothecate, rehypothecate, sell, lend and stake for its own purposes in any way it chooses.
- The crypto assets subject to the arrangement are highly liquid and for which a Level 1 valuation exists.[1]
- Entity B is not required to post collateral to the lender in the arrangement.
- Entity B does not operate a crypto-asset platform and does not provide Entity A with a token native to its platform that represents the rights to the underlying crypto assets lent and any accrued fees on the crypto asset loaned. Such arrangements are beyond the scope of this discussion.
- Access to the private key is not shared by both parties in the arrangement.[2] The lender and borrower each manage their own private keys for the crypto assets while in their respective wallets.
- Entity A does not sell rights to crypto assets loaned to third parties (i.e., the securitization of crypto-asset lending arrangements for sale is beyond the scope of this discussion).

Issue 1: May the crypto asset lent be derecognized?

Analysis

- Paragraph 34 of IAS 2 requires the derecognition of inventory when it is sold because the entity no longer controls it. IFRS 15 *Revenue from Contracts with Customers* clarifies that an item is sold when the entity satisfies a performance obligation by transferring a promised good or service to a customer. An asset is transferred when (or as) the customer obtains control of the asset.
- Paragraph 112 of IAS 38 requires the derecognition of an intangible asset when it is disposed, or when no future economic benefits are expected from its use or disposal.
- Paragraph 114 provides additional guidance on when an intangible asset may be disposed of:

> The disposal of an intangible asset may occur in a variety of ways (eg by sale, by entering into a finance lease, or by donation). The date of disposal of an intangible asset is the date that the recipient obtains control of that asset in accordance with the requirements for determining when a performance obligation is satisfied in IFRS 15. IFRS 16 applies to disposal by a sale and leaseback.

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[1] IFRS 13 *Fair Value Measurements* establishes a fair value hierarchy that categorizes fair value inputs into three levels. Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date.

[2] A private key is an encrypted code used to authorize transactions and prove ownership of a crypto asset. A crypto asset cannot be removed from a crypto wallet without the corresponding private key. Therefore, private keys represent the final control and ownership of crypto assets.

- Therefore, knowing if the transferring entity has lost control of the original crypto asset and the receiving entity has obtained control of the asset is critical to determining whether a lent crypto-asset should be derecognized.

Factors that may suggest the derecognition requirements are not met

Crypto assets classified as inventory

- For crypto-asset lending arrangements when the crypto asset is classified as inventory, the lender must consider whether they meet the derecognition requirements in paragraph 34 of IAS 2. This happens when the crypto asset is sold, and revenue is recognized for the sale.
- In the case of a crypto-asset lending arrangement, the borrower is required to return the crypto asset to the lender and the lender remains exposed to the crypto asset's full price risk. Therefore, one might think that the borrower is not exposed to the full price risk of the crypto asset, which may be considered a significant component of the overall risks and rewards of crypto-asset ownership. Because all the risks and rewards of ownership are not transferred to the borrower, one might conclude the borrower has not obtained control of the crypto asset, leaving control with the lender.

Crypto assets classified as intangible assets

- For crypto-asset lending arrangements when the crypto asset is classified as an intangible asset, the lender needs to apply the derecognition requirements in paragraph 112 of IAS 38. This happens when the crypto asset is disposed of or when no future economic benefits are expected from its use or disposal.
- In this fact pattern, the lender continues to receive future economic benefits from the crypto assets through the fee ("interest") income and through disposal in the future. Disposal of an intangible asset may occur in many ways and the disposal date is defined as the date the recipient obtains control of the asset in accordance with the requirements for determining when a performance obligation is satisfied in IFRS 15. Since the lender retains the crypto-asset's full price risk, one might conclude that control of the asset has not transferred to the borrower.

Repurchase agreements

- One might consider whether the crypto-asset lending arrangement is in substance a repurchase agreement. Paragraphs B64 and B68 of IFRS 15 provide the following guidance on repurchase agreements, which may indicate that the lender has not lost control of the crypto asset:

  B64 A repurchase agreement is a contract in which an entity sells an asset and also promises or has the option (either in the same contract or in another contract) to repurchase the asset. The repurchased asset may be the asset that was originally sold to the customer, an asset that is substantially the same as that asset, or another asset of which the asset that was originally sold is a component.

B68 If the repurchase agreement is a financing arrangement, the entity shall continue to recognise the asset and also recognise a financial liability for any consideration received from the customer. The entity shall recognise the difference between the amount of consideration received from the customer and the amount of consideration to be paid to the customer as interest and, if applicable, as processing or holding costs (for example, insurance).

Factors that may suggest the derecognition requirements are met

- Whether the crypto asset lent is classified as inventory or as an intangible asset, it is derecognized if the lender no longer controls it. Applying the guidance in paragraph 33 of IFRS 15, one might think that the lender has lost control over the crypto asset because the lender may no longer:
  (a) have the ability to direct the use of the asset (the borrower has the right to use the crypto asset lent to pledge, repledge, hypothecate, rehypothecate, sell, lend and stake for their own purposes); and
  (b) prevent the borrower from directing the use of the asset and obtaining the benefits from it. The loan being due on demand does not in and of itself prevent the borrower from directing the use of the asset. It is only seen to have a direct impact on the term of the crypto-asset lending arrangement (e.g., similar to a cash loan that is due on demand and does not prevent the borrower from directing the use of the cash).
- One might think that the crypto-asset lending arrangement does not represent a repurchase arrangement because there is no contract to buy or sell the crypto asset lent and no exchange of consideration upon lending or settling the arrangement. Furthermore, the lender has no obligation to repurchase the crypto asset, nor does the arrangement give rise to a call option on the crypto asset. One might think that accounting for crypto-lending arrangements as repurchase arrangements may not accurately portray the economic nature and substance of the arrangement.
- One might also consider that, at the end of the arrangement, the borrower might need to purchase an equivalent quantity of the same type of crypto asset borrowed at the prevailing market price to fulfill its obligation to return the crypto asset to the lender. This might be the case if the borrower does not possess the crypto asset at the end of the term. This might indicate that the borrower obtained control of the crypto asset. The hypothetical scenario outlined in paragraph BC425 in the Basis for Conclusions of IFRS 15 might be viewed as having some similarities to this fact pattern. In this hypothetical scenario, the initial issuance and return of the asset subject to the repurchase arrangement takes place at the prevailing market price at the time of each exchange, thereby resulting in the customer effectively obtaining control of the asset.

The Group's Discussion

The Group agreed that views on the accounting for the lending of crypto assets are diverse and that such transactions are not clearly captured within the scope of any IFRS Accounting Standards. The

Group noted that the premise of the analysis is that an entity applies the derecognition requirements in either IAS 2 or IAS 38 to the crypto asset lent, depending on whether the crypto asset is held for sale in the ordinary course of business or not. If the lender applies one of these standards, the Group agreed that they would need to consider whether control of the crypto asset has transferred to the borrower to determine whether it should derecognize the crypto asset. The Group indicated that the analysis provides a detailed breakdown of the factors an entity might consider when determining whether control of the crypto asset lent has transferred to the borrower when applying the derecognition requirements in these standards.

Some Group members indicated that they think the lender has retained control of the asset in this fact pattern. They pointed out that the risks and rewards of ownership of the asset have not transferred to the borrower because the lender is still exposed to its full price risk. Furthermore, the due-on-demand feature in the arrangement might also indicate that the lender has retained control of the asset.

Some Group members indicated that they think the lender has lost control of the asset in this fact pattern. They pointed out that the borrower has unrestricted rights to direct the use the asset during the borrowing period (i.e., they may pledge, repledge, hypothecate, rehypothecate, sell, lend and stake the asset in any way they choose).

Several Group members identified other factors the lender might consider when determining whether to derecognize the loaned crypto asset. Several Group members indicated that the lending of crypto assets might be analogized to securities lending transactions. Under IFRS 9, loaned securities are not derecognized because the lender retains substantially all the risks and rewards of ownership of the asset. Some Group members indicated that the Interpretations Committee's June 2019 agenda decision on the classification of cryptocurrencies might prevent the lender from applying the derecognition requirements in IFRS 9 to the lending of cryptocurrencies. However, one Group member thought that this agenda decision applies narrowly to the holding of cryptocurrencies, and not to the lending of such assets. They indicated that this might not preclude an entity from applying the guidance in IFRS 9 to cryptocurrency lending.

Some Group members indicated that this fact pattern is similar to a repurchase agreement in IFRS 15. However, most of them noted that there is no contract to buy or sell the crypto asset lent and no exchange of consideration upon lending or settling the arrangement. Therefore, they thought that the guidance on repurchase agreements in IFRS 15 should not be applied to this transaction.

One Group member indicated that the accounting for crypto-asset lending might be analogized to the lending of an entity's own equity. Another Group member noted that one might consider analogizing this transaction to an inventory consignment arrangement because the due-on-demand feature might indicate the lender still controls the asset. One Group member thought that although cryptocurrencies do not currently meet the definition of cash, they share many of the same characteristics. Since entities derecognize loaned cash, they would favour an accounting policy that results in the derecognition of loaned cryptocurrency as well.

Issue 2: If the lender can derecognize the original crypto asset, is it appropriate to recognize

a new asset and, if so, what type of asset?

Analysis

Does the crypto-asset receivable meet the definition of an asset?

- Paragraph 4.3 of the *Conceptual Framework for Financial Reporting* defines an asset as "a present economic resource controlled by the entity as a result of past events." The lender controls the right to receive crypto assets because the lender has the contractual ability to restrict other parties from obtaining the economic benefits from this right. The past event that gives rise to this right is the contractual arrangement that gives rise to the lender's right to the return of the crypto assets.
- Paragraph 4.4 of the *Conceptual Framework* defines an economic resource as "a right that has the potential to produce economic benefits." The new item represents a right to receive crypto assets from the lender. The right to receive an asset is an economic resource with the potential to produce economic benefits through the sale of either the right to receive the crypto assets or the ultimate sale of the underlying crypto assets upon receipt.
- Based on the above analysis, the crypto-asset receivable meets the definition of an asset. However, the new asset is differentiated from the original crypto asset because it represents the right to receive the crypto asset lent rather than the original crypto asset (i.e., the crypto asset is in an encumbered state). Judgment may be required to determine the nature of the new asset and how it might be measured.

Might the crypto-asset lending arrangement be a financial asset?

- Paragraph 11 of IAS 32 Financial Instruments: Presentation defines a financial asset as:

  any asset that is…
  (c) a contractual right:

  (i) to receive cash or another financial asset from another entity; or
  (ii) to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity.

- In most cases, a crypto-asset lending arrangement requires the return of an equivalent quantity of the same crypto asset lent on termination of the arrangement (i.e., the settlement of the arrangement takes place through the delivery of a non-financial asset). Therefore, the arrangement does not convey a contractual right to receive cash or another financial asset from the borrower, nor does it convey the right to exchange financial assets or liabilities with the borrower under conditions that are potentially favourable to the lender. Thus, the crypto-asset lending arrangement does not meet the definition of a financial asset.
- Paragraph 2.4 of IFRS 9 states:

  This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements.

- Further to the above, paragraph 2.6 of IFRS 9 notes, "There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments," and that these include contracts "when the non-financial item that is the subject of the contract is readily convertible to cash."
- Most crypto-asset lending arrangements do not imply contracts to buy or sell a non-financial item because there is usually no exchange of consideration upon lending the crypto asset and upon settlement of the arrangement. These arrangements are typically settled gross in the same type and quantity of the crypto asset lent. Furthermore, the economic substance of these arrangements are not contracts to buy or sell crypto assets, nor are they crypto-asset-repurchase arrangements.
- Based on the guidance in IAS 32 and IFRS 9, crypto-asset lending arrangements would not appear to meet the definition of a financial asset in most cases.

Might the crypto-asset lending arrangement be inventory?

- Paragraph 6 of IAS 2 defines inventories as assets:
  (a) held for sale in the ordinary course of business;
  (b) in the process of production for such sale; or
  (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.
- The primary consideration in this instance is whether the lender is in the business of selling rights to receive crypto assets in the ordinary course of business. If not, the crypto-asset lending arrangement will not meet the definition of inventory. In this fact pattern, Entity A does not sell the rights to receive crypto assets in the ordinary course of business. Therefore, these rights are unlikely to meet the definition of inventory.

Might the crypto-asset lending arrangement be an intangible asset?

- In considering whether the right to receive an intangible asset might be classified as an intangible asset, one might consider whether IAS 38 has any scope exclusions preventing this classification. Paragraph 3(c) of IAS 38 indicates that the standard does not apply to leases of intangible assets accounted for in accordance with IFRS 16 *Leases* because IFRS 16 applies to those assets. Therefore, one might consider whether the right to receive a crypto asset meets the definition of a lease in IFRS 16. In most instances, the crypto-asset lending arrangement seems unlikely to result in a lease because the crypto assets lent are fungible assets and do not give rise to an "identified asset." Therefore, the right to receive a crypto asset would not appear to be in the scope of IFRS 16.
- Paragraph 8 of IAS 38 states, "An intangible asset is an identifiable non-monetary asset without physical substance." The right to receive crypto assets may be considered identifiable because

it arises from a contractual right to receive the same type of crypto asset loaned and the respective fee. The right to an intangible asset also represents a non-monetary item. However, it may be unclear whether the intent of IAS 38 is to include assets that represent rights to an intangible asset.

- Paragraph 6 of IAS 38 states, "Rights held by a lessee under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights are within the scope of this Standard." However, this paragraph specifically references the rights under licensing agreements from the lessee's perspective and it may be unclear whether this may be appropriately analogized to rights to receive an intangible asset in the absence of any explicit requirements.
- Based on this analysis, it may be unclear whether a crypto-asset lending arrangement may be classified as an intangible asset. This arrangement might represent an intangible asset because it meets the definition of an intangible asset in IAS 38. However, one might think that the right to an intangible asset is not the same as the underlying intangible asset. Furthermore, an entity might conclude that the right to receive crypto assets is beyond the scope of the June 2019 Interpretations Committee agenda decision on the holdings of cryptocurrencies because this agenda decision narrowly focused on the holdings of the cryptocurrency itself.

Might the crypto-asset lending arrangement not be a financial asset, inventory or an intangible asset?

- If no other IFRS Accounting Standard contains specific guidance on how to account for crypto-asset lending arrangements, an entity would apply paragraph 10-12 of IAS 8 when developing a policy. As noted in IAS 8, in the absence of an IFRS Accounting Standard that specifically applies to a transaction, management shall refer to, and consider the applicability of the requirements in IFRS Accounting Standards dealing with similar and related issues in developing and applying an accounting policy. Management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards.

Analogize to amortized cost financial instrument

- Financial assets are measured at amortized cost if they meet the criteria in paragraph 4.1.2 of IFRS 9. This paragraph requires the contractual terms of the arrangement "give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding" (also referred to as the "SPPI test").
- Although the crypto-asset lending arrangement does not give rise to cash flows, it does give rise to the exchange of non-financial assets that, by analogy, are similar to cash settlement. Therefore, when applying the concepts in IFRS 9 by analogy, an entity might determine that settlement of the crypto-asset lending arrangement with the same type and quantity of crypto assets lent (plus consideration – that closely approximates an interest charge) has similar economic characteristics to the cash settlement of a foreign currency loan that is a financial asset.

- Proponents of this view recognize that although the crypto-asset lending arrangement itself may or may not be deemed to be a monetary item, the underlying crypto asset functions as digital currency on the blockchain and has similar characteristics as a medium of exchange in some contexts. Therefore, the crypto asset might be analogized to a foreign currency because the crypto asset is not denominated in the entity's functional currency. This analogy might not conflict with the June 2019 Interpretations Committee agenda decision on the holdings of cryptocurrencies which concluded that cryptocurrencies are not cash because this is in respect of the right to receive crypto currency and is by analogy to its economic nature rather than by fact.
- Assuming that the economic substance of the crypto-asset lending arrangement meets the SPPI test, one would also consider the objective of the business model in which the asset is held. If the asset is held in a business model whose objective is to hold the asset in order to collect contractual cash flows (or, in this case, contractual crypto settlement), one might view the asset as having the economic characteristics of an instrument measured at amortized cost.
- Measuring the crypto-asset lending arrangement at amortized cost under IFRS 9 would require an entity to include an allowance for expected credit losses. While financial assets measured at amortized cost need to be assessed for expected credit losses at each balance sheet date, the arrangement may not be deemed impaired if it is expected to be settled in line with its terms (i.e., the lender expects to receive the specified type and quantity of crypto-asset units in line with the terms of the arrangement).
- Furthermore, the valuation of the crypto-asset lending arrangement is primarily derived from the value of the underlying crypto asset, which is not denominated in the entity's functional currency. Therefore, the arrangement is unlikely to be denominated in the entity's functional currency. Simple arrangements specify that it will be settled with crypto assets of the same type and quantity (plus fee or "interest" consideration). The arrangement might be analogized to a monetary item in accordance with paragraph 8 of IAS 21 *The Effects of Changes in Foreign Exchange Rates*: "Monetary items are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency."
- Therefore, an entity might reasonably conclude that when applying its accounting policy selected in accordance with IAS 8, it might be more relevant and reliable to measure these crypto-asset lending arrangements at their current value expressed in the entity's functional currency. So, an entity might measure the asset by translating the value of the unit lent plus accrued fees or interest consideration to its functional currency at the balance sheet date. For example, if the amortized cost expressed in units of crypto at the balance sheet date was 10 units of crypto and a unit of crypto had a value of $1,500 per unit at the balance sheet date, the translated value of the instrument would be $15,000, minus a loss allowance, at that date. Analogizing crypto assets to a foreign currency (monetary item) might be reasonable given its functional equivalence and use as a medium of exchange on the blockchain and its pricing being in a currency other than the entity's functional currency. The exchange differences arising on translation to the functional currency are recognized in profit and loss in accordance with paragraph 28 of IAS 21.

Analogize to financial instrument measured at fair value through profit and loss (FVTPL)

- As already noted, the June 2019 Interpretations Committee agenda decision on the holdings of cryptocurrencies concluded that cryptocurrencies are not considered cash. Therefore, it might be viewed that the crypto-asset lending arrangement may not be analogized to a monetary item or a foreign currency. It might be viewed that the arrangement violates the SPPI requirement in IFRS 9 to be eligible for measurement at amortized cost because the exposure to the price volatility of the underlying crypto assets represents an exposure that is beyond SPPI. This exposure to the price volatility of the underlying crypto assets might not be considered analogous to foreign exchange movements because it is not a foreign currency. It might also be viewed that the arrangement violates the SPPI requirements because the fee ("interest") and principal payments are settled gross in the form of the same type of crypto asset, which is not analogous to cash. Thus, repayments that are not analogous to cash may not be considered interest and principal from a strict technical perspective.
- If the instrument's economic characteristics mostly reflect a financial instrument measured at FVTPL, the entity might initially and subsequently measure the instrument at fair value with changes recognized in profit or loss. The fair value of the crypto-asset lending arrangement analogized to a financial instrument measured at FVTPL would be measured in accordance with IFRS 13
- *Fair Value Measurement*, and its exposure to credit risk would presumably be considered when valuing the crypto asset in its encumbered state (i.e., the value of lending arrangement and the risk of non-performance (credit risk) by the counterparty).

Analogize to intangible asset

- An entity might consider analogizing the crypto asset loan arrangement to an intangible asset in accordance with IAS 38. If the crypto asset is accounted for in accordance with IAS 38, the entity would need to consider whether the arrangement would be subsequently measured using the cost model or revaluation model. Paragraph 75 of IAS 38 states that fair value shall be measured by reference to an active market when applying the revaluation model. Unlike the underlying crypto asset that has been lent, the crypto-asset lending arrangement itself is not traded in an active market. Therefore, it would appear that an entity would not be permitted to apply the revaluation model to subsequently remeasure the arrangement.
- Under the cost model, decreases in value below cost and expected credit losses may need to be recognized as impairments; however, increases in value above cost would not be recognized before realization. An entity would need to consider whether the cost model provides relevant and reliable information for such crypto-asset lending arrangements.

The Group's Discussion

The Group agreed with the analysis. Most Group members thought that subsequently measuring crypto-asset loans at fair value provides financial statement users with the most relevant information. This is because the lender holds the crypto asset for price appreciation and for lending. Therefore, users need information that reflects the price risk of the underlying crypto asset and the credit risk of the borrower.

Some Group members thought the right to receive a crypto asset does not meet the definition of a financial asset, inventory or an intangible asset. They thought that the lender would need to apply IAS 8 to develop and apply an accounting policy. Most of these Group members indicated that analogizing the right to receive a crypto asset to a financial instrument measured at fair value through profit and loss might provide the most relevant and reliable information to financial statement users. Although the right to receive a crypto asset does not meet the definition of a financial asset (i.e., it is not a right to receive cash or another financial asset), it does have similar characteristics to accounts receivable denominated in a currency that is not the functional currency of the lender. One Group member indicated that an entity might consider the liquidity of the underlying asset (in this fact pattern, it is highly liquid) and the term of the loan (in this fact pattern, it is a short-term loan) in determining how to classify and measure it.

One Group member thought that the right to receive a crypto asset might meet the definition of an intangible asset. However, they also acknowledged it is unclear whether the intent of IAS 38 is to include assets that represent rights to an intangible asset. They indicated that the right to receive the crypto asset might meet the definition of inventory if the lender sells these rights in the ordinary course of business.

Issue 3: If the lender cannot derecognize the original crypto asset, how should the original crypto asset be measured?

Analysis

- The classification of a non-financial asset directs how the asset should be measured. Crypto assets lent that are recognized as intangible assets may be subsequently measured using either the cost model or the revaluation model. Fair value measurements under the revaluation model are limited to fair values that can be derived by reference to an active market. Crypto assets recognized as inventory are measured at the lower of cost and net realizable value. However, entities that are considered commodity broker-traders measure their inventories at fair value less costs to sell.
- Crypto assets that are recognized as non-financial assets and measured at their fair value are subject to the requirements under paragraphs 27-29 of IFRS 13. Paragraph 27 states:

  > A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use.

- The fair value measurement of a non-financial asset based on its highest and best use does not refer specifically to the need to factor credit risk in the asset's valuation. Furthermore, the highest and best use implies that the value should not be less than the value of the crypto asset traded in an active market, given that a market participant is able to call the crypto asset lent on demand and is likely able to sell the crypto asset in an active market. However, an entity might consider factoring credit risk into the crypto asset's valuation on the basis that it is valuing the asset in its encumbered state.

- One might consider that the crypto asset in its encumbered state is not traded in an active market. The lack of an active market does not prevent entities from measuring their inventories at fair value less costs to sell. Therefore, these entities might apply the principles in paragraphs 27-29 of IFRS 13 to determine the fair value of inventories representing the crypto assets in their encumbered state. However, consistent with the discussion on analogizing the crypto-asset lending arrangement to an intangible asset, an entity would not be permitted to apply the revaluation model in IAS 38 to measure the crypto asset in its encumbered state because such a unit of account is not traded in an active market. Under the cost model, decreases in value below cost may need to be recognized as impairments; however, increases in value above cost would not be recognized. Whether expected credit losses that decrease value below cost would be considered in a cost-and-impairment model under IAS 38 is perhaps similar to the considerations for non-financial assets measured at fair value discussed above.

The Group's Discussion

The Group agreed with the analysis. Several Group members indicated that the lender might factor the credit risk of the borrower into its measurement of the crypto asset. They indicated that credit risk might be significant because the lender did not take any collateral. Given the potential significance of credit risk, some Group members think that a measurement model that takes credit risk into account would provide information relevant to financial statement users. However, some Group members indicated that it might be difficult to support this type of measurement model under current IFRS Accounting Standards. One Group member indicated that a crypto asset in an encumbered state is similar to a demand deposit with restrictions on use from a contract with a third party. They indicated that the lender might consider the accounting requirements for these types of arrangements when determining the accounting for loaned crypto assets.

Overall, the Group's discussion raised awareness of the factors a crypto-asset lender might consider when determining the accounting for such transactions. No further actions were recommended to the AcSB as a result of this discussion. However, some Group members indicated that the Group should continue to monitor developments in this space and consider if future discussions are needed.