# Cryptocurrencies – Other Considerations

## Extract, IFRS® Discussion Group Report on the Meeting – January 10, 2019

The Group discussed various cryptocurrency related topics at its January 2018, June 2018 and October 2018 meetings. The topics include investments in decentralized digital currencies (also called "cryptocurrencies"), mining or validation activities, and employee benefits.

At this meeting, the Group discussed two fact patterns involving:

- an entity that receives cryptocurrencies from the sale of goods or services and then subsequently monetizes them; and
- a commodity broker-trader who trades in cryptocurrencies and measures them at fair value less costs to sell (FVLCS).

*Fact Pattern 1*

A retailer accepts cryptocurrency as a form of payment for goods (i.e., widgets) it sells in the ordinary course of business. To minimize exposure to changes in the value of the cryptocurrency, the retailer monetizes the cryptocurrency collected for fiat currency shortly following receipt.

### *Issue 1: Should the cryptocurrency collected be accounted for under the scope of IAS 2* Inventories *or IAS 38* Intangible Assets*?*

*Analysis*

The cryptocurrency is not purchased and held for resale nor is it an asset or material used in the production process. Rather, the cryptocurrency is collected as a form of payment for the retailer's sale of widgets in the ordinary course of business. As a result, the cryptocurrency does not form part of the retailer's inventory as it would not meet the definition in paragraph 6 of IAS 2.

The retailer is not considered a commodity broker-trader because, in the fact pattern, it monetizes cryptocurrency to minimize exposure to changes in value. A commodity broker-trader's inventories are principally acquired with the purpose of selling in the near future and generating a profit from fluctuations in price or broker-trader's margin.

In September 2018, the IFRS Interpretations Committee discussed how an entity applies existing IFRS Standards to account for cryptocurrency holdings. In the IFRIC Staff Paper (agenda paper AP4A), paragraphs 70 and 71 outline the staff's view. If an entity holds cryptocurrencies for sale in the ordinary course of business, it would meet the definition of inventories. If an entity does not apply IAS 2, it applies IAS 38 because cryptocurrencies meet the definition of an intangible asset. Most Committee members agreed with the staff's conclusions.

Therefore, the cryptocurrency the retailer collected is not within the scope of IAS 2 but within the scope of IAS 38.

*The Group's Discussion*

Group members who expressed a view thought that the analysis was reasonable. A few Group members emphasized the importance of considering the business model of the entity. They thought that if the cryptocurrency is being held for a long period, such behaviour may indicate the entity has a speculation strategy to realize a profit.

A question was raised whether the cryptocurrency would be measured at the fair value of the goods given up. A few Group members thought this question could arise depending on how the retailer priced the good (e.g., whether the goods were priced in fiat currency but settled in units of the cryptocurrency of equal value or whether the goods were priced in cryptocurrency). Group members noted that the non-cash consideration guidance in IFRS 15 *Revenue from Contracts with Customers* would apply given the cryptocurrency is not a financial asset.

*Fact Pattern 2A*

- Entity A buys and sells cryptocurrency for others or on its own account. The cryptocurrency is principally acquired with the purpose of selling in the near future and generating a profit from fluctuations in price or broker-traders' margin, and therefore, is within the scope of IAS 2
- There is a liquid market for the specific cryptocurrencies that Entity A trades and, as such, the cryptocurrencies are readily convertible to cash. Entity A measures its cryptocurrency at FVLCS in accordance with paragraph 3(b) of IAS 2.
- On January 1, 2018, Entity A purchased 100 units of cryptocurrency at $1,000/unit for a total cost of $100,000.
- On January 15, 2018, the entity enters into a sales agreement with a customer to deliver 100 units of that same cryptocurrency (i.e., non-financial item) on January 31, 2018 for $1,100/unit. The fair value of the contract was nil at the date it was entered into as the contract was at the money.
- On January 31, 2018, Entity A delivers the cryptocurrency to the customer and collects $110,000 cash. On this date and immediately prior to sale, the fair value of the cryptocurrency was $1,050/unit.
- For simplicity, all other costs, such as fees paid to validate transactions and any other costs to purchase or dispose of the cryptocurrencies in question, are assumed to be nil.
- Entity A assesses the sales agreement and determines it meets the own use scope exception in paragraph 2.4 of IFRS 9. The sales agreement was entered into for delivering the cryptocurrency in accordance with Entity A's expected sale requirements. Entity A does not have a history of settling similar contracts net in cash or another financial instrument or by exchanging financial instruments. Entity A does not make the designation permitted in IFRS 9 to measure the sales agreement at fair value through profit and loss.

### *Issue 2A: Given this sales agreement meets the own use scope exception in IFRS 9, how should the commodity broker-trader record and present the sale of the cryptocurrency on the statement of comprehensive income?*

*Analysis*

Entity A is not required to apply IFRS 9 because the sales agreement meets the own use scope exception. Appendix A of IFRS 15 defines revenue as "income arising in the course of an entity's ordinary activities." In this fact pattern, the purchase and sale of cryptocurrency are activities within the ordinary course of Entity A's operations and the sale is with a customer. Therefore, the commodity broker-trader applies IFRS 15 to the sale of its cryptocurrency inventory.

Paragraph 82 of IAS 1 *Presentation of Financial Statements* requires that the statement of comprehensive income include a separate line for revenue. Paragraph 113 of IFRS 15 further requires separate presentation or disclosure of revenue from contracts with customers.

Based on paragraph 3(b) of IAS 2, Entity A is only excluded from applying IAS 2 in measuring its inventories. This means that the non-measurement requirements in IAS 2 still apply, such as paragraph 34 of IAS 2 that states "[w]hen inventories are sold, the carrying amount of those inventories shall be recognised as an expense in the period in which the related revenue is recognised."

The following reflects the journal entries that Entity A should record for the sales agreement:

| **Activity** | **Journal Entry** |
|---|---|
| Purchase of cryptocurrency on Jan. 1 | Dr: Cryptocurrency inventory $100,000<br>Cr: Cash $100,000 |
| Change in FVLCS of cryptocurrency on Jan. 15 | Dr: Cryptocurrency inventory $10,000<br>Cr: Remeasurement gains/losses $10,000 |
| Change in FVLCS of cryptocurrency prior to sale | Dr: Remeasurement gains/losses $5,000<br>Cr: Cryptocurrency inventory $5,000 |
| Sale and transfer of cryptocurrency on Jan. 31 | Dr: Cash $110,000<br>Cr: Revenue $110,000<br>Dr: Expense for cryptocurrency inventory sold including realized changes in FVLCS $105,000<br>Cr: Cryptocurrency inventory $105,000 |

Although different presentation approaches are possible in the statement of comprehensive income, the composition of the line items presented should be transparent and the line-item descriptions should faithfully represent the composition. Entities should also consider disaggregating actual cost of sales from realized and unrealized cryptocurrency inventory remeasurement gains and losses. If an entity presents a gross margin subtotal, entities should ensure it is transparent as to whether that subtotal includes or excludes unrealized cryptocurrency inventory remeasurement gains and losses.

*The Group's Discussion*

Some Group members commented that Fact Pattern 2A is not commonly observed in today's market because cryptocurrencies are typically traded at the spot rate instead of settling through forward contracts. However, one Group member noted that it is possible an exchange traded fund may be created for cryptocurrencies in the future, in which case forward contracts may become more common.

A few Group members also indicated not seeing commodity broker-traders apply the own use scope exception. A question was raised as to whether such scope exception is available to commodity broker-traders because their intent is to acquire and sell to generate profit from fluctuations in price. The own use scope exception is for contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item. The scope exception's objective does not seem to describe broker-traders, who are neither consumers nor producers of the items they trade.

In discussing the presentation approaches in the statement of comprehensive income, several Group members noted that the factors to consider are similar to the discussion in June 2018 on the cannabis accounting topic.[1] Given the current guidance in IAS 1, different presentation approaches could exist. However, consistent with the above analysis, entities should consider their financial statement users' needs and provide information that is sufficiently disaggregated and transparent so that the users understand what is, or is not, included in the financial statement line items presented.

*Fact Pattern 2B*

- The facts are the same as Fact Pattern 2A, except that Entity A concludes that the sales agreement does not meet the own use scope exception in paragraph 2.4 of IFRS 9. The reason is that Entity A has a history of settling similar contracts on a net cash basis.
- The sales agreement is accounted for as a derivative within the scope of IFRS 9. Entity A does not designate the derivative as part of a hedging relationship for accounting purposes.

***Issue 2B: Given this sales agreement does not meet the own use scope exception in IFRS 9, how should the commodity broker-trader record and present the sale of the cryptocurrency on the statement of comprehensive income?***

*Analysis*

The IFRS Interpretations Committee discussed a fact pattern that is consistent with Fact Pattern 2B at its November 2018 meeting.[2] The tentative agenda decision indicated that the request assumes that the entity has an accounting policy of recognizing revenue on a gross basis for such contracts. The Committee only addressed the submitter's question, which is whether the entity is permitted or required to make an additional journal entry that would:

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1 In June 2018, the Group discussed how changes in the fair value less costs to sell of cannabis plants should be presented in the statement of comprehensive income (i.e., IAS 2 and IAS 41: Cannabis Accounting – Presentation).

2 Refer to the IFRS Interpretations Committee's tentative agenda decision, "Physical settlement of contracts to buy or sell a non-financial item (IFRS 9 *Financial Instruments*)."

- reverse the accumulated gain or loss previously recognized in profit or loss on the derivative (even though the fair value of the derivative is unchanged); and
- recognize a corresponding adjustment to either revenue (in the case of the sale contract) or inventory (in the case of the purchase contract).

The Committee concluded that IFRS 9 neither permits nor requires an entity to make the additional journal entry described in the request as it would effectively negate the requirement in IFRS 9 to account for the contract as a derivative.

However, a secondary question is whether the sales agreement can be recognized either on a gross basis (i.e., revenue and cost of sales) or net basis (i.e., net profit or loss in a similar manner to a trading transaction) upon physical settlement in delivering the cryptocurrency.

Based on the assumption in the tentative agenda decision, it seems to suggest there is an accounting policy of recognizing revenue on a gross basis or on a net basis. However, the Committee did not specifically address whether the sale would be recognized as revenue under IFRS 15 or other revenue under a gross basis.

The journal entries for physical settlement of the sales agreement on either gross and net presentation would be as follows:

<table>
<tr><th>Activity</th><th colspan="2">Journal Entries<br>(same for gross and net presentation basis except as noted below)</th></tr>
<tr><td>Purchase of cryptocurrency on Jan. 1</td><td colspan="2">Dr: Cryptocurrency inventory $100,000<br>Cr: Cash $100,000</td></tr>
<tr><td>Change in FVLCS of cryptocurrency on Jan. 15</td><td colspan="2">Dr: Cryptocurrency inventory $10,000<br>Cr: Remeasurement gains/losses $10,000</td></tr>
<tr><td>Change in fair value of contract prior to sale</td><td colspan="2">Dr: Derivative asset/liability $5,000<br>Cr: Derivative gains/losses $5,000</td></tr>
<tr><td>Change in FVLCS of cryptocurrency prior to sale</td><td colspan="2">Dr: Remeasurement gains/losses $5,000<br>Cr: Cryptocurrency inventory $5,000</td></tr>
<tr><th></th><th>Gross Presentation Basis</th><th>Net Presentation Basis</th></tr>
<tr><td>Physical settlement of sales contract and transfer of cryptocurrency on Jan. 31</td><td>Dr: Cash $110,000<br>Cr: Derivative asset/ liability $5,000<br>Cr: Revenue $105,000<br><br>Dr: Expense for cryptocurrency inventory sold including realized changes in FVLCS $105,000<br>Cr: Cryptocurrency inventory $105,000</td><td>Dr: Cash $110,000<br>Cr: Derivative asset/ liability $5,000<br>Cr: Cryptocurrency inventory $105,000</td></tr>
</table>

The comments on the presentation format under the analysis of Issue 2A would also apply to Issue 2B. In addition, the presentation of the derivative gain or loss in the statement of comprehensive income would follow Entity A’s policy for the presentation of gains and losses on derivatives not designated as hedges for accounting purposes.

*The Group's Discussion*

One Group member considered the substance of a commodity broker-trader's activity, which is to make profit on commission by buying or selling for others or on its own account. In this case, recording the sale of the cryptocurrency on a gross basis, with cost of goods sold, does not seem consistent with the commodity broker-trader's activity. Alternatively, the commodity broker-trader could present the transaction on a net basis that would show the commission or profit from acquiring and selling the cryptocurrency. A few Group members thought commodity broker-traders would likely present the transaction using a net basis given the nature of their activities.

Several Group members were unclear whether the IFRS Interpretations Committee's tentative agenda decision is intended to apply to a situation involving a commodity broker-trader. The Group recommended that the AcSB staff seek clarity on whether the scope of the tentative agenda decision is intended to encompass the activities of commodity broker-traders.

Overall, the Group's discussion raises awareness of other scenarios that may involve cryptocurrencies. Except for the AcSB staff seeking clarity on the intent of the IFRS Interpretations Committee's tentative agenda decision, no further action was recommended to the AcSB.

(For a full understanding of the discussions and views expressed, listen to the audio clip).