What You Need To Know Before Adding Cryptocurrencies To Your Balance Sheet

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From Square's purchase of $170 million in bitcoin to Tesla's sizable $1.5 billion purchase, 2021 is off to a running start as notable public companies adopt crypto-friendly investment strategies. Whether the appeal is the anticipation of quick returns, a means to preserve wealth or, more simply, the fear of missing out, the trend is likely to continue.

Meanwhile, financial leaders, accountants, lawyers and other advisers anxiously await much needed regulatory guidance. Notwithstanding the show of faith by Tesla and Square, 84% of finance executives do not plan to hold bitcoin as a corporate asset due to financial volatility and presumed risk. Further, 18% noted "complex accounting treatment" as a reason to hold off digital asset purchases.[1] The SEC and FASB have not yet issued cryptocurrency-specific rules or regulations, however, some limited guidance attempts to analogize and retrofit current frameworks to these emerging asset classes. Similarly, U.S. GAAP does not yet include targeted guidance on accounting for cryptocurrencies. Here, we outline certain U.S.

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regulatory and accounting considerations when adding cryptocurrency to the balance sheet.

What is the Asset Class?

In the case of bitcoin and similar cryptocurrencies, determining the appropriate asset class is an exercise of elimination and deduction. It is not cash or a cash equivalent, it is clearly not a physical asset and it does not pass the SEC's Howey Test to qualify as an investment. Rather, the SEC considers bitcoin a commodity (though Ripple Lab's recent win alludes to potential scrutiny in the SEC's analyses and resulting classifications). When perusing the list of asset contenders, under U.S. GAAP, bitcoin lands in the intangible asset bucket.[2]

How is it Treated?

As an intangible asset, a company would initially record its purchase of the cryptocurrency at cost, or the price paid for the asset. The company must assess impairment of the asset at least annually and more frequently in the case of a "triggering event," or when there is greater than 50% probability that the fair value of the bitcoin is below the value currently presented in its financial statements. If a company determines, following the annual or ad-hoc assessment, that the asset is impaired, the company must write down the asset and record a loss. If there is a subsequent rebound or substantial appreciation in value of that asset? For U.S. filers, the answer is "too bad"—any gains must wait until the cryptocurrency is sold or disposed of (companies under IFRS may recoup subsequent gains through Other Comprehensive Income).

Some argue the existing accounting rules for traditional assets are not compatible with the realities and use cases for digital assets, and there was hope for imminent, pointed guidance. FASB, however, confirmed again in March 2021 that it removed digital currencies from its agenda, in part, based on research indicating that the "issues" around cryptocurrency were not pervasive.[3]

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Key Risk Considerations

Cryptocurrencies like bitcoin are fairly easy to record at purchase because companies generally know the amount paid for an asset and little judgement is required. The subsequent analysis and accounting, however, involves significant judgment and subjectivity. The resulting increased risk coupled with the volatility and security concerns of cryptocurrency also necessitates clear and thorough internal policies and public disclosures.

Consideration: Triggering Events

Companies should carefully consider, based

on the overall risk tolerance of the Board and management, how internal policies define triggering events related to cryptocurrency. As the cryptocurrency market is volatile, companies should clarify expectations for the accounting team on both qualitative and quantitative tests:

- *How frequently should the company check the price of the relevant cryptocurrency?*
- *What pricing index will the company rely upon?*
- *What percentage change thresholds should a company apply?*
- *What type of documentation should the company retain to evidence the decision to perform an impairment test, or often more important, the decision not to perform the test?*
- *What type of industry reports should be reviewed?*

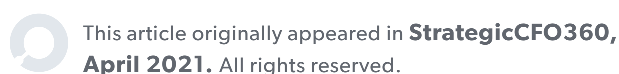
These types of ongoing procedures may become cumbersome for the accounting team without clear, internally documented responsibilities.

Consideration: Public Disclosures

As with all financial statement line items, disclosure is critical, especially related to company assumptions, judgements or estimates. Regarding cryptocurrency, companies should disclose, among other items, if any triggering events occurred during the period, methods and key assumptions related to impairment testing performed and related conclusions, and if the company used or sold cryptocurrency in business transactions. The SEC is likely to scrutinize these cryptocurrency disclosures, and, as many blockchain-based transactions are anonymous in nature, this can also affect completeness and accuracy of disclosures for related parties. It is equally important for companies to disclose the risks (e.g., unknown regulatory future, no long-term basis for longevity of cryptocurrency, cyber and fraud risks) related to their purchases, and make investors aware where cryptocurrency may affect the operations of a company. For example, as companies in diverse industries (e.g., automobile manufacturing, technology) are investing in cryptocurrency, investors should be made aware if this is a one-time transaction or a shift in the business model.

Conclusion

In the absence of defined guidance within U.S. GAAP, financial leaders, accountants, lawyers and other advisers are currently navigating the complexities of accounting considerations when purchasing cryptocurrency. Bitcoin and other popular virtual commodities are not investments. Under current SEC and accounting guidance, these cryptocurrencies qualify as intangible assets and are subject to valuation and impairment testing rules under GAAP. And this class of assets is often subject to extreme volatility. Therefore, when incorporating crypto-friendly investment strategies, it's important for organizations to identify potential risks associated with significant impairments early on, as well as carefully consider how and when to disclose these risks in public filings and statements.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[1] https://www.gartner.com/en/newsroom/press-releases/2020-02-16-gartner-survey-suggests-most-finance-executives-not-planning-to-hold-bitcoin-as-a-corporate-asset

[2] ASC 350, Intangibles—Goodwill and Other

[3] https://www.fasb.org/jsp/FASB/Document_C/DocumentPage&cid=1176176260390

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