



In This Issue

- [Introduction](#)
- [FASB Reaches Tentative Decisions on Presentation and Disclosure Requirements](#)
- [A Recap of Discussions at the 2022 AICPA & CIMA Conference on Current SEC and PCAOB Developments](#)
- [“Dear Issuer” Letter](#)
- [Looking Ahead](#)
- [Contacts](#)

Crypto Assets — A Flurry of Activity as the Year Comes to a Close

Introduction

On the heels of recent marketplace news and activity in the crypto industry, there has been a flurry of activity associated with accounting and reporting considerations related to crypto assets, specifically by both the FASB and the SEC. The FASB once again discussed its project on the accounting for and disclosure of crypto assets at its December 14, 2022, meeting, reaching tentative decisions on the presentation and disclosure of those assets. Meanwhile, the SEC staff spoke about digital assets in a number of sessions at the 2022 AICPA & CIMA Conference on Current SEC and PCAOB Developments, focusing on (1) the accounting for crypto lending arrangements, (2) [SEC Staff Accounting Bulletin \(SAB\) No. 121](#) (SAB 121), (3) other accounting and disclosure considerations, and (4) considerations related to assurance and internal control over financial reporting (ICFR). Further, in light of recent bankruptcies and financial distress in the crypto market, the SEC’s Division of Corporation Finance (the “Division”) issued a “Dear Issuer” [sample letter](#) on December 8, 2022, to companies regarding recent developments related to the crypto asset markets.

This publication summarizes the FASB’s and SEC’s most recent activity and discussions related to crypto assets, including the issuance of the Division’s “Dear Issuer” letter. For information about the FASB’s other tentative decisions related to its project on the accounting for and disclosure of crypto assets, see Deloitte’s [September 8, 2022](#), and [October 18, 2022](#), *Heads Up* newsletters.

FASB Reaches Tentative Decisions on Presentation and Disclosure Requirements

At its December 14, 2022, [meeting](#), the FASB reached the following tentative decisions on presentation and disclosure requirements for crypto assets:

- *Presentation* — The Board tentatively decided to require an entity to:
 - Present on the balance sheet the aggregate amount of crypto assets (within the scope of the Board’s project on the accounting for and disclosure of such assets¹) separately from other intangible assets that are measured through the use of other measurement bases (e.g., intangible assets that are measured at cost less impairment).
 - Present gains and losses on crypto assets in net income² and separately present changes in the carrying amount (e.g., impairments and amortization) of other intangible assets that are measured through the use of other measurement bases (e.g., goodwill and other intangible assets subject to ASC 350).
 - Classify crypto assets received as noncash consideration in the ordinary course of business that are converted nearly immediately³ into cash as operating cash inflows.



Connecting the Dots

The Board acknowledged that some stakeholders were concerned about the net income volatility that could result from presenting fair value changes in net income. However, the Board believed that the benefits derived from holding a crypto asset are similar to those derived from holding equity securities that have a readily determinable fair value (i.e., holding and selling crypto assets at an appreciated value). As a result, the Board unanimously decided to require fair value changes in crypto assets to be presented within net income.

Further, the Board’s tentative decision to require the presentation of crypto assets received as operating cash inflows if those assets are converted nearly immediately was in response to a particular fact pattern that could potentially distort financial statement information. In this fact pattern, an entity would, in the normal course of business, receive crypto assets as noncash consideration for a revenue-generating activity. If the entity were to immediately convert the crypto assets it just received for cash, the cash flows associated with converting the crypto assets would be presented as investing cash flows. As a result, the cash flows associated with the crypto assets received in the normal course of business might not be classified as operating cash flows under current guidance, an outcome that the Board believes would not represent the economics of the transaction. Accordingly, the Board tentatively decided that an entity should be required to classify as operating cash flows those crypto assets that are received as noncash consideration if the crypto assets are converted nearly immediately for cash.

¹ At its August 31, 2022, meeting, the Board tentatively decided that a crypto asset would be within the scope of this project if it is an intangible asset that (1) is secured by cryptography residing on a distributed ledger, (2) is fungible, and (3) does not provide the holder with an enforceable right to, or claims on, goods, services, other assets. For more information about the project’s scope, see Deloitte’s September 8, 2022, [Heads Up](#).

² At its October 12, 2022, meeting, the Board tentatively decided that all entities would be required to initially measure crypto assets at fair value in accordance with ASC 820, with subsequent changes in fair value being recognized in comprehensive income. For more information about the decision to require fair value measurement, see Deloitte’s October 18, 2022, [Heads Up](#). For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte’s [“Titles of Topics and Subtopics in the FASB Accounting Standards Codification.”](#)

³ The FASB did not expand on what would be considered “nearly immediately” at the Board meeting or in its summary of tentative Board decisions.

- *Disclosure* — The Board tentatively decided to require an entity to:
 - Disclose, in both interim and annual periods, significant crypto asset holdings, including the name, cost basis, fair value, and number of units of each significant crypto asset held as well as how the cost basis was determined (e.g., average cost, specific identification). Fair value and cost basis of the entity's other insignificant crypto asset holdings may be aggregated into a single line item.
 - Disclose, at year-end, a reconciliation of activity for its crypto holdings. The reconciliation would include information such as purchases, sales, gains, and losses during the period and a description of purchases and sales made during the period.
 - Disclose, at year-end, the difference between the sale price and the cost basis of crypto assets sold during the period.
 - Disclose, in both interim and annual periods, the nature and duration of restrictions on the sale of crypto assets and circumstances that could cause a lapse in the restrictions.
 - Comply with all ASC 820 disclosure requirements for crypto assets for both interim and annual periods.

The presentation and disclosure requirements would apply to all public and private entities.

Next Steps

The FASB will discuss potential scope refinements and transition requirements for crypto assets at a future meeting.

A Recap of Discussions at the 2022 AICPA & CIMA Conference on Current SEC and PCAOB Developments

Digital assets were once again an area of focus in several sessions of this year's conference. In response to recent market conditions, an SEC commissioner emphasized that individuals and businesses in the digital asset market should leverage the lessons learned from traditional finance: investors and counterparties should perform appropriate due diligence, ask for proof of reserve, and be mindful of conflicts of interest and other counterparty and investment risks. However, the commissioner noted that while it is prudent for businesses dealing with crypto assets to apply best practices and that some regulation may follow, such regulation should not be so difficult to comply with that it becomes a barrier to entry for smaller companies.

In addition, the SEC staff observed that there are a number of different accounting issues that the SEC has spent considerable time addressing. For arrangements for which there are no accounting standards that are directly on point, the staff has drawn upon existing accounting standards in determining which accounting treatment best depicts the economics of digital asset arrangements. The staff emphasized that there are unique risks inherent to arrangements involving digital assets that are not present in other types of arrangements.

Accounting for Crypto Lending Arrangements

The SEC staff stated that it has observed different approaches in the application of U.S. GAAP or IFRS[®] Accounting Standards to crypto lending transactions and that the staff believes that some of the approaches do not faithfully represent the underlying economics of the transactions or serve the needs of investors. The staff described a basic fact pattern in which a lending entity loans a fixed quantity of crypto assets to a borrower for a specific period. While the loan is outstanding, the borrower has the right to use the crypto assets at its sole discretion (e.g., to sell or to pledge the crypto assets to a third party). At the end of the loan term, the borrower is required to return the same type and quantity of crypto assets to the lending entity. The lending entity earns a fee as compensation, which is typically expressed as

a percentage of the crypto assets lent. In certain arrangements, the lending entity might also require the borrower to pledge collateral to the lending entity.

The SEC staff stated that with regard to this fact pattern, it concluded that it would not object to the following accounting treatment:

- The lending entity derecognizes the crypto assets when they are lent to the borrower because the lending entity no longer has the right to the economic benefits of the crypto assets and therefore does not have control over the crypto assets lent until they are returned.
- At derecognition of the crypto assets, the lending entity recognizes an asset that reflects the lending entity's right to receive the crypto assets back from the borrower (referred to below as a crypto asset loan receivable), as follows:
 - The crypto asset loan receivable would be measured at inception and at subsequent reporting dates on the basis of the fair value of the crypto assets lent, with changes in fair value reflected in profit and loss. The staff noted that this accounting could result in the recognition of a gain or loss at the inception of the loan, which would be calculated as the difference between the carrying value of the crypto assets and the fair value of the lent crypto assets at the time of the loan's inception. The staff also noted that it believes that any gains or losses that are recorded upon initial derecognition of the lent crypto assets or are based on remeasurement of the crypto asset loan receivable would be presented separately from revenue in the income statement.
 - Because the lending transaction exposes the entity to the borrower's credit risk, the entity should recognize an allowance for credit losses at the inception of the loan and at the end of each subsequent reporting period. In recognizing the allowance, the lending entity would look to the principles of ASC 326 under U.S. GAAP or to IFRS 9⁴ under IFRS Accounting Standards.



Connecting the Dots

At its October 12, 2022, Board [meeting](#) to discuss its project on the accounting for and disclosure of crypto assets, the FASB tentatively decided to require all public and private entities to initially and subsequently measure certain crypto assets at fair value in accordance with ASC 820. If that proposed requirement is included in a final ASU,⁵ we would expect that upon adoption of such guidance by an entity that applies U.S. GAAP, any gain or loss recognized upon the lending of digital assets within the scope of the ASU related to the difference between (1) the carrying value of the lent assets and (2) the fair value of the crypto asset loan receivable would be minimal; this is because the assets would be required to be carried at fair value. However, there may still be a requirement to record a loss related to the lending entity's recognition of an allowance for credit losses.

⁴ IFRS 9, *Financial Instruments*.

⁵ The FASB has not yet completed its standard-setting due process in the project, which includes reaching decisions on other aspects of the guidance. In addition, once it reaches decisions on those matters, the Board would still need to expose for public comment a proposed ASU on the project before finalizing any requirements. Accordingly, an entity that is not considered an investment company or a broker-dealer should continue to measure crypto assets at historical cost less impairment.

The SEC staff also emphasized the importance of disclosing information to satisfy the overall principle of providing investors with information regarding the terms, nature, and risks and uncertainties associated with the arrangements. Entities should look to existing accounting guidance as a starting point in identifying other relevant disclosures to meet the overall principle. The staff listed some examples of disclosures that it would expect regarding these types of arrangements:

- *Collateral* — As noted above, lending arrangements may require the borrower to post collateral to the lender. In such instances, the staff would expect disclosures of the following:
 - A description of the type and amount of collateral posted by the borrower.
 - Any requirement for the borrower to pledge additional collateral during the term of the loan.
 - How the lending entity monitors its ability to liquidate the collateral in the case of the borrower's default.
 - Changes in the collateral's fair value during the term of the loan.
- *Credit risk* — The staff would expect disclosure of information that would give investors insight into how the lending entity monitors and manages its exposure to credit risk. The disclosures currently required by ASC 326 or IFRS 7⁶ (which includes disclosure requirements for financial instruments within the scope of IFRS 9) provide a meaningful starting point for considering which disclosures would be important for investors. Specific disclosures the staff would expect include:
 - Factors that management considers in evaluating and managing the entity's exposure to credit risk at inception and on an ongoing basis.
 - Qualitative and quantitative factors influencing estimates of expected credit losses.
 - Changes during the period in the allowance for expected credit losses, including current-period provisions, write-offs, and recoveries of previous write-offs.
 - Crypto asset loans that are past due and the determination of such status.

The SEC staff also stated that lending entities should consider providing disclosures if a lending arrangement involves a related party or concentration of credit risk. Finally, the staff noted that the examples given are not intended to represent a comprehensive list, and entities should think about how to provide decision-useful information.



Connecting the Dots

The treatment described by the SEC staff is different from the approach previously outlined in Q&A 25 of AICPA Practice Aid [Accounting for and Auditing of Digital Assets](#). The response to the Q&A was subsequently rescinded. Companies should consider consulting with their professional advisers for assistance with lending-related transactions associated with crypto assets.

SAB 121

On March 31, 2022, the SEC issued [SAB 121](#), which:

- Provides the SEC staff's view that it would be appropriate for an entity that has an obligation to safeguard crypto assets to record a liability and corresponding asset on its balance sheet at the fair value of the crypto assets.

⁶ IFRS 7, *Financial Instruments: Disclosures*.

- Adds Section FF to SAB Topic 5;⁷ this section includes “interpretive guidance for entities to consider when they have obligations to safeguard crypto-assets.”

During the session on current projects of the SEC’s Office of the Chief Accountant at the 2022 AICPA & CIMA Conference on Current SEC and PCAOB Developments, the SEC staff reiterated the unique risks and complexities of arrangements involving digital assets and noted that the SEC has received questions since the issuance of SAB 121 specifically related to its scope. The staff emphasized that it is important for companies to understand the facts and circumstances of a transaction when determining whether it is within the scope of SAB 121.

For additional information, see Deloitte’s April 6, 2022 (updated July 28, 2022), [Financial Reporting Alert](#) and Appendix B of the AICPA Practice Aid [Accounting for and Auditing of Digital Assets](#).

Other Accounting and Disclosure Considerations

The SEC staff discussed accounting issues related to crypto assets deemed to be securities when the issuer is registering the assets in compliance with federal securities laws (often referred to as an initial coin offering). The staff emphasized that it is important for an entity to understand the explicit and implicit terms and conditions of the crypto assets being offered in determining the accounting treatment. The staff also noted that such terms should be clearly disclosed in the filings. It shared the following nonexhaustive list of examples of important terms that the Division may focus on when reviewing companies’ filings:

- Vesting terms.
- Conversion features.
- Holder’s ability to obtain or transfer the crypto assets, or return them to the issuer.
- Voting rights, dividends, and other distribution features.
- Minimum sale or issuance requirements.
- Consideration of rights or obligations contingent on future events.
- Sales of future token issuances.
- In instances in which obligations are related to the issuance of assets upon completion of technology supporting the asset, a description of development status and the expected date the technology will be completed.

In addition, the SEC staff noted that a company’s accounting conclusions should be well-supported, including providing the rationale for rejecting other alternatives, and that such conclusions should be communicated with the company’s auditors and audit committee. To help facilitate a smooth review, companies should complete such preparations before submitting any registration statement or offering document to the staff.

Assurance and ICFR

The SEC staff shared views regarding auditing transactions involving crypto assets, emphasizing the importance of risk assessment, understanding the company’s ICFR, and the audit response planned for the identified risks as well as evaluating whether sufficient audit evidence has been obtained. The staff noted, at a high level, that there are a host of audit considerations that come with the novelty related to crypto assets, including whether companies need to engage the services of individuals with specialized skills or knowledge in

⁷ SEC Staff Accounting Bulletin Topic 5.FF, “Miscellaneous Accounting: Accounting for Obligations to Safeguard Crypto-Assets an Entity Holds for Its Platform Users.”

cryptography, distributed ledger technology, valuation, or the related laws and regulations. The staff further observed that in light of the abundance of factors to consider and the potential risks, ongoing risk assessment is crucial in the design and implementation of processes and controls to respond to those risks.

The SEC staff cited the following examples of factors to consider as part of a risk assessment:

- How the private keys are generated and managed.
- Whether there is a fraud risk.
- Whether there is a risk of management override of controls over the private keys that could result in the misuse or misappropriation of assets.
- Whether the information pulled from the blockchain is reliable and whether third-party providers are involved.

Further, when crypto assets are on a decentralized blockchain, auditors need to be mindful of the risks associated with related-party transactions because (1) pseudonyms are widely used and (2) it can be difficult to spot a related-party transaction. Moreover, because of the way the blockchains are designed, it is nearly impossible to reverse fraudulent or erroneous transactions.

In the session on PCAOB inspection updates, the PCAOB staff indicated that the Board continues to select audits for inspection when transactions in crypto assets are material to the financial statements. The PCAOB staff also noted an inspection deficiency in which the auditor's procedures for evaluating the sufficiency and appropriateness of the evidence obtained for crypto assets or crypto transactions were insufficient.

For more information about the 2022 AICPA & CIMA Conference on Current SEC and PCAOB Developments, see Deloitte's December 18, 2022, [Heads Up](#).

“Dear Issuer” Letter

On December 8, 2022, the Division released the “Dear Issuer” [letter](#) that highlights the types of comments the Division may issue regarding the need for entities to evaluate their exposure to recent bankruptcies and financial distress in the crypto asset markets, as well as their exposure to other parties and regulatory impacts, and to address any such material impacts in their disclosures.

The letter urges companies to “evaluate their disclosures with a view towards providing investors with specific, tailored disclosure about market events and conditions, the company's situation in relation to those events and conditions, and the potential impact on investors.” At the 2022 AICPA & CIMA Conference on Current SEC and PCAOB Developments, the SEC staff also explained that the sample letter focuses on the direct and indirect impact of market events, which may include:

- A company's exposure to counterparties and other market participants' risks.
- Risks related to the company's liquidity and ability to obtain financing.
- Risks related to legal proceedings.
- Investigations or other regulatory impacts in the crypto asset markets.

The SEC staff stated that the comments in the letter should not be considered new disclosure requirements but rather example comments that the staff may issue on the basis of current disclosure requirements. Companies may determine that some of the example comments do not apply to their businesses. In addition, companies should exercise judgment in evaluating

their disclosures because the list of comments in the letter is not meant to be comprehensive. The staff also reminded companies that they should consider these disclosures in transactional filings and disclosure documents that might not typically be subject to further review by the Division, such as automatically effective registration statements or prospectus supplements for takedowns from existing shelf registration statements.

Looking Ahead

As the crypto and digital assets world continues to evolve, the accounting issues may likewise change. The accounting considerations for transactions in this space can be complex, and the appropriate treatment will depend on the specific facts and circumstances. Therefore, entities may need to use judgment and consider consulting with their accounting advisers and legal counsel in making this determination. Entities should also continue to monitor the evolving legal and regulatory landscape.

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