Deloitte.

Heads Up | Volume 30, Issue 6
April 25, 2023

In This Issue

- Overview
- AICPA Practice Aid Updated in Response to SEC Staff's Views
- Recent Restatements of Crypto Asset Miners Related to Digital Asset Impairment
- Recent Crypto Transactions Gaining Popularity
- Contacts

AICPA Updates Practice Aid on Digital Assets, and Other Crypto Accounting Hot Topics

Overview

The accounting for digital assets continues to evolve and make news. In March 2023, the FASB issued a proposed ASU[1] on the accounting for and disclosure of crypto assets (see Deloitte's March 27, 2023, *Heads Up* for additional details). In addition, at the 2022 AICPA & CIMA Conference on Current SEC and PCAOB Developments, the SEC staff presented its views on the accounting for crypto lending (the "SEC staff's views"[2]), which prompted the AICPA to update its practice aid *Accounting for and Auditing of Digital Assets*[3] in February 2023 to reflect those views. Further, during the first quarter of 2023, we observed certain restatements by crypto miners related to their application of the impairment guidance on intangible assets in ASC 350.[4] There has also been a recent uptick in certain types of transactions involving crypto assets in which entities must use significant judgment to determine and apply the appropriate accounting model.

This *Heads Up* discusses (1) the updates made to the AICPA practice aid in response to the SEC staff's views, (2) certain restatements of crypto asset miners, and (3) recent crypto asset transactions that are gaining popularity.

[1] FASB Proposed Accounting Standards Update (ASU), *Intangibles — Goodwill and Other — Crypto Assets (Subtopic 350-60): Accounting for and Disclosure of Crypto Assets.*

[2] For additional information on the SEC staff's views, see Deloitte's December 23, 2022, *Heads Up*.

[3] The practice aid provides nonauthoritative interpretive guidance from the AICPA's Digital Asset Working Group on how to account for and audit digital assets.

[4] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

AICPA Practice Aid Updated in Response to SEC Staff's Views

Q&A 25 in the AICPA practice aid discusses crypto asset lending. Before it was updated in February 2023 to reflect the SEC staff's views, Q&A 25 stated the following:

> Assume a lender lends 100 units of a crypto asset (Crypto Asset ABC) for a term of six months to a borrower. The borrower will pay a fee in total of six units of Crypto Asset ABC for borrowing Crypto Asset ABC during the six-month loan period, paying one unit of Crypto Asset ABC 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, the borrower is required to deliver 100 units of Crypto Asset ABC back to the lender. For purposes of the Q&A, assume that:
>
> - Crypto Asset ABC is an intangible asset under FASB ASC 350.
> - The ownership of loaned Crypto Asset ABC is transferred to the borrower upon the transfer, and the borrower has the right to transfer, encumber or pledge the crypto asset in any way it chooses.
> - The borrower is not required to post collateral to the lender in the arrangement.
> - The borrower has identified its functional currency as the U.S. dollar under FASB ASC 830, *Foreign Currency Matters*.
>
> How should the lender account for the loan?

Under superseded Q&A 25, the lender's accounting could be summarized as follows:

- The lender would have applied the guidance in ASC 610-20 or ASC 606 when accounting for the transfer of Crypto Asset ABC that was deemed to be an intangible asset under ASC 350-10-40-1.
- After applying the guidance in ASC 610-20 or ASC 606, as appropriate, the lender would have continued to recognize Crypto Asset ABC on its balance sheet because control of Crypto Asset ABC was not transferred to the borrower since the borrower was required to return 100 units of Crypto Asset ABC. As a result, control would not have passed to the borrower under the repurchase agreement provisions in ASC 606-10-55-68.
- Because control of Crypto Asset ABC had not passed to the borrower, the lender would have presented the loaned Crypto Asset ABC by using a balance sheet caption that reflected the fact that Crypto Asset ABC had been loaned to another party (e.g., Crypto Asset ABC loaned).
- The lender would have continued to account for the loaned Crypto Asset ABC under the intangible asset model in ASC 350.

That guidance can be contrasted with the guidance in updated Q&A 25, which includes the following key takeaways:

- Under U.S. GAAP, there is no explicit guidance on crypto lending.
- The SEC staff believes that it *would be appropriate* for a lender to derecognize a crypto asset when it is lent to the borrower because control of the asset has transferred to the borrower.[5]
- At derecognition of a crypto asset, the SEC staff would *not object* to the lender's recognition of an asset that reflects the lender's right to receive the asset 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 on 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. This accounting could result in the recognition of a gain or loss at the inception of the loan, which would be presented separately from revenue in the income statement and measured as the

[5] Updated Q&A 25 indicates that in the assessment of "whether the crypto assets lent should be derecognized in this fact pattern, various indicators of control and elements of asset derecognition would be considered." The Q&A provides a list of such indicators.

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.

    - Because the lending transaction exposes the lender to the borrower's credit risk, the lender should recognize an allowance for credit losses related to the crypto asset loan receivable in accordance with ASC 326.

- The SEC staff *would not object* to an entity's application of the updated guidance as the adoption of a new accounting principle under ASC 250. In such a case, the entity would be required to account for the change in accounting principle on a retrospective basis for all periods presented.

Updated Q&A 25 also provides some additional disclosures that may apply to crypto lending arrangements, including those associated with (1) the terms, risks, and nature of the lending arrangement; (2) the collateral provided in the arrangement (if required); (3) how an entity applied ASC 326 when determining the expected credit losses at inception; and (4) an entity's vulnerability to concentrations under the principles of ASC 275, ASC 850, and ASC 820, as applicable.

In addition, the AICPA notes in updated Q&A 25 that it understands that "the SEC staff would not object to similar conclusions under IFRS, including application of the principles in IFRS 9, *Financial Instruments* regarding the allowance for credit losses." An entity reporting under IFRS® Accounting Standards should therefore consider the model described above when accounting for crypto lending arrangements, especially if it is planning to go public in the United States.

Connecting the Dots

Under the model in updated Q&A 25, entities derecognize and measure loaned crypto assets at fair value and take into account credit risk, which is a significant change from the guidance in the superseded Q&A. Accordingly, entities applying the updated Q&A's guidance could see material changes to their financial statements. Public entities, and private entities seeking to register with the SEC, are subject to the SEC's requirements, which are reflected in updated Q&A 25. Other private companies should consider whether they would achieve better financial reporting results under the guidance in the updated Q&A and should consult with their accounting advisers if they wish to retain the view in the superseded Q&A.

Entities should note that the guidance in updated Q&A 25 applies only to (1) lender accounting (the AICPA's position on borrower accounting, as illustrated in Q&A 26 of the practice aid, has not changed) and (2) crypto assets accounted for as intangible assets. Accordingly, the guidance in updated Q&A 25 does not extend to loans of financial assets such as stablecoins that meet the definition of a financial asset. However, since it is unclear what the SEC staff's view is regarding stablecoin lending, this topic may be subject to future deliberation.

Under the guidance in the FASB's March 2023 proposed ASU, all public and private entities would be required to subsequently measure crypto assets within the ASU's scope at fair value in accordance with ASC 820. If that guidance is finalized and adopted by an entity that applies U.S. GAAP, we would expect a minimal effect on the entity's recognition of any gain or loss associated with the lending of digital assets that is within the scope of the guidance and is related to the difference between (1) the carrying value of the lent assets and (2) the fair value of the crypto asset loan receivable. This is because the lender would have to carry the crypto assets at fair value before executing the loan. However, the lender may still be required to record a loss related to its recognition of an allowance for credit losses.

Recent Restatements of Crypto Asset Miners Related to Digital Asset Impairment

During the first quarter of 2023, we observed restatements by two SEC registrants related to the application of the impairment guidance on intangible assets in ASC 350. The restatements involved the registrants' use of a spot price at a standard cutoff time rather than their use of the lowest observable intraday fair value of the digital assets as required by ASC 350-30-35-19.

Connecting the Dots

Q&A 6 in the AICPA practice aid provides (along with Q&A 5) nonauthoritative guidance on crypto asset impairment and notes that "[i]mpairment testing of indefinite-lived intangible assets is required **whenever** events or changes in circumstances indicate it is more likely than not that impairment has occurred" (emphasis added). Further, Section IV of AU Chapter 2 in the practice aid, which discusses an entity's audit processes and controls, specifies the following related to the valuation measurement date and time:

> Unlike traditional markets, the market for digital assets does not close, and an entity may inappropriately value its digital assets at times of the day that are not consistent across reporting periods and not in accordance with its valuation policies. This, in combination with the significant intra-day volatility of digital assets, could result in a material misstatement of valuation.

In addition to its focus on the measurement of the impairment of crypto assets, the SEC has also been challenging registrants that reverse impairment charges on crypto assets when presenting non-GAAP measures. The SEC believes that reversing impairment charges when providing non-GAAP measures would be inconsistent with the general principle of Rule 100 in Regulation G,[6] which prohibits misleading non-GAAP measures.

Given these recent restatements and the AICPA's guidance on the measurement and presentation of the impairment of crypto assets, entities should carefully evaluate their impairment methods and non-GAAP reporting policies when accounting for and reporting on crypto assets.

Changing Lanes

Crypto asset miners should also be aware that the guidance in the FASB's March 2023 proposed ASU would require an entity to present cash received from the "nearly immediate" sale of crypto assets that were received as noncash consideration in the ordinary course of business (e.g., in exchange for the transfer of goods and services to a customer) as cash flows from operating activities. Some crypto asset miners currently present, as investing activities under ASC 230-10-45-12, cash received from the sale of crypto assets received as compensation for mining activities, even if the crypto assets received are converted to cash nearly immediately after receipt. This presentation could lead to odd reporting because an entity could report no operating cash inflows. As a result, for example, a miner would need to change, from an investing activity to an operating activity, its presentation of cash flows received from nearly immediately selling crypto assets obtained as compensation in the ordinary course of business. According to the proposed ASU, the term "nearly immediately" means "a short period of time that is expected to be within hours or a few days, rather than weeks."

[6] Regulation G, Rule 100, "General Rules Regarding Disclosure of Non-GAAP Financial Measures."

Recent Crypto Transactions Gaining Popularity

Simple Agreement for Future Tokens

A simple agreement for future tokens (SAFT) refers to an investment contract between an investor and a company trying to develop a blockchain project. In exchange for an up-front payment, the company or investee typically promises to deliver project-related tokens to the investor in the future once the blockchain project is launched. Funds received from the investor are used to develop the blockchain project. The investor enters into the SAFT with the expectation that associated tokens will be created and exchanged in the open market at a higher price than what the investor paid up front. Although the SAFT concept was first established in 2017, it has gained popularity recently as a result of an increase in the number of early-stage blockchain projects as well as the need for such projects to access capital before issuing associated tokens.

The relevant terms and conditions included in a SAFT vary. For example, the agreement might specify a precise or variable number of tokens to be delivered, or it could give investors the right to receive (1) a full or partial refund in the form of cash or (2) equity in the company if the investee fails to issue tokens by a certain date or if there is a change in control or dissolution event. To apply the accounting guidance that appropriately reflects the substance of a SAFT, investors and investees need to carefully evaluate the facts and circumstances of the transaction. We note that a SAFT may have characteristics that are similar to those of a sale of future equity (SAFE) and that the accounting for a SAFE may be a useful consideration in the evaluation of a SAFT. Entities contemplating entering into a SAFT should consider consulting with their accounting adviser.

Issuing Tokens From an Offshore Foundation or a DAO

Crypto asset issuer entities continue to explore new issuance structures. One structure that is becoming increasingly popular involves a company's set up of an offshore foundation that issues tokens. Alternatively, a company may establish an offshore foundation as well as a decentralized autonomous organization (DAO) that issues the tokens (instead of the foundation, which does not issue the tokens). One of the most popular DAOs currently is Uniswap. DAOs are not formal legal entities; instead, they are governed by a set of preestablished protocols or smart contracts. Accordingly, DAOs are self-managing, and any decision-making is collectively performed by the token holders and executed automatically through smart contracts. Tokens can be issued by DAOs on the basis of preset protocols.

Complicated accounting issues can stem from these structures (i.e., consolidation matters under ASC 810). Companies exploring setting up various organizational structures for token issuance should consult with their accounting advisers for further considerations.

Tokenized Assets

Tokenization is a growing trend that is changing traditional ways of transacting in different industries. It refers to the digital representation of one or more assets that can then be transacted on a blockchain through smart contracts. Goals of tokenization include achieving faster transaction processing, increasing security as a result of the underlying blockchain technology, and reducing transaction fees. Many applications of tokenized transactions exist on private or permissioned blockchains on which a single entity has control over the network and only verified participants are allowed to transact. The tokens on these blockchains are often designed to facilitate an exchange. As a result, they can have utility on their specific blockchain, such as being redeemed to discount or waive transaction costs, can be backed by specific assets including real property or commodities, or can be forms of art or other nonfungible tokens that represent a unique digital representation of an asset with special characteristics.

Real-world use cases for tokenized transactions observed to date include the following:

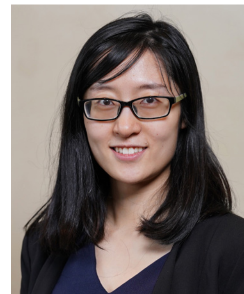
- *Repurchase agreements (or "repos")* — Large financial institutions may implement blockchain solutions to facilitate repurchase agreements involving short-term sales of securities (e.g., intra-day repos). Customers (borrowers) benefit from increased transaction times (near instantaneous), enhanced security, and the potential for interest savings.
- *Cash transfers* — Entities, including traditional finance banks, have created or procured a native blockchain and issued tokens to facilitate real-time cash transfers between customers.
- *Environmental credits* — Some companies have tokenized environmental credits to bring more liquidity and transparency to the marketplace as well as to create a more secure, blockchain-based asset to represent the underlying credit.
- *Real estate* — Real estate tokens are a digital representation of the underlying real estate. Contractual details are defined in smart contracts that permit automatic transactions or transfers if a predefined event occurs. Benefits of tokenizing real estate include the ability to invest in specific real estate properties through fractional shares, reduced transaction fees, and improved liquidity.

In our experience, permissioned blockchain solutions that use a token simply to facilitate transactions involving other goods or services will often be accounted for in a manner similar to non-blockchain-based transactions. However, the introduction of blockchain solutions in traditional platforms can have accounting implications, particularly if a token represents a separate asset and is not simply a digital representation of another asset. Companies exploring such solutions are encouraged to consult with their accounting advisers.

Contacts

For information about this publication, please contact:

Stephen McKinney
Managing Director
Deloitte & Touche LLP
+1 203 761 3579
smckinney@deloitte.com



Sherry Ren
Senior Manager
Deloitte & Touche LLP
+1 206 716 7252
shren@deloitte.com

For information about Deloitte's service offerings related to crypto assets, please contact:

Amy Park
Partner
Deloitte & Touche LLP
+1 312 486 4515
amyjpark@deloitte.com

Dbriefs for Financial Executives

We invite you to participate in Dbriefs, Deloitte's live webcasts that give you valuable insights into important developments affecting your business. Topics covered in the Dbriefs for Financial Executives series include financial reporting, tax accounting, business strategy, governance, and risk. Dbriefs also provide a convenient and flexible way to earn CPE credit — right at your desk.

Subscriptions

To subscribe to Dbriefs, or to receive accounting publications issued by Deloitte's Accounting and Reporting Services Department, please register at My.Deloitte.com.

The Deloitte Accounting Research Tool

Put a wealth of information at your fingertips. The Deloitte Accounting Research Tool (DART) is a comprehensive online library of accounting and financial disclosure literature. It contains material from the FASB, EITF, AICPA, PCAOB, and SEC, in addition to Deloitte's own accounting manuals and other interpretive guidance and publications.

Updated every business day, DART has an intuitive design and navigation system that, together with its powerful search and personalization features, enable users to quickly locate information anytime, from any device and any browser. While much of the content on DART is available at no cost, subscribers have access to premium content, such as Deloitte's *FASB Accounting Standards Codification Manual*. DART subscribers and others can also subscribe to *Weekly Accounting Roundup*, which provides links to recent news articles, publications, and other additions to DART. For more information, or to sign up for a free 30-day trial of premium DART content, visit dart.deloitte.com.

Heads Up is prepared by members of Deloitte's National Office as developments warrant. This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

The services described herein are illustrative in nature and are intended to demonstrate our experience and capabilities in these areas; however, due to independence restrictions that may apply to audit clients (including affiliates) of Deloitte & Touche LLP, we may be unable to provide certain services based on individual facts and circumstances.

About Deloitte
Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. In the United States, Deloitte refers to one or more of the US member firms of DTTL, their related entities that operate using the "Deloitte" name in the United States and their respective affiliates. Certain services may not be available to attest clients under the rules and regulations of public accounting. Please see www.deloitte.com/us/about to learn more about our global network of member firms.

Copyright © 2023 Deloitte Development LLC. All rights reserved.

Follow us @DeloitteAcctg