Think Ahead

Technical factsheet

Accounting for cryptocurrencies

Contents

Introduction	2
Cash or cash equivalents	2
Financial assets at fair value through profit or loss	2
Intangible assets	3
Subsequent measurement of cryptocurrency as an intangible asset	4
Amortisation	5
Accounting for cryptocurrency as inventory	5
Disclosure of judgements and uncertainties	6
Events after the end of the reporting period	6

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Introduction

The issues surrounding cryptocurrencies have gathered pace over the past few years and the accounting aspects for cryptocurrencies can be confusing as there is no specific accounting standard in this area.

Cryptocurrency is an intangible digital token, which is recorded using a distributed ledger infrastructure, such as blockchain, and provides the owner with various rights of use. These digital tokens are owned by the entity that owns the key that allows the owner to create a new entry in the ledger. Essentially, they represent specific amounts of digital resources that the entity has the right to control and whose control can be reassigned to third parties.

There have been many suggestions on how cryptocurrency should be accounted for but many would not be valid because they fail to meet the definition of certain aspects of accounting standards.

Cash or cash equivalents

While many individuals view cryptocurrency as a form of digital money, it cannot be accounted for as cash because it is not considered to be equivalent to cash (ie currency) as defined in FRS 102, *The Financial Reporting Standard applicable in the UK and Republic of Ireland*. For clarity, 'cash' is defined as:

'Cash on hand and demand deposits.' [1]

Cash equivalents are defined as:

*'Short-term, highly liquid investments that are readily convertible to known amounts of **cash** and that are subject to an insignificant risk of changes in value.'* [2]

Cryptocurrencies would fail to meet the definition of cash on the grounds that they cannot readily be exchanged for any good or service. Even though an increasing number of entities will accept digital currencies as payment, they do not yet represent legal tender and hence there is no requirement for an entity to accept digital currency as a form of payment.

Cryptocurrencies would also fail to meet the definition of 'cash equivalents' because they are subject to significant price volatility. Indeed, at the time of producing this technical factsheet, the value of some cryptocurrencies had fallen dramatically, and it is unknown how long this fall in value will last.

Financial assets at fair value through profit or loss

Some commentators have suggested that cryptocurrencies may be accounted for as a financial asset at fair value through profit or loss. The definition of a 'financial asset' is:

*'Any **asset** that is:*

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[1] FRS 102 Glossary: **cash**

[2] FRS 102 Glossary: **cash equivalents**

(a) ***cash;***
(b) an equity instrument of another entity;
(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; or*
(d) a contract that will or may be settled in the entity's own equity instruments and is:
i. a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or
*ii. a **derivative** that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.'* [3]

ACCA would not agree that cryptocurrency should be accounted for as a financial asset at fair value through profit or loss. As noted above, cryptocurrency cannot represent cash; nor can it be equity in an entity, or a contract that creates a right or obligation to deliver or receive cash or another financial instrument in settlement. Cryptocurrency is also not a debt security (although it could be argued that it could be a form of equity security) because it does not represent an ownership interest in an entity.

Intangible assets

FRS 102 defines an 'intangible asset' as:

*'An identifiable non-monetary **asset** without physical substance. Such an asset is identifiable when:*

*(a) it is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or **liability**; or*
(b) it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.' [4]

Cryptocurrencies do appear to meet the definition of an intangible asset and hence FRS 102, Section 18 *Intangible Assets other than Goodwill* will apply. The definition above confirms that an asset is separable if it is capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability.

'Monetary' and 'non-monetary' items are not defined in the glossary to FRS 102, and Section 30 *Foreign Currency Translation* merely explains that monetary items are translated at the closing rate and non-monetary items measured in terms of historical cost are translated at the exchange rate at the date of the transaction. Non-monetary

[3] FRS 102 Glossary: **financial asset**
[4] FRS 102 Glossary: **intangible asset**

items measured at fair value in a foreign currency are translated at the exchange rate when the fair value was determined.

IAS 21, *The Effects of Changes in Foreign Exchange Rates*, explains that an essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Hence, ACCA would agree that cryptocurrency meets the definition of an intangible asset per FRS 102 as it is capable of being separated from the holder and sold or transferred individually. In addition, when judged against the requirements of IAS 21, it does not give the holder a right to receive a fixed or determinable number of units of currency.

Cryptocurrencies do not have a physical substance and hence the most appropriate classification is that of an intangible asset.

An entity can only recognise an intangible asset on the balance sheet (statement of financial position) when:

(a) it is probable (ie more likely than not) that the expected future economic benefits that are attributable to the asset will flow to the entity, and
(b) the cost or value of the asset can be measured reliably.

As cryptocurrency can be traded on an exchange, there is an expectation that the entity will receive an inflow of economic benefits. However, as is well known, the value of cryptocurrencies can be significantly volatile and hence they are regarded as non-monetary for the purposes of financial reporting.

Subsequent measurement of cryptocurrency as an intangible asset

After initial recognition at cost, FRS 102, Section 18 allows an intangible asset to be subsequently measured under the cost model or revaluation model.

Cost model

Under the cost model, cryptocurrency is measured at cost (including all directly attributable costs) less subsequent amortisation and impairment losses.

Revaluation model

Under the revaluation model, intangible assets are measured at a revalued amount provided there is an active market for them (which may not be the case for all cryptocurrencies). An 'active market' is defined as:

'A market in which all the following conditions exist:

(a) the items traded in the market are homogeneous;
(b) willing buyers and sellers can normally be found at any time; and
(c) prices are available to the public.' [5]

Where no active market exists for the cryptocurrency, they must be measured under the cost model.

[5] FRS 102 Glossary: **active market**

Where an active market does exist for the cryptocurrency and the entity's accounting policy is to measure them under the revaluation model, then that model must be applied to all cryptocurrencies in that asset class. While there is no specific timeframe as to the frequency of revaluations, FRS 102, para 18.18D states that revaluations must be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.

It is unusual for an intangible asset to have an active market. However, there may be an exception where cryptocurrencies are concerned because they are often traded on an exchange and hence it may be possible to apply the revaluation model to such assets.

Revaluation increases are recognised in other comprehensive income and accumulated in equity. This is because the revaluation model in FRS 102, Section 18 applies the Alternative Accounting Rules in company law, which require revaluation gains to be recognised in a revaluation reserve and presented in equity in the balance sheet. Revaluation gains can only be presented in profit or loss to the extent that the gain reverses a revaluation decrease of the same asset that was previously recognised in profit or loss.

Revaluation decreases are recognised in other comprehensive income (ie via the revaluation reserve) to the extent of a surplus in respect of that asset. Any excess revaluation decrease is recognised in profit or loss as debit balances on a revaluation reserve cannot arise.

Amortisation

Under FRS 102, no intangible asset can have an indefinite useful life. In contrast, IAS 38 *Intangible Assets*, allows an entity to assign an indefinite useful life to an intangible asset where this can be demonstrated. It may be justifiable to assign an indefinite useful life to a cryptocurrency for the purposes of IAS 38, but this cannot be done under FRS 102.

Under FRS 102, intangible assets must be amortised on a systematic basis over the useful economic lives. If management are unable to assign a reliable useful economic life to a cryptocurrency, the maximum amortisation is ten years. It can be shorter, but not longer. ACCA would remind preparers that the ten-year 'cap' on amortisation applies only in situations where management cannot reliably estimate the useful economic life. Where a longer life can be justified with supporting documentation, then that period should be used.

Accounting for cryptocurrency as inventory

Depending on the entity's business model, it may be appropriate to account for cryptocurrency under FRS 102, Section 13 *Inventories*. This is because FRS 102, Section 13 would apply to the stock of intangible assets. For clarity, FRS 102 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.' [6]

Where an entity would hold cryptocurrencies for sale in the ordinary course of business, then it is treated as inventory and measured at the lower of cost and estimated selling price less costs to complete and sell. The inventory should also be reviewed at each reporting date to identify if there are indicators of impairment. Where there are indicators of impairment, the cryptocurrency must be written down to estimated selling price with the value of the impairment loss being recognised in profit or loss.

Disclosure of judgements and uncertainties

Information about judgements is required by FRS 102, para 8.6. Information about key sources of estimation uncertainty is required by FRS 102, para 8.7 and small entities applying the presentation and disclosure requirements of FRS 102, Section 1A *Small Entities* are encouraged to provide such disclosures.

Cryptocurrencies bring with them a lot of judgement and uncertainty where recognition and measurement are concerned. To that end, FRS 102 would require management to disclose judgements that have been made concerning the accounting treatment for cryptocurrencies.

Events after the end of the reporting period

FRS 102, Section 32 *Events after the End of the Reporting Period* requires disclosure of material non-adjusting events in the notes to the financial statements. Given the fact that the value of cryptocurrency is significantly volatile, the entity would be required to disclose any material changes in fair value of cryptocurrency that take place between the reporting date and the date on which the financial statements are authorised for issue. This would require management exercising professional judgement in determining whether any non-disclosure could influence the economic decisions that the users of the financial statements make on the basis of those financial statements.

Auditors should also devise specific procedures to assess whether the disclosure of material non-adjusting events in the value of cryptocurrency is adequate.

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[6] FRS 102 Glossary: **inventories**