

DIGITAL & CRYPTO ASSETS

Specialized accounting and fair value measurement



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Today's presenters



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Agenda

- AICPA Digital Assets Practice Aid
- CFTC Staff Advisory
 - FCM's Accepting Virtual Currencies from Customers into Segregation
- OCC and Digital Assets

Summary of AICPA Digital Assets Practice Aid – Questions 11 to 23

The AICPA Digital Assets Working Group has recently included non-authoritative guidance for financial statement preparers to consider when accounting for digital/crypto assets under specialized accounting topics and the use of fair value measurement in accordance w/ U.S. GAAP.

Meeting the definition of an investment company when engaging in digital asset activities

Accounting by an investment company for digital assets it holds as an investment

Recognition, measurement, and presentation of digital assets specific to broker-dealers

Considerations for crypto assets that require fair value measurement

Accounting for stablecoin holdings

Terminology

Digital assets

Defined broadly as digital records that are made using cryptography for verification and security purposes, on a distributed ledger (referred to as a *blockchain*).

Crypto assets

The type of digital assets that:

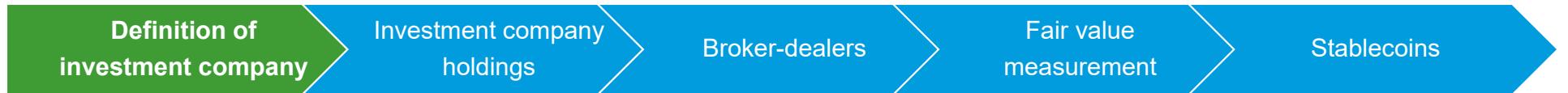
- a. Function as a medium of exchange and
- b. Have all the following characteristics (not all-inclusive):
 - i. Not issued by a jurisdictional authority, e.g. a sovereign government
 - ii. Do not give rise to a contract between the holder and another party
 - iii. Not considered a security under the Securities Act of 1933 or the Securities Exchange Act of 1934.

Examples of crypto assets: bitcoin, bitcoin cash, ether.

Meeting the definition of an investment company when engaging in digital asset activities

Q11: Would participation in digital asset activities (for example, mining activities) disqualify an entity from classification as an investment company within the scope of FASB ASC 946, *Financial Services—Investment Companies*?

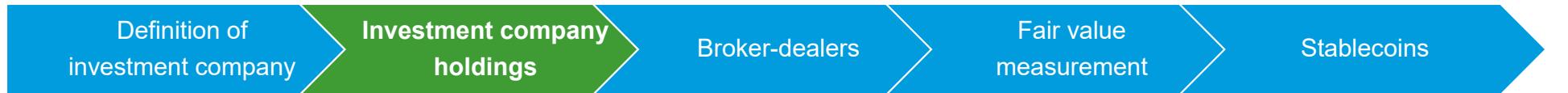
- An investment company should have no substantive activities other than its investing activities and should not have significant assets or liabilities other than those relating to its investing activities, subject to certain exceptions
- Consider evidence of its business purpose and substantive activities, e.g. offering memorandum, publications, partnership documents showing investment objectives
- Purchasing digital assets w/ the objective of selling for capital appreciation vs. procuring and operating significant computer and networking equipment to obtain digital assets
- Evaluate whether “other than investing” activities are substantive



Accounting by an investment company for digital assets it holds as an investment

Q12: How should an entity that qualifies as an investment company under FASB ASC 946, *Financial Services—Investment Companies*, account for investments in digital assets?

- Determine whether holdings of digital assets represent debt or equity securities (ASC 946-320) or an other investment (ASC 946-325)
- Initially measure at transaction price, incl. commissions and other charges
- Subsequently measure at FV, unless an exception applies requiring equity method accounting (ASC 946-323) or consolidation (ASC 946-810), e.g. the digital asset provides control over an operating entity providing services to the investment company



Recognition, measurement, and presentation of digital assets specific to broker-dealers

What does the Practice Aid not address?

- How an entity determines whether it is within the scope of ASC 940, *Financial Services—Brokers and Dealers* and the AICPA's Audit and Accounting Guide, *Brokers and Dealers in Securities* (the Broker-Dealer Guide)
- If an entity is an SEC filer, or planning to become an SEC filer, and a conclusion is reached that the entity is within scope of ASC 940, consider discussing the conclusion w/ the SEC's Office of the Chief Accountant
- Any entity applying ASC 940 should (a) not selectively apply certain portions, and (b) consider the discussion of the SEC's financial responsibility rules provided in the [Joint Staff Statement on Broker-Dealer Custody of Digital Asset Securities](#)
- The SEC and FINRA staffs have not provided guidance on how a broker-dealer may demonstrate physical possession or control nor how a broker-dealer may engage in a digital asset business in compliance w/ the financial responsibility rules



Recognition, measurement, and presentation of digital assets specific to broker-dealers (cont.)

Q13: How should an entity that is a broker-dealer in the scope of FASB ASC 940, *Financial Services—Brokers and Dealers*, present digital assets held or received on behalf of customers on its statement of financial condition?

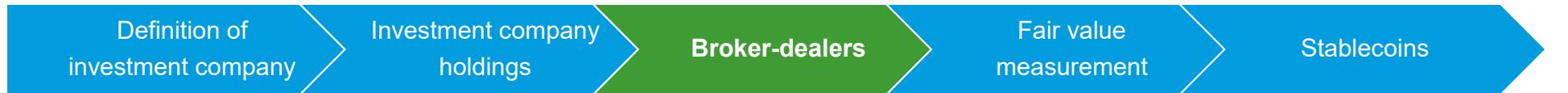
- Consider guidance in ASC 940-20-25-1: Not reflected on the statement of financial condition unless the transaction fails to settle on the contracted settlement date
- Consider discussion of the SEC's financial responsibility rules (registered broker-dealers)



Recognition, measurement, and presentation of digital assets specific to broker-dealers (cont.)

Q14: How should a broker-dealer in the scope of FASB ASC 940 recognize revenue for purchases or sales transactions in digital assets on behalf of its customers?

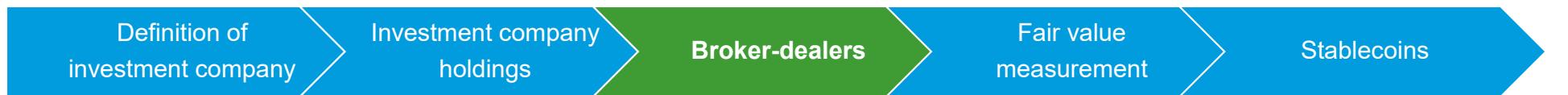
- *Agency transactions* are transactions in which the broker-dealer “is simply a middleman between two counterparties ... [and] is acting in a broker capacity”
- ASC 940-20-25-2: Commission income is recognized when (or as) the broker-dealer satisfies its performance obligations under the contract in accordance w/ ASC 606, *Revenue from Contracts with Customers*



Recognition, measurement, and presentation of digital assets specific to broker-dealers (cont.)

Q15: How should the digital assets owned by a broker-dealer in the scope of FASB ASC 940 as part of its proprietary trading portfolio be measured?

- ASC 940-320-35-1,-2: Positions resulting from proprietary trading should be measured at FV w/ changes in FV recognized in profit and loss
- Broker-Dealer Guide 5.02: A broker-dealer accounts for inventory and derivative positions at FV
- Industry practice has been to interpret the definition of inventory held by a broker-dealer to include financial instruments and physical commodities held as proprietary positions; extending the interpretation of inventory to include digital assets held as proprietary trading is reasonable



Considerations for crypto assets that require fair value measurement

Q16: When determining the fair value for crypto assets, what is the principal market?

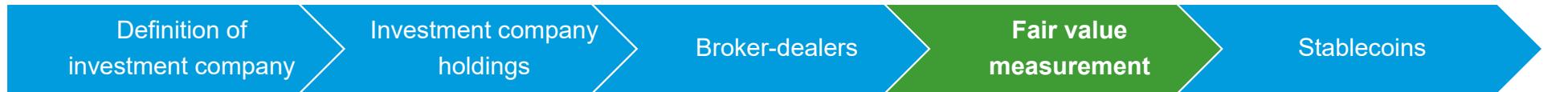
- FV measurement contemplates an orderly transaction to sell the asset or transfer the liability in its principal market (or in the absence of a principal market, the most advantageous market)
- Important to consider the reliability of volume and level of activity when determining the principal market
- The principal market should be based on the market w/ the greatest volume and level of activity that the entity can access
- Should consider all information that is reasonably available, but not required to undertake an exhaustive search of all possible markets
- The price in the principal market should be used to measure FV even if there is a more advantageous price in a different market



Considerations for crypto assets that require fair value measurement (cont.)

Q17: What are some items an entity should consider about the markets in which crypto assets trade when determining the fair value of a crypto asset holding?

- Determine the principal (or most advantageous) market
- Assess whether the market is active or inactive
- Evaluate whether reported market trades are orderly
- Determine whether the information produced by the market is reliable



Considerations for crypto assets that require fair value measurement (cont.)

Q18: Assume the principal (or most advantageous) market for a given crypto asset is an active market with quoted prices for identical assets. Given the characteristics of the principal market, an entity concludes the fair value would be classified as Level 1. How is the fair value of the crypto asset determined in this circumstance?

- ASC 820-10-35-6: If there is a principal market, the FV measurement should be based on the quoted price in that market, even if prices in a different market are potentially more advantageous
- ASC 820-10-35-44: If an entity holds a position in a single asset or liability (including a position comprising a large number of identical assets or liabilities) and the asset or liability is traded in an active market, the FV of the asset or liability should be measured within Level 1 as “P x Q”
- ASC 820-10-35-36C: Where bid-ask spreads are provided, FV should be based on the price within the bid-ask spread that is most representative of FV, e.g. bid, ask, mid-point, or some other point within the range



Considerations for crypto assets that require fair value measurement (cont.)

Q19: Is it appropriate for a reporting entity to adjust the fair value measurement of a crypto asset to reflect the size of the entity's holding of the crypto asset?

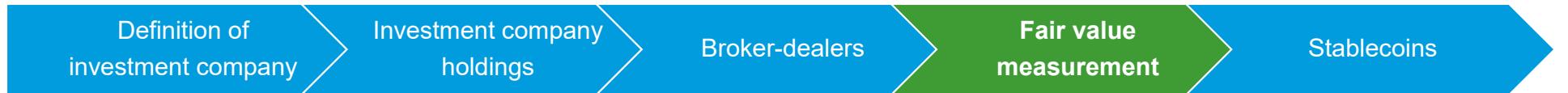
- ASC 820-10-35-36B: Entities should select inputs that are consistent w/ the characteristics of the asset/liability that market participants would take into account, e.g. a control premium or noncontrolling interest discount
- Size premiums or discounts are a characteristic of the *holding* rather than a characteristic of the *asset/liability* and are not permitted in FV measurement



Considerations for crypto assets that require fair value measurement (cont.)

Q20: Crypto asset markets often operate continuously, without a traditional market close. How should entities determine the fair value of the crypto asset in such circumstances?

- It may be reasonable for an entity to establish an accounting convention (a cut-off time) based on prices at:
 - The close of the business day
 - A fixed Coordinated Universal Time (UTC)
 - Other timing as deemed reasonable, e.g. traditional close time based on local market jurisdictions
- Consider transactions that take place after the cut-off time but before the end of the reporting period
- Any convention used should be reasonable and consistently applied, and changes should be made only if facts and circumstances support a change



Considerations for crypto assets that require fair value measurement (cont.)

Q21: If the principal (or most advantageous) market is not active or does not have orderly transactions (that is, not Level 1), how does management weigh inputs from different sources in the determination of the fair value of a crypto asset?

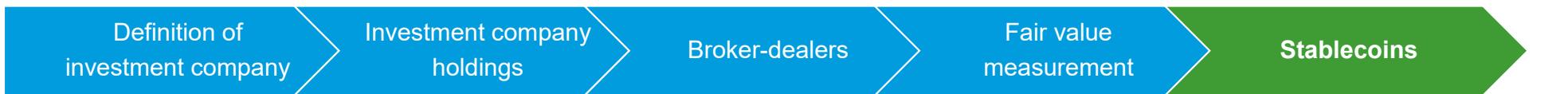
- Transaction = orderly; instrument = identical; market = active but not principal (or most advantageous)
 - May require adjustments that market participants would apply to arrive at a FV consistent w/ the entity's principal (or most advantageous) market
- Transaction = orderly; instrument = identical; market = not active
 - Transaction price would be considered; amount of weight placed on the transaction price when compared to other indications of FV will depend on facts and circumstances
- Transaction = not orderly
 - Little weight, if any, would be placed on the transaction price
- No sufficient information to conclude whether a transaction is orderly
 - Consider the transaction price in the analysis, i.e. give it some weight, but may also supplement the transaction price w/ other valuation inputs or techniques (maximize relevant observable inputs; minimize unobservable inputs)



Accounting for stablecoin holdings

Q22: How should investors that do not apply specialized industry guidance account for a holding of a stablecoin?

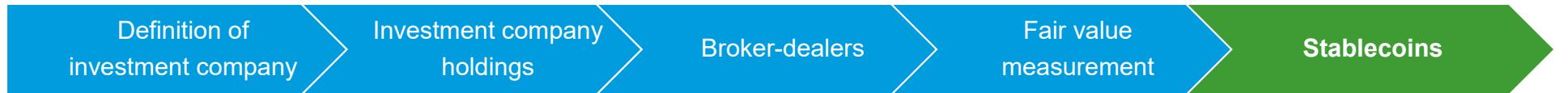
- Accounting for an investment in a stablecoin will depend on the following facts and circumstances (not all-inclusive)
 - Purpose and how does it achieve that purpose?
 - Rights and obligations of the holder, e.g. is the stablecoin collateralized; what are the eligible forms of collateral; can the stablecoin be traded w/ parties other than the issuer?
 - Who is issuing or pooling resources to support the stablecoin?
 - Does the stablecoin convey an interest in the issuing entity?
 - What is the legal form, e.g. debt or equity?
 - Can the stablecoin be redeemed for, exchanged for, or converted into its underlying asset?
 - Do the mechanisms to minimize price volatility work, e.g. how volatile is the stablecoin price vs. its intended peg?
 - Any credit or liquidity concerns?
 - What laws and regulations apply to the stablecoin?



Accounting for stablecoin holdings (cont.)

Q23: Entity A owns 100 units of a stablecoin, a digital asset that has a stated value of one U.S. dollar and is collateralized on a 1:1 basis by dollars held in a segregated bank account by the issuing entity. The holders of the units only have the right to redeem each unit for one U.S. dollar. How should Entity A account for its stablecoin?

- ≠ Derivative (requires payment in cash equal to the stated value at inception, i.e. does not meet the “no initial or small initial net investment” criteria)
- = Financial asset (can be redeemed for cash); typically also eligible for the FV option under ASC 825, *Financial Instruments*
- If = security per ASC Master Glossary: Generally ASC 320, *Investments—Debt and Equity Securities*
- If ≠ security per ASC Master Glossary: Generally ASC 310, *Receivables* (contractually redeemable for cash)
- May also need to consider the definitions of cash or cash equivalent



CFTC staff advisory

- On October 21, 2020, the CFTC Staff issued an [Advisory on Virtual Currency for Futures Commission Merchants](#)
 - Virtual currency held as customer funds by an FCM must be deposited only with a bank, trust company, or another FCM, or with a clearing organization that clears virtual currency futures, options on futures, or cleared swap contracts (each such entity, a “Depository”).
 - An FCM must deposit virtual currency held as customer funds with a Depository under an account name that clearly identifies the funds as customer funds and shows that the funds are segregated as required by the Act and Commission regulations. An FCM also is required to obtain the appropriate written acknowledgment letter from each Depository holding customer funds.
 - Virtual currency must be available for withdrawal from a Depository upon the demand of an FCM, so that delivery pursuant to the terms of the contracts to which the virtual currency relates will be made without delay.
 - An FCM may not invest any segregated futures customer or segregated cleared swap customer funds in virtual currency to be held on behalf of customers.

OCC and digital assets

- OCC has remained relatively silent about their stance on digital assets in the past
- In May 2020, a new Comptroller of Currency, Brian Brooks, was instated and the OCC has taken a fervent interest in digital assets.
 - Brooks is the former CLO of Coinbase, the largest US based digital asset exchange
- In June 2020, the OCC requested public comment on a proposal to update the activities and operational rules on digital banking activities
- Also announced support for a new fintech charter that would allow crypto focused and other traditional fintech firms to be licensed through the national banking regime

OCC Statement on Custody of Digital Assets & Request for Additional Rules from OCC

- On July 22nd, 2020, the OCC published a letter clarifying national banks' and federal savings associations' authority to provide digital asset custody services for customers
 - Permits holding unique cryptographic keys associated with digital assets
 - Akin to modern form of traditional banking activities related to custody
- “As financial markets are increasingly digitized, the need will increase for banks and other service providers to leverage new technology and innovative ways to serve their customer's needs.”
- On September 1st, 2020, in response to the request on the sufficiency of OCC's policies around digital banking, Senate Banking Chair, Mike Crapo, urged the OCC to develop rules around the use of digital assets and DLT by banks
- Crapo praised the move by the agency to allow banks to custody digital assets and stated that “it would be prudent to provide similar clarity for payments.”

Resources

- [AICPA Digital Assets Practice Aid](#)
- [Joint Staff Statement on Broker-Dealer Custody of Digital Asset Securities](#)
- [CFTC Staff Advisory on Virtual Currency for Futures Commission Merchants](#)
- [RSM Webinar #1](#)
- [RSM Webinar #2](#)
- <https://rsmus.com/what-we-do/services/blockchain-consulting.html>



ANY QUESTIONS?



THANK YOU FOR
YOUR TIME AND
ATTENTION

