CHARTERED PROFESSIONAL ACCOUNTANTS CANADA

An Introduction to Accounting for Cryptocurrencies Under Accounting Standards for Private Enterprises

January 2019

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Purpose of This Publication

This publication has been prepared to inform readers about digital currencies commonly referred to as "cryptocurrencies" and the primary issues involved in accounting for cryptocurrency holdings under Accounting Standards for Private Enterprises (ASPE Standards). This publication also includes a brief summary of some of the tax implications of investing in and transacting with cryptocurrencies. CPA Canada also prepared a publication that addresses **accounting for holdings of cryptocurrencies under International Financial Reporting Standards** (IFRS® Standards).

We encourage managements to investigate and better understand the key features of cryptocurrencies relevant to their businesses. In addition, preparers of financial reports should evaluate the appropriateness of their accounting policies for cryptocurrencies and ensure their disclosures about cryptocurrencies are sufficiently transparent to meet the needs of users. Preparers should consult with their professional advisors.

We encourage accounting standards-setters to undertake research in this area to better understand and evaluate the potential impacts of cryptocurrencies and to ensure the accounting for cryptocurrencies produces relevant and useful information.

We invite readers to contact us with any feedback or insights that could help us develop future publications on this topic.

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Background

The word "cryptocurrencies" is often used as a blanket term for all crypto-assets. For the purposes of this paper, we use the term cryptocurrencies to mean only those cryptocurrencies that are used as a medium of exchange and intended to act as an alternative to government-issued fiat currencies. Our focus is on only this specific subset of crypto-assets. These cryptocurrencies are without physical substance and are generally not linked to any currency, or backed by any government, central bank, legal entity, underlying asset or commodity. For example, Bitcoin would be considered such a cryptocurrency while tokens that do not function as a general-purpose medium of exchange would not.

Holdings of cryptocurrencies allow individuals and businesses to transact directly with each other without an intermediary such as a bank or other financial institution. These cryptocurrency transactions rely on a key technology called blockchain technology. For an introduction to blockchain technology, refer to the CPA Canada publication ***Technological Disruption of Capital Markets and Reporting?: An Introduction to Blockchain.***

The rapid rise and volatility of cryptocurrencies have led to increased global interest and scrutiny by organizations, investors, regulators, governments, and others. Interested parties are concerned about the accounting and tax implications associated with cryptocurrencies.

Figure 1 below shows how the market capitalization of cryptocurrencies increased by US$547 billion or 3,038% during 2017.[1] This dramatic increase was followed by a drastic decline in 2018 as the market capitalization of cryptocurrencies fell by approximately US$490 billion or 80% to US$126 billion. The most popular and widely used cryptocurrency is Bitcoin; however, there are over 2,000 cryptocurrencies in circulation.[2] Each of these cryptocurrencies has its own unique features and characteristics which make understanding and accounting for them particularly challenging.

1 https://coinmarketcap.com/charts

2 https://coinmarketcap.com as at December 31, 2018.

FIGURE 1

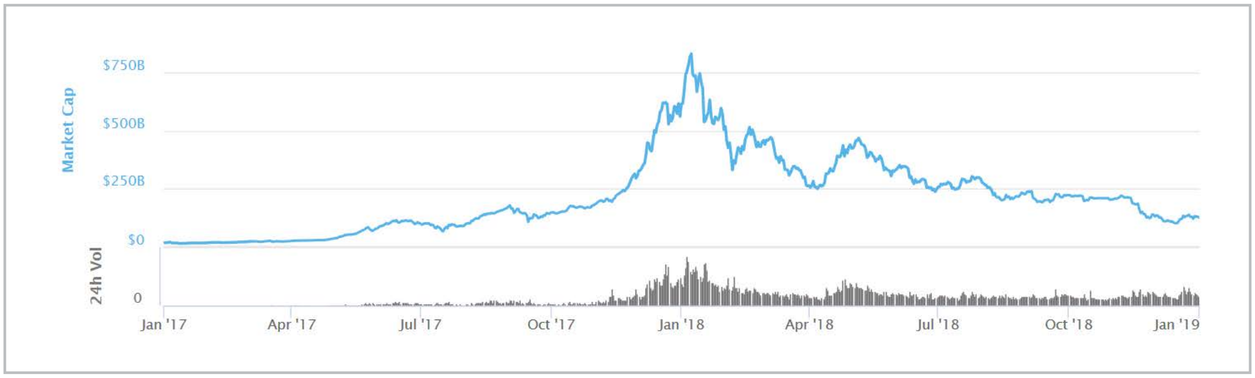


Figure 1 illustrates the volatility in the market capitalization of cryptocurrencies between January 1, 2017 and December 31, 2018.[3]

Cryptocurrency offerings such as "initial coin offerings" and "initial token offerings" are gaining traction in the global financial markets with over US$17 billion raised in 2018.[4] Figure 2 below shows the growth in the size of global funding and number of ICOs issued since January 2014. Securities regulators have raised concerns related to such offerings because of issues around volatility, transparency, valuation, custody and liquidity, as well as the use of unregulated cryptocurrency exchanges.[5] There is also a fundamental concern about whether these offerings constitute an offering of securities.

3 Coindesk, ICO Tracker (www.coindesk.com/ico-tracker, 2019)

4 Ibid.

5 For example, see ***CSA Staff Notice 46-307, Chairman's Testimony on Virtual Currencies: The Roles of the SEC and CFTC*** (https://www.sec.gov/news/testimony/testimony-virtual-currencies-oversight-role-us-securities-and-exchange-commission, February 6, 2018)

FIGURE 2

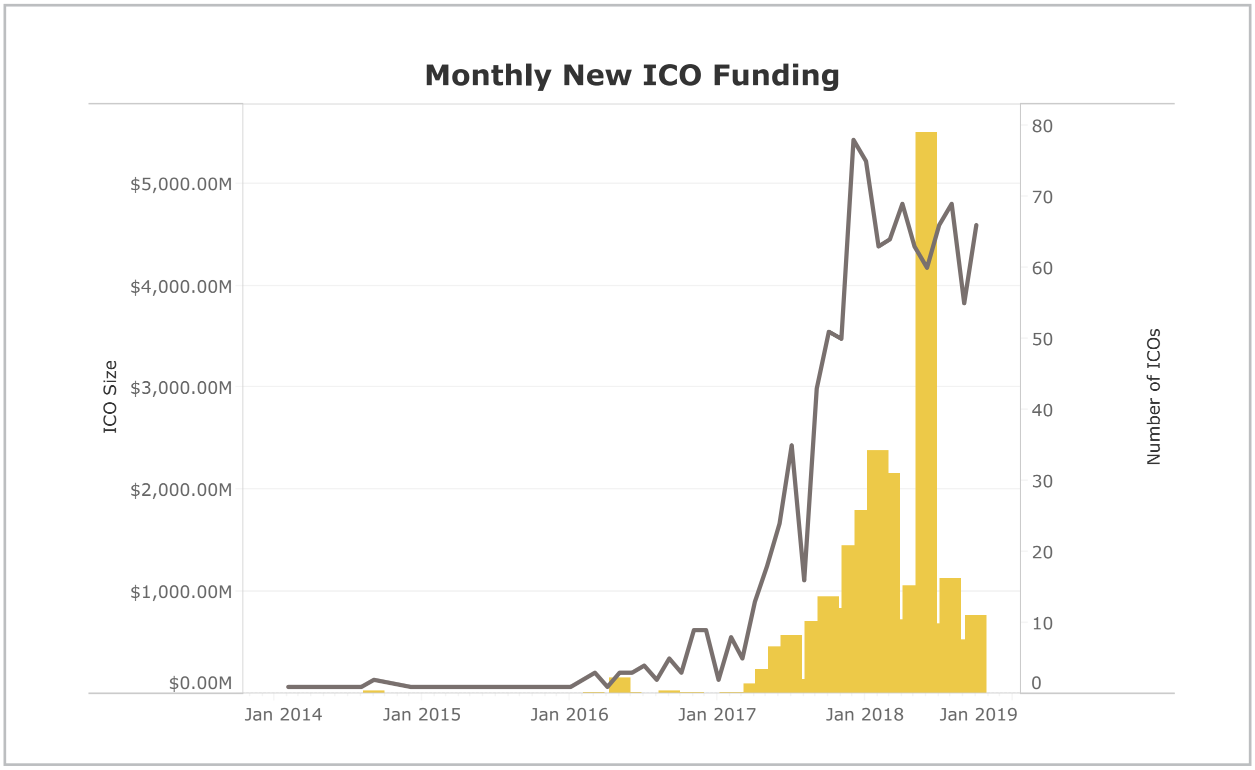


Figure 2 illustrates the growth in the size of global funding (in US dollars) and number of ICOs issued between January 2014 and December 2018.[6]

Scope

This publication addresses the accounting under ASPE for holdings of cryptocurrencies acquired from third parties. The accounting by entities which mine cryptocurrencies or undertake initial coin or token offerings is not addressed in this paper. Furthermore, some entities may hold cryptocurrencies as an intermediary or as an agent. These circumstances are also not addressed in this paper.

6 Coindesk, ICO Tracker (www.coindesk.com/ico-tracker, 2019)

Accounting Issues

Existing ASPE Standards do not explicitly refer to cryptocurrencies. The primary accounting questions are whether cryptocurrencies are assets and, if so, what type of asset in terms of ASPE Standards?

As previously noted, there are over 2,000 cryptocurrencies and more are being developed. Different cryptocurrencies can have different characteristics, and the reasons for acquiring them can vary, resulting in different accounting consequences. As a result, an accounting policy established for one cryptocurrency may not be appropriate for others. The discussion of accounting issues in this publication is not based on any specific cryptocurrency. Entities should evaluate each cryptocurrency holding separately based on the circumstances, the characteristics of the cryptocurrency and the characteristics of the market for it.

Is a Cryptocurrency an Asset?

Before considering whether a specific ASPE Standard might apply to a cryptocurrency, the question that must first be addressed is whether the cryptocurrency meets the definition of an asset. The definition of assets in Section 1000, *Financial Statement Concepts*, in Part II of the *CPA Canada Handbook—Accounting* is "economic resources controlled by an entity as a result of past transactions or events and from which future economic benefits may be obtained" (paragraph 1000.24). This definition is expanded as follows:

Assets have three essential characteristics:

1. they embody a future benefit that involves a capacity, singly or in combination with other assets, in the case of profit-oriented enterprises, to contribute directly or indirectly to future net cash flows;
2. the entity can control access to the benefit; and
3. the transaction or event giving rise to the entity's right to, or control of, the benefit has already occurred. (paragraph 1000.25)

Entities will need to assess whether each cryptocurrency held qualifies as an asset.

Determining Which ASPE Standard to Apply

Paragraph .03 of Section 1100, Generally Accepted Accounting Principles, requires an entity to apply the ASPE Standards and Guidelines that are applicable to transactions or events encountered by the entity. Although ASPE Standards do not explicitly refer to cryptocurrencies, the scope of an ASPE Standard may include items with the characteristics of cryptocurrencies and therefore be applicable.

Assuming the definition of an asset is met, the following standards provide guidance on the accounting for various asset classes and merit consideration to determine whether they address items with the characteristics of cryptocurrencies:

1. Cash (Section 1540, *Cash Flow Statement*)
2. Non-cash financial assets (Section 3856, *Financial Instruments*)
3. Investments (Section 3051, *Investments*)
4. Intangible assets (Section 3064, *Goodwill and Intangible Assets*)
5. Inventory (Section 3031, *Inventories*).

Is a Cryptocurrency Cash (or a Cash Equivalent)?

Paragraph 1540.06(a) defines cash by stating: "Cash comprises cash on hand and demand deposits."

Currency (including foreign currency) is generally accounted for as cash. The term "cryptocurrency" suggests it is a currency; however, this does not mean it is necessarily cash for accounting purposes.

Cash is primarily used as a medium of exchange — to enable the buying and selling of goods and services, the purchase of investments and the settlement of debts. It may be that some (but not all) cryptocurrencies can be used as a medium of exchange; indeed, that was the original purpose behind Bitcoin and some other cryptocurrencies. However, at this time it appears that cryptocurrencies represent a limited medium of exchange compared to most traditional fiat currencies. In part this is because, unlike established currencies such as the Canadian and U.S. dollars, they are not supported by a central bank or recognized as legal tender in most jurisdictions. In addition, some very large financial institutions in Canada and the U.S. have banned the purchase of cryptocurrencies on their credit card platforms.[7] One institution cited "high volatility and risk as the leading factors behind their decision."[8]

7 The Canadian Press. *TD Bank halts allowing customers to use credit cards to buy cryptocurrency* (www.cbc.ca/news/business/td-banks-bitcoin-1.4549697, February 23, 2018)

8 CNBC. *JPMorgan Chase, Bank of America & Citi bar people from buying bitcoin with a credit card* (www.cnbc.com/2018/02/02/jpmorgan-chase-bank-of-america-bar-bitcoin-buys-with-a-credit-card.html, February 2, 2018)

Cryptocurrencies do not currently seem to meet the definition of a cash equivalent in paragraph 1540.06(b) which is "short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value" since they do not have a short-term life and often have significant short-term value changes.

Furthermore, in some cases there are constraints on the liquidity of such cryptocurrencies and their conversion to a fiat currency.

It is not likely at the current time that cryptocurrencies qualify to be accounted for as cash or a cash equivalent.

Is a Cryptocurrency a Non-Cash Financial Asset?

A key characteristic of a financial asset is that the holder of the financial asset has the contractual right to receive cash or another financial asset from another entity or to exchange financial instruments with another entity under conditions that are potentially favourable to the holder. The holder of a cryptocurrency generally does not have any such contractual right. Therefore, cryptocurrencies do not seem to meet the definition of a non-cash financial asset in accordance with Section 3856, Financial Instruments.

However, certain contracts to buy or sell cryptocurrencies in the future (e.g., forward contracts or options) or other contracts that settle in cash based on movements in a particular cryptocurrency may meet the definition of a derivative and be subject to financial-instruments accounting.

Is a Cryptocurrency an Investment?

The scope of Section 3051, *Investments*, includes "certain other non-financial instrument investments (such as works of art and other tangible assets held for investment purposes)" [paragraph 3051.01 (b)]. Cryptocurrencies that meet the definition of an asset and are held for investment purposes could be within the scope of Section 3051.

Section 3051 requires these "other non-financial instrument investments" to be measured at cost. At the end of each reporting period, the cryptocurrency should be assessed for impairment in accordance with Section 3051. An impaired holding should be written down to the amount that could be realized by selling the cryptocurrency.

If a cryptocurrency holding has been written down to reflect an impairment and its value subsequently increases, the previously recognized impairment loss should be reversed (3051.26). The reversal is the lower of the increase in value and the previous impairment write-down.

Is a Cryptocurrency an Intangible Asset?

An intangible asset is defined in Section 3064 *Goodwill and Intangible Assets*, as "an identifiable non-monetary asset without physical substance" [paragraph 3064.08(h)]. Cryptocurrencies are generally identifiable and without physical substance. Cryptocurrencies are also generally non-monetary as they do not meet the definition of monetary assets in paragraph 3064.08(i) being "assets to be received in fixed or determinable amounts of money." Consequently, it appears that many cryptocurrencies that qualify for recognition as an asset but do not qualify to be accounted for as investments in accordance with Section 3051, or as inventories in accordance with Section 3031 are likely to meet the definition of intangible asset and are therefore within the scope of Section 3064.

A cryptocurrency accounted for as an intangible asset should be measured initially at cost. It is likely that cryptocurrencies would qualify as indefinite-lived intangibles if there are no factors to indicate a finite useful life, and therefore would not be amortized.

A cryptocurrency would be assessed for impairment in the same manner as any other indefinite-lived intangible asset. If its fair value decreases below the carrying amount, the cryptocurrency holding would be written down to its current fair value. The impairment loss would not be reversed if the fair value subsequently increased.

Is a Cryptocurrency Inventory?

Section 3064 does not apply to intangible assets held for sale in the normal course of business; such intangible assets should be accounted for in accordance with Section 3031, *Inventories*. Cryptocurrencies within the scope of Section 3031 would be measured at the lower of cost and net realizable value under the general inventory model required by Section 3031. As a result, decreases in net realizable value would be recorded in the income statement while increases in net realizable value in excess of previously recorded decreases would not be recorded.

However, the accounting is different for commodity broker-traders. Paragraph 3031.06 defines commodity broker-traders as those who buy or sell commodities for others or on their own account for the purpose of selling in the near future and generating a profit from fluctuations in price. Broker-traders measure inventories of commodities at fair value less costs to sell; changes in fair value are recorded in income. While this accounting result will seem logical to many, it is available only to those entities that meet the definition of a broker-trader.

Other Considerations

Section 1100, *Generally Accepted Accounting Principles* discusses how management would develop an accounting policy when primary sources of GAAP (i.e., the standards and guidelines in ASPE) do not deal with transactions or events encountered by the entity. However, as discussed above, it appears that one of the ASPE Standards applies to a cryptocurrency holding although which ASPE Standard may depend on the specific facts and circumstances. Therefore, it appears it would be inappropriate for management to look beyond primary sources of GAAP in accounting for a cryptocurrency holding.

Summary of Analysis

The chart below summarizes our analysis of which ASPE Standards might be applied in accounting for cryptocurrencies:

Asset class and the applicable ASPE Standard	Are cryptocurrencies within the scope of the applicable ASPE Standard?	Initial measurement	Subsequent measurement	Accounting for a decrease in value	Accounting for an increase in value
Cash and cash equivalents (Section 1540)	✘	not applicable	not applicable	not applicable	not applicable
Non-cash financial assets (Section 3856)	✘	not applicable	not applicable	not applicable	not applicable
Investments (Section 3051)	✓	cost	cost less accumulated impairment losses	include in income statement	only recognize increases to an amount that does not exceed previously recorded decreases

Asset class and the applicable ASPE Standard	Are cryptocurrencies within the scope of the applicable ASPE Standard?	Initial measurement	Subsequent measurement	Accounting for a decrease in value	Accounting for an increase in value
Intangible assets (Section 3064)	✓	cost	cost less accumulated amortisation (if applicable) and accumulated impairment losses	include in income statement	increase in fair value is not accounted for
Inventory (Section 3031) — Commodity broker / dealer	✓	cost	fair value less cost to sell	include in income statement	include in income statement
Inventory (Section 3031)	✓	cost	lower of cost or net realizable value	include in income statement	only recognize increases in net realizable value up to an amount that does not exceed previously recorded decreases

✓ = possible, depending on the circumstances

✗ = not likely, depending on the circumstances

Disclosure

Entities should comply with the disclosure requirements of the ASPE Standard they use in accounting for cryptocurrencies (e.g., Sections 3031, 3051 or 3064). However, given the complexity and volatility associated with cryptocurrencies, entities should consider whether additional disclosures about their cryptocurrency holdings are necessary.

Section 1000, *Financial Statement Concepts*, states:

> "The objective of financial statements is to communicate information that is useful to investors, creditors and other users ("users") in making their resource allocation decisions and/or assessing management stewardship. Consequently, financial statements provide information about:
>
> a. an entity's economic resources, obligations and equity;
>
> b. changes in an entity's economic resources, obligations and equity; and
>
> c. the economic performance of the entity."
>
> (paragraph 1000.12)

Section 1400, *General Standards of Financial Statement Presentation*, requires fair presentation in accordance with GAAP. This is achieved by "providing sufficient information about transactions or events having an effect on the entity's financial position, results of operations and cash flows for the periods presented that are of such size, nature and incidence that their disclosure is necessary to understand that effect" [paragraph 1400.04(b)].

In addition to the disclosures required by a specific ASPE Standard, the following disclosures, among others, may also be relevant:

- a description of the cryptocurrency, its important characteristics and the purpose of holding it (e.g., investing, buying goods and services)
- the number of units of the cryptocurrency held at year end
- how the accounting policy was determined
- the fair value for the cryptocurrency
- information on the market risk associated with the cryptocurrency (e.g., historical volatility)

Tax Implications

The Canada Revenue Agency (CRA) has stated that transactions involving cryptocurrencies are subject to tax and are characterized as a commodity and not considered to be a currency issued by a government of a country.[9] As such, when using cryptocurrencies to purchase goods or services, the CRA treats this as a barter transaction, for income tax purposes. As per the CRA, "In a barter transaction between persons who are dealing with each other at arm's length, it is a fundamental principle that each of those persons considers that the value of whatever is received is at least equal to the value of whatever is given up in exchange".[10] This principle serves as the basis to determine the cost base of the cryptocurrency, as well as the consideration in respect of a sale or disposition transaction.

Income Tax Implications

Receiving Cryptocurrencies as Payment for Goods and Services

When an enterprise accepts cryptocurrency as payment for goods or services provided in the normal course of business, the CRA's guidance on barter transactions states that the enterprise will be considered to have sold the goods or services at a price at which the enterprise would normally have charged a third party.[11] The cost of the cryptocurrency to the vendor/service provider for future transactions will be this value. A future gain or loss on the disposal of the cryptocurrency will be either on account of income or capital and the rationale for this determination is discussed below.

Using Cryptocurrencies to Acquire Goods and Services

The concept of valuing the property given up also applies to the purchaser of goods and services. For the purchaser, the cost of property received (or the value of services acquired) will be equal to the value of the property given up, being the cryptocurrency. As a gain or loss will arise on the disposition of the cryptocurrency, the enterprise will need to determine whether this will be on account of income or capital.

9 CRA Views 2013-0514701I7, "Bitcoins" (December 23, 2013).

10 CRA Interpretation Bulletin IT-490, Barter Transactions July 5, 1982 (archived)

11 CRA Interpretation Bulletin IT-490, Barter Transactions, July 5, 1982

Cryptocurrency Trading

Where an enterprise disposes of cryptocurrencies, whether through a barter transaction or simply through trading, the enterprise must determine whether gains or losses are on account of income or capital. In particular, the cryptocurrency could be inventory or property acquired as an adventure in the nature of trade; any future gain or loss will be on account of income. Alternatively, the property may be a capital property, meaning that future gains or losses will be on account of capital.

As no specific rules have been provided by the government at this time for cryptocurrencies, the usual considerations for property transactions will apply. There are no hard and fast rules, but the factors that have been considered by the courts in deciding include the following:

- the frequency of transactions
- the holding period of the property
- whether there was an intention to acquire the property for resale at a profit
- the nature and quantity of the property held
- the time spent on the activity
- specific market knowledge of the taxpayer
- relationship to other business activities

Goods and Services Tax / Harmonized Sales Tax (GST/HST) Implications

CRA has indicated that where a taxable supply of a good or service is made and the consideration for that supply is cryptocurrency, the consideration for the supply is deemed to be equal to the fair market value of the cryptocurrency at the time.[12] Thus, this is consistent with the income tax treatment. The supplier must collect and remit the GST/HST on that amount of consideration. If the supplier is a GST/HST registrant, the recipient should be eligible to claim an input tax credit for the amount of GST/HST.

Apart from this guidance, the CRA has provided minimal guidance on the GST/HST implications of cryptocurrency transactions. One of the key questions that remain outstanding is whether the supply of cryptocurrency will be considered a taxable supply for GST/HST purposes. At the time of this publication, CRA has indicated that further guidance on this issue will be released in the near future.

12 CRA Interpretation Bulletin IT-490, Barter Transactions July 5, 1982 (archived)

Greater certainty on how general tax principles will apply to cryptocurrency transactions may only become available when the government provides specific tax rules or guidance for cryptocurrency transactions or cryptocurrency transactions are dealt with as part of a tax court case.

Appendix—Where to Find More Information

This appendix provides links to external resources that may be useful:

1. The Accounting Standards Advisory Forum (ASAF) meeting on December 9, 2016, included cryptocurrencies on the agenda.
   a. Data sheet: *Digital currency—A case for standard setting activity.* https://www.aasb.gov.au/admin/file/content102/c3/AASB_ASAF_DigitalCurrency.pdf
   b. Audio webcast—www.ifrs.org/-/media/feature/meetings/2016/december/asaf/asaf-audio/cryptocurrencies-ap5.mp3
2. Bank of Canada. *Digital Currencies and Fintech.* www.bankofcanada.ca/research/digital-currencies-and-fintech/
3. CPA Canada. *Audit considerations related to cryptocurrency assets and transactions.* www.cpacanada.ca/en/business-and-accounting-resources/audit-and-assurance/canadian-auditing-standards-cas/publications/cryptocurrency-audit-considerations
4. CPA Canada. Blockchain Technology and Its Potential Impact on the Audit and Assurance Profession. www.cpacanada.ca/en/business-and-accounting- resources/audit-and-assurance/canadian-auditing-standards-cas/publications/impact-of-blockchain-on-audit
5. CPA Canada. *Introduction to accounting for cryptocurrencies under IFRS.* www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/international-financial-reporting-standards-ifrs/publications/accounting-for-cryptocurrencies-under-ifrs
6. CPA Canada. *Technological Disruption of Capital Markets and Reporting?: An Introduction to Blockchain.* www.cpacanada.ca/en/business-and-accounting-resources/other-general-business-topics/information-management-and-technology/publications/introduction-to-blockchain-technology
7. CPA Ontario. Navigating the Brave New World of Cryptocurrency and ICOs. May 2018. https://media.cpaontario.ca/stewardship-of-the-profession/pdfs/Navigating-the-Brave-New-World-of-Cryptocurrency-and-ICOs.pdf
8. Deloitte. *Blockchain: A technical primer.* February 6, 2018. www2.deloitte. com/insights/us/en/topics/emerging-technologies/blockchain-technical-primer.html

9. EY. *Applying IFRS: Accounting by holders of crypto-assets*. August 2018. www.ey.com/Publication/vwLUAssets/EY-applying-ifrs-accounting-by-holders-of-crypto-assets/$File/EY-applying-ifrs-accounting-by-holders-of-crypto-assets.pdf

10. EY. *IFRS (#): Accounting for crypto-assets.* 2018. www.ey.com/Publication/vwLUAssets/EY-IFRS-Accounting-for-crypto-assets/$File/EY-IFRS-Accounting-for-crypto-assets.pdf

11. Grant Thornton International Ltd. *IFRS Viewpoint — Accounting for cryptocurrencies — the basics.* www.grantthornton.global/globalassets/1.-member-firms/global/insights/article-pdfs/ifrs/ifrs-viewpoint-9---accounting-for-cryptocurrencies--the-basics.pdf

12. The IFRS Discussion Group meeting on January 10, 2018 included cryptocurrencies on the agenda.
    a. Meeting report. https://www.frascanada.ca/-/media/frascanada/acsb/ifrsdg-past-meetings/2019-01-10-cryptocurrencies-other-considerations-en.pdf
    b. Audio webcast. www.frascanada.ca/international-financial-reporting-standards/ifrs-discussion-group/january-10,-2018/item85275.aspx

13. KPMG. *Introducing blockchain and cryptocurrencies.* https://home.kpmg.com/xx/en/home/insights/2018/07/ifrstoday-podcast-04-blockchain-cryptocurrencies-190718.html

14. Oliver Wyman. *Cryptocurrencies And Public Policy.* www.oliverwyman.com/our-expertise/insights/2018/feb/cryptocurrencies-and-public-policy.html

15. Ontario Securities Commission. *Information on Cryptocurrency Regulation in Canada.* http://research.osc.gov.on.ca/c.php?g=699050&p=4969862

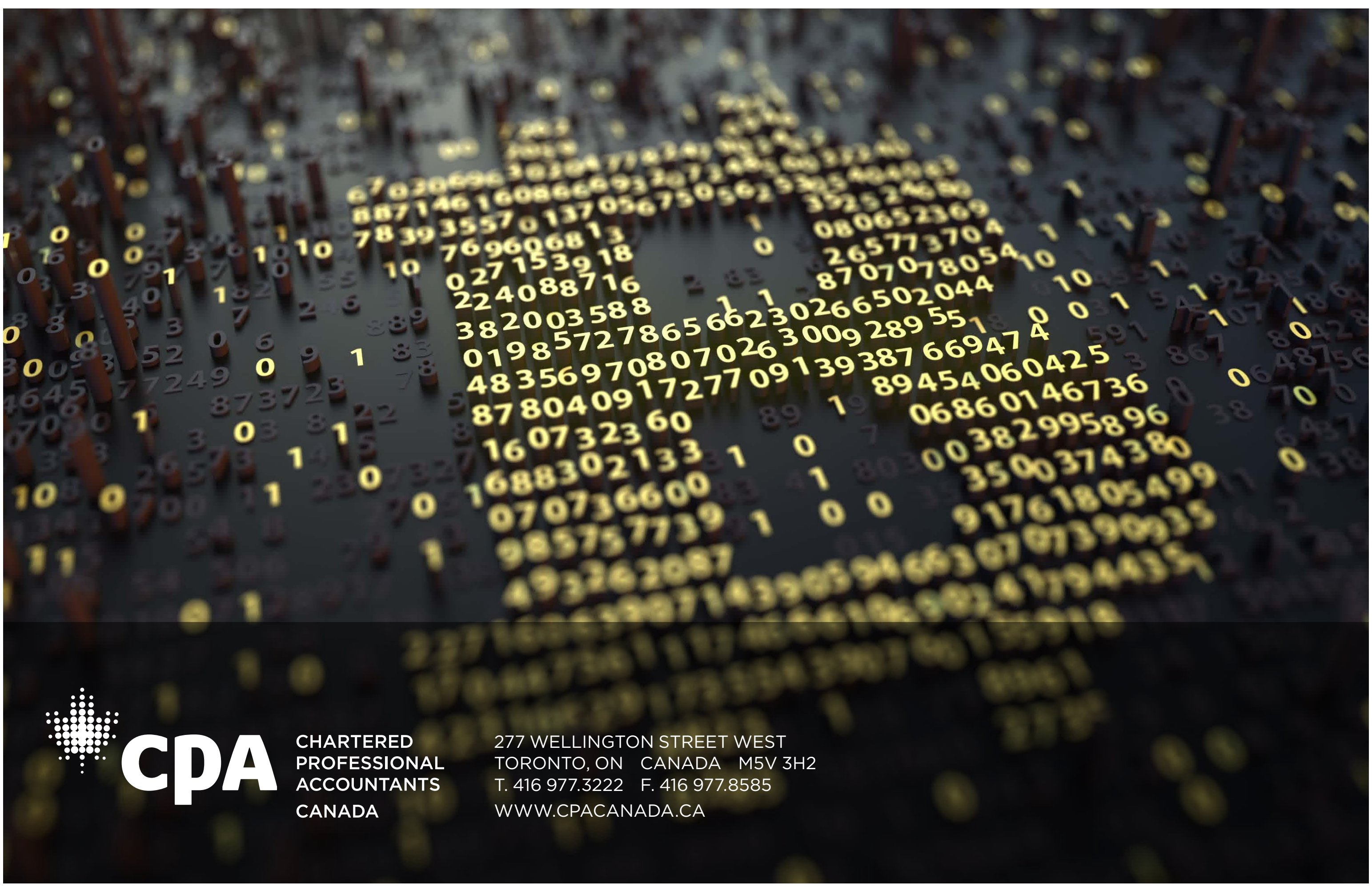
16. PwC. *Cryptocurrency — despite its name — is not accounted for as currency.* March 2018. www.pwc.com/us/en/cfodirect/assets/pdf/point-of-view/cryptocurrency-bitcoin-accounting.pdf

17. PwC. *Cryptographic assets and related transactions: accounting considerations under IFRS.* September 2018. https://www.pwc.com.au/ifrs/cryptographic-assets-and-related-transactions-accounting-considerations-under-ifrs.html

18. PwC. *Making sense of bitcoin, cryptocurrency, and Blockchain.* www.pwc.com/us/en/industries/financial-services/fintech/bitcoin-blockchain-cryptocurrency.html

19. The Standing Senate Committee on Banking, Trade and Commerce. *Digital Currency: You Can't Flip This Coin!* June 2015. https://sencanada.ca/content/sen/committee/412/banc/rms/12jun15/home-e.htm

20. U.S. Securities and Exchange Commission. *Spotlight on Initial Coin Offerings and Digital Assets.* www.investor.gov/additional-resources/specialized-resources/spotlight-initial-coin-offerings-digital-assets



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