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Digital currencies and blockchain: implications for accounting

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Accounting for Virtual Currencies (Crypto-assets) in Japan

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The views expressed in this presentation are those of the presenter and are not necessarily the official views of the Accounting Standards Board of Japan.

Why we developed the Standard

- In 2016, the Payment Services Act (the Act) was amended:
  - Virtual currencies were defined and recognized as a means of payment
  - A registration system for virtual currency dealers was introduced
  - Registered virtual currency dealers became subject to financial statement audits
- The ASBJ was asked to develop a Standard under Japanese GAAP, but decided to address only limited issues, because:
  - The virtual currency business was at a very young stage
  - There was uncertainty regarding the legal status of virtual currencies under Japanese private law

The Standard

On March 14, 2018, the ASBJ issued the *Practical Solution on the Accounting for Virtual Currencies under the Payment Services Act*

- An English summary of the standard can be found at:

  https://www.asb.or.jp/en/wp-content/uploads/2018-0315_2_e.pdf

- The Standard is effective from the beginning of the fiscal year that begins on or after April 1, 2018
  - Early application is permitted

Scope

- The Standard addresses the accounting for virtual currencies as defined in the Act, <u>except for those that were issued by the entity itself</u>

  - The so-called Initial Coin Offerings (ICOs) by the entity were scoped out of the Standard

  - Virtual currencies that were issued by the entity itself were scoped out because we were not confident that we had identified all of the issues that needed to be addressed

Virtual Currencies Held by an Entity on Its Own Behalf

Measurement at the balance sheet date

An active market for the virtual currency･･･	
exists	does not exist
Market price	Cost, written down to the estimated disposal value (including zero) if such value is lower than cost

Active Market

A market in which transactions for the virtual currency take place with sufficient frequency and volume to provide pricing information on an ongoing basis

*The Standard adopted a definition of "active market" that is consistent with the definition in IFRS 13

Virtual Currencies Held by a Virtual Currency Dealer on Behalf of Its Customers

- Virtual currencies held on behalf of its customers are recognized as assets, measured in the same way as virtual currencies held by an entity on its own behalf
- The obligation to return the virtual currencies to the customers are recognized as liabilities, measured at the same amount as the corresponding asset
- The ASBJ decided that both assets and liabilities should be recognized because:
  - It was difficult to prescribe whether, and if so when, the legal rights have transferred
  - The entity holds the private keys of all virtual currencies, including those held on behalf of its customers
  - It was consistent with how cash held on behalf of others were accounted for

Current Activities at the ASBJ

- The ASBJ has not started standard-setting work after the issuance of the Standard
  - The regulator set up the Study Group on the Virtual Currency Dealing Business to discuss legal and regulatory issues
- We are observing the developments of the Study Group, and our observations thus far include the following:
  - There is no established definition of ICOs
    - One common characteristic of ICOs is that the issuer issues tokens to investors
    - The conditions of the ICO are generally presented in a White Paper, prepared by the issuer
  - There is no established definition of tokens
    - In the context of ICOs, tokens are digital assets recorded on the blockchain

Accounting Issues Surrounding ICOs

When an entity (the issuer) receives consideration in exchange for the tokens issued in an ICO, how should it be accounted for?

- Is the unit of account the token or the individual rights and obligations arising from the transaction?
- If the unit of account is the individual rights and obligations, an analysis of the rights and obligations arising from the transaction would be necessary
  - This may be challenging if the legal status is not clear or the conditions are not clearly set out in the White Paper
- When we look at the individual rights and obligations, the transaction may not be an exchange of equal value
  - Investors focus on resale value, rather than the value of goods and services they receive from the issuer
  - It may be challenging to faithfully represent a transaction that is <u>not</u> an exchange of equal value

Identifying Obligations Arising from ICOs

- If the White Paper indicates that the entity has absolutely no obligations, the consideration received is likely to be recognized as income

- In some ICOs, obligations are conditional and it is highly unlikely that the conditions will be met
  - Income is unlikely to be recognized until the uncertainty (ie whether the conditions are met) is resolved

- The issue becomes more complicated when the obligation relates to the provision of services
  - The interaction with the revenue recognition standard needs to be considered
    - Our understanding is that the revenue recognition standard is based on the assumption that the transaction is an exchange of equal value

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