

This paper provides the technical advice from EFRAG TEG to the EFRAG Board, following EFRAG TEG's public discussion. The paper does not represent the official views of EFRAG or any individual member of the EFRAG Board. This paper is made available to enable the public to follow the EFRAG's due process. Tentative decisions are reported in EFRAG Update. EFRAG positions as approved by the EFRAG Board are published as comment letters, discussion or position papers or in any other form considered appropriate in the circumstances.

EFRAG [draft] discussion paper - Crypto-Assets (Liabilities) – Holders and Issuers Perspective Cover Note

Objective

- 1 The objective of this session is to obtain EFRAG Board members' approval of the Discussion Paper (DP) (paper 08-02).
- 2 EFRAG TEG recommended the DP for approval on March 26 2020, subject to drafting suggestions which have been reflected in this version presented for today's session.

Why is this DP being issued now?

- 3 This DP represents a key deliverable of the EFRAG Research Agenda of the current work plan and is the result of research activity mainly conducted in 2019, which involved considerable engagement with external parties that contributed to the research.
- 4 The next deliverable from the ongoing EFRAG research activity is likely to be only available in late 2020/beginning of 2021 when the DP on Intangibles will be ready for issuance.
- 5 When EFRAG TEG discussed and approved to recommend to the EFRAG Board the issuance of the DP on 26 March 2020, EFRAG TEG members considered whether it was appropriate to still issue this DP during the Covid19 crisis, when constituents are struggling to cope with the current situation and are asking to be allowed to focus on essential standard-setting consultations.
- 6 EFRAG TEG considered that EFRAG should be fully flexible in terms of consultation period(s) and outreach approach(es) on published documents and activities, so that no undue solicitation of constituents' views is done on a topic that is not perceived as a priority. Some EFRAG TEG members also commented that the issuance of this DP was offering the opportunity for EFRAG to add value to stakeholders by providing informative reading on a complex and evolving topic to financial reporting professionals during a challenging period.
- 7 The issuance of this DP at this point in time ensures timeliness of its content related to a rapidly evolving topic. It would also be aligned timeline wise with the issuance of publications on the topic by the various influential bodies (European Parliament which has just issued a publication, Bank of International Settlements, International Monetary Fund, European Commission, ESAs etc.) and it contributes by providing an in-depth look at the accounting perspective.
- 8 In conclusion, EFRAG TEG agreed not to delay the issuance of the result of a valuable research effort whose issuance marks an accomplishment in the process of the ongoing EFRAG work plan. However, they recommended that the EFRAG Secretariat should develop a flexible approach to the consultation.

- 9 The EFRAG Secretariat is considering a dedicated communication strategy, so that the longer and more flexible consultation approach to this DP is properly conveyed. For example, videos outlining the contents might be only launched after the summer, to refocus constituents' attention.

Background on the DP

- 10 The EFRAG research project on the accounting for crypto-assets and liabilities (EFRAG research) was approved by the EFRAG Board following the EFRAG Agenda Consultation in 2018.
- 11 The EFRAG research observed that the growth potential of crypto-assets transactions has led to increased stakeholder attention on related market developments and risks, and drawn the attention of NSS, accounting firms, market practitioners and academics as well as of regulators and policy makers from the EU and beyond.
- 12 Recent EU regulatory and national accounting developments on crypto-assets related activities include:
- (a) The PACTE Law in France, enacted in May 2019, marked a key milestone in creating a legal environment for the issuance and holding of crypto-assets and giving legitimacy for related market activities.
 - (b) The March 2020 announcement by the Federal Financial Supervisory Authority (BaFin) of Germany that cryptocurrencies are to be defined as financial instruments, will provide a level of clarity and facilitate related transactions in Germany allowing for growth potential in the crypto-asset market.
- 13 Furthermore, several publications, including public consultations, have been issued by leading European institutions including the Basel Committee for Bank Supervision, European Commission, European Parliament, European Central Bank, European Banking Association and European Securities and Markets Authority. These publications highlight the key economic and technological features, business models, risks and regulation of crypto-assets.
- 14 Several of these institutions have constituted working groups that are monitoring crypto-assets related developments. In addition, some jurisdictions outside of the EU (Japan) have developed (and continue to develop) national GAAP guidance on the accounting for crypto-assets.
- 15 This DP was conducted in the following two phases:
- (a) A **“preliminary desktop research” phase** during which the EFRAG research team conducted a review of related IASB and NSS, accounting firms, regulatory, legal, academic and other specialist literature; and
 - (b) A **phase to corroborate and enhance findings** that included outreach to crypto-assets experts. Outreach involved participation of experts with diverse functional backgrounds from 13 jurisdictions including leading markets.
- 16 The IASB has been monitoring developments in crypto-assets since December 2016. So far, the IASB has decided not to undertake standard-setting mainly because the evidence obtained by the IASB staff indicated that crypto-asset transactions are not prevalent amongst entities preparing financial statements applying IFRS Standards.
- 17 Nonetheless, in March 2019, the IFRS Interpretations Committee (IFRS IC) discussed the accounting for cryptocurrencies (a sub-set of crypto-assets that represent a significant proportion of the overall crypto-assets market capitalisation) and in June 2019 issued an agenda decision clarifying the appropriate accounting treatment for cryptocurrencies.

- 18 Some stakeholders consider the IFRS IC clarification, at this stage, to be sufficient, given that the crypto market is at an early stage of development and not highly prevalent for the IFRS reporting community. However, other stakeholders including some of those who participated in the EFRAG research outreach have called for further clarification and development of IFRS requirements for crypto-assets (liabilities).

Objective and scope of the DP

- 19 The focus of this DP is on the accounting by holders and issuers of crypto-assets as these are broad topics that encompass most of the accounting issues that are likely to be relevant for IFRS entities. The DP has the following objectives:

- (a) Provide both a **problem definition** and **propose possible preliminary approaches and areas of focus in developing IFRS requirements**. The problem definition aspect primarily outlines existing approaches and identifies issues related to accounting for crypto-assets whilst assessing factors that can justify the need for clarification of IFRS requirements. These factors include the significance of crypto-assets activities, related economic characteristics, rights and obligations, regulatory requirements, trends and potential market developments.

The DP had initially intended to focus on problem definition as a first phase to be followed by accounting solutions development. However, ongoing developments have prompted the EFRAG research project to also formulate and propose next steps for IFRS development.

- (b) Obtain constituents' feedback on the above. The DP content and constituents' feedback can inform the next IASB agenda consultation and the contents of a potential future IASB project.

- 20 The **scope of the DP is on crypto-assets (liabilities)**, which are the first but not only use case of blockchain technology. The scope excludes the extended applications of blockchain of which some may meet the definition of accounting assets or liabilities and/or have gaps in their accounting requirements. This is mainly because (1) crypto-assets (liabilities) have a longer transaction history and evidence of being monetisable than extended blockchain applications and (2) unlike for the extended blockchain applications, the nature, economic characteristics and possible accounting of crypto-assets (liabilities) have been subject to considerable analysis within NSS, accounting firms, academic and other stakeholder literature.

- 21 To facilitate the reading of this DP, background information on crypto-asset activities, market development, economic characteristics and related regulation is provided in the accompanying appendices in the DP.

- 22 A glossary and definitions of the terms used in the EFRAG research is available in an appendix. The terms were derived from different source material and publications examined during the development of this DP

Key findings and proposed accounting options in the DP

- 23 The DP identifies the following areas for possible clarification and amendments of IFRS requirements for holders and issuers of crypto-assets (liabilities):

- (a) Enhancing IFRS accounting guidance for holders of crypto-assets and specifically the application of IAS 38 *Intangible Assets*, IAS 2 *Inventories*, IAS 7 *Statement of Cash Flows* and IAS 32 *Financial Instruments: Presentation* to holders;

- (b) Clarifying IFRS accounting for issuers of crypto-assets and specifically the application of IFRS 15 *Revenue from Contracts with Customers*, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, IFRS 9 *Financial Instruments* and IAS 32 to issuers; and

- (c) Emergent valuation/measurement considerations under IFRS 13 *Fair Value Measurement* or other applicable IFRS Standards.
- 24 The DP sets out the following possible options for developing IFRS requirements:
- (a) **Option 1:** No amendment to current IFRS Standards – this option entails no change in applicable IFRS Standards. In effect, preparers will continue to apply existing IFRS including having to develop their own accounting policy (IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*).
 - (b) **Option 2:** Amend and/or clarify IFRS Standards – this option proposes that several amendments or clarification guidance to current IFRS Standards (such as IAS 38, IAS 2, IAS 32, IAS 7, IAS 37, IFRS 9, IFRS 13 and IFRS 15) might be needed for the accounting by holders and issuers of crypto-assets (liabilities).
 - (c) **Option 3:** A new IFRS Standard to address crypto-assets (liabilities) with a possibility to also cover digital assets (liabilities) – this option would require developing a new standalone IFRS Standard for crypto-assets (liabilities) on the premise that they are unique assets and liabilities. A new IFRS Standard can address the multiple issues on different topics related to crypto-assets (liabilities), including those that are summarised and intended to be addressed under Option 2.
- 25 Constituents will be asked which of the three options listed in paragraph 24 they consider to be the most appropriate solution or whether they consider there to be other possible approaches to address the IFRS accounting for crypto-assets (liabilities).
- 26 Constituents will also be asked specific questions on the various solutions explored in options 2 and 3.
- 27 The DP also highlights a cross-cutting gap in IFRS requirements for non-financial assets held as investments, which arose after the withdrawal of the previously applicable IAS 25 *Accounting for Investments*. Such requirements would have been applicable to a broad set of transactions including crypto-assets that are held as investments but do not qualify as financial assets and other non-financial assets (e.g. gold held as investments by monetary authorities). As a result, the DP proposes that for its future agenda, the IASB could also consider developing a new Standard for non-financial instruments held as investments.

EFRAG discussions so far

- 28 This DP reflects the input and feedback from EFRAG TEG (six meetings), EFRAG-TEG CFSS (one meeting), EFRAG Academic Panel (one meeting), EFRAG FIWG (one meeting) and EFRAG User Panel (one meeting) provided during the various discussions over the course of its development.
- 29 EFRAG TEG (including one EFRAG-TEG CFSS meeting) has discussed the topic and a draft of the DP during seven of its meetings in 2019 and 2020 (February, May, September, December 2019; January, and March (twice) 2020). The DP was initially scheduled for EFRAG-TEG recommended approval in January 2020; however a number of EFRAG TEG members (including the EFRAG Chairwoman) considered that it would be a missed opportunity if the DP did not set forth some preliminary direction for possible stand-setting to address the IFRS accounting gaps highlighted by the EFRAG research for holders and issuers of crypto-assets (liabilities).
- 30 The DP was also subject to external reviews as well reviews by individual EFRAG TEG members.
- 31 EFRAG TEG recommended the DP for approval by the EFRAG Board at its webcast meeting on March 26 2020, subject to drafting suggestions which have been reflected in the this version presented for today's session.

Questions for EFRAG Board members

- 32 Do EFRAG Board members approve the draft Discussion Paper?
- 33 Do EFRAG Board members agree to grant a longer period for the consultation, than the usual 6 months?

Agenda Papers

- 34 In addition to this cover note, agenda paper 08-02 – *EFRAG [draft] discussion paper – Crypto-assets(liabilities)* – has been provided for the session.