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## **Preliminary recommended options on developing IFRS requirements for Crypto-Assets (Liabilities)**

### **Objective**

- 1 This paper provides EFRAG Secretariat's preliminary recommended options on the way forward, which have been developed based on the feedback received to the EFRAG [Discussion Paper on Accounting for Crypto-Assets \(Liabilities\)](#) (DP).
- 2 In January 2022, whilst formulating EFRAG's position on the way forward for IFRS requirements, the EFRAG TEG will be asked to consider the EFRAG Secretariat preliminary recommended options in addition to the stakeholders' feedback as summarised in agenda paper 09-02.

### **EFRAG Secretariat preliminary recommended options**

#### *Preliminary recommended options on Way Forward in developing IFRS requirements*

- 3 As highlighted in agenda paper 09-02, the feedback received was more supportive of Option 2 (i.e., amend or clarify existing IFRS requirements) than was the case for Option 3 (develop a unique crypto-assets (liabilities) standard). Constituents' feedback also shows that the need for amendment of IFRS Standards is mainly related to holders' accounting Standards (IAS 38 *Intangible Assets* and possibly IFRS 9 *Financial Instruments* and IAS 40 *Investment Property*) while the need for clarifying IFRS requirements is related to multiple holders-, issuers- and valuation-related Standards. The feedback showed that Option 2 can be applied in different ways including:
  - (a) Issuance of interpretations through agenda decisions similar to the 2019 IFRS IC agenda decision on cryptocurrencies with no claim on the issuer.
  - (b) Development of application guidance within existing IFRS Standards related to a range of holders, issuers, and valuation topics. However, there will be a need for such guidance to focus on transactions where there is consensus on the economic substance of the transactions.
  - (c) A narrow-scope amendment to exclude crypto-assets from the scope of IAS 2 *Inventories* and IAS 38 and either allow an accounting policy choice through IAS 8 or 'manually' include them in the scope of IFRS 9 as done for own use derivatives or include them in the scope of IAS 40. If crypto-assets are to be included in the scope of IFRS 9, there may be a need to amend IFRS 9 to mitigate against unintended consequences such as creating structuring opportunities.

- (d) Amending existing IFRS Standards (IAS 2 and IAS 38) to make them suitable for crypto-assets (e.g., targeted amendments to allow fair value disclosures under IAS 38, allow FVPL under IAS 38 ).
- 4 Another option proposed by some constituents was an interim standard that could include application guidance, which refers to existing IFRS Standards (i.e., it has an element of Option 2- clarify IFRS), but it could also provide additional guidance where existing IFRS Standards do not sufficiently address crypto-transactions (e.g. mining activities, hybrid tokens) or where required IFRS (e.g. IAS 38) do not reflect the economic substance of these transactions.
- 5 As noted in agenda paper 09-02, there are pros and cons associated with either of these alternatives. After weighing these pros and cons, the EFRAG Secretariat recommends a focus on a combination of the variants of Option 2 listed in paragraph 3, specifically, the development of clarifying application guidance addressing a range of holders, issuers and valuation topics alongside scoping crypto-assets out of IAS 2 and IAS 38 into IFRS 9 or IAS 40.
- 6 In the medium to long term, the IASB could consider the amendment of IAS 38 to allow FVPL for certain intangible assets including crypto-assets. The development of a non-financial investment standard could also be an alternative to the amendment of IAS 38 and would help to future proof and make IFRS requirements suitable for a broad range of transactions.
- 7 The EFRAG Secretariat does not recommend the immediate development of a unique crypto-assets (liabilities) Standard due to the risk of its obsolescence (i.e., the IASB should avoid developing IFRS requirements that could be outpaced by the crypto-ecosystem evolution). We also note that while an interim Standard could provide application guidance by referencing existing IFRS and address gaps in existing IFRS, there could be questions around its scope, shelf-life, and whether it will be endorsed.
- 8 The EFRAG Secretariat also notes that EFRAG has in the past expressed reservations about guidance that is provided outside of Standards (e.g., through IFRS IC agenda decisions and educational material). Hence, we would recommend any approaches to developing IFRS requirements should primarily focus on the amendment of existing Standards including providing application guidance within these Standards and/or, as noted, the development of a new Standard for non-financial assets held as investments.

*Preliminary recommendations for holders' accounting*

- 9 *Intangible asset or inventory classification:* As noted above, the EFRAG Secretariat recommends a narrow-scope amendment to exclude crypto-assets from the scope of IAS 2 and IAS 38 and to either allow an accounting policy choice through IAS 8 or to include crypto-assets in the scope of IFRS 9 or IAS 40.
- 10 In the medium to long-term, the EFRAG Secretariat recommends that the IASB does either of the following: a) amend IAS 38 to allow FVPL and permit more intangible assets held for trading (including crypto-assets) to be measured at fair value, or b) develop a Standard for investments in non-financial assets. Either of these choices should ensure that the business model and economic characteristics are considered whilst determining the appropriate recognition and measurement for crypto-assets. Should IAS 38 be amended, EFRAG's Discussion Paper [Better Information for Intangibles- Which way to go?](#) would be a useful reference for holistically considering issues around the accounting for intangibles. We consider that the development of a Standard for investment in non-financial assets could complement the various tangible and intangible asset Standards (IAS 2, IAS 16, IAS 38 and IAS 40).

- 11 *Financial asset classification:* The EFRAG Secretariat does not recommend updating IAS 32 definitions to either incorporate financial-instruments-like crypto-arrangements where there is no enforceable contractual arrangement or to include cryptocurrency flows that are not equivalent to fiat-currency cash flows. We note the concern of unintended consequences from changing IAS 32 definitions of financial instruments and financial assets (liabilities). Instead of amending IAS 32, the EFRAG Secretariat considers that crypto-assets could be ‘manually’ included in the scope of IFRS 9 and/or the IASB could develop application guidance that clarifies, if and when, crypto-assets are eligible to be in the scope of IFRS 9.
- 12 *Cash or cash equivalent classification:* The EFRAG Secretariat agrees with constituents that there are various aspects of clarification on the eligibility of some crypto-assets for cash or cash equivalent classification needed. However, we do not consider an immediate update of the IAS 32 definition of cash (currency) or the IAS 7 definition of cash and cash equivalent to be necessary. This is because: a) there seems to be no ambiguity amongst stakeholders that CBDCs qualify to be classified as cash; and b) the IASB could clarify the eligibility of stablecoins for cash equivalent classification without needing to update the definition of cash or cash equivalent. Therefore, we recommend the IASB provides application guidance within IAS 7 that clarifies if/when some fiat-currency-backed stablecoins or crypto-assets labelled as e-money by authorities would qualify for the cash equivalent classification.
- 13 *Other topics for clarification in accounting by holders:* The EFRAG Secretariat recommends application guidance that clarifies the following:
  - (a) accounting by intermediary holders as this type of holding is likely to become prominent and, in the absence of guidance, there is likely to be diversity in practice.
  - (b) guidance on accounting for holdings due to mining activities.
  - (c) accounting for hybrid tokens. Specifically, whether the predominant component should dictate the accounting choice.

*Preliminary recommended options on issuer accounting*

- 14 Based on feedback received, the activities relating to raising funds using ICOs and similar offerings are still in an early stage of development and still not sufficiently prevalent for IFRS reporting entities. The EFRAG Secretariat, therefore, agree with many respondents that it may be premature at this stage of the issuance ecosystem lifecycle to develop a new standard for accounting for issuance of crypto-assets.
- 15 Furthermore, although not specifically noted by respondents, the EFRAG Secretariat is aware that future developments in raising funds are likely to move away from the traditional early-stage Initial Coin Offerings (ICOs), Security Token Offerings (STOs) and initial Exchange Offerings (IEOs) fundraising models into a more complex decentralised mechanism involving Initial Dex Offerings (IDOs) and more recently Initial Stake Pool Offerings (ISPOs). This may be another reason why a solution based on developing a new standard may be premature at this stage, and a more appropriate and perhaps faster alternative would be to leverage existing IFRS requirements and amend or provide guidance to existing IFRS requirements where guidance is lacking or is unclear.
- 16 IDOs started launching in recent years (2020, 2021) and involve a project that launches a token through a decentralised liquidity exchange. Unlike ICOs, the IDO model allows crypto startups to raise funds through build-in liquidity pools without depending on intermediaries. ISPOs are even more recent and involve a crypto holder “staking” a particular token into a designated wallet (for example the Cardano wallet) and are rewarded with newly released tokens. The ISPO model is at an early stage of development and more research would be needed to understand it better and the underlying accounting implications. These latest fundraising/token raising

models are part of emerging developments such as DeFi and NFTs. However, at this stage, it is mainly retail investors, startups and venture capitalists that partake in these types of issuance activities.

- 17 Furthermore, as noted by some respondents, the regulatory environment in the different jurisdictions will also continue to develop and will provide greater clarity over crypto-asset activities including ICOs and similar offerings.
- 18 Similar to what some respondents noted, the EFRAG Secretariat acknowledges that absent a contractual agreement with a customer, application of IFRS 15 and IAS 32 might be difficult. The proposed application guidance could clarify this issue further. The guidance in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* offers a broad basis for application when neither IAS 32 *Financial Instruments: Presentation* nor IFRS 15 *Revenue from Contracts with Customers* would apply.
- 19 However, the EFRAG Secretariat consider that further research is needed to determine whether the issuance of hybrid tokens, which typically operate through smart contracts or a decentralised mechanism, involves a virtual or intangible contractual arrangement, before concluding that IAS 37 would apply. The ongoing development of regulation could also provide clarity in this regard. Therefore, following Option 2 (amend or clarify IFRS requirements) as a way forward might pose the best solution at this stage.

*Preliminary recommended options on valuation*

- 20 The EFRAG Secretariat recommends that similar to the recommendation for issuer accounting any clarifications needed for valuation of crypto-assets (liabilities) are included in either of the alternatives that fall within Option 2 - Amendments to existing IFRS Standards or application guidance that incorporates the relevant references to the fair value guidance in IFRS 13 and provides additional guidance where needed.
  - (a) Both alternatives would provide guidance on a measurement basis for crypto-assets (liabilities). In case, fair value was considered an appropriate measure, the fair value measurement principles and valuation techniques within IFRS 13 would be generally applicable.
  - (b) However, either of the two alternatives would need to consider whether additional fair value guidance is needed that is more specific for crypto-assets. One respondent that is involved in crypto-asset valuations noted that additional guidance would be needed in relation to the following areas in IFRS 13, and provided suggestions on how they could be addressed:
    - (i) Active market determination and level 1 inputs definition
    - (ii) Principal market
    - (iii) Fair value definition and “exit price” requirement.

**Questions to EFRAG TEG**

- 21 Does EFRAG TEG have comments on and agree with the EFRAG Secretariat's preliminary recommended options on developing IFRS requirements?
- 22 Does EFRAG TEG have comments on and agree with the EFRAG Secretariat's preliminary recommended options on accounting by holders?
- 23 Does EFRAG TEG have comments on and agree with the EFRAG Secretariat's preliminary recommended options on accounting by issuers?
- 24 Does EFRAG TEG have comments on and agree with the EFRAG Secretariat's preliminary recommended options on valuation requirements?