

Accounting for Virtual Currencies

Accounting Standards Board of Japan

April 2018

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➤ 1 The Standard under Japanese GAAP

Why We Undertook This Project

- ❖ 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 recommended by the Standards Advisory Council to develop guidance for the accounting for virtual currencies
- ❖ The ASBJ accepted the recommendation but decided to address only limited issues, considering that:
 - ▶ the virtual currency business was at a very young stage; and
 - ▶ there was uncertainty regarding the legal status under Japanese private law

Exposure Draft and Final Standard

❖ Exposure Draft

- ▶ On December 6, 2017, the ASBJ issued for public comment the Exposure Draft *Practical Solution on the Accounting for Virtual Currencies under the Payment Services Act*
- ▶ The comment period ended February 6, 2018

❖ Final Standard

- ▶ On March 14, 2018, the ASBJ issued the *Practical Solution on the Accounting for Virtual Currencies under the Payment Services Act*
- ▶ The Standard is effective from the beginning of the fiscal year that begins on or after April 1, 2018
 - ▶ Early application is permitted

- ❖ The Standard addresses the accounting for **virtual currencies** as defined in the Act, except for those that were issued by the entity itself (including its parent, subsidiaries, and affiliates)
 - ▶ We decided to scope out virtual currencies that were issued by itself for the following reasons:
 - ▶ We had decided to address only limited issues
 - ▶ We were not confident that we had identified all of the issues that needed to be addressed
 - ▶ This decision will scope out the so-called Initial Coin Offerings (ICOs) by the entity
 - ▶ It was unclear whether “tokens” issued in ICOs represented obligations, and if so, whether such obligations gave rise to liabilities for accounting purposes

Virtual Currencies under the Act

- ❖ Virtual currencies under the Act are proprietary value that can be transferred using an electronic data processing system and that can be either:
 - a. used against unspecified parties as a means of payment and can be traded with unspecified parties; or
 - b. can be exchanged with other virtually currencies defined in (a).
- ❖ The following are **not** virtual currencies under the Act:
 - ▶ Japanese or foreign fiat currencies
 - ▶ assets denominated in fiat currencies
 - ▶ “prepaid cards” issued in exchange for the prepayment of goods or services
 - ▶ “points” under point services

Are Virtual Currencies Assets?

❖ Our conclusion: **YES**

- ▶ As of the date the Standard was issued, the legal status of virtual currencies under Japanese private law was not clear
- ▶ It was not clear whether any legal property rights could be attached to virtual currencies
- ▶ Nonetheless the ASBJ concluded that virtual currencies could be treated as assets for accounting purposes, because they may contribute to cash inflows to the entity through sales or conversion to cash

What Type of Assets are Virtual Currencies?

❖ Our conclusion: **A new independent category of assets**

- ▶ We concluded that virtual currencies did not fit into any of the existing categories

Foreign currencies	Foreign currencies generally refer to fiat currencies, and virtual currencies may have characteristics different from foreign currencies.
Financial assets	Virtual currencies do not meet the definition of financial assets (other than cash).
Inventories held for trading	Virtual currencies are not always held for trading.
Intangible assets	Virtual currencies do not have physical substance but intangible assets generally are not intended to be held for trading.

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 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 (1/2)

❖ Recognition and measurement at the balance sheet date

	Assets	Liabilities
Initial recognition	Virtual currencies should be measured at market price at the date they were deposited by the customer	The same amount as the corresponding asset should be recognized as a liability to represent the obligation to return the virtual currency to the customer
Measurement at the balance sheet date	Same as virtual currencies held by an entity on its own behalf	The same amount as the corresponding asset

Virtual Currencies Held by a Virtual Currency Dealer on Behalf of Its Customers (2/2)

- ❖ **Why we decided to recognize both assets and liabilities**
 - ▶ **It is difficult to prescribe whether, and if so when, the legal rights have transferred**
 - ▶ **The entity holds the private key, which is needed to dispose of the virtual currencies held on behalf of its customers**
 - ▶ **It is consistent with how cash held on behalf of others were accounted for**

- ❖ **When an entity sells its virtual currencies, the resulting gain or loss should be presented as the net amount in the income statement**
 - ▶ **The net amount is calculated as the selling proceeds less the cost of virtual currencies sold**
 - ▶ **Gross presentation of income and expenses arising from trading activities may be misleading**

Example of Required Disclosures for a Virtual Currency Dealer

[Virtual Currencies Held by the Entity on its Own Behalf]

Those With an Active Market

Virtual Currency A	xxx units	XXX
Virtual Currency B	xxx units	XXX
...		...
Others		XXX
	Subtotal	<u>X,XXX</u>

Those Without an Active Market

Virtual Currency X	xxx units	XXX
Virtual Currency Y	xxx units	XXX
...		...
Others		XXX
	Subtotal	<u>X,XXX</u>

Total Virtual Currencies Held by the Entity on its Own Behalf		<u>X,XXX</u>
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Virtual currencies of de minimis amounts can be aggregated with other virtual currencies

The same amount should be recognized as a liability

[Virtual Currencies Held by the Virtual Currency Dealer on Behalf of its Customers]

Total Virtual Currencies Held by the Virtual Currency Dealer on Behalf of its Customers	<u>X,XXX</u>
Total Virtual Currencies	<u><u>X,XXX</u></u>

Equals the amount on the balance sheet

➤ 2 Potential Issues to Consider under IFRS

An Example of Accounting Policies Disclosed under IFRS

- ❖ Company A has disclosed its accounting policies as follows:

Type	Classification	Standard	Measurement
Virtual currencies held for trading	Inventories	IAS 2	Fair value less costs of disposal
Virtual currencies held on behalf of its customers	Inventories	IAS 2	Fair value less costs of disposal*
Virtual currencies that are not inventories	Intangible assets with indefinite useful lives	IAS 38/ IAS 36	Cost less impairment (if any)

*The same amount is recognized as a liability

Cases to Consider: Case 1

Company B newly issued X-coins in exchange for Y-coins, a virtual currency with an active market. The fair value of Y-coins at the date of exchange was 10 million CUs.

Company B recognized Y-coins as assets at 10 million CUs.

X-coins can be used for future price reductions of services provided by Company B. Therefore, Company B recognized “deferred revenue” (ie liabilities) of 10 million CUs.

At the end of the reporting period, Company B had not provided the services, but the fair value of Y-coins had increased to 50 million CUs.

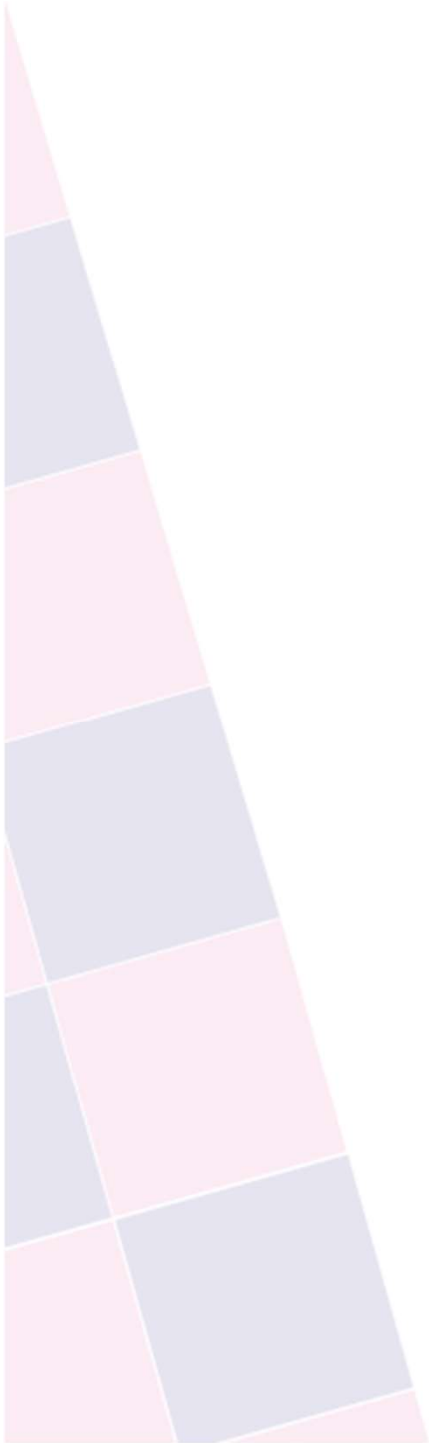
- ❖ Should the initial 10 million CUs worth of Y-coins received be recognized as income or liabilities?
- ❖ Should the change in the value of Y-coins be recognized in the period the change occurred?


Cases to Consider: Case 2


Company C issues 10 million units of Z-coins at an ICO. Upon issuance, 8 million units are sold to third parties and 2 million units are assigned to itself. The cost of Z-coins to Company C is zero.

After a successful ICO, Z-coins are traded in an active market and the fair value of Z-coins is 10 CU per unit of Z-coins at the end of the period.

- ❖ Should the 2 million units of Z-coins assigned to Company C ever be recognized? Would the assignment of Z-coins to itself qualify as a transaction that should be accounted for?**



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