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Cayman Islands Cryptocurrency funds: Accounting challenges

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The increase in digital assets has created a twist on the alternative fund industry – the cryptocurrency (or crypto) fund. With change comes opportunity as well as challenges. This emerging market segment has led to an influx of new entrants and an evolving landscape for existing players in the fund industry. But it also presents challenges for financial reporting and accounting for cryptocurrencies. How should digital assets be accounted for?

What is a Cryptocurrency fund?

Most funds fit into the classification of either traditional fund or alternative fund. Alternative funds are fund structures where investments are non-traditional in nature (traditional being long equities and bonds), and can cover a multitude of investment types from derivatives and private equity to more obscure such as art and antiques. Cryptocurrency funds are a form of alternative funds where the investment portfolio consists of digital assets.

There has also been a recent upsurge in opportunities for investors to take advantage of this recent technology by subscribing into funds via digital assets as opposed to more traditional methods such as cash.

Cryptocurrency – security and technology

New technology means new ways of thinking. Old methods need updating or replacing. How has recent changes in technology impacted digital assets?

Cryptocurrency is a digital asset which uses both cryptography (security via encryption) and blockchain (or similar technology to ensure transaction is secure) to allow traders and investors safe, swift transactions either on an exchange or peer-to-peer.

Cryptocurrency is unitized and is often used as a medium of exchange, seen by many as an alternative to fiat currency (i.e legal cash).

Cryptocurrency accounting issues

Unfortunately for cryptocurrency funds, cryptocurrencies and digital assets are not specifically included in the International Financial Reporting Standards (IFRS) or US Generally Accepted Accounting Principles (US GAAP) framework. Therefore need further consideration when accounting for such items. An assessment is required as to which standard is most appropriate.

Approaches for recording cryptocurrency – assessing the options under IFRS

Under IFRS, Cryptocurrencies do not meet the criteria for classification as cash or financial assets (which is the quasi-form of digital assets in layman terms) for reason presented below.

Cash and Cash Equivalents

Cryptocurrency does not meet the definition of 'cash' by following IAS 7 Statement of Cashflows and IAS 32 Financial Instruments: Presentation ("IAS 32") because they are not considered legal tender in virtually all jurisdictions and are not backed by a central bank or government (cryptos are decentralized). In addition, they cannot readily be exchanged for any good or service. Therefore under IFRS they cannot be considered as cash.

They are not categorized as 'cash equivalents' under IFRS as cash equivalents are not subject to price volatility which cryptos have proved to be in recent years.

Financial Assets

Cryptocurrencies may take the quasi-form of investments or 'financial assets' in a crypto-fund. However they do not meet the requirements of financial assets under IAS 32 because possession of cryptocurrencies do not give the holders any contractual rights to receive cash or another financial assets. Therefore they should not be accounted for at fair value through profit or loss.

Property

It would not be appropriate for cryptocurrency holdings to be accounted for as 'property' under either IAS 40 Investment Properties or IAS 16 Property, Plant and Equipment as digital assets are not physical assets and do not have a physical form.

So how do you account for digital assets?

There is no perfect "glass-slipper" solution under IFRS, so Grant Thornton take the 'best-fit' approach which is in line with industry general practice. There are two preferred solutions for accounting for digital assets. Either recording them as an intangible asset under IAS 38, or classifying them as inventory under IAS 2.

Intangible Asset

Cryptocurrencies meet the criteria for intangible assets, namely:

i. Identifiable – firstly they are unitized and therefore separable, and secondly, they can be traded on an exchange or in peer-to-peer transactions;
ii. Non-monetary - the value of a cryptocurrency is not fixed or determinable and therefore meets the definition of non-monetary versus monetary;
iii. Without physical substance – being digital in nature.

Cryptocurrencies under IAS 38 would be accounted for either:

i) at cost (and subsequently measured at cost less accumulated amortisation and impairment losses); or
ii) for actively traded cryptocurrency assets, under the revaluation model where it is subsequently measured at fair value less accumulated amortisation and impairment losses.

N.B. amortization is considered not applicable for cryptos as the life of the asset is considered infinite.

Inventory

Inventory can be used as an alternative to Intangibles for recording Digital assets in a fund structure where the assets are considered as held for trading (i.e. digital assets are acquired by the entity with the purpose of selling them in the near future and generating a profit from fluctuations in price or brokertraders' margin). In this scenario, the assets would qualify for IAS 2's accounting as inventory at fair value less costs to sell, with changes in fair value less costs to sell being recognised in profit or loss in the period of the change.

Alternatively, if the assets are not held for trading but rather, held for medium to long term asset appreciation, it may be more appropriate to account for the assets not as inventory, but as intangible assets.

IFRS versus US GAAP

US GAAP follows a similar thought pattern to IFRS. Under US GAAP, cryptocurrency would qualify as an infinite intangible asset under ASC 350 and also inventory under ASC 330 (for actively traded digital assets, similar to IFRS criteria above). Similar to IFRS, digital assets would not qualify as cash or property under US GAAP.

The difference under US GAAP is that it is generally seen as acceptable to account for digital assets as fair value investments, provided the entity falls within the scope of an investment company under ASC 946. This is not the case under IFRS.

In the absence of clear guidance by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB), there will be continue to be judgement and interpretation involved in accounting for cryptocurrencies both under IFRS or US GAAP.

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Contact us

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