

## Technical Alert: 2/2018

**Date:** 31 October 2018

**Subject:** Cryptocurrencies and ICOs News Briefing

### **Cryptocurrencies and ICOs: are these just buzzwords or are they here to stay?**

The aim of this publication is to raise awareness amongst the Members of the Institute about the relatively new era of cryptocurrencies and Initial Coin Offerings (ICOs)<sup>1</sup>, and share the latest updates on standard-setting, regulation and guidance issued worldwide. We also pose some questions to the Members to identify the magnitude of companies' involvement in cryptocurrencies and ICOs in Cyprus.

#### **Introduction**

Cryptocurrencies and ICOs are gaining momentum across the globe. However, this type of investment is highly speculative. Regulatory authorities have published warnings to investors about the risks from cryptocurrencies and ICOs. For instance, the European Securities and Markets Authority (ESMA) has issued an alert in November 2017 concerning the high risks of ICOs<sup>2</sup>. Additionally, the European Supervisory Authorities (ESAs) have issued, in February 2018, a warning to consumers regarding the risks from buying virtual currencies<sup>3</sup>.

Cryptocurrencies are susceptible to money laundering and terrorist financing. They allow greater anonymity than traditional non-cash payment methods. Also, customer and transaction records might be kept by various entities, based in different jurisdictions, making it harder to enforce cryptocurrencies in the law, and regulators to access them. The European Union's 5<sup>th</sup> Anti-Money Laundering Directive (AMLD)<sup>4</sup>, published in May 2018, aims to tackle such issues by combatting terrorist financing risks linked to virtual currencies. It requires obliged entities to follow customer due diligence requirements to discontinue the anonymity of cryptocurrencies. In addition, companies need to provide evidence on the origin of income received from cryptocurrencies. Furthermore, the Financial Action Task

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<sup>1</sup> Definitions for cryptocurrencies and ICOs can be found in Appendix 1

<sup>2</sup> <http://www.iosco.org/library/ico-statements/EU%20-%20ESMA%20-%20Statement%20to%20Investors%20on%20Initial%20Coin%20Offerings.pdf>

<sup>3</sup> <https://www.esma.europa.eu/press-news/esma-news/esas-warn-consumers-risks-in-buying-virtual-currencies>

<sup>4</sup> <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32018L0843&from=EN>

Force (FATF) published guidance<sup>5</sup> of risk-based approach to cryptocurrencies advocating that countries license virtual currency exchanges.

Apart from the risks that expose investors, other actors need also to be careful when engaging with cryptocurrencies. For instance, those charged with governance, the preparers of the financial statements and professional advisors must be educated on what cryptocurrencies are and the risks brought by such an investment. It is also vital to ensure correct accounting treatment of those, and appropriate disclosure in the financial statements.

There are several difficulties brought by cryptocurrencies, one of them being the limited guidance when it comes to their accounting treatment. Cyprus is reporting under the International Financial Reporting Standards (IFRS) as adopted by the European Union for all its companies (as per Article 142 (1)(α) of Companies Law (Cap 113)<sup>6</sup>. IFRS standards however are silent on this matter. As such, companies investing in cryptocurrencies in Cyprus need to determine the accounting treatment themselves for the time being. The International Accounting Standards Board (IASB) considered adding a project in this area, though this has not yet materialised. The IASB is being skeptical about the resources needed to carry out this project given the insufficient evidence that exists. They have consulted the IFRS Interpretations Committee (IFRIC) and plan to discuss this topic at a future IASB meeting. Furthermore, the European Financial Reporting Advisory Group (EFRAG) has approved adding a related project to their research agenda.

Additionally, various jurisdictions have regulated cryptocurrencies, issued guidance and have taken a formal position on how to account for cryptocurrencies. As it concerns Cyprus, any activity relating to virtual currencies is not currently regulated by the Cyprus Securities and Exchange Commission (CySEC), unless a virtual currency meets the criteria and falls under the existing regulatory framework as per CySEC's announcement in November 2017<sup>7</sup>.

Below we provide more information about the work undertaken so far by the IASB, IFRIC, EFRAG and several jurisdictions.



*(Photo by S3studio/Getty Images)*

<sup>5</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/Guidance-RBA-Virtual-Currencies.pdf>

<sup>6</sup> [http://www.cylaw.org/nomoi/enop/non-ind/o\\_113/full.html](http://www.cylaw.org/nomoi/enop/non-ind/o_113/full.html)

<sup>7</sup> <https://www.cysec.gov.cy/CMSPages/GetFile.aspx?guid=d8d643c1-74f9-4723-98b6-e5e8c79be7fa>

## Standard-setting update

### **International Accounting Standards Board (IASB)**

The IASB has performed research on transactions relating to cryptocurrencies, published in one of the IASB's Staff papers in July 2018 *Transactions involving commodities and cryptocurrencies*<sup>8</sup>. They have identified three different areas:

- (a) holding cryptocurrencies;
- (b) ICOs; and
- (c) mining cryptocurrencies<sup>9</sup>.

The IASB describes that cryptocurrency transactions are increasingly common in some jurisdictions, for example Canada but not in others. The occurrence of cryptocurrency transactions seems to be related to the regulatory and legal environment in different jurisdictions. Such transactions are currently not regulated in Cyprus. In some jurisdictions (e.g. Belarus, Estonia, Japan and Switzerland), some entities hold cryptocurrencies but report applying local GAAP.

For those entities that are IFRS reporters, the IASB has identified that the majority account for cryptocurrency holdings as a financial asset at fair value through profit or loss, applying IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*. A small number applies either IAS 38 *Intangible Assets* (using the cost or revaluation model) or IAS 2 *Inventories* (measured at cost or at fair value through profit of loss using the commodity broker-trader exemption).

From the research conducted by the IASB, the entity that engaged in an ICO initially accounted for the receipt of funds as a liability (reported as 'deferred income'). Their research identified only a few IFRS reporters that had raised finance through an ICO before or during 2017 but this is expected to increase in 2018.

All entities that report mining of cryptocurrencies account for transaction fees received as revenue in their 2017 or 2018 financial statements.

The IASB's Board decided at its July 2018 meeting<sup>10</sup> to ask the IFRIC to:

- provide further information about how an entity might apply existing IFRS Standards in determining its accounting for holdings of cryptocurrencies and ICOs.
- consider possible standard-setting activities suggested by the IASB's Board members.

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<sup>8</sup> <https://www.ifrs.org/-/media/feature/meetings/2018/july/iasb/ap12d-ias37.pdf>

<sup>9</sup> Definition can be found in Appendix 1

<sup>10</sup> <https://www.ifrs.org/news-and-events/updates/iasb-updates/july-2018/>

## **Standard-setting update** *continued*

### **International Accounting Standards Board (IASB)** *continued*

The IASB's staff members will continue monitoring the mining of cryptocurrencies but concluded that this should not be investigated by the IFRIC at this time.

### **IFRS Interpretations Committee (IFRIC)**

The IFRIC discussed at its September 2018 meeting the topic of cryptocurrencies (agenda item 4)<sup>11</sup>.

The majority of the IFRIC members agreed with the IASB's staff conclusion for the holding of cryptocurrencies and ICOs:

- Cryptocurrencies meet the definition of an intangible asset when applying existing IFRS standards. If an entity does not apply IAS 2 to account for these cryptocurrencies, it applies IAS 38.
- ICOs: there are several IFRS standards that an entity might consider in determining the appropriate accounting to apply for ICOs, e.g., IFRS 9, IFRS 15 *Revenue from Contracts with Customers*, IAS 32 *Financial Instruments: Presentation* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Having said that, the Committee also provided advice to the Board about the usefulness of information provided by existing IFRS Standards in respect to holdings of cryptocurrencies. Some members have reservations whether IAS 38 will provide useful information for decision making. It was noted that IAS 38 was not designed with cryptocurrencies in mind.

Furthermore, there were a range of views for possible standard-setting activities the IASB Board could undertake. These include:

- developing an investments standard;
- amending the scope of IAS 38 to explicitly exclude cryptocurrencies - and include cryptocurrencies within the scope of IFRS 9 or IAS 40 *Investment Property*;
- deferring standard setting – asking IFRIC to publish an agenda decision on either only disclosure requirements for cryptocurrencies, or recognition, measurement and disclosure requirements.

The IASB Board will consider the Committee's advice when it discusses the matter at a future meeting.

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<sup>11</sup> <https://www.ifrs.org/groups/ifrs-interpretations-committee/#meetings>

## European Financial Reporting Advisory Group (EFRAG)

The EFRAG Board approved adding a project on cryptocurrencies to the EFRAG research agenda at its meeting in September 2018. At this stage they have gathered information on local GAAP accounting on the topic, to enhance the project plan presented to the EFRAG Board in September 2018. An updated project plan (agenda item 8) was presented at the EFRAG Board meeting in October 2018<sup>12</sup>. EFRAG has not yet concluded on what the scope should cover, i.e. whether it should include ICO accounting.

## Intelligence gathered from jurisdictions

Below we provide activities undertaken by few jurisdictions and professional bodies in relation to cryptocurrencies.

### 1. Canada

The Canadian Securities Exchange (CSE) has launched in February 2018 a securities clearing and settlement platform based on the Ethereum Blockchain that allows companies to raise capital with security tokens.

The Chartered Professional Accountants of Canada (CPA) has issued guidance in May 2018 titled '*An introduction to Accounting for cryptocurrencies*<sup>13</sup>'. In this publication CPA sets out the definitions of cash, non-cash financial asset, investment property, intangible assets and inventory as per IFRS standards to identify to which category a cryptocurrency might fall. It concludes that cryptocurrencies are likely to meet the definition of an intangible asset under IAS 38. However, the paper notes that concerns have been raised on the application of IAS 38 and the measurement of cryptocurrencies at cost as it is not reflective of the economic substance and does not provide relevant information to users of financial statements.

### 2. Japan

In April 2017, Japan amended the Payment Services Act, which introduced a regulation for Japanese virtual currencies businesses. It legally defines virtual currency as a form of payment. It also requires virtual currency exchange services to register with Japan's Financial Services Agency (FSA) to obtain a license.

The Accounting Standards Board of Japan (ASBJ Standard) published in March 2018 a standard on the accounting for virtual currencies under local Japanese GAAP.

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<sup>12</sup> <https://www.efrag.org/Meetings/1708160919054547/EFRAG-Board-meeting-18-October-2018>

<sup>13</sup> <https://www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/international-financial-reporting-standards-ifs/publications/accounting-for-cryptocurrencies-under-ifs>

## Intelligence gathered from jurisdictions *continued*

### 3. Lithuania

The Ministry of Finance of the Republic of Lithuania has published guidelines for cryptocurrency and ICOs in June 2018<sup>14</sup>. They are divided into four areas: regulation, taxation, accounting, and Anti-Money Laundering/ Combating the Financing of Terrorism.

As it concerns the accounting of cryptocurrencies, a position paper *Accounting Guidelines on Cryptocurrency and Tokens* was issued in June 2018 by the Authority of Audit, Accounting, Property Valuation and

Insolvency management of Lithuania<sup>15</sup> on how to account for cryptocurrencies. If these are used as means of payment (cryptocurrency coins), they should not be considered as intangible assets. Instead they should be attributed to financial assets, which is measured at fair value by presenting the change in fair value in the profits/loss statement. If there is no reliable measure of the fair value of the cryptocurrency, this cryptocurrency should be measured at acquisition cost minus impairment amount.

### 4. Malta

The Maltese government put forward a legal framework for blockchain, cryptocurrency and DLT (Distributed Ledger Technology) as of June 2018. This comprises three crypto-positive bills. The first law, titled *Malta Digital Innovation Authority (MDIA) Act*, certifies the DLT platforms and establishes the Malta Digital Innovation Authority which will be the regulatory body for the industry. The second law, known as *Innovative Technology Arrangements and Services (ITAS) Act* relates to DLT arrangements and sets out the setup of exchanges and other entities involved in the cryptocurrency market. The third law, titled *Virtual Financial Assets (VFA) Act* determines the regulatory regime ruling ICOs and cryptocurrency exchanges.



<sup>14</sup><http://finmin.lrv.lt/uploads/finmin/documents/files/ICO%20Guidelines%20Lithuania.pdf>

<sup>15</sup> <http://www.avnt.lt/assets/Veiklos-sritys/Apskaita/VAS/Euras-ir-kripto valiuta/2018-06-07-Cryptocurrencies-accounting-guidance.pdf>

## Conclusion

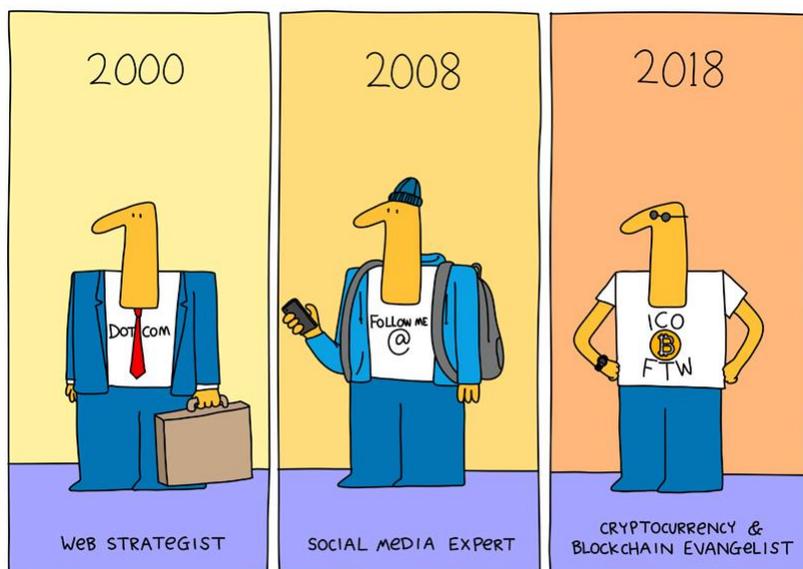
Several jurisdictions have now regulated cryptocurrencies and ICOs, and others are considering about this. It seems that these are not just buzzwords. Given though the turbulent environment, no one can guarantee that cryptocurrencies are here to stay, making it a good long-term investment. Moreover, we should keep in mind the risks of money laundering and terrorist financing associated with cryptocurrencies.

It is also difficult to provide an opinion on how to account for cryptocurrencies. Different types of cryptocurrencies have different characteristics. ICOs can result in different rights and obligations. We anticipate the results from the research that will be carried out by EFRAG and potentially the IASB to obtain further guidance.

In an effort to detect the extent to which entities are engaged in cryptocurrencies in Cyprus, the Members are kindly requested to provide information on their related experience:

- Are you aware of entities reporting holdings of cryptocurrencies in Cyprus? If yes, please list the entities (if this information can be publicly available)
- Are your clients involved in holdings or mining of cryptocurrencies or engage in ICOs? If yes, in which jurisdiction do your clients operate?
- How do the clients account for such transactions in their financial statements?
- How do you, as auditors, verify these transactions?

All members of the Institute are welcome to provide their views. Please contact us via email at [info@icpac.org.cy](mailto:info@icpac.org.cy).



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TO COACH PEOPLE THROUGH DISRUPTION

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## Appendix I

### Definitions

***This appendix provides relevant and useful definitions***

#### ***Virtual currencies***

Virtual currencies, as defined by the European Central Bank (ECB), in a 2015 report titled *Virtual Currency Schemes*<sup>16</sup>, constitute digital representations of value, not issued by a central bank, credit institution or e-money institution, which in some circumstances can be used as an alternative to money.

Similarly to ECB, the 5<sup>th</sup> AMLD, describes virtual currencies as a digital representation of value that is not issued or guaranteed by a central bank or a public authority. It goes further to explain that it is not necessarily attached to a legally established currency and does not possess a legal status of currency or money but is accepted by natural or legal persons as a means of exchange and which can be transferred, stored and traded electronically.

Virtual currency is distinct from fiat currency, which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It is distinguished from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency.

Virtual currencies can be either centralised and decentralised. Cryptocurrencies are decentralised and as defined by FATF in its report dated June 2014 *Virtual Currencies Key Definitions and Potential AML/CFT Risks*<sup>17</sup>, decentralised virtual currencies are distributed, open-source, math-based peer-to-peer virtual currencies that have no central administrating authority, and no central monitoring or oversight. Examples: Bitcoin, Ethereum, Litecoin, Dash, Monero and Ripple.

#### ***Cryptocurrencies***

Cryptocurrencies are a subset of virtual currencies. ECB, as well as, the International Monetary Fund (IMF) support this classification.

There is no generally accepted definition of the term ‘cryptocurrency’. Hereby we provide a definition obtained from FATF<sup>18</sup> referring to cryptocurrency being a math-based, decentralised convertible virtual currency that is protected by cryptography —

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<sup>16</sup> <https://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemesen.pdf>

<sup>17</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf>

<sup>18</sup> <http://www.fatf-gafi.org/media/fatf/documents/reports/Virtual-currency-key-definitions-and-potential-aml-cft-risks.pdf>

### ***Cryptocurrencies continued***

i.e. it incorporates principles of cryptography to implement a distributed, decentralised, secure information economy. Cryptocurrency relies on public and private keys to transfer value from one person (individual or entity) to another and must be cryptographically signed each time it is transferred. The safety, integrity and balance of cryptocurrency ledgers is ensured by a network of mutually distrustful parties (in Bitcoin, referred to as miners) who protect the network in exchange for the opportunity to obtain a randomly distributed fee (in Bitcoin, a small number of newly created bitcoins, called the “block reward” and in some cases, also transaction fees paid by users as an incentive for miners to include their transactions in the next block).

### ***Initial Coin Offerings (ICOs)***

ICO is an unregulated<sup>19</sup> means by which funds are raised for a new cryptocurrency venture. An ICO is used by startups to bypass the rigorous and regulated capital-raising process required by venture capitalists or banks. In an ICO campaign, a percentage of the cryptocurrency is sold to early backers of the project in exchange for legal tender or other cryptocurrencies, but usually for Bitcoin<sup>20</sup>.

### ***Distributed Ledger Technologies (DLT)***

DLT refers to the technological infrastructure and protocols that allows simultaneous access, validation and record updating in an immutable manner across a network spread across multiple entities or locations.

DLT, more commonly known as the blockchain technology, was introduced by bitcoin and is now a buzz word in the technology world given its potential across industries and sectors. In simple words, the DLT is all about the idea of a “decentralized” network against the conventional “centralized” mechanism and is deemed to have far-reaching implications on sectors and entities that have long relied upon a “trusted third-party”<sup>21</sup>.

### ***Mining of cryptocurrencies***

An integral part of a cryptocurrency network that performs two important functions. First it is used to generate and release new cryptocurrency tokens for circulation via the cryptocurrency network, and secondly, it is used to verify, authenticate and then add the ongoing network transactions to a public ledger<sup>22</sup>.

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<sup>19</sup> Some ICOs may be regulated according to securities regulators in some jurisdictions. See [http://www.iosco.org/publications/?subsection=ico-statements for some announcements by regulators on ICOs](http://www.iosco.org/publications/?subsection=ico-statements%20for%20some%20announcements%20by%20regulators%20on%20ICOs).

<sup>20</sup> Definition obtained from Investopedia <https://www.investopedia.com/terms/i/initial-coinoffering-ico.asp>

<sup>21</sup> Definition obtained from Investopedia <https://www.investopedia.com/terms/d/distributed-ledger-technology-dlt.asp>

<sup>22</sup> Definition obtained from Investopedia <https://www.investopedia.com/terms/m/mining.asp>

## Appendix II

### Useful links

***This appendix provides other useful links to external resources:***

1. Accounting Standards Advisory Forum (ASAF), April 2018, *Commodity loans and related transactions*  
<https://www.ifrs.org/-/media/feature/meetings/2018/april/asaf/asaf-03-commodity-loans-and-related-transactions-april-2018.pdf>
2. Bitcoin magazine, June 2018, *Malta Approves Favorable Cryptocurrency Bills in Next Step as a Blockchain Island*  
<https://bitcoinmagazine.com/articles/malta-passes-favorable-cryptocurrency-laws-next-step-blockchain-island/>
3. CNBC, March 2018, *Your guide to cryptocurrency regulations around the world and where they are headed*  
<https://www.cnbc.com/2018/03/27/a-complete-guide-to-cyprocurrency-regulations-around-the-world.html>
4. CSE, 2018, *CSE Unveils Canada's First Platform for Clearing and Settling Securities through Blockchain Technology*  
<https://thecse.com/en/about/publications/cse-news/cse-unveils-canadas-first-platform-for-clearing-and-settling-securities>
5. CySEC, May 2018, *Introduction of new rules governing derivatives on virtual currencies*  
<https://www.cysec.gov.cy/CMSPages/GetFile.aspx?guid=2cd4bb96-9cf7-476d-abce-7f7583406c80>
6. Financial Stability Board, October 2018, *Crypto-asset markets: Potential channels for future financial stability implications*  
<http://www.fsb.org/wp-content/uploads/P101018.pdf>
7. Forbes, July 2018, *Maltese Parliament Passes Laws That Set Regulatory Framework for Blockchain, Cryptocurrency And DLT*  
<https://www.forbes.com/sites/rachelwolfson/2018/07/05/maltese-parliament-passes-laws-that-set-regulatory-framework-for-blockchain-cryptocurrency-and-dlt/#28c7860149ed>