

The latest perspectives on crypto lending

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At a glance

The AICPA revised its crypto lending guidance such that a lender may be required to derecognize crypto assets accounted for as intangible assets if they are loaned to a borrower and control is transferred.

What happened?

In February 2023, the AICPA updated its guidance on the accounting for crypto asset lending. Question 25 of the AICPA's Practice Aid, *Accounting for and auditing of digital assets* ("Digital Assets Practice Aid") was amended to reflect comments made by the SEC staff at the AICPA & CIMA Conference on Current SEC and PCAOB Developments in December 2022 and discussions between the SEC staff and the AICPA digital assets working group. The revised question now indicates that it is appropriate for a lender of crypto assets to derecognize the crypto asset upon transfer of control of the assets to a borrower. The guidance is applicable to reporting entities that file financial statements with the SEC and apply US GAAP or IFRS.

When the loaned crypto assets are derecognized by the lender, the SEC staff would not object to the lender recognizing an asset (which may be referred to as a crypto asset loan receivable) that represents its right to receive the crypto assets from the borrower at the end of the loan period. Because the crypto asset loan receivable exposes the lender to the credit risk of the borrower, the lender should recognize an allowance for expected credit losses utilizing the principles in ASC 326, *Financial Instruments – Credit Losses*.

The AICPA's Digital Assets Practice Aid also provides disclosure guidance regarding the terms, risks, and nature of the lending arrangements and collateral information (if collateral is required). Disclosure requirements from other related standards may also be applicable (e.g., expected credit loss disclosures in ASC 326).

Why is this important?

A lender of crypto assets will now derecognize the crypto assets if ownership of the assets is transferred to the borrower and the borrower has the right to control the crypto assets at its discretion. This is a significant change from the guidance formerly included in Question 25, which required the lender to consider the repurchase right guidance in ASC 610-20, *Gains and Losses from the Derecognition of Nonfinancial Assets*; thus, the lender would not have derecognized the loaned crypto assets because control did not transfer to the borrower.

What's next?

The revised interpretive guidance in the AICPA's Digital Asset Practice Aid is effective immediately. The SEC staff would not object to this model being applied retrospectively like a new accounting principle under ASC 250, *Accounting Changes and Error Corrections*.

The Appendix includes the updated guidance that will be reflected in Sections 3.4 and 5.3 of PwC's *Crypto assets* guide.



Appendix

3.4 Borrowing and lending transactions

In February 2023, the AICPA updated its guidance on the accounting for crypto asset lending as outlined in Question 25 of the AICPA's Practice Aid, *Accounting for and auditing of digital assets* ("Digital Assets Practice Aid"). Question 25 provides an example of a reporting entity that lends crypto assets to a counterparty for a specified period of time in return for a fee. The fact pattern in Question 25 is similar to the following: Lender lends 1,000 units of a crypto asset to Borrower for one year. The loaned crypto asset meets the definition of an intangible asset in ASC 350, *Intangibles – Goodwill and Other*. The lending arrangement requires Borrower to pay a fee of one unit of the crypto asset each month during the term and return 1,000 units of the crypto asset to Lender at the end of the term. Control of the loaned crypto asset is transferred to Borrower upon the transfer, and Borrower has the right to transfer, encumber, and pledge the crypto asset at its discretion.

Applying the revised guidance results in a conclusion that it would be appropriate for the lender to derecognize the loaned crypto assets in this circumstance.

The AICPA's Digital Assets Practice Aid provides a list of factors that should be considered when evaluating whether loaned crypto assets should be derecognized.

Excerpt from AICPA Practice Aid *Accounting for and auditing of digital assets*

In assessing whether the crypto assets lent should be derecognized in this fact pattern, various indicators of control and elements of asset derecognition would be considered, including, but not limited to, the following:

- The lender has transferred the present rights to the economic benefits associated with the crypto asset for a different right to receive crypto assets in the future;
- The lender cannot sell, pledge, loan, or otherwise use the lent crypto assets while the loan is outstanding, as those rights have been transferred to the borrower;
- Inherent in the realization of the economic benefits associated with the crypto asset loan receivable is exposure to credit risk of the borrower; and
- The borrower of the crypto assets can deploy those assets at its discretion for the duration of the lending arrangement and bears the risk of loss or theft of those assets, and otherwise has the ability to direct the use of the assets transferred.

When the loaned crypto assets are derecognized by the lender, the SEC staff would not object to the lender recognizing an asset that represents its right to receive the crypto assets from the borrower at the end of the loan period (which may be referred to as a crypto asset loan receivable). The crypto asset loan receivable would be recognized at the fair value of the loaned crypto assets at the time the crypto assets are transferred to the borrower unless industry-specific guidance applies to the loan (e.g., investment company guidance under ASC 946, *Financial Services – Investment Companies*). The lender would recognize any difference between the fair value of the crypto assets at the time of transfer and the carrying amount of the crypto assets in the income statement. Given the crypto assets are accounted for as intangible assets under ASC 350, they were initially measured at cost and then subsequently evaluated for impairment prior to derecognition. Accordingly, the derecognition of the carrying amount of the crypto assets and the recognition of the crypto asset loan receivable at fair value will often result in a gain. The lender would continue to remeasure the crypto asset loan receivable to the fair value of the loaned crypto assets at each subsequent reporting date.

Additionally, because the crypto asset loan receivable exposes the lender to the credit risk of the borrower, the lender should recognize an allowance for expected credit losses related to the crypto asset loan receivable utilizing the principles in ASC 326, *Financial Instruments – Credit Losses*.

The revised interpretive guidance in the AICPA's Digital Asset Practice Aid is effective immediately. The SEC staff would not object to this model being applied like a new accounting principle under ASC 250, *Accounting Changes and Error Corrections*, which requires the guidance to be applied retrospectively for all periods presented (unless impracticable to do so).

The accounting by the borrower in a crypto lending arrangement outlined in Question 26 of the AICPA's Digital Assets Practice Aid was not revised. We believe the borrower in a crypto lending arrangement may determine that it has obtained control of the asset and would accordingly recognize the crypto asset on its balance sheet. It would also recognize an obligation to return the crypto asset to the lender. While the asset may be accounted for under ASC 350 as an intangible, the obligation to return the asset could be viewed as a hybrid instrument with a debt host contract and payments linked to the fair value of the crypto assets. Accordingly, the borrower may need to assess whether bifurcation of the embedded feature is required under ASC 815, *Derivatives and hedging*, with specific consideration given to whether the crypto assets could be net settled.

5.3 Disclosures related to crypto lending

The AICPA updated its guidance on the accounting for crypto asset lending as outlined in the AICPA's Digital Assets Practice Aid. See CA 3.4 for additional information.

As part of the updated guidance, Question 25 of the AICPA's Digital Assets Practice Aid provides examples of disclosures that may be applicable to the lender. Disclosures may include, but are not limited to, the following:

- The terms, risks, and nature of the lending arrangements
- How management evaluates and monitors risk exposure (e.g., credit risk)
- If collateral is required, the type and amount of collateral, whether additional collateral is required to be pledged, and the collateral management policies implemented by the lender, such as how it can liquidate the collateral in the event of borrower default
- Disclosures using the principles of ASC 326, such as factors used to develop expected credit losses including, but not limited to:
 - information about the credit risk characteristics of the borrowers and lending arrangements, both quantitative and qualitative
 - changes in the allowance for expected credit losses, such as current period provisions and write-offs and, if applicable, recoveries of previous write-offs
 - crypto loans that are delinquent and how the status of such loans past due is determined
- Any vulnerability due to concentrations using the principles in ASC 275, *Risks and Uncertainties*
- If the lending arrangement involves a related party, the disclosures in ASC 850, *Related Party Disclosures*
- Disclosures in ASC 820, *Fair Value Measurement*, related to measuring the crypto asset loan receivable

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