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FTX Fiasco Adds Wrinkle to Plan for Crypto Accounting Rules

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- Plan so far doesn't contemplate complexities of tokens
- FASB aims to issue proposal in first half of 2023

US accounting rulemakers were already considering tackling the thorny issue of accounting for freshly minted crypto tokens in their prolonged effort to write guidance for digital assets.

Then came the collapse of crypto exchange FTX, and a new headache for accounting rulemakers.

While questions about FTX's self-generated tokens and their real worth are just a part of the company's financial puzzle, there's a narrow area where the Financial Accounting Standards Board could bring clarity to the market.

The place: ensuring that businesses creating a crypto token don't just assign it a value and report it on its balance sheet as an asset.

"If I am the issuer of a token, I should not record that on my balance sheet; that's so obvious," said Aaron Jacob, head of accounting solutions at TaxBit, a cryptocurrency software company.

Known primarily as a platform for customers to buy and sell cryptocurrency, FTX operated via a web of opaque, interrelated businesses, including Alameda Research, a trading firm that used FTX-minted crypto tokens as collateral for risky bets. The company's operations were so rife with problems that the man in charge of combing through its books—the former liquidator of Enron Corp.—said he'd never seen such a "complete failure" to provide trustworthy financial information. Questions loom about whether FTX inflated its balance sheet with self-created tokens, called FTT, which customers could buy to make discounted trades on the FTX platform.

The FTT token began collapsing in value on Nov. 6, after Alameda Research CEO Caroline Ellison tweeted an offer to buy FTT held by a rival exchange, Binance Holdings, at a below-market price.

As a privately held company, FTX wasn't required to publish its financial statements, so it's hard to tell how it recognized and measured those tokens. Its financial statements were audited—by Prager Metis CPAs LLC for FTX Trading Ltd. and Armanino LLP for FTX US—but the company's new CEO said the audited financials couldn't be trusted. The new chief, John J. Ray III, shared balance sheet information Nov. 17 showing line items for FTX's crypto holdings measured at fair value. In the sworn declaration submitted in bankruptcy court, he expressed "substantial concerns as to the information presented in these audited financial statements." The balance sheets shared in the bankruptcy documents did not differentiate between the value of holdings of FTT versus holdings of other cryptocurrencies, such as bitcoin or ether.

FASB set out to write accounting rules for cryptocurrency with businesses like MicroStrategy Inc. and Telsa Inc. in mind, not necessarily companies that created their own tokens. It wanted to create accounting rules so businesses could consistently account for the bitcoin they hold as investments. Right now, there are no formal rules. Businesses follow guidance from the American Institute of CPAs that says companies that don't qualify as investment companies should account for crypto holdings as intangible assets.

This means companies record digital assets on their balance sheets at historical cost, minus drops in value during the period. Companies are only allowed to record price dips and never recoveries, unless they sell their holdings at a profit. For volatile digital assets, that means companies almost always have to record impairments, even if they're only paper losses.

FASB's Crypto Agenda

FASB plans to issue a proposal for public comment in the first half of 2023, its chief said in November. Under the plan so far, crypto assets would be recorded at fair value, an accounting measurement method meant to reflect the most up-to-date price in the market. FASB wants to exclude stablecoins and non-fungible tokens from the forthcoming guidance, but hasn't specifically scoped out tokens made or held by a creator of those tokens.

The board's researchers indicated at an October meeting—a month before FTX's woes made headlines—that they'd have to study the topic of tokens created by a company. Their research about whether to exclude tokens from the draft proposal is continuing, FASB said this week.

"You can't create a coin out of thin air and decide, 'This coin is worth this amount.' The market won't accept it," said Gabriel Brin, vice president of tax and accounting product at Ledgible, a crypto software firm.

Native tokens created by companies for use on their own platforms differ from cryptocurrencies like bitcoin or ether, but not all are the same. Some are structured similarly to equity securities, with voting rights or distributions. Some have a more utilitarian function, such as providing access to a trading or lending platform. Customers pay for them differently, too; some pay cash, others pay with cryptocurrencies. This sparks

more accounting questions, such as whether that payment should be considered equity, revenue, or deferred revenue. If it's refundable, it could potentially have to be recorded as a liability in some cases, said Robert Graham, national assurance leader for digital assets and blockchain at Marcum LLP.

"There's going to be a lot of edge cases and specific cases where it's hard to write broad-based guidance," Graham said.