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FINANCIAL REPORTING OF CRYPTOCURRENCIES

Cryptocurrencies (and related non-fungible tokens 'NFTs') are in vogue with increasing adoption by some banks and large companies (e.g., MicroStrategy and Coinbase) and more recently even the country of El Salvador is adopting bitcoin as legal tender.

Whilst financial services companies are obvious first movers to disrupt slow and expensive international money transfer services, wider adoption is following in other industries with an increasing number of payment service providers offering near instant conversion back to fiat currency to reduce exposure to price volatility.

INNOVATION FOR MARITIME SUPPLY CHAINS

In the shipping industry, new services are being brought to market that use distributed ledger technology to track goods in transit in real-time to guarantee product authenticity and traceability through supply chains. It seems easy to envisage daily shipping rates paid for in stablecoins or cryptocurrencies leveraging payment service providers to eliminate price volatility risk.

At the same time, we are reading about various initiatives which promise to revolutionise the shipping industry by adopting blockchain technologyto tokenise asset ownership, allowing smaller investors some exposure to otherwise inaccessible direct investments.

This could increase liquidity and competition in the shipping industry, whilst decreasing barriers to entry, with a longer-term potential to eliminate manual paperwork with smartcontracts.

According to the CFA Institute Research Foundation (2021), *"Blockchain technology allows users to create a single distributed database that is accessible to everyone – where anyone in the world can view balances and submit transactions at any time – but where the ledger is not controlled by any single corporation, government, person or entity. In other words, a 'distributed ledger' that is 'permissionless' and is maintained on a decentralised basis.* [1]*"*

Cryptocurrencies can be described as an innovative tokenised form of asset, which are designed to have a use-case such as a 'medium of exchange' or 'store of value' to transact with other counterparties on a peer-to-peer basis in near real-time over a blockchain or decentralised ledger. The network effect of trends in adoption tend to drive long-term price movements.

The CFA Institute Research Foundation (2021) estimated that the market capitalisation of the cryptoassets market exceeds US$0.350tn, and now it already it exceeds US$2.35tn. [2]

Many institutional andindividual investors consider digital assets, including cryptocurrencies, as an alternative asset class to storevalue, diversify their portfolio holdings and potentiallyenjoy high sustainable returns in the long run despitethe extreme volatility.

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1). Matt Hougan and David Lawant 2021 'Cryptoassets: The guide to Bitcoin, Blockchain and cryptocurrency for investment professionals' CFA Institute research Foundation

2). https://www.coingecko.com/en/global_charts accessed 4 September 2021

TRANSPARENCY AND THE NEED FOR STANDARDS

Tokenised investments clearly have potential to be more transparent with real-time price and transaction information available to everyone equally, whilst the legal status may often remain as securities, which are regulated investment products.

There are approximately 11,600 digital assets being traded around the world and 400 exchanges [3], in addition to peer-to-peer transactions. Meanwhile, accounting standards have not evolved.

There is a widespread misconception that cryptocurrencies can be treated as cash or foreign currency for accounting purposes. This confusion probably arises due to the similarities of some digital assets with foreign currencies, especially stablecoins that are available in a variety of different currency denominations. However, accounting standards do not see the risks of ownership being comparable to holding cash in a bank account because the stablecoin tokens are not backed by government (whereas a central bank digital currency would be).

Digital assets that are purchased and sold under the terms of a specific financial contract usually require accounting treatment in line with traditional financial instruments under IFRS and US GAAP.

Rather unintuitively, cryptocurrencies and related digital assets are generally classified as intangible digital assets under IFRS and US GAAP. The rationale for this is they have no physical substance, no shareholder rights, and lack any enforceable financial contract against any single counterparty. This is in contrast to normal definitions of financial instruments with a contractual right to receive cash or another financial instrument. IFRS allows for cryptocurrency to be fair valued when an active market price exists, whereas US GAAP confines this to investment entities. The default position of using historic cost less impairment is generally less relevant or meaningful information for financial statement users.

An alternative classification, particularly for broker-traders/dealers, is to treat cryptocurrency as inventory held for sale, at cost less costs to sell and again subject to impairment testing. Under IFRS, a business can then fair value holdings in cryptocurrency where there is an observable market price.

Careful judgement is required to determine how to account for a specific transaction that involves a cryptocurrency or a digital asset, and further complexity is added by differing treatments by tax authorities that tend to view cryptocurrencies as property.

HOW CAN WE HELP?

Moore Monaco is considered one of the world's leading shipping consultancy firms due to our specialist sector knowledge and wide-ranging advice and assistance. Working closely with our Blockchain and Crypto currency specialists, we are available to provideguidance on cryptocurrency transactions and how this will affect your business.

For more information or to discuss how we could help you, please contact us.

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3). https://coinmarketcap.com/ accessed 4 September 2021

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