

March 15, 2018

About the *Practical Solution on the Accounting for Virtual Currencies under the Payment Services Act*

Introduction

1. On March 14, 2018, the Accounting Standards Board of Japan (ASBJ) issued the *Practical Solution on the Accounting for Virtual Currencies under the Payment Services Act* (hereinafter ‘the Standard’) as part of Japanese GAAP. The Standard is effective from the beginning of the fiscal year that begins on or after April 1, 2018. Early application is permitted.
2. This paper explains the background of the Standard and summarizes its main requirements. It should be noted that this paper was prepared by the ASBJ secretariat for the convenience of English speakers for information purposes only and has not been officially approved for issuance by the ASBJ.

Background

3. In 2016, the Payment Services Act (Act No. 59 of 2009) was amended to define *virtual currencies* and to introduce a registration system for virtual currency dealers. From the annual period following the annual period to which April 1, 2017 belongs, the financial statements of registered virtual currency dealers will be subject to financial statement audits by a certified public accountant or an audit corporation.
4. In March 2017, the Standards Advisory Council (SAC), the body that discusses and recommends new agenda items to the ASBJ, recommended that the ASBJ develop guidance for the accounting for virtual currencies, so that the audits of the financial statements of registered virtual currency dealers can be implemented smoothly.
5. Following the recommendation of the SAC, the ASBJ started its deliberations in April 2017. The ASBJ decided to address only limited issues, considering that the virtual currency business was at a very young stage and its future was unpredictable, and that there was uncertainty regarding the legal status of virtual currencies under Japanese private law. The ASBJ will consider whether to address other issues that are not addressed in this Standard separately, based on the development of the virtual currency business and the requests of constituents.
6. On December 6, 2017, the ASBJ issued for public comment the Exposure Draft *Practical Solution on the Accounting for Virtual Currencies under the Payment Services Act* (hereinafter ‘the Exposure Draft’). The comment period for the Exposure Draft ended on February 6, 2018.

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The ASBJ discussed these comment letters and incorporated some of the suggestions provided in finalizing the Standard.

Main Requirements

Scope

Overview

7. The Standard addresses the accounting for virtual currencies as defined in the Payment Services Act, except for those that were issued by the entity itself (including its parent, subsidiaries and affiliates).
8. The Standard includes requirements that apply to an entity that holds virtual currencies on its own behalf as well as a virtual currency dealer that holds virtual currencies on behalf of its customers. Virtual currency dealers refer to those defined in the Payment Services Act.

Virtual Currencies as Defined in the Payment Services Act

9. In short, the Payment Services Act defines virtual currencies as proprietary value that can be transferred using an electronic data processing system and that can be either:
 - (a) used against unspecified parties as a means of payment and can be traded with unspecified parties; or
 - (b) can be exchanged with other virtually currencies defined in (a).
10. Under the Payment Services Act, the following are not virtual currencies:
 - (a) Japanese fiat currency;
 - (b) foreign fiat currency;
 - (c) assets denominated in fiat currencies;
 - (d) “prepaid cards” issued in exchange for the prepayment of goods or services; nor
 - (e) “points” under point services (services in which points are issued according to a certain percentage of the sales amount of the goods or services, or are issued for each visit to the store or use of service).

Virtual Currencies that Were Issued by the Entity Itself

11. Those who commented on the Exposure Draft asked the ASBJ to clarify the accounting for the issuance of virtual currencies, including the so-called “Initial Coin Offerings (ICOs)”. However,

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the ASBJ decided to exclude virtual currencies that were issued by the entity itself (including its parent, subsidiaries and affiliates) for the following reasons:

- (a) As noted in paragraph 5 of this paper, the ASBJ had decided to address only limited issues, considering that the virtual currency business was at a very young stage and its future was unpredictable; and
- (b) The ASBJ had focused its discussions on virtual currencies that were not issued by the entity itself. Although the ASBJ had identified some of the issues that needed to be addressed in the context of virtual currencies that were issued by the entity itself, the ASBJ was not confident that it had identified all of such issues. The issues that the ASBJ had identified include, for example:
 - (i) when the entity issues virtual currencies in exchange for consideration (which may be other virtual currencies), whether the entity should recognize income or a liability; and
 - (ii) when the entity issues virtual currencies and sells most of them to third parties but assigns a portion of them to itself, whether such assignment qualifies as a transaction that should be accounted for.

Accounting for Virtual Currencies Held by an Entity on Its Own Behalf

Measurement at the Balance Sheet Date

12. The Standard prescribes the following regarding the measurement of virtual currencies at the balance sheet date for virtual currencies held by an entity on its own behalf (that is, excluding those held by a virtual currency dealer on behalf of its customers):
 - (a) If an active market exists for the virtual currency, such virtual currency should be measured using the market price at the balance sheet date, and any difference between the carrying amount should be recognized as a gain or loss.
 - (b) If an active market does not exist for the virtual currency, such virtual currency should be measured at its cost. However, if the estimated disposal value is lower than cost, the virtual currency should be measured using the estimated disposal value (including zero or a memorandum value), and the difference between the carrying amount should be recognized as a loss. This loss should not be reversed in subsequent periods.

Definition of “Active Market”

13. The Standard prescribes that an active market exists for the virtual currency when there is a

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market in which transactions for the virtual currency take place with sufficient frequency and volume to provide pricing information on an ongoing basis. The Standard adopted a definition of “active market” that is consistent with the definition in IFRS 13 *Fair Value Measurement*.

Change in the Status of “Active Market”

14. The Standard prescribes the following regarding the change in the status of “active market”:
 - (a) When the status of the market for the virtual currency changes from active to inactive, the price observed immediately before the market becomes inactive should be used to determine the cost of that virtual currency, and the accounting in subsequent periods should follow paragraph 12(b) of this paper.
 - (b) When the status of the market for the virtual currency changes from inactive to active, the accounting should follow paragraph 12(a) of this paper.

Accounting for Virtual Currencies Held by a Virtual Currency Dealer on Behalf of Its Customers

Recognition of Assets and Liabilities

15. The Standard prescribes the following regarding the recognition of assets and liabilities relating to virtual currencies held by a virtual currency dealer on behalf of its customers:
 - (a) A virtual currency dealer should recognize an asset when a virtual currency is deposited by the customer based on the agreement between the virtual currency dealer and the customer. Such virtual currency should be measured using the market price at the date the virtual currency was deposited.
 - (b) At the same time, a virtual currency dealer should recognize the obligation to return the virtual currency to the customer as a liability. The liability should be measured at the same amount of the corresponding asset.

Measurement at the Balance Sheet Date

16. The Standard prescribes the following regarding the measurement of virtual currencies at the balance sheet date for virtual currencies held by a virtual currency dealer on behalf of its customers:
 - (a) A virtual currency dealer should measure the virtual currency held on behalf of its customers at the balance sheet date consistent with paragraph 12 of this paper, that is, based on whether an active market exists for that virtual currency.

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- (b) A virtual currency dealer should measure the liability recognized in relation to the virtual currency held on behalf of its customers at the balance sheet at the same amount of the corresponding asset.

Accordingly, no gain or loss should arise from virtual currencies held by a virtual currency dealer on behalf of its customers.

Presentation and Disclosures

Presentation

- 17. The Standard prescribes that, when an entity sells its virtual currencies, it should present the net amount (calculated as the selling proceeds less the cost of the virtual currencies sold) in the income statement.

Disclosures

- 18. The Standard requires the following disclosures:
 - (a) The balance sheet amount of virtual currencies held by the entity on its own behalf.
 - (b) The balance sheet amount of virtual currencies held by the virtual currency dealer held on behalf of its customers.
 - (c) For virtual currencies held by the entity on its own behalf, showing separately those with an active market and those without an active market, the quantity and amount of each type of virtual currency. Virtual currencies with immaterial balance sheet amounts can be aggregated.

Disclosures may be omitted if the balance sheet amount of virtual currencies (in the case of a virtual currency dealer, the total of virtual currencies held on its own behalf and virtual currencies held on behalf of its customers) is immaterial compared to the total assets of the entity.

Basis for Conclusions

Are Virtual Currencies Assets?

- 19. As of the date the Standard was issued, the legal status of virtual currencies under Japanese private law was not clear, and it was not clear whether any legal property rights could be attached to virtual currencies. Nevertheless, the ASBJ concluded that virtual currencies could be treated as assets for accounting purposes, because they may contribute to cash inflows to the entity through sales or conversion to cash.

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Can Virtual Currencies be Classified in Any of the Existing Categories of Assets?

20. Concluding that virtual currencies could be treated as assets for accounting purposes, the ASBJ considered whether virtual currencies could be classified in one of the existing categories of assets under Japanese GAAP.

Foreign Currencies

21. Virtual currencies may be held to store the means of payment and the value of such virtual currencies may fluctuate when measured using the home currency of the entity. Accordingly, the ASBJ considered whether virtual currencies should be classified as foreign currencies for accounting purposes.
22. Both under Japanese GAAP and under international standards, it is generally assumed that “currencies” are fiat currencies. In contrast, virtual currencies are not backed by the government (or any other authority). Accordingly, the ASBJ concluded that virtual currencies may have different characteristics compared to foreign currencies and, therefore, should not be classified as foreign currencies for accounting purposes.

Financial Assets

23. Virtual currencies may be held for investment purposes and have characteristics that are similar to those of financial assets, such as equity securities. Accordingly, the ASBJ considered whether virtual currencies should be classified as financial assets (other than cash) for accounting purposes.
24. Japanese GAAP defines financial assets as “cash, contractual rights to receive cash or other assets from another party, contractual rights to exchange financial assets or financial liabilities with another party under potentially advantageous terms or securities representing investments in another entity, including shares”. International standards explain that a financial instrument is a contract that results in a financial asset for one party and a financial liability or equity instrument for another party. Based on these definitions, the ASBJ concluded that virtual currencies do not meet the definition of financial assets (other than cash) for accounting purposes.

Inventories Held for Trading

25. Virtual currencies may be viewed to be similar to commodities (such as gold) whose price fluctuates due to reasons other than real demand when they are held for investment purposes. Accordingly, the ASBJ considered whether virtual currencies should be classified as inventories held for trading.

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26. Japanese GAAP requires that inventories held for trading achieve its operating objectives and be held for sale. Because virtual currencies can be held for purposes other than inventories (for example, they can be used as a means of payment), the ASBJ concluded that it would be inappropriate to classify all virtual currencies as inventories held for trading for accounting purposes.

Intangible Assets

27. Under the Payment Services Act, virtual currencies are proprietary value that can be transferred using an electronic data processing system and, accordingly, are intangible in nature. Accordingly, the ASBJ considered whether virtual currencies should be classified as intangible assets for accounting purposes.
28. Neither Japanese GAAP nor international standards generally do not contemplate the existence of intangible assets held for trading. Accordingly, the ASBJ concluded that virtual currencies should not be classified as intangible assets for accounting purposes.

Conclusion

29. After considering the potential categories of assets, the ASBJ concluded that there is no category of assets that would be appropriate for virtual currencies. Accordingly, the ASBJ decided to prescribe that virtual currencies were an independent category of assets.

Measurement of Virtual Currencies

30. Historically, the ASBJ has noted that the use of market prices would be appropriate when the purpose of holding the asset is to generate profit from changes in the value of the asset, and that the use of cost would be appropriate when the purpose of holding the asset is to generate cash inflows through its operating activities.
31. Under the current circumstances, it is assumed that virtual currencies with an active market are held to generate profit from changes in the value of the assets, to use them as a means of payment and to temporary hold them to operate a virtual currency shop. Accordingly, for virtual currencies with an active market, the ASBJ concluded that the holder of the virtual currencies bears the price risk and, accordingly, they should be classified as assets held with the objective of generating profit from changes in the value of the asset.
32. On the other hand, for virtual currencies without an active market, it is often difficult to obtain the market price in an objective manner and there are operational constraints to immediately trade such virtual currencies. Accordingly, the ASBJ concluded that it would be inappropriate to consider the changes in the value of the virtual currencies as part of the results of the entity's

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operations.

33. Based on the discussions above, the ASBJ concluded that virtual currencies with an active market should be measured at their market price with any changes in that price being recognized in profit or loss, and those without an active market should be measured at cost.
34. The ASBJ noted that, when using a cost model for a virtual currency without an active market, the carrying amount should be written down to the estimated disposal value if that estimated disposal value is lower than the cost. The estimated disposal value would be estimated based on the amount of cash that is certain to be collected, or otherwise it would be estimated at zero or at a memorandum value.

Virtual Currencies Held by a Virtual Currency Dealer on Behalf of Its Customers

35. Virtual currency dealers may hold virtual currencies on behalf of its customers. Historically, under Japanese GAAP, the accounting for assets held on behalf of its customers has been determined based on the entity's rights to the assets held on behalf of its customers. However, in the case of virtual currencies, the legal status of virtual currencies under Japanese private law was unclear and it would be difficult to prescribe whether, and if so when, the legal rights have transferred. Furthermore, it was noted that it is the entity that holds the private key which is required to dispose of the virtual currencies held on behalf of its customers.
36. The ASBJ emphasized the similarities between virtual currencies held on its own behalf and those held on behalf of its customers. Consistent with how cash held on behalf of others are accounted for under Japanese GAAP, the ASBJ concluded that virtual currencies held on behalf of its customers should be recognized as an asset and be measured consistently with how virtual currencies held on its own behalf would be measured.