Making change: Should bitcoin be on your balance sheet?

Throughout its 12-year history, bitcoin has been known for many things: wild swings in volatility, concerns about its potential use in criminal transactions, and occasional related cyberattacks. But in the last year, with its value skyrocketing, the fringe-dwelling digital currency has garnered mainstream attention by accepting invitations to appear on corporate balance sheets.

Consider MicroStrategy, a publicly traded maker of business intelligence software, which in August 2020 began spending existing cash on its balance sheet to buy large quantities of bitcoin. Its initial $250-million outlay has since been supplemented, with the firm's investment soaring to $2.2 billion as of early April 2021 (valued at about $5.3 billion).[1] At one point, the $482-million company even completed a debt offering so it could buy $1 billion in bitcoin.[2]

"Global macroeconomic, monetary, and digital evolutions have converged, requiring all forward-thinking corporations to consider alternative assets on their balance sheet," said MicroStrategy President and CFO Phong Le. "The ecosystem and the regulatory environment for digital assets, especially bitcoin, have matured to the point that this strategy is becoming approachable and mainstream."[3]

Other companies, ranging from electric car maker Tesla[4] to Square,[5] the payments company, have followed MicroStrategy's lead, adding bitcoin to their balance sheets.

When Coinbase, the country's largest crypto exchange, went public through a direct listing in mid-April this year, its valuation at the end of its first trading day—nearly $86 billion, more than 10 times its previous private valuation[6]—seemed to signal pent-up institutional enthusiasm.

But most finance leaders appear to be taking a sit-and-see attitude: one survey of 77 finance executives found that only 5% intend to invest in bitcoin as a corporate asset this year.[7]

Why the hesitation? The list of concerns includes the financial risk associated with bitcoin's volatility, worries over the depth and liquidity of cryptocurrency exchanges, and a lack of clarity around how bitcoin can—and cannot—be used. Still, there are numerous reasons for a company to add digital assets to its balance sheet, whether it's seeking the asymmetric risk return observed over previous years or as a natural hedge against fluctuating fiat currencies; whether it's part of a corporate strategy to embrace modern, open technologies; or as a complement to an operational strategy that includes accepting digital assets as payments.

In this edition of *CFO Insights*, we'll explore how bitcoin has earned Wall Street's interest and discuss whether the upside is such that it deserves yours. In addition, we'll ask: how evolved are the tax and accounting rules around digital assets? What are the options for safekeeping? And what's the most persuasive use case for it—as a hedge against inflation, an alternative to gold, or merely a bold demographic flex?

Tales of the crypto

Finance leaders may find bitcoin mystifying because it defies traditional definitions of a financial asset. There's no cash flow attached to it (as opposed to debt or equity) and no bond-like yield to track. Unlike traditional currency, it is not backed by any government. Moreover, the supply of bitcoin is fixed—limited to 21 million by algorithmic constraints. And using bitcoin as a store of value—as MicroStrategy does—is quite distinct, in terms of accounting and tax treatment, from using it in business transactions.

To add to the complexity, bitcoin is not the only digital asset. While bitcoin's roughly $1 trillion market cap dwarfs that of its closest competitor—Ethereum—which boasts a market cap of just over $240 billion,[8] there are numerous types of digital assets, each having its own unique characteristics. Central bank digital currencies (CBDCs) and stablecoins, for example, are digital representations of fiat currency. Issued by a central bank, their value is derived from an actual currency in circulation. Equity and derivative tokens are digital assets whose value may represent actual corporate stock or a legal right to another asset or financial instrument. Some digital assets have additional attributes, such as voting rights on a protocol, or they may provide a level of access for participation in a decentralized application.

Against this backdrop, finance leaders who may be considering bitcoin (or its rivals) aren't likely to have the benefit of consulting a longstanding playbook or copying the foolproof approaches of others. Such a bold move requires painstaking effort, disciplined analysis, fresh thinking and rethinking, and rigorous execution and alignment. For starters, it means clarifying the company's risk tolerance.

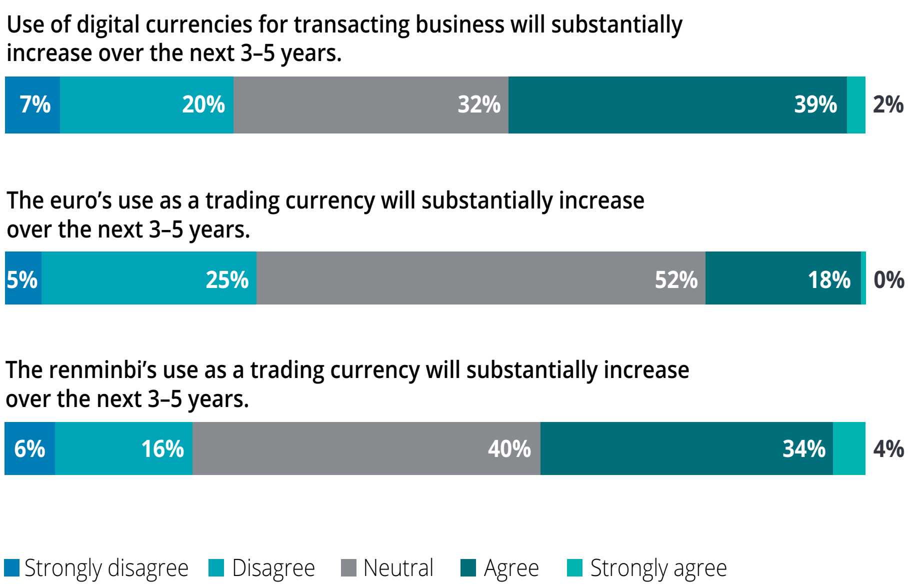
Specifically, when company executives are deciding and executing on an investment in digital assets, governance is key. More than creating a policy, governance begins with understanding the types of investment the company is making and where a particular alternative investment vehicle, like bitcoin, fits within the broader investment strategy. Given that it's a financial investment, it's imperative that top executives, including the CFO, treasurer, and board of directors, have a clear understanding of the asset's risk profile, the company's tolerance for risk, and how these two dimensions may—or may not—align.

Risk tolerance also requires judgments on issues, including the following:

- What percentage of the cash on hand, after accounting for operating costs, will be assigned to alternative investments in digital assets?
- What range of risk is the company comfortable with? Risk is a moving target, and adjustments may need to be made within an agreed-upon band of risk tolerance.
- With digital assets, treasury needs to consider not just the investment side, but also how and whether these assets may figure into daily operations such as payments, debt management, raising funds, IPOs, etc.
- How can treasury be more strategic in using these assets to advance efficiencies in payroll, vendor payment, trade, customer interactions, and cross-border transactions with subsidiaries and others?

Figure 1. How CFOs view the future of digital currencies

More than 40% of finance chiefs expect the use of digital assets to increase in the near-term. (Percent of CFOs selecting each level of agreement for each statement.)



Source: *CFO Signals*™, Q4 2020, CFO Program, Deloitte LLP

Bitcoin considerations do not end with assessing risk tolerance. By design, bitcoin exists independent of any institution or government; no single entity is responsible for it. Every valid transaction is encrypted into a ledger, known as the blockchain, and verified through network consensus. Such a decentralized, peer-to-peer distribution system presents regulatory and other agencies with distinct challenges. Attempts at rulemaking, as finance executives will likely find, have mostly been makeshift.

Accounting, disclosure, and tax matters

Given the absence of any specific guidance regarding accounting for cryptocurrencies, finance leaders may need to work with the accounting function to draw on various pertinent sections of US Generally Accepted Accounting Principles (GAAP).

First, the accounting will be determined by what the company is accounting for. In general, the practice has settled on accounting for bitcoin as an "indefinite-lived intangible asset." That means it does not meet the accounting definition of cash or a cash equivalent, a financial instrument, or inventory.

According to US GAAP, acquired digital assets (intangibles) should be accounted for at cost, subject to subsequent impairment, as appropriate. That means that when the asset is impaired, the company must write down the value on its books. The converse, however, is not true. The value of such an asset cannot be written up when, and if, the price goes up or a previously written-down asset subsequently recovers. As a consequence, for accounting purposes, it is virtually impossible to book any ROI on digital assets held as investments.

That said, if the company believes fair value to be more reflective of the economics of its investment, it has the flexibility to provide disclosures that it believes are meaningful to its investors.

Similarly, the related disclosures need to be drawn from various sections within US GAAP to align with the accounting, resulting in a patchwork. For example, the disclosure requirements within Intangibles – Goodwill and Other (ASC 350) apply to the digital assets held as an investment. And additional disclosures under Fair Value Measurement (ASC 820) would be required for the nonrecurring fair value measurement used to determine impairment of those digital assets.

Outside of the United States, the accounting rules vary in different jurisdictions and therefore, treatment of digital assets could vary. Accounting under International Financial Reporting Standards (IFRS) may similarly view bitcoin as an intangible asset. However, the intangible asset guidance under IFRS may differ from US GAAP in certain circumstances. When a company uses digital assets like bitcoin to transfer funds across borders—say, to a foreign subsidiary in Europe—it should be prepared to encounter complexities in other jurisdictions.

To the extent the company sells digital assets or uses them in its business transactions, additional disclosures may be required. These disclosures, drawn from assorted areas of US GAAP, should articulate the accounting to an investor and explain why the digital assets, and related transactions, are presented the way they are in the financial statements.

From a tax standpoint, digital assets held for investment purposes are generally deemed a capital asset, meaning that

The case for using crypto operationally

The use of crypto for conducting business presents a host of opportunities and challenges. To spark your company's thinking about these digital assets, here are some of the rationales behind why some companies are currently using them operationally, as outlined in "Corporates using crypto: Conducting business with digital assets":

- **To gain access to new demographic groups.** Users often represent a more cutting-edge clientele that values trans parency in their transactions. One recent study found that up to 40% of customers who pay with crypto are new customers of the company. And their purchase amounts are twice those of credit card users.[1]
- **To help spur internal company awareness about this new technology.** It also may help position the company in this important emerging space for a future that could include central bank digital currencies.
- **To possibly enable access to new capital and liquidity pools,** perhaps through traditional investments that have been tokenized. It may also provide access to new asset classes.
- **To use certain options that are simply not available with fiat currency.** For example, programmable money can enable real-time and accurate revenue-sharing while enhancing transparency to facilitate back-office reconciliation.
- **To serve important clients and vendors** who want to engage by using crypto. Your business may need to be positioned to receive and disburse crypto to assure smooth exchanges with key stakeholders.
- **To make use of a new avenue** for enhancing a host of more traditional treasury activities, such as enabling simple, real-time, and secure money transfers, helping strengthen control over the capital of the enterprise, and managing the risks and opportunities of engaging in digital investments.

capital losses can only be used to offset capital gains.

Grasping the risks: controls and custody

Before investing in a digital asset, here are some steps finance leaders may want to consider:

1. Assign members of the finance function to conduct **rigorous due diligence** about how the chosen digital asset operates and related market vulnerabilities, as well as terms and conditions.
2. Collaborate with IT to gain familiarity with the **technical underpinnings** of the digital asset. It's important to understand the blockchain—the decentralized, distributed ledger technology—supporting the asset and how the associated governance system works; this may have a direct bearing on the resilience of the system. Such knowledge can also help identify the types of risks the company should be monitoring.
3. Decide if your company will **custody the asset** itself or rely on third-party vendors. Self-custody may provide easy access to the assets, but it also presents additional risk in terms of accidental loss, establishing who has the authority to conduct transactions, and how transactions are monitored and recorded.
4. If the company chooses to **use an exchange or custodian** to store its digital assets, careful consideration of a number of potential risks is in order. These include: how does the third-party exchange or custodian secure private key material? Can the company trust the accuracy of account statements furnished by the third-party vendor? What plans exist in the event of a liquidation of the custodial services?
5. Take time to **make the case** for bitcoin. By and large, bitcoin and other cryptocurrencies have gathered momentum based on their ever-expanding potential. Now that some companies have begun to use bitcoin as a reserve asset, the argument for doing so becomes clearer. With so many central banks blanketing their pandemic-fatigued economies with cheap money, some executives worry about the long-term value of fiat currency. They view bitcoin as an alternative way to protect shareholder value. Like other commodities, bitcoin provides a hedge against inflation. Some see it as "digital gold"—just lighter and easier to move than the bars stored at Fort Knox. Those who are digital natives may be most comfortable shifting around virtual assets on their cellphones. Also, be advised: using bitcoin as a store of value, as some companies do, embodies a much different use case than using it as a means to transact.

Betting on bitcoin?

The terrain of digital assets represents a new frontier of possibilities for corporate balance sheets. On that frontier, however, few of the norms associated with legacy investments in securities, fiat currency, or treasuries may apply. Gaining a full understanding of the risks may warrant the assistance of third-party technical help.

Some companies that see cryptocurrency as a fad have changed their names in a bid to cash in. But those who have added bitcoin to their balance sheet, making it part of their corporate treasuries, have moved far beyond the hypothetical. Having done their analysis, they've now got something to prove.

End notes

1 "MicroStrategy buys more than $1 billion worth of bitcoin, adding to massive holdings," CNBC, February 24, 2021.

2 "MicroStrategy Raises $1.05B in Latest Debt-for-Bitcoin Offering," CoinDesk, February 19, 2021.

3 " Corporates investing in crypto: considerations regarding allocations to digital assets," Deloitte Development LLC, February 2021.

4 "Tesla buys $1.5 billion in bitcoin, plans to accept it as payment," CNBC, February 8, 2021.

5 "Square CFO Amrita Ahuja is betting big on Bitcoin," CFO Daily, ***Fortune***.com, March 28, 2021.

6 "Coinbase's Public Listing Is a Cryptocurrency Coming-Out Party," ***New York Times***, April 15, 2021.

7 "Survey finds 5% of corporate CFOs plan to buy Bitcoin in 2021," Cointelegraph, February 17, 2021.

8 Today's Cryptocurrency Prices by Market Cap, CoinMarketCap, retrieved April 8, 2021.

[1] "Study Shows Merchants That Accept Bitcoin Attract New Customers and Sales," ***Business Wire***, September 29, 2020.

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