FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Board Meeting Handout
Agenda Prioritization
August 31, 2022

Meeting Purpose

1. The purpose of this memo is to assist the Board in determining whether to add a project to its technical agenda to consider certain disclosures related to a borrower entity's use of bank credit and services. If the Board decides that a project should be added, then the staff will ask the Board whether the project should be addressed directly by the Board or by the Emerging Issues Task Force (EITF).

2. The questions for the Board on this potential project are as follows:

Questions for the Board
1. Does the Board want to add a project to its technical agenda to consider certain disclosures related to a borrower entity's use of bank credit and services?
2. If the answer to Question 1 is yes, does the Board believe that the project would be best addressed by the Board or the EITF?
3. If the answer to Question 1 is yes, does the Board (a) have feedback on the project's objective or scope and/or (b) request additional information for the staff research?

Issue Background

2. The Board received an agenda request that highlights a perceived lack of certain disclosures about the use of bank credit and other services (for example, cash management), specifically:

   (a) An arrangement available on demand but does not provide committed access, known as "uncommitted" credit facilities, is not disclosed unless used.

   (b) The use of bank credit is not separately reported between committed and uncommitted credit facilities.

   (c) Disclosure of the intraperiod use of bank credit is not required, and, thus, an entity may purposefully reduce borrowing balances at the reporting date.

(d) There is no disclosure requirement for the use of bank services, and there is no transparency in situations in which service fees are offset against income from compensating balance that a borrower is required to maintain with the bank.

3. The agenda request suggests that the Board consider requiring the following disclosure to address the issues raised:

   (a) Disclosure of the average use of all committed and uncommitted credit facilities during the reporting period

   (b) Disclosure of the average overdrawn account balances during the reporting period

   (c) Disclosure of the gross use of banking services and the associated costs during the reporting period

   (d) A description of the banking arrangements, specifically the number of service providers for both credit and services

   (e) A description of the nature and number of uncommitted credit providers that also provide services

   (f) A description of the nature of credit provision, including any compensating balance requirements.

Existing Disclosure Requirements

4. Topic 470, Debt, provides limited disclosure guidance on bank borrowings. Paragraph 470-10-50-1 requires disclosure of the aggregate amount of maturities for all long-term debt for each of the five years following the balance sheet date, and paragraphs 470-10-50-2 through 50-4 require information relevant to the classification of debt as a long-term liability. In addition, Topic 440, Commitments, and Topic 860, Transfers and Servicing, require disclosure of assets pledged as security for loans and disclosure of financial assets pledged as collateral, respectively.

5. Regulation S-X Rule 5-02 requires the following disclosures about the use of bank credit facilities:

   (a) The general character of each type of long-term debt, including maturities, the rate of interest, contingencies, and priority

   (b) The amount and terms (including commitment fees and the conditions under which commitments may be withdrawn) of unused commitments for long-term and short-term financing

(c) The amount of the lines of credit that support a commercial paper borrowing arrangement or similar arrangements

(d) The weighted-average interest rate for short-term borrowing outstanding

(e) State separately amounts payable to (i) banks for borrowings, (ii) factors or other financial institutions for borrowings, (iii) holders of commercial paper, (iv) trade creditors, (v) related parties, (vi) underwriters, promoters, and employees (other than related parties), and (vii) others

(f) Separate disclosure should be made of the cash and cash items that are restricted as to withdrawal or usage. The provisions of any restrictions should be described in a note to the financial statements. Restrictions may include legally restricted deposits held as compensating balances against short-term borrowing arrangements, contracts entered into with others, or entities' statements of intention with regard to particular deposits.

6. Regulation S-X Rule 4-08 requires disclosures of assets subject to a lien, the obligations collateralized, and any default in principal, interest, sinking fund, or redemption provisions with respect to any issue of securities or credit agreements or any breach of covenant of a related indenture or agreement. Any significant changes in the authorized amounts of bonds, mortgages, and similar debt since the date of the latest balance sheet filed should also be disclosed.

7. In addition, Regulation S-K Item 303 requires that SEC registrants discuss liquidity and capital resources in the management's discussion and analysis section of filings. The discussion provides information about the registrant's ability to generate and obtain adequate amounts of cash to meet its requirements and its plans for cash in the short term and separately in the long term. Also, SEC registrants are required to identify and separately describe internal and external sources of liquidity.

Board Meeting Handout

Accounting for and Disclosure of Digital Assets

August 31, 2022

Meeting Purpose

1. The purpose of this decision-making meeting is to ask the Board to establish (a) which digital assets would be within the scope of guidance resulting from this project and (b) which types of entities should apply that guidance.

2. This handout is organized as follows:

   (a) Background

   (b) Feedback—Scope

   (c) Possible Criteria for the Scope of the Project

   (d) Entity-Type Considerations.

Questions for the Board
1. Does the Board agree with the scope of the accounting for and disclosure of digital assets project as recommended by the staff?
2. Which types of entities does the Board think should be within the scope of this project?
3. Does the Board want the staff to do any further research or outreach on the project's scope?

Background

3. On May 11, 2022, the Board added a project to its technical agenda. The objective of the project is to improve the accounting for and disclosure of certain digital assets.

4. This handout summarizes the potential criteria for the scope of this project in the context of three broad categories, as follows:

(a) Intangible Assets, Securities and Financial Assets, and Contracts: Within this category, the handout discusses leveraging existing GAAP definitions in developing a portion of the criteria for the scope of this project.

(b) Other Key Characteristics: Within this category, the handout discusses various characteristics of digital assets that differentiate them from other assets in developing a portion of the scoping criteria. Among the characteristics discussed are the following:

(i) Medium of exchange

(ii) Store of value

(iii) Secured through cryptography

(iv) Reside or created on a distributed ledger or "blockchain."

(c) Fungibility and Marketability: Within this category, the handout discusses criteria that relate to the fungibility and marketability of digital assets because those factors may increase the cost and complexity associated with requiring information about digital assets or decrease the relevance of that information. Among the possible criteria discussed are the following:

(i) Fungibility

(ii) Active markets/reliable market price in established markets

(iii) Readily convertible to cash

(iv) Observable transactions for fiat.

Feedback—Scope

5. Respondents to the 2021 Invitation to Comment, *Agenda Consultation,* provided detailed feedback on which assets should be considered if the Board were to pursue a project on accounting for digital assets. A majority of respondents favored a narrow scope, while a few respondents noted that the Board should broadly consider all digital assets. Additionally, some respondents recommended a phased approach to establishing the project's scope.

6. The most frequently cited suggestion was to model the scope after the definition of *crypto assets* included in the AICPA Practice Aid, Accounting for and Auditing Digital Assets (Digital Assets Practice Aid),[1] which provides nonauthoritative guidance on the application of existing GAAP to digital assets. This guide was created by the AICPA's Digital Assets Working Group. The Digital Assets Practice Aid broadly defines *digital assets* as: "digital records that

[1] https://www.aicpa.org/resources/download/accounting-for-and-auditing-of-digital-assets-practice-aid-pdf

are made using cryptography for verification and security purposes, on a distributed ledger (referred to as a blockchain).”

7. The Digital Asset Practice Aid goes on to differentiate crypto assets from digital assets. It does so by stating that crypto assets are a subset of digital assets that:
   (a) Function as a medium of exchange
   (b) Have all the following characteristics:
      (i) They are not issued by a jurisdictional authority (for example, a sovereign government).
      (ii) They do not give rise to a contract between the holder and another party.
      (iii) They are not considered a security under the Securities Act of 1933 or the Securities Exchange Act of 1934.
8. The Digital Asset Practice Aid explains that those characteristics are not all-inclusive and other facts and circumstances may need to be considered. It also lists examples of crypto assets that meet those characteristics, including bitcoin, bitcoin cash, and Ether.
9. Other narrow-scope suggestions included digital assets that are traded in active markets or those with a readily determinable fair value that do not otherwise qualify as a financial asset.
10. Separately, some respondents recommended that the Board pursue a two-phase approach to a digital asset project, which would start with a narrow scope to provide more immediate guidance for certain digital assets and then consider a broader scope.
11. Other respondents recommended that the Board set a broad scope to address all digital asset holdings. Overall, most respondents who favored a broad scope supported a project that would address all types of digital assets, such as, but not limited to, crypto assets, stablecoins, nonfungible tokens (NFTs), and central bank digital currencies.
12. Many stakeholders acknowledged the evolution in the digital asset space and how that evolution may necessitate starting with a narrow scope that can be expanded in targeted ways after the initial project is completed.

Possible Criteria for the Scope of the Project

Intangible Assets, Securities and Financial Assets, and Contracts

13. The staff explored how intangible assets, securities and financial assets, and contracts are defined and accounted for and how the current guidance may relate to the project scope.

14. The Master Glossary defines *intangible assets* as follows:

> Assets (not including financial assets) that lack physical substance. (The term intangible assets is used to refer to intangible assets other than goodwill.)

15. The staff analyzed the definition of intangible assets as part of potentially including that definition as a criterion for the scope of this project.

16. Given that the definition of intangible assets specifically excludes financial assets as defined in GAAP, the staff has included the Master Glossary definition of *financial assets* below.

17. The Master Glossary defines *financial assets* as follows:

> Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:
>
> (a) Receive cash or another financial instrument from a second entity
> (b) Exchange other financial instruments on potentially favorable terms with the second entity.

18. One aspect of the projects scope that has been raised by Board members and stakeholders is the need to exclude securities because guidance already exists in GAAP for how to account for those assets.

19. The Master Glossary has two definitions for *security*. They are as follows:

    (a) Definition 1 (See Topic 260, Earnings Per Share, and Topic 505, Equity): The evidence of debt or ownership or a related right. It includes options and warrants as well as debt and stock.

    (b) Definition 2 (See Topic 320, Investments—Debt Securities, Topic 321 Investments—Equity Securities, Topic 470, Debt, Topic 815, Derivatives and Hedging, Topic 860, Transfers and Servicing, Topic 952, Franchisors, and Topic 958, Not-for-Profit Entities): A share, participation, or other interest in property or in an entity of the issuer or an obligation of the issuer that has all the following characteristics:

        (i) It is either represented by an instrument issued in bearer or registered form or, if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer.

        (ii) It is of a type commonly dealt on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment.

(iii) It either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations.

20. Others have used the definition of *security* under the Securities Act of 1933 or the Securities Exchange Act of 1934 in defining digital assets. Those definitions (not necessarily GAAP definitions) and other factors are used when determining whether something is a security for regulatory or legal purposes.

21. The description of crypto assets in the Digital Assets Practice Aid excludes tokens that give rise to a contract between the holder and another party. Additionally, on the basis of outreach, stakeholders supported excluding contracts as part of the criterion of the scope of this project. They noted that the majority of the crypto assets for which there is a pressing need to address the accounting would not meet the Master Glossary definition of *contract* and, therefore, should be included within the scope of this project.

22. The Master Glossary defines *contract* as "An agreement between two or more parties that creates enforceable rights and obligations."

23. The staff considered whether financial assets, securities, and contracts should be excluded from the scope of the project. For example, if an asset meets the definition of *financial instrument,* the Board could consider excluding those assets from the scope of this project.

Other Key Characteristics

24. In order to further narrow the scope of this project, the staff considered the characteristics of the underlying phenomena to distinguish certain digital assets from other assets.

25. The staff thinks that the differentiating characteristics of the digital assets commonly referred to as *cryptocurrencies* or *crypto assets* are that they are created or reside on blockchains and are secured through cryptography. Providing those characteristics as scope criteria would avoid other digital intangible assets (for example, software or data) from being within the scope of this project. Appropriately including the technological form (that is, distribution through the blockchain and secured through cryptography) also is important because, while impossible to predict the future of these assets, it allows for flexibility as the technology continues to evolve.

26. Some of the descriptions or definitions of digital assets used by other organizations include phrases like *store of value* or *medium of exchange*. On the basis of the staff's analysis, these other characteristics may not be helpful in defining the scope of this project for the following reasons:

    (a) Other assets share these characteristics (real estate may be viewed as a store of value and money is a medium of exchange).

(b) A medium of exchange may depend on the perspective of the holder.

(c) A digital asset may not be considered a medium of exchange by some in practice because of limitations of networks.

(d) Evaluating whether an asset is a medium of exchange or store of value is subjective. For example, relative volatility may lead some stakeholders to conclude that a digital asset is a poor store of value.

Fungibility and Marketability

27. In addition to the key characteristics, the staff explored the fungibility of the assets and characteristics of their marketability (or market activity) as it relates to the project scope which led the staff to consider adding the following criteria to the scope of this project:

(a) Fungibility

(b) Active markets/reliable market price in established markets

(c) Readily convertible to cash

(d) Observable transactions for fiat.

Fungibility

28. For something to be fungible, it must be interchangeable. Merriam-Webster Dictionary defines *fungible* as "being something (such as money or a commodity) of such a nature that one part or quantity may be replaced by another equal part or quantity in paying a debt or settling an account."

Active Markets/Reliable Market Price in Established Markets

29. Another criterion raised by some stakeholders that the Board could consider adding to the scope of this project is requiring that the digital asset be traded in an active market or an established market with reliable market prices.

30. *Active market* is defined in the Master Glossary as "A market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis."

Readily Convertible to Cash

31. Another criterion that the Board could consider in establishing the scope of this project is whether the digital assets are readily convertible to cash. Assets that are readily convertible to cash have both of the following:

(a) Interchangeable (fungible) units

(b) Quoted prices available in an active market that can rapidly absorb the quantity held by an entity without significantly affecting the price.

Observable Transactions for Fiat

32. The staff also considered whether the project's scope should include a criterion that the digital asset can be traded for a fiat currency (such as the U.S. dollar), given the difference in the process on how the value of those assets are derived. Some digital assets can be traded only for other digital assets (which then can be traded for a fiat currency), rather than a direct trade for a fiat currency. The staff observes that if an entity exchanges one digital asset for another that there is existing accounting for that exchange in GAAP, including the requirements for nonmonetary exchanges, revenue recognition, and gains and losses from the derecognition of nonfinancial assets.

Entity-Type Considerations

33. The request to account for certain digital assets at a fair value (rather than at cost less impairment) generally has been consistent across different entity types that do not currently apply industry-specific guidance that results in digital assets being accounted for at fair value. Similarly, users and practitioners have not identified a reason, broadly speaking, that there should be differences in the accounting for digital assets because of the entity type.

34. That said, certain industries have specialized accounting practices, including accounting for substantially all investments at fair value, with changes in value recognized in earnings (income) or in the change in net assets. Examples of those entities include the following:

(a) Brokers and dealers in securities (Topic 940)

(b) Defined benefit pension, other postretirement, and health and welfare plans (Topics 960, 962, and 965)

(c) Investment companies (Topic 946).

35. It is possible that certain measurement decisions in this project could contradict the guidance for those entities. Therefore, as the staff brings individual groups of issues to the Board (for example, measurement, presentation, and disclosure), the staff will ensure that the effects of those issues could have on these entities (who currently are required to measure all investments at fair value) are assessed and the applicability of those individual areas be considered.

36. The concerns raised by stakeholders about the measurement of digital assets and the complexity related to the current accounting are the same across public, private, and not-

for-profit entities. In fact, the staff's understanding is that most of the entities that hold digital assets are nonpublic business entities, some of which may accessing the public debt or equities markets in the future. Therefore, the effect of the guidance that results from this project may be more pervasive for private companies than for others. Also, the staff will evaluate future issues throughout the deliberations in this project under the Private Company Decision Making Framework to assess the applicability of the proposed guidance to private companies.