

Securities Regulation Daily Wrap Up, ACCOUNTING AND AUDITING—Crypto should be recorded as liability and corresponding asset, says new Staff Accounting Bulletin, (Apr 1, 2022)

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SAB 121 addresses the accounting for obligations to safeguard crypto-assets that an entity holds for platform users, draws objection from Commissioner Peirce.

In newly released Staff Accounting Bulletin 121 (SAB 121), the SEC staff has addressed the proper accounting for entities that safeguard crypto-assets based on crypto's unique technological, legal, and regulatory risks. The staff states that because of those risks, affected companies should record a liability and corresponding asset on their balance sheets at fair value.

Commissioner Hester Peirce [criticized](#) the SAB, not because of the accounting determination which she believes may be appropriate, but because of the way the SEC is making the change. In her view, the SEC should have used a process that involves a public consultation, not an SAB, to make the accounting adjustment.

The staff believes the guidance in [SAB 121](#) is necessary due to the increase in the number of entities that provide platform users with the ability to transact in crypto-assets, as well as the special risks posed by those assets. Along with technological risks, the staff cites the lack of legal precedent surrounding crypto, and the relatively small number of regulatory requirements that apply to entities that hold crypto-assets for platform users.

Fact pattern. To frame the guidance, the staff established a scenario where Entity A operates a platform that allows its users to transact in crypto-assets, and provides a service where it will safeguard the platform users' crypto-assets, including maintaining the cryptographic key information necessary to access the crypto-assets. Entity A also maintains internal recordkeeping of the amount of crypto-assets held for the benefit of each platform user.

Entity A secures the crypto-assets and protects them from loss or theft, and any failure to do so exposes Entity A to significant risks, including possible financial loss. The platform users have the right to request that Entity A transact in the crypto-asset on the user's behalf, or to transfer the crypto-asset to a digital wallet for which Entity A does not maintain the cryptographic key information. However, execution and settlement of transactions involving the platform users' crypto-assets may depend on actions taken by Entity A.

Guidance. The staff states that as long as Entity A is responsible for safeguarding the crypto-assets held for its platform users, including maintaining the cryptographic key information necessary to access the crypto-assets, the staff believes Entity A should present a liability on its balance sheet to reflect its obligation to safeguard the crypto-assets held for its platform users. Further, because Entity A's loss exposure is based on the significant risks associated with safeguarding the crypto-assets, the staff believes it would be appropriate to measure this safeguarding liability at initial recognition and each reporting date at the fair value of the crypto-assets that Entity A is responsible for holding for its platform users.

The staff also believes it would be appropriate for Entity A to recognize an asset at the same time that it recognizes the safeguarding liability, measured at initial recognition and each reporting date at the fair value of the crypto-assets held for its platform users.

Disclosures. The staff also is of the view that the notes to the financial statements should include clear disclosure of the nature and amount of crypto-assets that Entity A is responsible for holding for its platform users, with separate disclosure for each significant crypto-asset, and the vulnerabilities Entity A has due to any concentration in such activities.

In addition, because the crypto-asset safeguarding liabilities and the corresponding assets are measured at the fair value of the crypto-assets held for its platform users, the entity would be required to include disclosures regarding fair value measurements, the staff states. The staff notes that accounting for the liabilities and corresponding assets should be described in the footnotes to the financial statements. The staff believes that Entity A also should consider disclosure about who holds the cryptographic key information, maintains the internal recordkeeping of those assets, and is obligated to secure the assets and protect them from loss or theft.

In SAB 121, the staff states that disclosures regarding the significant risks and uncertainties associated with the entity holding crypto-assets for its platform users may also be required outside the financial statements under existing Commission rules, such as in the description of business, risk factors, or management's discussion and analysis of financial condition and results of operation.

According to the staff, Entity A may need to provide disclosure describing the types of loss or additional obligations that could occur, including customer or user discontinuation or reduction of use of services, litigation, reputational harm, and regulatory enforcement actions and additional restrictions. Entity A also should consider a discussion of the analysis of the legal ownership of the crypto-assets held for platform users, including whether they would be available to satisfy general creditor claims in the event of a bankruptcy, the staff states.

SAB 121 goes on to say that Entity A may need to provide disclosure of the potential impact that the destruction, loss, theft, or compromise or unavailability of the cryptographic key information would have to the ongoing business, financial condition, operating results, and cash flows of the entity. In the staff's opinion, Entity A should also consider including, to the extent material, information about risk-mitigation steps the entity has put in place.

Commissioner Peirce took issue with this language, noting that SAB 121 is unusual among SABs in the detailed description of disclosure the staff expects to see. She said that while past SABs have included statements suggesting companies should consider other disclosure requirements outside of the financial statements, SAB 121's granular guidance is unique. The SAB, as a staff statement, is not enforceable, she noted, yet but much of the language in the document reads as if it is.

Timing. The final section of SAB 121 addresses how and when the guidance should be applied. The staff states that it expects an entity that files reports under 1934 Act Sections 13(a) or 15(d), or an entity required to file periodic and current reports pursuant to Rule 257(b) of Regulation A, to apply the guidance in SAB 121 no later than its financial statements covering the first interim or annual period ending after June 15, 2022, with retrospective application as of the beginning of the fiscal year to which the interim or annual period relates.

The staff expects all other entities to apply the guidance beginning with their next submission or filing with the SEC, with retrospective application, at a minimum, as of the beginning of the most recent annual period ending before June 15, 2022, provided the filing also includes a subsequent interim period that also reflects application of the guidance. If the filing does not include such subsequent interim period, then the staff expects it to be applied retrospectively to the beginning of the two most recent annual periods ending before June 15, 2022.

For all entities, the staff concludes, in the financial statements that reflect the initial application of SAB 121, the effect of the initial application should be reported in the carrying amounts of assets and liabilities as of the beginning of the annual period specified, and entities should include clear disclosure of the effects of the initial application of the guidance.

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