Before you go crypto

Audit Insights

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What to know before you go crypto: Risks and opportunities for not-for-profit organizations

As digital assets (cryptocurrencies) such as Bitcoin become more mainstream among institutional investors and for-profit enterprises, the ecosystem is also an increasingly important consideration in investment and fundraising strategies of not-for-profit organizations (NFPs), including colleges and universities.[1] Over the last few years, some NFPs have established mechanisms to accept digital assets from donors and/or invest in these assets themselves. However, many NFPs are still evaluating their crypto risk appetite, and knowing where to start can be daunting.

In What to Know Before You Go Crypto, KPMG Audit partners Robert Sledge and Keith Kaetzel outline key areas that for-profit company boards considering direct investments in digital assets should evaluate. These include having a clear investment strategy, knowing how to account for digital assets and implementing appropriate internal controls. These areas are also relevant for higher education and other not-for-profit entities, along with additional considerations.

Stay on top of the evolving regulatory landscape

In August, U.S. Securities and Exchange Commission (SEC) Chair Gary Gensler advocated for Congress to grant the SEC additional powers to oversee the crypto market. He noted gaps in crypto rules: "We need additional congressional authorities to prevent transactions, products and platforms from falling between regulatory cracks. We also need more resources to protect investors in this growing and volatile sector."[2]

In addition, with increased scrutiny by investors, regulators and other stakeholders of environmental, social and governance (ESG) policies and strategies, the high energy consumption involved in mining certain cryptocurrencies has prompted concerns.[3]

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[1] Emma Whitford, "Your Crypto Made This Possible," Inside Higher Ed, May 24, 2021, https://www.insidehighered.com/news/2021/05/24/colleges-line-accept-bitcoin-cryptocurrency-donations. .
[2] Gary Gensler, "Remarks Before the Aspen Security Forum," U.S. Securities and Exchange Commission, August 3, 2021, https://www.sec.gov/news/public-statement/gensler-aspen-security-forum-2021-08-03.
[3] "Cambridge Bitcoin Electricity Consumption Index," University of Cambridge Judge Business School Cambridge Centre for Alternative Finance, accessed October 25, 2021, https://cbeci.org/index.

Consider the risks

Although cryptocurrencies continue to gain acceptance as alternative investments and means of payment, they are still relatively speculative and volatile, so any decision to engage in transactions or holdings involving digital assets requires a thorough understanding of the risks.

Before transacting — including accepting cryptocurrency from donors — colleges, universities and other NFPs should, with board involvement, carefully consider risk factors and establish clear policies around donations and investments in digital assets. For example:

- What guidelines will you follow before accepting a donation in cryptocurrency? How will approvals occur?
- What information will you require from donors for proper identification? How will you assure that information is accurate?
- Given the risk of loss and impacts on financial reporting, will you hold or immediately liquidate donations in cryptocurrency?
- Will you make investments directly or indirectly (e.g. exchange traded funds or other methods)?
- How will these payments or investments be administered? Who will administer them?

Understand accounting implications

For NFPs considering digital assets as an investment, it's important to remember that cryptocurrency is not considered a traditional security or financial asset. While not specifically addressed under U.S. generally accepted accounting principles (GAAP), digital assets are usually accounted for by for-profit companies as intangible assets. Accordingly, such entities are unable to recognize market value increases in their crypto holdings, and they generally recognize impairment charges for market value decreases. Clearly, this accounting is not optimal for entities seeking to reflect crypto market performance in their financial statements.

On the other hand, certain NFPs applying GAAP are in a unique position. Colleges, universities and most NFPs — excluding not-for-profit healthcare organizations — that account for nonmarketable investments at fair value are currently able to reflect crypto held directly for investment at fair value in their financial statements.[4] Accordingly, there are potentially different accounting treatments if the holder of cryptocurrency is an affiliated academic medical center rather than a university. And because crypto is a volatile asset class, there may be significant financial statement impacts when the fair value model is applied. Although fair value accounting may in some cases be more desirable, NFPs should consider this potential volatility in reporting and, as described further below, establish robust policies and procedures to appropriately measure market value changes.

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[4] Association of International Certified Professional Accountants, Accounting for and Auditing of Digital Assets, 2020, 22, Accounting for and auditing of Digital Assets practice aid (PDF) | Resources | AICPA.

Many NFPs also invest in commingled alternative investment funds measured at net asset value (NAV) as a practical expedient to estimate fair value under GAAP. Such funds may hold digital assets as part of a broader investment strategy or a specific crypto strategy. In either case, digital assets held in these funds are part of the fund's NAV, as established by the fund manager. NFPs should understand the risks, nature, and extent of exposure to these assets in their funds' holdings and relation to their direct holdings, if any.

Get your controls in order

As organizations further assess their risk appetite for investing in or accepting digital assets, it may be prudent to hire an outside advisor to better understand the risks and opportunities. In addition, organizations holding or transacting with digital assets directly will likely need to engage a reputable custodian or broker.

If the decision is made to hold crypto as a direct investment, it is critical to make sure policies in crypto-based assets and custodial arrangements, including appropriate internal controls, are in place. Talk with your independent auditor early in the process to ensure appropriate scoping of processes and data required for annual audits. Internal audit can also play a critical role by evaluating the adequacy of crypto protocols and performing periodic testing during the year.

An advisor can also help assess whether the custodian has robust controls to ensure proper safeguarding, pricing of, and access to the cryptocurrency, as well as appropriate periodic reporting. In applying the fair value model under GAAP, the cryptocurrency's principal market is identified and that determination drives the relevant data for pricing. If you rely on a third-party adviser or custodian for pricing, have you assessed whether the third-party's data and valuation methodology is consistent with the requirements of GAAP?

As Sledge and Kaetzel outlined, "When engaging in this emerging space, it's important to evaluate whether a service organization such as a custodian or an exchange has a SOC report, usually a SOC I Type II attestation report; whether it provides details on the transaction process, such as how private keys are created and how the assets are stored post-trade; and what end-user controls are in place and how they work with controls at the service organization."[5]

Know before you go…

NFPs should prepare to transact in the crypto markets in a thoughtful way. Being able to manage, account for and control risks associated with investing in or accepting digital currencies is critical. Accounting standard setters are evaluating what standards should be developed for reporting digital assets,[6] and legislation could reframe how the asset class is regulated.

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[5] Sledge and Kaetzel, Before You Go Crypto, 3.
[6] Financial Accounting Standards Board, Invitation to Comment: Agenda Consultation, June 24, 2021, FASB In Focus—Invitation to Comment: Agenda Consultation (June 24, 2021).

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