

# Bitcoin and the New Frontier of Virtual Currency

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## Abstract

This study includes a literature review of the history and formation of Bitcoin and a layman's description of how it functions. Further on, it will provide an examination of likely future accounting standards for virtual currencies by the Financial Accounting Standards Board (FASB). Finally, this study will take a look at sound management practices for handling Bitcoin reserves in a world increasingly welcoming of digital currency.

## Research Concern

More businesses and individuals are taking advantage of virtual currencies such as Bitcoin. For those parties who use it, a basic understanding of how Bitcoin operates, and awareness of future public policy on it will be important.

## Research Questions

- How does Bitcoin function when processing transactions?
- How should a business account for virtual currencies on its books?
- What accounting standards should we expect FASB to apply to virtual currencies?

## Precedent Literature

- *Mastering Bitcoin*, by Andreas M. Antonopoulos, (California, O'Reilly Media, 2014)
- *The Case To Regulate Digital Currency as a Security or Commodity*, by Nicole D. Swartz, (New Orleans, Tulane Journal of Technology and Intellectual Property, 2014)
- *Bitcoin: A Peer-to-Peer Electronic Cash System*, by Satoshi Nakamoto, (2008)

## Research Procedure

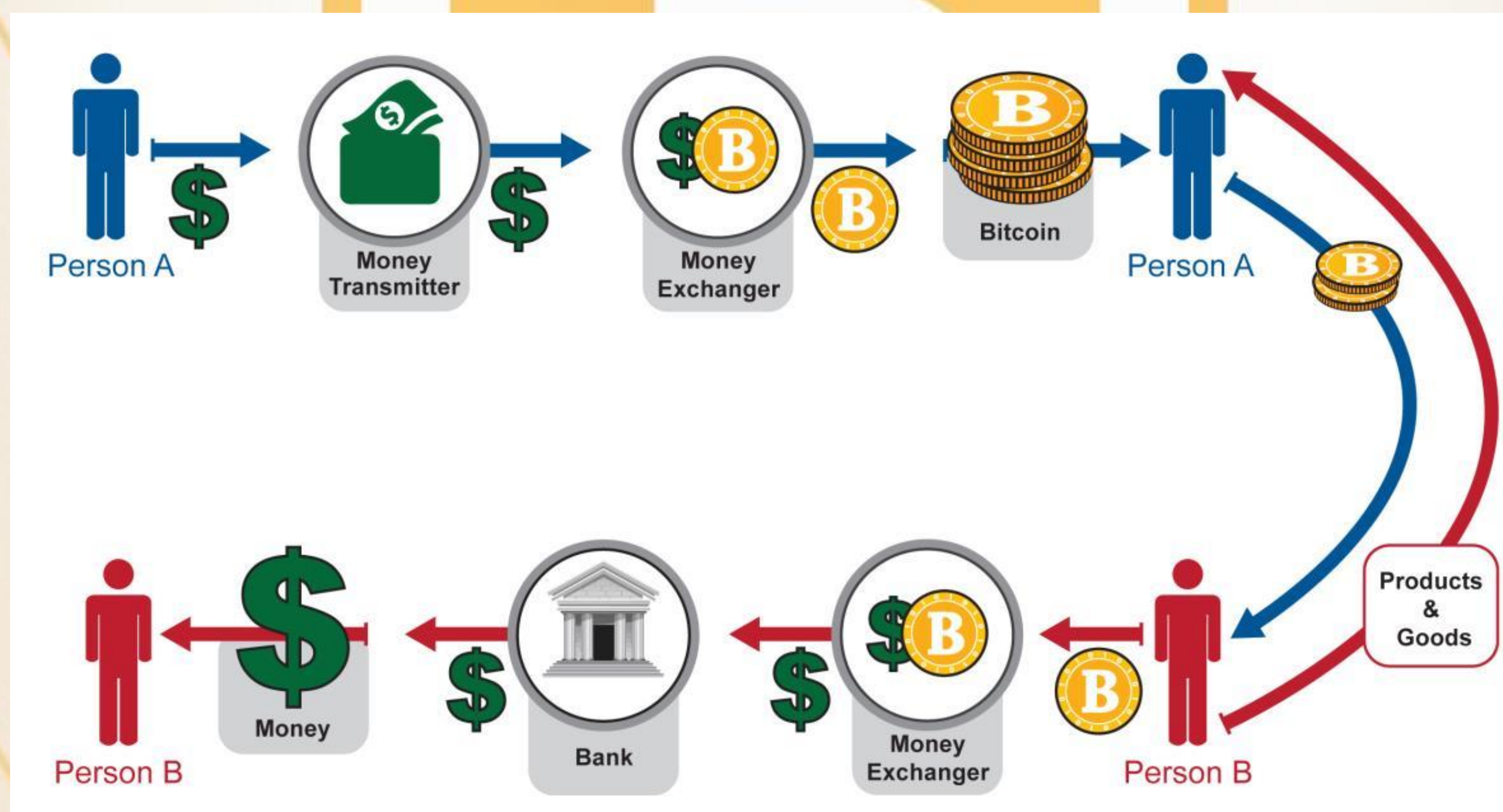
Research was primarily a literature review. With Bitcoin entering circulation so recently (Jan. 2009), secondary sources were readily available, but studies of long-term performance were scarce. Primary sources made up a significant amount of the content reviewed, many from both policy makers and those who had a significant hand in Bitcoin's development.

Predictions for FASB's future accounting standards for virtual currencies such as Bitcoin were based on two factors. One, prior decisions by the Board on comparable new developments in financial systems. And two, similar decisions made by organizations known to influence the Board.

## How Does Bitcoin Work?

Bitcoin is a

**decentralized** ..... (no central administrator)  
**virtual** ..... (exists entirely in digital records)  
**currency** ..... (medium of exchange)



*Bitcoin's system of exchange allows for a system of direct exchange of currency between two parties, without a middleman of any kind, such as a bank, between them.*

Transactions are verified and are recorded online sequentially in the "blockchain," essentially a collectively managed general ledger. All users maintain privacy through a system of encrypted keys, a sequence of characters unique to them.

## Managing Virtual Currency

According to the IRS, as of 2014, virtual currencies are to be taxed as capital gains. The agency views Bitcoin as an asset, not a currency. Every transaction users make in Bitcoin must be tracked and the value in US dollars must be recorded. - (IRS Notice 2014-21, Mar 25, 2014)

Holders of virtual currency may wish to account for their holdings separately for both financial and tax purposes, adjusting their entries for federal tax expense when accrued.

## FASB's Future Position?

- *Federal Reserve Chairman Ben Bernanke gives a "cautious blessing."* - (Bernanke, Letter to Department of Homeland Security, Sept. 6, 2013)
- *IRS regards virtual currencies as property, not currency.* - (IRS Notice 2014-21, Mar 25, 2014)
- *SEC states that the currency is capable of "luring investors into Ponzi schemes."* - (Securities and Exchange Commission, Ponzi Schemes Using Virtual Currency, July 23, 2013)

Based on these and other organizations' statements, it's likely that FASB will also require Bitcoin to be recorded as an asset, and potentially require disclosure of public encryption keys to identify the source of transactions.

## Future Research

As virtual currencies continue to develop, comparisons of the viability of various digital media of exchange can be conducted. In addition, the stability of Bitcoin itself is yet to be determined. Evaluating its position in the next five years would provide much needed insight.