

NAVIGATING THE BRAVE NEW WORLD OF CRYPTOCURRENCY AND ICOs



The rise of cryptocurrencies and ICOs presents numerous challenges and opportunities for CPAs. CPAs play a variety of roles as business leaders in Ontario – from advisors, to accountants and auditors, to executives and entrepreneurs building companies in all sectors. Across all of these roles, CPAs will encounter challenges such as determining how to account for cryptocurrency assets, developing new business models enabled by blockchain technology and funded by ICOs, and adapting audit approaches to manage the technical complexity and market volatility of cryptocurrencies.

EXECUTIVE SUMMARY

Chartered Professional Accountants of Ontario (CPA Ontario) is embarking on a series of thought leadership initiatives intended to provide tangible insights for our members around emerging issues in Ontario and to help shape the future of the profession. This paper – the first in the series – explores the rise of cryptocurrencies and Initial Coin Offerings (ICOs) in Ontario. The paper aims to advance dialogue amongst Chartered Professional Accountants (CPAs) and the broader business community about the various challenges related to cryptocurrencies and ICOs, from accounting and audit issues to challenges navigating the current regulatory environment.

Over the past decade, blockchain technology has captured the imagination of technologists around the world. A blockchain is a decentralized, distributed digital ledger that uses cryptography to securely record transactions in a verifiable and permanent way. Blockchain technology promises a secure, transparent digital infrastructure layer in which every transaction is validated – technology that could be truly transformative to entire industries, including accounting and finance.

The most prominent use of blockchain technology to date has been in cryptocurrencies. A cryptocurrency is a digital medium of exchange built on a blockchain that enables peer-to-peer transactions. As of late April 2018, over 1,500 cryptocurrencies exist and have a combined market capitalization of US\$400 billion¹. Cryptocurrencies are often launched with an ICO. In the past year, ICOs have exploded in popularity as a highly efficient new mechanism for raising capital for new projects and applications based on blockchain technology. The cryptocurrency market heated up in late 2017, going from US\$100 billion to US\$800 billion in market capitalization from July 2017 to January 2018². A dramatic dip in the market in early 2018 did little to slow the rise of ICOs: in just the first four months of 2018, ICOs have raised US\$6.3 billion in funding, 18% more than in all of 2017³.

1 Coindesk ICO Tracker
2 Coindesk ICO Tracker
3 Coinmarketcap.com

A fundamental question underlies the tension between cryptocurrency token issuers and securities regulators: are cryptocurrency tokens a type of security requiring compliance with securities regulation?

The rise of cryptocurrencies and ICOs presents numerous challenges and opportunities for CPAs. CPAs play a variety of roles as business leaders in Ontario – from advisors, to accountants and auditors, to executives and entrepreneurs building companies in all sectors. Across all of these roles, CPAs will encounter challenges such as determining how to account for cryptocurrency assets, developing new business models enabled by blockchain technology and funded by ICOs, and adapting audit approaches to manage the technical complexity and market volatility of cryptocurrencies.

This explosive growth in ICOs has also led to tension between securities regulators and ICO advocates as they grapple with balancing investor protection, capital formation, and innovation. Some ICO advocates have charged that regulatory intransigence is stifling innovation in the province by adding excessive requirements and delaying new launches in a fast-moving, highly competitive space. They urge prompt legislative action and regulatory reform that would treat cryptocurrency markets as something new, and the development of new regulatory frameworks that protect investors while enabling capital formation and innovation. Securities regulators, for their part, have the immediate duty to protect the public interest in a market that too often has seen over-inflated promotion and under-informed investors, as well as serious instances of fraud, money laundering, and funding of criminal activity.

A fundamental question underlies this tension between issuers and securities regulators, namely: are cryptocurrency tokens a type of security requiring compliance with securities regulators or are they something else entirely? To date securities regulators appear to be taking a “substance over form” approach on ICOs. They are concluding that under existing regulatory frameworks, even though the issuer may choose to highlight the utility or voucher-like characteristics of their token, most tokens in fact meet the definition of a security. In Canada, this trend has been demonstrated with three high-profile ICOs – Impak, TokenFunder, and Kik Interactive – each of which has been considered a security offering by the securities regulator, despite the arguments of some issuers.

\$6.3 billion

In the first four months of 2018, ICOs have raised US\$6.3 billion in funding, 18% more than in all of 2017.

The debate surrounding ICO regulation is not unique. Rather, it is another example of the push and pull between innovators and various regulatory bodies playing out around a number of other disruptive business models globally, including Uber, Airbnb, Google, and Facebook. Because ICOs disrupt the highly regulated space of capital markets, the scrutiny in this case by securities regulators has been acute and has come relatively early in the innovation lifecycle.

For CPAs, given their broad range of roles as business and strategic leaders, the ICO market presents exciting opportunities. CPAs are uniquely positioned to bridge the gap between ICO issuers and securities regulators, based on their understanding of both worlds. However, many issues CPAs will face as they engage in the cryptocurrency domain remain unresolved, and CPAs will need to rely on their skills, training, and professional judgement to navigate the domain's uncertainty successfully. By remaining up to date on the technology and regulatory landscape, and observing professional standards, CPAs can facilitate the conversation among stakeholders, bridge discordant perspectives, and help to expedite innovation in Ontario.

ICOs also present significant risks. CPAs need to ensure they fully understand the nature of the businesses with which they engage, and the implications of the work that they undertake. Given the current securities regulatory environment, Ontario CPAs should refrain from participating in any offering that does not treat a token as a security. CPAs should educate ICO issuers to the realities and risks of the current environment, and encourage them to work with the OSC and other applicable securities regulators to find the most expeditious route to a fully compliant issuance. As existing securities regulations evolve, or as new ones emerge, CPAs should remain abreast of changes and advise their clients and businesses accordingly.

It is incumbent on everyone involved, from individuals to businesses to regulators, to move quickly and cooperatively to ensure the right frameworks are in place to help this emerging space thrive. Governing bodies in accounting and finance are no exception. Where historically a slower pace of change allowed for more deliberate and measured responses from regulators and governing bodies of the profession,



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CPA Ontario remains highly supportive of innovation in blockchain-related technologies, and we encourage all members to educate themselves and engage in this emerging space; however, cryptocurrencies and ICOs represent a specific application of blockchain technology that warrants some caution.

today we need to grapple with emerging issues more quickly. The challenge ahead for the profession, which includes CPA Ontario, Chartered Professional Accountants of Canada (CPA Canada), the Canadian Accounting Standards Board (AcSB), and the Auditing and Assurance Standards Board (AASB), is evolving our practices to address emerging issues in a timely manner without sacrificing the level of deliberation required to effectively protect the public interest.

To that end, CPA Ontario is developing educational content around cryptocurrencies and ICOs to help CPAs more effectively engage in the cryptocurrency market, and to a broader extent, in blockchain innovation. CPA Canada will be releasing two publications in the coming weeks addressing accounting for cryptocurrency holdings and the associated audit implications. Finally, the AcSB is encouraging the International Accounting Standards Board (IASB) to more quickly define clear accounting standards that will provide the right level of transparency, accountability, and efficiency needed in this market.

Where historically a slower pace of change allowed for more deliberate and measured responses from regulators and governing bodies of the profession, today we need to grapple with emerging issues more quickly.

The potential for blockchain-related technology to transform the accounting and finance profession is simultaneously exciting and daunting. CPA Ontario remains highly supportive of innovation in blockchain-related technologies, and we encourage all members to educate themselves as they engage in this emerging space; however, cryptocurrencies and ICOs represent a specific application of blockchain technology that warrants some caution. We are advocates of smart regulation in the ICO market – regulation that is sustainable, not onerous.

Ontario is ideally positioned to be a leader in blockchain-related technology and the exciting business opportunities that can come with it. A sustainable ICO market promises to be a new source of broad-based funding and lifeblood to fledgling enterprises that could help the burgeoning innovation economy in Ontario to thrive. CPAs can play a role in making that happen.

NAVIGATING THE BRAVE NEW WORLD OF CRYPTOCURRENCY AND ICOs

INTRODUCTION

Clear direction for CPAs on one of the most complex issues in fintech – and how CPAs can help innovation in Ontario thrive

When Bank of Canada Governor Stephen S. Poloz shared what keeps him awake at night in a speech at Canadian Club Toronto in late 2017, he ended the list with “all the noise I keep hearing about cryptocurrencies.”⁴ Cryptocurrency and its issuance through Initial Coin Offerings (ICOs) indeed captured headlines and the public’s imagination in 2017, crossing into mainstream consciousness and generating immense hype.

For professionals handling financial transactions, this excitement is tempered by uncertainty. As with novel financial innovations of the past at their inception, cryptocurrencies and ICOs do not fit neatly into existing regulatory or reporting frameworks. While regulation and accounting and reporting treatments are being worked out, CPAs in their roles as business leaders and gatekeepers of financial transactions in one of the world’s top global financial and innovation centres must translate this new economic activity into defensible accounts and practices that can be relied upon by ICO issuers, lenders, securities regulators, and investors.

In a December 2017 speech, the US Securities and Exchange Commission (SEC) Chairman Jay Clayton said, “where the application of expertise and judgment is expected, I believe that gatekeepers and others, including securities lawyers, accountants and consultants, need to focus on their responsibilities.”⁵

CPAs have the skills, training, and judgment to navigate the domain’s uncertainty and ambiguity with the hallmark integrity of the profession. Doing this well requires CPAs to understand the technology, act with objectivity and professional skepticism in their dealings with cryptocurrency and ICOs, and provide rigorous disclosure where assumptions, ambiguity, and estimates occur.

The significance of CPAs applying their expertise here extends beyond the effects on any one company, client, or transaction. CPAs are in a position today to influence the province’s competitiveness in the development of this new technology by helping to bridge a divide that has emerged between innovators eager to move quickly with the technology and securities regulators charged with protecting investors and markets from fraud and abuse. As strategic thinkers with an understanding of both business and regulatory concerns, CPAs can facilitate the conversations among these stakeholders and articulate the needs of both realms, resulting in an accelerated movement forward of legitimate cryptocurrency innovation and capital raising in the province.

As the excitement – and froth – surrounding ICO markets continues to mount in 2018, our CPAs must continue to act with integrity and due care, and help to bring a measure of clarity to the complex conversation that cryptocurrencies and ICOs have generated.

4 Stephen S. Poloz. *Issues keeping the governor awake at night*. Speech at Canadian Club Toronto. Dec. 17, 2017

5 U.S. Securities and Exchange Commission. *Statement on Cryptocurrencies and Initial Coin Offerings*. Dec. 11, 2017



BLOCKCHAIN:

a decentralized, distributed and public digital ledger that uses cryptography to securely record transactions across many computers so that the record cannot be altered retroactively without the alteration of all subsequent blocks. Blockchain began as the underlying technology for the cryptocurrency Bitcoin, but it can also be used to move, store, and exchange anything of value, and has the potential to transform business operating models dramatically.

CPA Canada has published two papers on blockchain technology: one an introductory overview of the technology and its potential implications, and the other, an exploration of how blockchain technology could impact the audit and assurance profession.

PART 1:

CRYPTOCURRENCY AND INITIAL COIN OFFERINGS

A cryptocurrency is a digital medium of exchange that is developed and exists as an entry on a blockchain. Cryptocurrencies enable peer-to-peer transactions while maintaining near-anonymity for users, relying on cryptography for security and the blockchain to ensure the integrity of transactions.⁶

Opinions on cryptocurrency are polarized. In 2014, prominent Silicon Valley investor Marc Andreessen likened Bitcoin to “personal computers in 1975, the Internet in 1993,” stating that when such innovations cross the chasm into mainstream products and services, “many people wonder why its powerful promise wasn’t more obvious from the start.”⁷ Taking the opposite stand, in 2017 JP Morgan CEO Jamie Dimon simply described Bitcoin as “a fraud.”⁷ Dimon has since said he regrets that statement, though he is still not a fan of cryptocurrency.⁸

Whatever the case, today over 1,500 cryptocurrencies exist, with no end to the proliferation in sight.⁹ Many are being launched through ICOs, also referred to as initial token sales. An ICO is a novel fundraising method, resembling a mix of crowdfunding and initial public offering, in which a new cryptocurrency is developed in conjunction with a blockchain-enabled project or application, and sold in exchange for Bitcoin, Ethereum, or dozens of other cryptocurrencies, or – occasionally – fiat currency.

Since the first initial coin offering (a US\$5 million token sale by Mastercoin in 2013), entrepreneurs have embraced this technique for sidestepping angel investors and venture capitalists to raise enormous funds from a broad base of supporters located anywhere in the world. In 2017, San Francisco-based Brave Software demonstrated the power potential of ICOs when it raised over US\$35 million in under thirty seconds to fund the development of a web browser with a token-based advertisement model.¹⁰ 2017 was the ICO’s breakout year, witnessing over 340 token sales worldwide resulting in over US\$5 billion in capital raised, with the largest – San Francisco-based Filecoin’s US\$257 million dollar token sale – punctuating the frenzy.¹¹

Noteworthy ICOs

2013 – Mastercoin

 **US\$5 million**

2017 – Brave Software

 **US\$35 million**

2017 – Filecoin

 **US\$257 million**

6 See CPA Canada's *Introduction to Blockchain* for a comprehensive explanation of blockchain technology.

7 CNBC. *Jamie Dimon is betting big on the technology behind 'fraud' bitcoin.* Oct. 16, 2017.

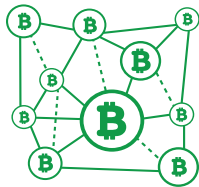
8 CNBC. *Jamie Dimon says he regrets calling bitcoin a fraud and believes in the technology behind it.* Jan. 9, 2018.

9 Coinmarketcap.com

10 Coindesk.com. *\$35 Million in 30 Seconds: Token Sale for Internet Browser Brave Sells Out.* May 31, 2017.

11 Coindesk ICO Tracker

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The growth in cryptocurrency activity and market capitalization has been staggering. By the end of February 2018, nearly US\$8 billion had been raised through ICOs since their introduction five years earlier.¹² As of April 2018, the market capitalization of all cryptocurrency sits at approximately US\$400 billion, up from US\$18 billion only one year before.¹³

The tumultuous new domain has seen dramatic extremes of success and scandal. At one end of the scale, there have been nine-figure capital raising events for promising projects, and the first announcement of an ICO by a major brand, Kodak, resulting in a near 90% spike in its share price. At the other end, there have been an increasing number of enforcement actions by securities regulators around the world against fraudulent ICOs and enormous thefts from online cryptocurrency exchanges, including the January 2018 theft of US\$530 million worth of cryptocurrency from Japan-based exchange Coincheck.¹⁴ Lying somewhere in between on this scale – depending on your point of view – are controversial developments such as the introduction of the first national cryptocurrency, the Venezuelan Petro, declared by Venezuelan President Nicolás Maduro to be an advance in the country's monetary sovereignty.¹⁵

The current hype around cryptocurrencies and their spectacular price appreciation has predictably led skeptics to view the market as a massive global bubble, inflated by countless unsophisticated investors who understand little about the businesses or applications underlying the coin offerings, but are motivated solely by “fear of missing out” (FOMO) on expected explosions in value of the coins themselves. For others, however, this current “coin rush” is only the tumultuous first phase of a novel technology that may soon become commonplace, with competitive implications for organizations across business sectors.

This context is important for CPAs to understand before they can make informed decisions regarding cryptocurrency, the development of controls related to the technology, or the appropriate approach to an ICO. Since the scope of this white paper does not permit for the depth of examination this technology deserves, CPAs are encouraged to pursue independent study and develop a deeper understanding of ICOs, cryptocurrency, and blockchain.

¹² Coindesk ICO Tracker

¹³ Coinmarketcap.com

¹⁴ Reuters. *Japan raps Coincheck, orders broader checks after \$530 million cryptocurrency theft.* Jan. 28, 2018.

¹⁵ Reuters. *Enter the 'petro': Venezuela to launch oil-backed cryptocurrency.* Dec. 3, 2017.

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HOW AN ICO WORKS

Most ICOs involve a common set of practices.

A team with either a blockchain-enabled project or the idea for one creates a token on a custom blockchain or one of several existing blockchain protocols such as Ethereum, Waves, or Hyperledger. The announcement of the token sale is usually accompanied by the release of a white paper that describes the project that the funds are being raised to finance. The white paper, which is essentially a marketing brochure and virtually the only source of information upon which investors make decisions, usually includes:

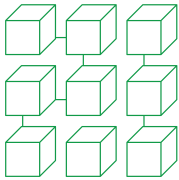
- the rationale for the token's existence;
- a technical explanation of the project and the token's implementation;
- a development roadmap and plan for the use of funds;
- a description of the team and advisors;
- the reasoning for the token's price at launch; and
- information about the total number of tokens to be released and held in reserve

A marketing campaign advertises the token sale and its timing, which can last weeks or months. During the ICO, anonymous token purchasers send Bitcoin or Ether from their online cryptocurrency wallets – software programs that store cryptographic keys providing access and the ability to transfer cryptocurrency – to an address specified in the white paper, and automatically receive the new token in exchange. Teams launching ICOs will usually retain a percentage of the tokens in reserve, and issued tokens are often quickly listed to one or several unregulated cryptocurrency exchanges.

The tokens provide buyers with access to an existing or proposed blockchain-enabled product or service, though undeniably, many buyers also purchase to speculate on the token's price appreciation in secondary markets. The token purchase does not confer equity in the issuing entity, voting rights in the platform's development, or access to cash flow.

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ICOs involve significant risks for investors. They typically fund new ventures, which are inherently high-risk. Moreover, there are no investor protections or mechanisms providing developer accountability after the funds are raised.



BLOCKCHAIN, CRYPTOCURRENCY, AND ICOS IN ONTARIO

Ontario, and specifically the Toronto-Waterloo corridor, has been the scene of important cryptocurrency developments. Two of Ethereum's founders, Vitalik Buterin and Anthony Di Iorio, emerged from the Toronto-Waterloo region. In 2017, Waterloo-based company Kik Interactive launched one of the world's top ten highest grossing token sales at the time of its offering. One of the first two Canadian ICOs with regulatory approval, TokenFunder, originated in Toronto.

While data on the number of ICOs and money raised by entities in Ontario is difficult to determine with certainty, the Toronto-Waterloo corridor is a hotbed of blockchain technology innovation, suggesting its potential to be a global hub for cryptocurrency development. Scores of blockchain companies have sprung from the region. In January 2018, Ontario pension giant OMERS in conjunction with Purpose Investments launched Ethereum Capital, formed with the strategy of buying controlling stakes in businesses based on Ethereum, the blockchain platform of choice for many ICOs. The following month, an Oakville-based company, Harvest Portfolios, received the green light from the Ontario Securities Commission (OSC) to become Canada's first blockchain exchange traded fund, listing on the Toronto Stock Exchange (TSX).

In March 2018, the owner of the TSX, TMX Group, announced that its subsidiary Shorcan Brokers Ltd. is building the first exchange-owned brokerage platform for cryptocurrency investors, and plans services that compile data on digital currencies and publish performance benchmarks such as indexes. "We're looking at a global market that is in its infancy, and as the digital currency network grows and traditional financial institutions want access, we are building a bridge between those

two worlds,” said Shorcan President Peter Conroy at the time of the announcement.¹⁶ Ontario’s TSX Venture Exchange has already listed several blockchain companies, including those specializing in enterprise blockchain and cryptocurrency mining. Of course, Toronto is also a leading financial center and home to the Big Five Canadian banks. With this financial industry overlaid upon a world-leading innovation ecosystem, the province has the conditions in place to become a global leader in blockchain and cryptocurrency innovation and commercialization.


To that end, the OSC has invited companies considering ICOs to approach its LaunchPad program, a team tasked with providing guidance on securities regulation and time-limited exemptive relief from prospectus and registration requirements to entities interested in testing new business models and financial technology with real customers. LaunchPad was created in 2016, and is part of a larger ‘regulatory sandbox’ initiative launched by the Canadian Securities Administrators (CSA), the umbrella organization coordinating provincial and territorial securities regulators. The initiative parallels programs adopted by securities regulators worldwide, including in the UK, Hong Kong, Singapore, Switzerland, and Australia.

LaunchPad Deputy Director Pat Chaukos describes the team’s aim: “We’re here to work with novel firms that actually want to get that balance right — who want to raise capital but do it in a way that investors are protected and understand what they’re buying, and want to do it within the regulatory environment.”

The type of support that LaunchPad provides is determined on a case-by-case basis, and depends on the applicant’s business model, the stage of the business’ operations, and the potential impacts on investors. Though not a requirement, any entity seeking relief from prospectus and registration requirements should seek legal advice from the outset of the planning process.

If alignment among regulators, innovators, and the financial sector can be achieved, the province has the potential to be a leading hub for exciting blockchain and cryptocurrency innovation.

¹⁶ Globe and Mail. *TMX enters bitcoin market with new cryptocurrency platform.* March 22, 2018.



The regulatory debate emerging around ICOs and cryptocurrencies is not unusual for a new, disruptive, tech-based business model. However, because ICOs disrupt the highly regulated space of capital markets, the scrutiny in this case by securities regulators has been acute and has come relatively early in the innovation lifecycle

PART 2:

REGULATORY THEORY AND PRACTICE WITH ICOs

Before delving into the specific regulatory issues surrounding ICOs, it is worth reminding ourselves of the much broader debate between innovation and regulation within the tech sector.

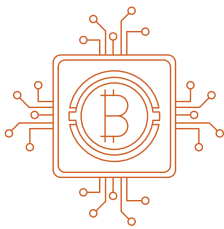


The world has seen countless examples of conflict between regulation and innovation as the tech sector has matured and companies have gone from start-ups to highly-valued, complex global enterprises. From Uber and Airbnb's brushes against municipal authorities to Facebook and Google facing increasing scrutiny and calls for regulation around privacy, this tension has often been the subject of headlines and fierce debate.

There appears to be a consistent pattern in how this dynamic plays out. Typically, early participants in new technology believe that existing regulatory frameworks are not equipped to deal with the disruptive new business models the technology creates. Regulators and legislators initially apply existing regulatory frameworks to protect the public interest, leading to early conflict and roadbumps. Over time, new regulations are created or existing frameworks are adapted, and companies adapt their business practices accordingly to fall in line. Both Uber and Airbnb continue to live through this dynamic in many of their global markets, with both companies curbing some of their more aggressive business practices and implementing new ones to comply with regulation and ensure consumer protection. Facebook and Google have gone through similar cycles in the past, and now face a fresh round of scrutiny as their increased scale gives rise to new, unforeseen challenges such as the manipulation of Facebook ads by Russian agents in the 2016 US Presidential election.

Thus, the regulatory debate emerging around ICOs and cryptocurrencies is not unusual for a new, disruptive, tech-based business model. However, because ICOs disrupt the highly regulated space of capital markets, the scrutiny in this case by securities regulators has been acute and has come relatively early in the innovation lifecycle, compared with other spaces where investor protection and fraud are not as high a concern.

Some ICO advocates claim that a lack of clarity around the existing regulatory framework and its application, along with slow movement towards new regulation that considers the unique characteristics of the cryptocurrency market, has had a chilling effect on Ontario companies seeking to fund legitimate business ideas through token sales.



Ontario's LaunchPad is just one example of how securities regulatory authorities are grappling with the challenge of regulating ICOs and cryptocurrency. Guidance from securities regulators and the results of companies working with these regulators have led to debate among stakeholders. The discord seems to stem from perceived ambiguity or outright disagreement regarding the application of regulation to companies seeking to launch ICOs. Some ICO advocates claim that a lack of clarity around the existing regulatory framework and its application, along with slow movement towards new regulation that considers the unique characteristics of the cryptocurrency market, has had a chilling effect on Ontario companies seeking to fund legitimate business ideas through token sales.

This debate is not unique to Ontario. Securities regulators throughout the world have been wrestling with how to handle cryptocurrency and ICOs. On the extreme end, China's Central Bank banned the practice. Other regulatory authorities around the world – including those in the US, EU, UK, Hong Kong, and Singapore – have issued statements indicating that ICOs are susceptible to money laundering, fraud, and risks of terrorist financing. At the same time, many authorities are working to determine how best to apply an existing regulatory framework in a way that balances protecting investors with facilitating capital formation and business innovation.

Put most simply, the core regulatory issue under debate is: are tokens securities, or something else?

Many issuers argue that their tokens should not be subject to securities regulation, as they effectively function as a form of digital currency. It is argued that they qualify as utility tokens, loosely defined as tokens intrinsic to and primarily to be used not for investment purposes, but in the operation of a blockchain-based product or service.

Jurisdictions around the world have taken different stances on this topic. Switzerland's Financial Market Supervisory Authority (FINMA) released guidelines differentiating payment tokens, asset tokens, and utility tokens, stating that "[u]tility tokens will not be treated as securities if their sole purpose is to confer digital

access rights to an application or service and if the utility token can actually be used in this way at the point of issue.”¹⁷ The UK’s Financial Conduct Authority (FCA) has only indicated that application of securities regulation to ICOs must be determined on a case-by-case basis.

In his February 6, 2018 testimony to the US Senate Committee on Banking, Housing and Urban Affairs, SEC Chairman Jay Clayton warned against proposed ICOs that “appear to elevate form over substance” by highlighting the utility or voucher-like characteristics of the tokens in an effort to claim that they are not securities. “While there are cryptocurrencies that, at least as currently designed, promoted and used, do not appear to be securities, simply calling something a ‘currency’ or a currency-based product does not mean that it is not a security,” he said. “By and large, the structures of ICOs that I have seen involve the offer and sale of securities and directly implicate the securities registration requirements and other investor protection provisions of our federal securities laws.”

Canadian securities regulators have acknowledged that a difference between utility and security tokens exists, while taking a similar position to that expressed by the SEC Chairman regarding the importance of substance versus form in evaluating ICOs. The August 2017 Canadian Securities Administrators’ Staff Notice 46-307 states, “In assessing whether or not securities laws apply, we will consider substance over form,” noting that “[e]very ICO/ITO is unique and must be assessed on its own characteristics.” The notice acknowledged that some tokens may not be subject to securities law, and mentioned tokens issued to provide functionality within a video game as an example, while adding “if an individual purchases coins/tokens whose value is tied to the future profits or success of a business, these will likely be considered securities.” The notice stopped short of defining the characteristics of a utility token.

In practice, as Canadian securities regulators have assessed the application of securities law to actual token issues, it has become increasingly clear that – despite the arguments of the issuers – these ICOs appear to meet the definition of a security for all substantive purposes, under the existing regulatory framework.

An examination of three high profile Canadian token sales – Impak, TokenFunder, and Kik Interactive – illustrates this regulatory trend.

In determining whether or not an investment contract exists, businesses should apply the following four-prong test. Namely, does the ICO/Initial Token Offering (ITO) involve:

1. An investment of money
2. In a common enterprise
3. With the expectation of profit
4. To come significantly from the efforts of others

– Canadian Securities
Administrator’s Staff Notice 46-307

¹⁷ FINMA, *Guidelines for enquiries regarding the regulatory framework for initial coin offerings (ICOs)*, Published 16 February 20

Details of the AMF's Exemptive Relief decision regarding Impak include:

- A minimum of 575,000 MPK and a maximum of 14,375,000 MPK would be issued in the token sale, equalling a minimum of CAN\$500,000 and a maximum of CAN\$10,000,000.
- Apart from accredited or eligible investors, investments were limited to CAN\$2500 per investor. Know-your-client and suitability reviews were to be conducted for each participant, and Impak needed to establish a system of controls to manage risks, including those related to the blockchain protocol and cybersecurity.
- Impak would have to make details about MPK and its valuation available to investors on its website and network within ten days after the end of each quarter.

ICOS AND REGULATION IN PRACTICE IN ONTARIO AND CANADA

Impak Finance

Montreal-based Impak Finance's ICO was the first to be approved by securities regulators in Canada. Impak CEO Paul Allard sought to issue 'Impak Coins' – dubbed MPK – via token sale to fund the development of a blockchain-based social network that connects users with merchants prequalified as having socially responsible business practices. Impak Coin buyers could use MPK as a currency within the network to purchase goods and services from these merchants and then receive 5% Impak coin back on their purchases.

Immediately upon entering into negotiations with Quebec's Autorité des marchés financiers (AMF), the sharp contrast between the fast-moving world of cryptocurrency technology and the deliberate approach of the regulatory authority became apparent to Allard.

Allard's comment on that process highlights the potential clash in perspective between ICO issuers and securities regulators: "One of the first meetings going through the KYC – know your client process – they said, 'Here we want people to send a fax.' For us, it's all mobile, it's all digital. So they had this huge chasm to cross," Allard said. "It was difficult in terms of negotiating the user experience."

After three months of negotiations with AMF and other provincial securities regulators, Impak's regulated ICO opened in September 2017, with Impak coins defined as securities issued by way of private placement, with relief from prospectus and dealer registration requirements for 24 months.

Impak Finance went on to raise CAN\$425,000 in the first 24 hours of its token sale, ultimately raising approximately CAN\$1.5 million from over 1,690,000 MPK issued to 2,266 investors.

CEO Alan Wunsche, a CPA himself, said: “I wanted to do the right thing, do it the right way, in Canada, and get regulatory exemptions where they made sense. Where the regulatory environment needs to change for the country to be competitive, we’re pushing for change.”

Some observers we spoke to were puzzled by the AMF decision, maintaining that “security” does not accurately describe what the MPK tokens are, and that therefore, the definition should not apply. Allard also maintains that MPK is a currency and not a security, but describes the reasoning behind accepting the compromise: “Why should we reinvent the wheel?” he says. “Instead of reinventing the law, which would take ten years, we said, ‘Ok, let’s bend.’”

This first Canadian ICO-related decision by securities regulators may have surprised some ICO issuers. In hindsight, however, it sent an unmistakably clear early signal on the approach that Canadian securities regulators would take on the core ICO question: if the Impak Coin did not meet the definition of a utility token not subject to securities law, what would?

TokenFunder

Toronto-based TokenFunder worked with the OSC to become the first Ontario-based company to launch a token sale approved by securities regulators. TokenFunder’s aim was to build a “smart token asset management platform” through which other companies could sell tokens of their own as regulated securities, with principles of accountability, governance, and investor protection built into the offering process. Knowing that investor protection is a key priority for securities regulators, TokenFunder designed a “Know-Your-Customer” (KYC) blockchain investment standard for both identity verification and investor suitability. TokenFunder then embedded KYC compliance within their platform, to enable future clients issuing tokens through the platform to be compliant with securities regulation. Discussing his motivations for pursuing regulatory approval CEO Alan Wunsche, a CPA himself, said: “I wanted to do the right thing, do it the right way, in Canada, and get regulatory exemptions where they made sense. Where the regulatory environment needs to change for the country to be competitive, we’re pushing for change.”

Details of the OSC's Exemptive Relief decision regarding TokenFunder include:

- TokenFunder would distribute 200,000 of 1,000,000,000 FDNR tokens in the token sale in exchange for proceeds equalling up to approximately CAN\$10,000,000.
- Apart from accredited or eligible investors, investments were limited to CAN\$2500 per investor.
- Know-your-customer and suitability reviews would have to be conducted for each investor, and TokenFunder needed to establish a system of controls to manage risks, including those related to the blockchain protocol and cybersecurity.

TokenFunder's token sale was approved in October 2017. The decision provided relief from prospectus and dealer registration requirements for 12 months, and permitted TokenFunder to raise up to CAN\$10 million with its token, dubbed FNDR, treated as a security issued by way of private placement.

With the approval, TokenFunder's six-month ICO period began on November 1st, 2017.

While certain that his decision to take the regulated route was the correct one, Wunsche reported feeling "competitive anxiety" arising from the extended negotiation period, as competitors launched unregulated ICOs to fund similar platforms without the delay or limitations that TokenFunder experienced. The benefit for TokenFunder is the certainty that it is not in violation of the law – which could prove a critical long-term advantage, given the increase in monitoring of ICOs by securities regulators with respect to securities law compliance.

Kik Interactive

The highest profile and most controversial Canadian company to execute a token sale is Kik Interactive, maker of a messenger app with over 300 million users worldwide. The Waterloo-based company is one of Canada's few unicorns – private tech companies valued at over a billion dollars. In 2017, the company announced plans for a token sale aimed at raising CAN\$157 million through the issuance of a token called Kin.¹⁸ The white paper described Kin as a currency that "will power a digital economy inside of the Kik app," facilitating digital service transactions and rewarding developers that contribute to the Kin network. On this basis, Kik argued that Kin should be considered a utility token.

While details of discussions between the two parties remain private, the outcome is well-known. The company elected to move forward with their token sale without the securities regulators' blessing, opting to prohibit Canadians from investing rather than run afoul of securities law.¹⁹ In September 2017, while Canadians sat on the

¹⁸ TechCrunch. *Chat app Kik to raise \$125M through an ICO in September*. Aug. 29, 2017.

¹⁹ Ted Livingston. *Canadian Residents Excluded from Next Week's Kin TDE*. Sep. 7, 2017

Kik Interactive elected to move forward with their token sale without the securities regulators' blessing, opting to prohibit Canadians from investing rather than run afoul of securities law.

sidelines, Kik raised nearly CAN\$125 million through its token distribution event, with over 10,000 people in 117 countries participating, making it one of top ten highest grossing token sales in the world at the time.

Kik CEO Ted Livingston later commented on the Canadian exclusion: "It is the most upsetting thing we have encountered on our crypto journey so far," he told media. "We will see what it ends up costing Canadians."²⁰ While it is too soon to tell the implications for would-be Canadian investors, the case appears to provide a high-profile example of the direction Canadian securities regulators are taking on utility tokens.

INNOVATION VS. REGULATION: CAN THE TENSION BE RESOLVED?

The lesson from these examples is clear: Canadian securities regulatory authorities appear to be treating all token offerings as securities under the existing regulatory framework. While they may acknowledge the possibility of utility tokens, in practice it appears they have not yet considered any ICO as involving a pure utility token, and at most are granting exemptions from the prospectus and registration requirements for new token issues. Overall, their practice would appear to be largely consistent with the principle of considering substance over form when evaluating ICOs.

This has opened up an apparent divide between ICO advocates and securities regulatory authorities.

In an open letter to the OSC on petition site change.org, William Mougayar, advisor to OMERS Ventures and the Ethereum Foundation, wrote that LaunchPad's "heavy handed and narrowly guided" approach, "classifying every token as a security," may dampen Ontario-based cryptocurrency innovation. Mougayar says in the letter that "[m]ost of the Ontario entrepreneurs I interact with are confused and scared to talk with the OSC or the CSA. Instead of attracting them, the OSC/CSA positions have repelled many of them to come forward."²¹ Mougayar is an advocate of securities regulators and legislators working without delay alongside innovators to develop a

²⁰ TechCrunch. *Kik could pave the way for more mainstream tech company ICOs*. Sept. 2017.

²¹ Change.org. *Sign the OSC Open Letter on ICOs Regulation*.

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new regulatory framework for the cryptocurrency market that considers its unique characteristics in order to ensure that rapid innovation in the space can continue without reduced investor protection.

For their part, securities regulators are charged with protecting investors – regardless of the novelty of the technology. Underscoring that responsibility are a number of fraudulent ICOs. A prime example is Quebec-based PlexCorps, which announced an ICO for its PlexCoin in a white paper declaring that investors could expect to see “a 1,354 percent profit in less than 29 days.” In December, after raising US\$15 million from retail investors, the SEC’s new Cyber Unit took its first ever action, obtaining an emergency asset freeze and filing charges in United States federal court against the company, calling it a “fast-moving Initial Coin Offering (ICO) fraud.”²² More recently, Payza – a Quebec-based cryptocurrency exchange service – was charged by the U.S. Department of Justice of facilitating as much as US\$250 million in money laundering on behalf of Ponzi schemes and child pornography sites, among other enterprises. Securities regulators on both sides of the border are stepping up their monitoring and enforcement efforts in 2018, with the SEC launching a widespread probe into the US cryptocurrency market and issuing subpoenas to cryptocurrency issuers and advisors²³ and the OSC requesting information from a number of trading platforms in Ontario in April 2018.²⁴

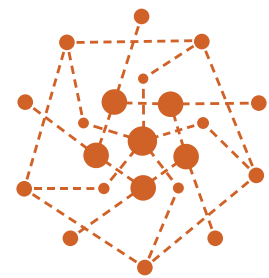
Furthermore, while LaunchPad’s mandate involves helping to foster today’s financial technology innovation, the team must also maintain a longer view, understanding that risks taken today can impact the long-term development and success of blockchain technology more generally in Ontario. LaunchPad Deputy Director Pat Chaukos says, “The last thing we want are practices to start happening and valuations that really have no meaning, because then we’ve lost any type of integrity around the potential of blockchain technologies because of some of the issues around cryptocurrencies.”

22 U.S. Securities and Exchange Commission.
SEC Emergency Action Halts ICO Scam.
Dec. 4, 2017.

23 Wall Street Journal. *Cryptocurrency Firms Targeted in SEC Probe.* February 28, 2018.

24 Globe and Mail. *Ontario Securities Watchdog Probes Cryptocurrency Companies Following Complaints.* April 6, 2018.

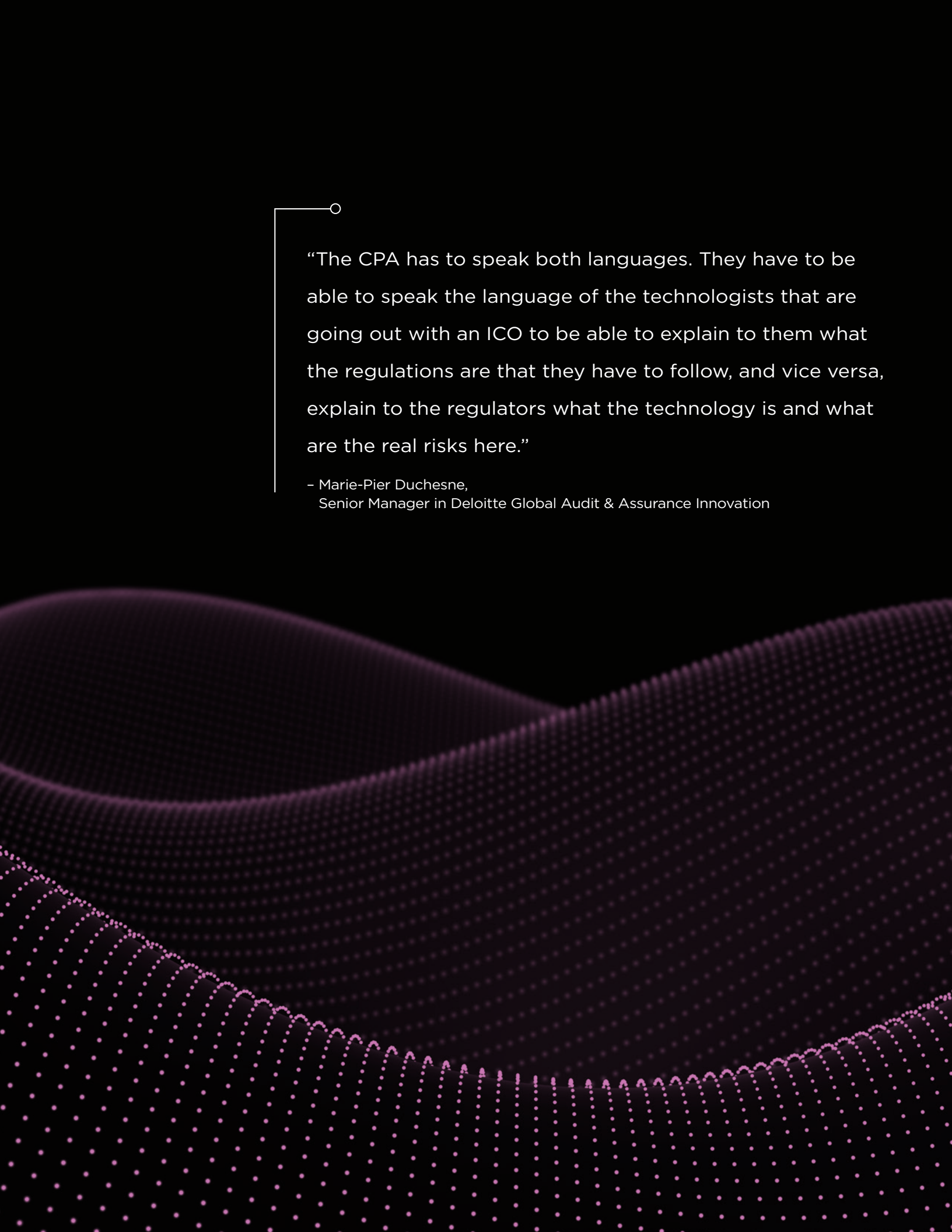
The tension also likely results from technologists' lean development and, in some cases, more libertarian perspectives clashing with the traditional and highly governed financial realm. Chaukos says, "I think the other challenge is that the people who are developing these new technologies understand technology, but don't understand that they're actually in a regulated space, so they were operating like 'I'm just building a technology. Why do I need to worry about regulation? I had no idea that regulatory and legal requirements apply.'" As noted earlier, this sentiment has been heard many times before from early participants in new technology and disruptive business models.



In short, we are left with two legitimate but sometimes competing interests. On the one hand, Ontario entrepreneurs need to remain competitive and use the power of ICOs to finance potentially game-changing new technologies and business models. On the other hand, investors need to be adequately protected in a cryptocurrency market that has been subject to reckless promotion and instances of fraud, money laundering, and other criminal activity. In the end, everyone needs to work towards the same goal of aligning investor protection with capital formation and business innovation.



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“The CPA has to speak both languages. They have to be able to speak the language of the technologists that are going out with an ICO to be able to explain to them what the regulations are that they have to follow, and vice versa, explain to the regulators what the technology is and what are the real risks here.”

– Marie-Pier Duchesne,
Senior Manager in Deloitte Global Audit & Assurance Innovation

PART 3:

THE ROLE FOR CPAs

CPAs can play a unique and critical role in the new world of cryptocurrencies and ICOs, helping to create that balance between investor protection, capital formation, and innovation.



CPAs understand both the entrepreneurial and the regulatory world. Their mandate spans both constituencies, as they act as business and strategic leaders, and as gatekeepers to the marketplace. CPAs are committed to help businesses achieve their goals efficiently and cost-effectively, while also ensuring they comply with all applicable securities legislation, and that the broader interests of investors and the public are protected. In the case of ICOs, CPAs can bring their understanding of the prevailing regulatory climate and process to bear on the advice they give to token issuers, who are sometimes inexperienced regarding regulatory requirements.

For their part, securities regulators are relatively new to the rapidly-evolving ICO marketplace. As MNP's Maruf Raza, Partner, National Director of Public Companies, says, "The securities regulators are still assessing how to align the ICO and cryptocurrency world into their traditional frameworks. The CPA can play a significant role in facilitating the bridge between the regulatory world – what we'll call the traditional world – and the new world."

Marie-Pier Duchesne, Senior Manager in Deloitte Global Audit & Assurance Innovation, agrees: "The CPA has to speak both languages. They have to be able to speak the language of the technologists that are going out with an ICO to be able to explain to them what the regulations are that they have to follow, and vice versa, explain to the regulators what the technology is and what are the real risks here."

In order to play this role effectively, CPAs will need to remain up to date on the technology and regulatory landscape, rely on their professional judgement, and engage with businesses seeking to participate in ICOs.

Gord Beal, Vice-President,
Research, Guidance and
Support with CPA Canada
regarding their upcoming
paper on accounting for
cryptocurrency holdings:

“The emergence of digital currencies and blockchain technology signal an important evolution in capital markets and our underlying economic system. The potential for disruption is significant. There are over 1,500 digital or cryptocurrencies currently in circulation and more are being developed. Each of these has its own unique features and characteristics which makes understanding and accounting for them particularly challenging. Stakeholders are asking for guidance on the accounting, audit and tax implications associated with this new asset class. CPA Canada is working on a publication to inform our members and other stakeholders about cryptocurrencies and the primary issues involved in accounting for them.

“We expect continued conversation around the issue as regulators and standards-setters in Canada and globally gain a better understanding of the different types of cryptocurrencies, the rights and risks associated with them, and the markets in which they trade. CPA Canada will monitor these developments and their potential implications in Canada.”

Before considering how CPAs should deal with the specific regulatory challenge currently presented by ICOs, it is worth briefly reviewing some of the other challenges and opportunities presented by the explosive growth of ICOs, cryptocurrencies and blockchain technology.

CHALLENGES AND OPPORTUNITIES FOR CPAs

CPAs play a variety of roles as business leaders in Ontario – from advisors to accountants and auditors to executives building and growing companies in all sectors. Across all of these roles, CPAs will face a wide range of challenges – from determining how to account for cryptocurrency assets, to developing new business models enabled by blockchain technology and funded by ICOs, to adapting audit approaches to manage the heightened technical complexity and market volatility of cryptocurrencies.

Here is an overview that illustrates the many cryptocurrency issues that CPAs will have to grapple with in the months and years ahead:

New business models

Major changes could come with the new disruptive business models that blockchain technology enables. “As far as blockchain technology overall is concerned, this is the second coming of the internet in a lot of different ways,” says Abhishek Sinha, Partner in the Financial Services Advisory practice of EY Canada. “Anything that you can think of that is a marketplace, there are people building a blockchain service around that,” says Jim Orlando, Managing Director at Toronto-based OMERS Ventures. “What will be different between now and five years from now is the technology that we now know as tokens on a blockchain is going to power new business models.” CPAs could play a major role in developing and deploying this next generation of token and blockchain enabled decentralized business models.

“What will be different between now and five years from now is the technology that we now know as tokens on a blockchain is going to power new business models,” says Jim Orlando, Managing Director at Toronto-based OMERS Ventures.

Accounting and financial reporting

While there is broad acceptance that cryptocurrency is likely an asset, there is no widespread agreement on which, if any, of the current accounting standards are most applicable. Holders of cryptocurrencies will need to determine how to classify them – are cryptocurrencies financial assets, intangible assets, inventory, investment property, or something else? “Everybody is trying to figure out what the accounting classification is,” says MNP’s Maruf Raza.

Given the complexity of accounting for cryptocurrency holdings, it will likely require considerable time and effort to build alignment across international stakeholders involved with setting IFRS® Standards. In the meanwhile, the AcSB is a strong supporter of short-term action by the IASB to help preparers hone in on the appropriate reporting for cryptocurrencies. The AcSB is also actively monitoring private company activity within Canada to determine whether a local standard needs to be developed for private companies under the Accounting Standards for Private Enterprises (ASPE).

As CPAs await clear guidance, they will need to lean heavily on disclosure. Raza says, “What you really need is rigorous disclosure around how you’re accounting for it, how you are valuing it and the source of those valuations.” CPAs working with issuers will also need to encourage more disclosure by the issuers to provide token holders with timely, relevant, reliable and accurate information on their holdings.

Auditing

Cryptocurrency technology presents a new level of complexity for auditors, specifically when it comes to determining the existence and valuation of a cryptocurrency. Determining existence is difficult given the semi-anonymous nature of cryptocurrency wallets. Auditors must also confirm that the custodian has the appropriate security in place to protect from loss, misappropriation, or unauthorized

“How will management ensure the accurate timing and frequency of valuation of investments and tokens? They ultimately, as we suspect, will need to determine the reasonable and good faith value of the investments that have a readily available market price. This is not easy.” says PwC Canada Partner and Trust & Transparency Solutions Leader Peter Hargitai.

use of the cryptocurrencies. “Auditors would need to go and do procedures around the custody aspect, including looking at encryption policies, cybersecurity, but also in terms of the management of the private key, who has access to the private key and making sure that the private key is not easily compromised. You then have to perform additional procedures around and in the blockchain itself to verify whether you actually hold those coins,” says PwC Canada Partner and Trust & Transparency Solutions Leader Peter Hargitai.

What this adds up to is a change in the way CPAs perform audits. Although CPAs are developing a sophisticated understanding of the technology, the average auditor may not be familiar with the technical nuances of cryptography and cryptocurrencies. This means auditors may need “to partner with experts who understand the underlying technology and help the audit partner go in and audit the transactions,” says Paritosh Gambhir, Audit Partner in KPMG’s Financial Services Practice.

Determining valuation is also difficult. Hargitai says, “How will management ensure the accurate timing and frequency of valuation of investments and tokens? They ultimately, as we suspect, will need to determine the reasonable and good faith value of the investments that have a readily available market price. This is not easy.”

Tax implications

The Canada Revenue Agency (CRA) has declared that cryptocurrency holdings should be treated as a commodity, with any gains realized by selling the currency subject to tax in the same manner as other commodities. The use of cryptocurrency in the sale and purchase of goods and services are governed by rules for barter transactions.²⁵ While statistics from the CRA are not available, early data for 2017 tax returns in the US suggests that less than 0.4% of US tax filers reported cryptocurrency gains in 2017 – despite an estimated 7% of Americans holding cryptocurrency assets in 2017,²⁶ and despite the Internal Revenue Service (IRS) tapping cryptocurrency exchange Coinbase to release client information for 14,000 users,²⁷ The CRA could take similar action and CPAs need to be aware of this issue as a potential source of problems for individuals holding cryptocurrencies.

25 BDO Canada. *The CRA’s Position on Cryptocurrency: Income Tax Implications*. March 15, 2018.

26 Fortune. *Bitcoin Investors Aren’t Paying Their Cryptocurrency Taxes*. February 13, 2018.

27 Coindesk. *Coinbase Ordered to Hand IRS Data on 14,000 Users*. November 30, 2017.

ICOS AND REGULATORY COMPLIANCE

ICOs represent a potential new way to raise early stage and growth capital for companies in Ontario, and CPAs are engaging in this market. However, whether as a seasoned CFO evaluating ICOs as a fundraising option, an entrepreneur looking to take their company to the next level, or an advisor helping clients make sense of this emerging technology, CPAs need to balance the sometimes competing interests of innovation, capital formation, and investor protection. Across all of these roles, CPAs should exercise their professional judgement and must act in a way that protects the public interest and reflects the character and hallmark integrity of the profession.



Securities regulators analyzing facts and circumstances under existing regulatory frameworks appear to be concluding that tokens offered through ICOs are considered securities for all substantive purposes. Issuers who seek to avoid, circumvent, or otherwise fail to properly comply with the securities regulation by arguing that they have a “pure utility token” offering could face enforcement action when the token is ultimately considered to be a security and in non-compliance with relevant securities regulations.

Given the current securities regulatory environment, Ontario CPAs should refrain from participating in any offering that does not treat a token as a security. CPAs should educate ICO issuers to the realities and risks of the current environment, and encourage them to work with the OSC and other applicable securities regulators to find the most expeditious route to a fully compliant issuance. As existing securities regulations evolve, or as new ones emerge, CPAs should remain abreast of changes and advise their clients and businesses accordingly.

THE PATH FORWARD

In the broadest sense, operating with professional competence as a CPA means maintaining professional skills and remaining up to date with developments, professional standards and regulation in the applicable area of professional service.

PROFESSIONAL COMPETENCE

A member shall sustain professional competence by keeping informed of, and complying with, developments in professional standards in all functions in which the member practises or is relied upon because of the member's calling.

– Rule 203, CPA Ontario Rules of Professional Conduct

Regarding cryptocurrency and ICOs, this means, among other things:

- Researching and enhancing understanding of blockchain technology, cryptocurrency, and ICOs;
- Remaining informed of and complying with regulatory changes in Canada and abroad – including securities regulation, accounting and audit standards;
- Maintaining professional skepticism and judgment in the face of external influences;
- Pushing for clarity regarding ICO-related business propositions and the functionality of the tokens being distributed to ensure proposed projects are credible and viable; and
- Educating prospective issuers on typical financial reporting requirements and effective internal controls relating to cybersecurity, the handling of tokens, and the management of private keys.

Specifically, CPAs involved with cryptocurrency and ICOs must be able to assist clients, in conjunction with their legal counsel, in answering the following questions, among many others:

- What is the ICO funding?
- What are the trade-offs between pursuing an ICO and raising capital through other means?
- Is the model for the operation of the token viable? How critical is issuance of a token or cryptocurrency to the business model?
- What are the characteristics of the cryptocurrency being developed? Does it meet any of the characteristics of a security as defined by the securities regulators of the appropriate jurisdiction?
- What volatility exposure exists if the cryptocurrency is denominated in Bitcoin or Ether?
- What is the liquidity risk arising from the settlement of cryptocurrency into fiat currency?
- Does launching an ICO present a reputational risk for the issuing entity, considering its sector, the characteristics of the organization, and the general perception of ICOs?
- What Know-Your-Customer (KYC) and anti-money laundering (AML) practices will be performed during the ICO?
- Does it make sense to seek an exemption from the requirement for a prospectus?

It is incumbent on everyone involved, from individuals to businesses to regulators, to move quickly and cooperatively to ensure the right frameworks are in place to help this emerging space thrive. Governing bodies in accounting and finance are no exception. Where historically a slower pace of change allowed for more deliberate and measured responses from the profession, today we need to grapple with emerging issues more quickly. The challenge ahead for the profession, which includes CPA Ontario, CPA Canada, the Canadian Accounting Standards Board, and the Auditing and Assurance Standards Board, is evolving our practices to address emerging issues in a timely manner without sacrificing the level of deliberation required to effectively protect the public interest.

The AcSB is working alongside other leading international bodies to define clear accounting standards and practices that will provide the right level of transparency, accountability, and efficiency needed in this market. Linda Mezon, Chair of the AcSB says, “We are encouraging the IASB to develop long-term solutions at a faster pace to keep up with the cryptocurrency world. In the interim, we have asked the IASB to consider issuing short-term guidance built around existing standards to help preparers hone in on an appropriate treatment.” In the coming weeks, as this guidance is being developed, CPA Canada will be releasing a publication addressing accounting for holdings of cryptocurrencies, and another addressing the associated audit implications.

CPA Ontario is developing educational content around cryptocurrencies and ICOs to help educate CPAs and new participants in the market about the potential risks involved. We are also developing foundational e-learning courses as well as a podcast series on blockchain and its associated use cases to help CPAs in Ontario build their understanding of this space. Our goal is to enable CPAs to more effectively engage in the cryptocurrency market, and to a broader extent, in blockchain innovation.

This paper is the first in a series of thought leadership activities designed to generate insight and spark meaningful conversation across our membership and beyond. We will continue to formulate additional ways to educate ourselves and our members on these emerging topics, grapple with issues, and adapt our practices to protect the public interest in the face of disruptive change.

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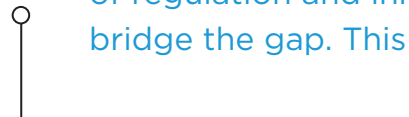
CONCLUSION:

GETTING INNOVATORS AND REGULATORS ON THE SAME PAGE

Canadian tech start-ups often have struggled to find adequate financing from angel and venture growth investors. ICOs promise a new source of broad-based funding and lifeblood to fledgling enterprises that could help the burgeoning innovation economy in Ontario to thrive.

The tension between regulators and innovators in the ICO space is not unique. Rather, it is another example of the tension between innovation and regulation that frequently seems to occur in the evolution of disruptive tech-based business models. Because ICOs disrupt the highly-regulated space of capital markets, the regulatory scrutiny has arguably been higher and earlier in the lifecycle of innovation than it has been with other new business models.

For CPAs, given their broad range of roles leading businesses large and small across all sectors, ICOs offer an exciting new area of business opportunity and a potential new way to raise capital. CPAs are engaging in this market and can help bridge the gap between securities regulators and issuers. However, ICOs also present significant risks. CPAs need to ensure they fully understand the nature of the businesses with which they engage, and the implications of the work that they undertake, to ensure they are consistently in compliance with applicable laws and the CPA Code of Professional Conduct.



In the early days of innovation of every industry, CPAs have been called upon to act at the intersection of regulation and innovation, and to help businesses bridge the gap. This is no different.

This means encouraging businesses and clients to work with the OSC and other applicable securities regulators, and refraining from participating in any offering that does not treat a token as a security. While some issuers may argue that there is ambiguity around the regulatory guidelines regarding utility tokens, this should not be mistaken for regulatory tolerance. On the contrary, it is increasingly clear that the actions taken publicly by the OSC, the SEC, and other securities regulators have resulted in ICO tokens being regulated under existing securities legislation. They are likely to treat any issuer – and possibly their advisers – who mistakenly (wilfully or not) declare their coins to be utility tokens, and sidestep the regulatory process for securities, as non-compliant and subject to enforcement. CPAs should acknowledge this regulatory reality, and work with the securities regulators to find the most expeditious route to a fully compliant issuance.

Navigating the rapidly expanding and multi-faceted world of cryptocurrency will call on the greatest strengths of CPAs. The good news is CPAs have been here before. In the early days of innovation of every industry, CPAs have been called upon to act at the intersection of regulation and innovation, and to help businesses bridge the gap. This is no different.

By remaining up to date on the technology and regulatory landscape, observing professional standards, and using professional judgment developed through CPA training, CPAs can facilitate the conversation among stakeholders, bridge discordant perspectives, and help to expedite innovation in Ontario. With that done well, investors, management, regulators, and even Bank of Canada Governors may have one less thing to keep them awake at night.

A number of individuals contributed to the development of this paper. CPA Ontario would like to thank all those who offered their time and expertise.

We invite readers to share with us their feedback and insights regarding this paper. If there are topics you would like us to explore in the future, please let us know. Any feedback or input can be sent to thoughtleadership@cpaontario.ca

About CPA Ontario

CPA Ontario protects the public interest by ensuring its members meet the highest standards of integrity and expertise. CPA Ontario serves and supports its more than 90,000 members and 19,000 students in their qualification and professional development in a wide range of senior positions in public accounting, business, finance, government, not-for-profits and academe. Chartered Professional Accountants are valued by organizations of all types and sizes for their financial expertise, strategic thinking, business insight, management skills and leadership.



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