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Corporate, M&A and Securities

Fintech Alert: SEC's Chief Accountant Discusses Financial Reporting for Initial Coin Offerings

Action Item: The Securities and Exchange Commission's ("Commission" or "SEC") registration requirements apply to offers and sales of securities in the United States and include filing audited financial statements. In July 2017, the Commission issued an investigative report relating to blockchain tokens, clarifying that the federal securities laws may apply to those who offer and sell tokens through initial coin offerings ("ICOs") in the United States. Digital tokens (also referred to as cryptocurrencies) are subject to the same financial reporting requirements as traditional securities when offered or sold on an exchange. In this alert, we have summarized certain accounting issues discussed in a speech by Wesley Bricker, the Commission's Chief Accountant in his remarks before the AICPA National Conference on Banks & Savings Institutions, which highlighted the regulatory and financial reporting requirements relating to ICOs.

Financial Reporting Requirements

The federal securities laws apply to any issuer seeking to offer or sell securities in the United States regardless of whether the issuer is a traditional or virtual company, whether the securities are paid for with U.S. dollars or digital coins or tokens, or whether the securities are distributed through stock certificates or virtual ledger.

In other words, the offering and sale of digital tokens are subject to the same registration laws as typical securities. Under the Securities Act of 1933, unless an exemption applies, all securities being offered or sold must be registered with the SEC. Registrants must provide the SEC with essential facts, including: a description of the company's properties and business; a description of the security to be offered for sale; information about the management of the company; and financial statements certified by independent accountants.

Mr. Bricker noted that SEC registration requirements require filing audited financial statements and suggested that organizations should consider both accounting and reporting guidance, like U.S. GAAP, when preparing related financial statements. Specifically, Mr. Bricker pointed out that SEC guidance on the matter focuses on "presentation and disclosure of financial statements, consolidation, translation, assets, liabilities, revenue, expenses, and ownership."¹ With that in mind, Mr. Bricker advises that issuers and holders of either traditional securities or virtual tokens consider the following:

Issuers:

- The required financial statement filing requirements
- Whether there are any liabilities requiring recognition or disclosure
- Whether there are any previously recognized assets that should be “de-recognized”
- Whether there are any revenues or expenses requiring recognition or deferral
- Whether there are any transactions with owners which result in either debt or equity classification and possible compensation expense
- Implications for the provision for income taxes

Holders:

- Whether specialized accounting guidance, like in the case of investment companies, applies to the presentation of the holder’s financial statement
- The characteristics of the digital coin or token in considering whether, how, and at what value the potential transaction should affect the holder’s financial statements
- The nature of the holder’s involvement in considering whether the issuer’s activities should be consolidated or accounted for under the equity method

Conclusion

Whether or not a particular transaction involves the offer and sale of a security will depend on facts and circumstances of the transaction. While not every digital token may be deemed a security, the facts and circumstances of each offering must be thoroughly analyzed. If a digital token is considered a security, then the offering is subject to SEC reporting obligations. An entity involved in ICOs should carefully consider potentially applicable SEC accounting, disclosure, and reporting guidance.

1. https://www.sec.gov/news/speech/speech-bricker-2017-09-011#_ftn23

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