

# Hot Topic: Digital assets

## Evaluating custody of digital assets

March 2022 (updated June 2023)<sup>1</sup>



**This Hot Topic explores accounting ownership of digital assets held by a custodian and when custody is a performance obligation.**



### Introduction

Individuals and entities frequently do not hold their own digital assets; instead, they engage a third party to hold them in either a custodial or non-custodial wallet. With a custodial wallet, the custodian holds the private cryptographic keys necessary to execute a transaction with those digital assets, while with a non-custodial wallet, the individual or entity maintains its own private cryptographic keys.

Despite the differences in these wallet types, for ease, this Hot Topic refers to all third-party wallet services as ‘custodial services’ and all wallet service providers as ‘custodians’.

This Hot Topic explores:

- whether the individual or entity (hereafter, the depositor) that has engaged the custodian owns the digital assets *for accounting purposes*; and
- when a custodial service is a performance obligation for a custodian under Topic 606 (revenue from contracts with customers).



### Applicability

All entities that either:

- engage unrelated custodians to hold their digital assets; or
- act as a digital asset custodian for individuals or other entities.



### Accounting ownership of digital assets purchased through a custodial account

The depositor and the custodian need to evaluate who owns custodied digital assets for accounting purposes, which may differ from the party that legally owns the digital assets.

<sup>1</sup> [Accounting ownership of digital assets controlled by the depositor before transfer into a custodial wallet](#) section has been updated to remove the reference to Question 25 in the AICPA Practice Aid, [Accounting for and auditing of digital assets](#), which was updated in March 2023 to reflect the views of the SEC staff on lenders’ accounting for crypto intangible asset loans and is no longer relevant to the section.

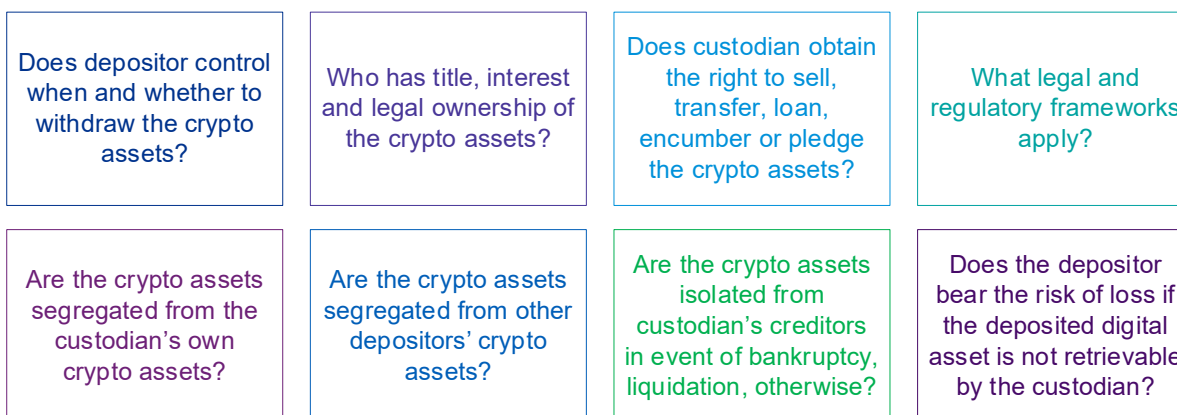
- If the accounting owner is the depositor, the depositor recognizes the digital asset and the custodian is a custodial service provider.
- If the accounting owner is the custodian, the depositor instead has a right to receive a digital asset in the future and the custodian is the obligor to that digital asset right. The arrangement to receive the digital asset in the future is evaluated under Topic 815 (derivatives and hedging) to determine whether it is, or includes, a derivative (see KPMG Handbook, [Derivatives and hedging](#)).

## Background

Currently, no explicit US GAAP exists on determining the accounting ownership of custodied digital assets. Therefore, entities generally look to the nonauthoritative guidance in Question 10 of the AICPA Practice Aid, [Accounting for and auditing of digital assets](#) (the AICPA Guide). Question 10 states that to make the accounting ownership determination, an entity generally evaluates which party (i.e. the depositor or custodian):

- ‘controls’ the crypto asset under the Topic 606 principle of control (i.e. which entity – the depositor or the custodian – has the ability to direct the use of and obtain substantially all the remaining benefits from the digital asset); and [\[606-10-25-25\]](#)
- has a digital asset that meets the essential characteristics of an asset as described in the FASB’s Conceptual Framework. [\[CON 8.E17\]](#)

In addition, Question 10 provides factors to assist entities in making the accounting ownership determination, including those that follow (not exhaustive).



Although legal ownership does not necessarily determine accounting ownership, Question 10 highlights that legal ownership and other legal considerations may affect this determination. Accordingly, advice from legal counsel may be necessary.

## Practical considerations

Beyond those outlined in Question 10 of [the AICPA guide](#), we have observed the following considerations (not exhaustive) also affect and/or assist in making the accounting ownership determination in practice. These additional, practical considerations are intended to supplement, and generally work in concert with, those outlined above; however, judgment and an entity’s own specific facts and circumstances will continue to affect the accounting ownership evaluation.

- **Protective rights.** The custodial agreement between the depositor and the custodian may include provisions that ostensibly limit the depositor’s right to withdraw or transfer the digital assets. For example, the custodian may have the right to (not exhaustive):
  - restrict the size of certain transactions (e.g. depositor could not withdraw all of its digital assets in one transaction immediately);
  - reject transactions that conflict with or violate applicable laws/regulations; and

refuse transactions in response to a subpoena or other government order.

We have also observed broader contractual language, such as “The custodian reserves the right to cancel or reject any trade order, in whole or in part, for any reason.”

Entities should consider whether provisions like these are protective rights of the custodian – e.g. to protect itself and personnel from legal liability or reputational damage – or, instead, *significantly* restrict the ability of the depositor to exercise control over the custodied digital assets. In isolation, protective rights generally do not suggest custodian control of custodied digital assets.

- **Holding the private keys is not determinative.** Under some custodial arrangements, the custodian holds the private cryptographic keys necessary to execute a transaction from the wallet in which the depositor’s digital assets are held (see *Introduction*). When considering the effect of this on the accounting ownership evaluation, we believe an entity would *not* substantively weight that the custodian could, by virtue of holding the private keys, decline to execute a valid transaction requested by the depositor. Instead, an entity would look at the rights and obligations of the parties to execute transactions and assume both parties to the custodial agreement will abide by its terms and conditions.
- **Omnibus wallet considerations.** In a segregated wallet structure, the deposited digital assets are held in a separate wallet (or wallets) – i.e. with its (their) own cryptographic keys – from those of other depositors. In an omnibus wallet structure, the depositor’s digital assets are (1) commingled with those of other depositors in one or more custodial wallets, and (2) typically acknowledged by both parties to be fungible with those of other depositors.

A segregated or omnibus wallet structure to the custodial arrangement is not, in our view, determinative to the accounting ownership evaluation. A segregated wallet does not necessarily mean the depositor controls the custodied assets, and an omnibus wallet does not necessarily mean the custodian controls them. We do believe, however, that some additional considerations come into play in an omnibus wallet scenario when determining accounting ownership. These include whether (not exhaustive):

- the custodial agreement requires a clear segregation of the depositor’s assets from other depositors’ digital assets and those proprietary assets of the custodian (if any); and
- the custodian maintains a balance of digital assets (by type of digital asset deposit) greater than or equal to the total of its depositors’ digital asset balances in its custodial accounts. This may be legally required of digital asset custodians in some jurisdictions. This 1:1 reserve for depositor accounts may be evidenced by some custodians through a ‘proof of solvency’ audit – i.e. a cryptographic audit proving digital asset reserves equal digital asset deposits.

Either of these increases the likelihood that the depositor is the accounting owner of the custodied digital assets.

- **Legal isolation of depositor’s digital assets.** Question 10 of [the AICPA guide](#) includes as a factor to consider whether the depositor’s digital assets would be isolated from the custodian’s creditors in the event of bankruptcy, liquidation or otherwise. In addition to the potential for the conclusion to differ by legal jurisdiction, relevant statutory and case law may be undeveloped (or immature). Consequently, we have observed entities decide to obtain legal advice when assessing this factor.
- **Control is binary.** The Question 10 framework, centered on the notion of control in Topic 606, *applies to both the depositor and the custodian even though Topic 606 only applies to the vendor in a sale transaction*. Topic 606 defines control as the ability to direct the use of and obtain substantially all the remaining benefits from an asset, including the ability to prevent other entities from directing the use of, and obtaining the benefits from, that asset. By the nature of this definition, control is a binary concept when there are only two parties involved and both parties are subject to it. It is not possible for two unrelated parties to simultaneously control a single asset like a digital asset (or fractional unit thereof). In the context of this evaluation undertaken by both parties, either the depositor controls the asset, or the custodian does; not both.

Therefore, in situations where it is unclear whether one of the parties controls the digital asset, it may often be relevant to evaluate the position of the *other* party. For example, if evaluating whether a depositor controls a digital asset, and there is some measure of contrary or conflicting evidence from the Question 10 framework, it may be useful to take the perspective of the custodian and consider instead what evidence supports that the *custodian* controls the digital asset. When evaluating the issue this way, it may become clear that the other party does not control the digital asset, or at least the evaluation could indicate where the preponderance of the evidence lies in this binary evaluation.

## Example: Omnibus custodial wallets

ABC Corp. acquires a material amount of bitcoin through its Custodian to be held in a custodial account. ABC's bitcoin is held in multiple omnibus wallets for which Custodian holds the private cryptographic keys, and ABC's bitcoin are commingled with those of other custodial customers.

The following are additional facts relevant to the accounting analysis.

- **Legal ownership.** The custodial agreement indicates that ABC is the legal owner of the bitcoin; title and interest reside with ABC.
- **Transfer and other rights.** Under the custodial agreement, only ABC is permitted to sell, transfer, loan, encumber or pledge the deposited bitcoin; Custodian has no such rights.
- **Cryptographic keys.** Custodian holds the private cryptographic keys to the custodial wallets; this means it must execute, and has the *capability* to reject, transactions requested by ABC. However, under the custodial agreement, Custodian can only reject valid transaction instructions from ABC if they are improper, for other specified protective reasons to Custodian, or for practical, operational reasons (e.g. transaction size limitations).
- **Access.** ABC can withdraw or sell/transfer its bitcoin at any time and for any reason. Custodian can only reject such requests as described in the preceding bullet. ABC accesses a brokerage portal to submit transactions.
- **Risks and rewards.** ABC bears all risk of loss associated with the bitcoin, except losses caused by Custodian's fraud, willful misconduct or gross negligence. ABC bears all risk and reward from fluctuations in the market price of bitcoin. ABC pays a fee for each purchase or sale of bitcoin processed by Custodian.
- **Tracking.** While ABC's bitcoin is held across multiple omnibus wallets, Custodian is required under the custodial agreement to maintain a separate ledger for each custodial depositor, including ABC.
- **Fungibility of bitcoin.** Each bitcoin owned by ABC and held in Custodian's omnibus custodial wallets is identical to and has the same fair value as any other bitcoin. Custodian is only obligated to return the same number of bitcoin owned by the depositor; it is not obligated to return the same specific bitcoin that were initially deposited by ABC.
- **Legal advice.** ABC has obtained legal advice from qualified counsel that under the terms of the custodial agreement and in the jurisdiction governing that agreement, counsel (1) expects that ABC's bitcoin would be isolated from Custodian's creditors in the event of Custodian bankruptcy or receivership, and (2) believes Custodian is effectively required to maintain sufficient bitcoin holdings to cover all depositors' bitcoin holdings on a one-to-one basis.

### Accounting analysis

ABC evaluates whether it controls the bitcoin held in the custodial wallets to determine whether it:

- recognizes the bitcoin; or

- recognizes a bitcoin receivable from Custodian that could potentially contain an embedded derivative under Topic 815.

Based on the facts outlined above, ABC concludes that it, and not Custodian, controls the custodied bitcoin in its name. Accordingly, ABC recognizes the bitcoin as an intangible asset.

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## Accounting ownership of digital assets controlled by the depositor before transfer into a custodial wallet

An entity may control a digital asset *before* transferring it to a custodial wallet. For example, in contrast to purchasing a digital asset through its custodial account, the entity may purchase a digital asset and control it in a non-custodial exchange wallet before transferring it to its custodial wallet.

Many digital assets (e.g. bitcoin, ether) get classified, and accounted for, as intangible assets. KPMG Executive Summary, [Accounting for crypto assets – entities that are not broker-dealers or investment companies](#) (see *Classifying a crypto asset under US GAAP*), explains why this is the case. Once recognized, intangible assets (digital or otherwise) are derecognized by an entity in a sale or transfer only when the criteria in Subtopic 610-20 (gains and losses from the derecognition of nonfinancial assets) are met. [350-10-40-1, 40-3]

Subtopic 610-20 relies on the control transfer guidance in Topic 606 to determine when and whether to derecognize a nonfinancial asset. Under Topic 606, control over an asset does not transfer when the transferor (i.e. the depositor in this scenario) has the substantive right to repurchase that asset (or a substantially equivalent asset – e.g. a fungible digital token). [606-10-55-66, 55-68; 610-20-25-6 – 25-7]

In the case of a custodial arrangement, *by design*, the depositor has the substantive right (other than for ‘protective’ reasons – see *protective rights*) to withdraw the digital assets placed in custody. Therefore, even if the custodian can direct the use of the depositor’s digital intangible asset while in its custody, we believe the depositor would not derecognize the asset because its right to withdraw that asset is, in effect, a call option (i.e. a repurchase right).

We observe that a custodian may not reach the same conclusion as that of a depositor in this situation. This is because, in contrast to Question 10 of [the AICPA Guide](#), which imposes the same control guidance on both the depositor and the custodian (see [Accounting ownership of digital assets purchased through a custodial account](#)), Topic 606 and Subtopic 610-20 only apply to the seller (transferor) in a sale (transfer) transaction; therefore, the custodian may not consider the depositor’s withdrawal right as determinative to its asset ownership evaluation as the transferee.



## Identifying custodial performance obligations

### Custody as a promised good or service

As evidenced by the fact that many entities offer digital asset custodial services for a fee, and many entities engage for such services in explicit custodial agreements, digital asset custodial services clearly have value to individuals and entities. In those arrangements, custodial services are clearly a promised service to the entity engaging for them.

However, in many scenarios, an exchange (or marketplace) will hold a customer’s digital asset(s) acquired thereon in custody on an ongoing basis for no consideration beyond the transaction fee (or digital asset purchase price, if the exchange is determined to have controlled the digital asset before its transfer to the

customer) paid to the exchange to acquire the digital asset. The customer has the right to withdraw the digital assets from the exchange platform without substantive penalty at any time.

The customer's right to continued digital asset custody with the exchange in these scenarios may constitute a 'material right' to obtain free custodial services, to which a portion of the earned transaction fee (or alternatively, purchase price of the digital asset) must be allocated under Topic 606.

- **No material right.** Some exchanges offer digital asset custodial services to noncustomers for free; individuals or entities can transfer their digital assets acquired *elsewhere than on the exchange* into exchange custody before, and irrespective of whether, the depositor enters into a purchase or sale transaction that generates revenue for the exchange. When that is the case, we believe the customer's right to free custodial services exists independently of the contract to acquire the digital asset on the exchange, and the right to the free custodial services is not a material right under Topic 606. [TRG 4-16.54]
- **Material right.** By contrast, if custodial services are *only* offered to customers for digital assets acquired on the exchange, or only to customers that have already transacted on the exchange, the right to free custodial services will generally be a material right. The exchange will need to allocate a portion of its transaction fee (digital asset) revenue to the material right.

Chapter 8 of KPMG Handbook, [Revenue recognition](#), discusses the identification of and accounting for material rights in further detail.

### Assessing whether custodial services are distinct

Material rights, to digital asset custodial services or otherwise, are always distinct, and never 'immaterial in the context of the contract'. [606-10-25-16B, 55-42]

A promised digital asset custodial service will generally be distinct from other promised goods and services in a contract.

- Digital asset custodial services are generally 'capable of being distinct' as evidenced by the fact that there are numerous entities that sell, or offer for free, these services such that they are 'readily available'. [606-10-25-20]
- A promise to provide digital asset custodial services is generally 'separately identifiable' because: [606-10-25-21, 606-10-55-150C]
  - it and the other promises with which it is typically bundled (e.g. a promise to execute a digital asset transaction, or a promise to transfer a digital asset) can be fulfilled independently of each other; and
  - neither the custodial service, nor the goods or services with which it is bundled, significantly modify or customize the other, or give rise to a combined, integrated output.

Section 4.3 of KPMG Handbook, [Revenue recognition](#), discusses identifying distinct performance obligations in detail.

## For further information

See KPMG Executive Summary, [Accounting for crypto assets – entities that are not broker-dealers or investment companies](#), and other digital asset [Hot Topics](#).

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