

Hot Topic: Digital assets

Evaluating custody of digital assets

March 2022 (updated February 2024)¹



This Hot Topic explores accounting ownership of digital assets held by a custodian and when custody is a performance obligation.²



Introduction

Entities frequently purchase digital assets in such a manner (e.g. on an exchange or through a custodian) that the purchase settles directly into a crypto wallet for which the entity does not control the private cryptographic keys (a ‘custodial’ wallet). Further, entities may transfer digital assets they have appropriately recognized on their balance sheet to a third-party custodian to hold.

This Hot Topic first explores whether an entity (hereafter, the depositor) that has engaged a custodian owns the digital assets *for accounting purposes*.

- If so, the depositor accounts for the digital assets in the same manner it would any such assets it self-custodies and the custodian is solely a custodial service provider. Despite not accounting for the digital assets themselves in this case, the custodian needs to consider whether it is subject to SEC Staff Accounting Bulletin No. 121 (SAB 121), and if so whether it has a safeguarding obligation for those assets (see KPMG Hot Topic, [SEC staff guidance on digital asset safeguarding obligations](#)).
- If not, the depositor instead has a digital asset receivable for which the custodian is the obligor. The custodian records the digital asset as its own and a liability to transfer that asset to the depositor in the future. The depositor’s right to receive the digital asset in the future and the custodian’s obligation to transfer that asset to the depositor in the future are both evaluated under Topic 815 to determine whether they are, or include, a derivative (see KPMG Handbook, [Derivatives and hedging](#)). In this case, because the digital asset is the custodian’s asset for accounting purposes, the custodian does not have a SAB 121 safeguarding obligation (see Question 20 in KPMG Hot Topic, [SEC staff guidance on digital asset safeguarding obligations](#)).

This Hot Topic then discusses when a custodial service is a performance obligation for a custodian under Topic 606 (revenue from contracts with customers).

¹ This Hot Topic has been updated to conform wording with that in KPMG Issues In-Depth, [Crypto intangible assets](#).

² For purposes herein, ‘custodian’ refers to the entity that controls the private cryptographic key information, whether or not legally a custodian.

Applicability

All entities that either:

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



Accounting ownership of digital assets purchased through a custodial account

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 digital asset under the Topic 606 principle of control (i.e. which party 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 intended to assist entities in making this accounting ownership determination, including those that follow (not exhaustive). [\[AICPA Digital Asset Guide Q10\]](#)

Does depositor control when and whether to withdraw the assets?	Who has title, interest and legal ownership of the assets?	Does custodian obtain the right to sell, transfer, loan, encumber or pledge the assets?	What legal and regulatory frameworks apply?
Are the assets segregated from the custodian’s own assets?	Are the assets segregated from other depositors’ assets?	Are the assets isolated from custodian’s creditors in event of bankruptcy, liquidation, otherwise?	Does the depositor bear the risk of loss if the deposited asset is not retrievable by the custodian?

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

Additional considerations

Beyond those enumerated above in Question 10 of [the AICPA guide](#), we have observed the following considerations (not exhaustive) also affect and/or assist in making the above-outlined 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 the specific facts and circumstances will continue to affect the accounting ownership evaluation.

- **Protective rights.** The 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. the depositor could be precluded from withdrawing 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.** When considering the effect of this on the accounting ownership evaluation of holding the private cryptographic keys (private key information) necessary to execute transactions from the wallet in which the digital assets are held, we believe an entity should *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.

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 some 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. This includes 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, 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

Scenario

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

The following are additional relevant facts.

- a. **Legal ownership.** The custodial agreement indicates that ABC is the legal owner of the BTC; title and interest reside with ABC.
- b. **Transfer and other rights.** Under the custodial agreement, only ABC is permitted to sell, transfer, loan, encumber or pledge the deposited BTC; Custodian has no such rights.
- c. **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).
- d. **Access.** ABC can withdraw or sell/transfer its BTC 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.
- e. **Risks and rewards.** ABC bears all risk of loss associated with the BTC, 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 BTC. ABC pays a fee for each purchase or sale of BTC processed by Custodian.
- f. **Tracking.** While ABC's BTCs are held across multiple omnibus wallets, Custodian is required under the custodial agreement to maintain a separate ledger for each custodial depositor, including ABC.
- g. **Fungibility of BTC.** Each BTC owned by ABC and held in Custodian's omnibus custodial wallets is identical to and has the same fair value as any other BTC. Custodian is only obligated to return the same number of BTCs owned by the depositor; it is not obligated to return the same specific BTCs that were initially deposited by ABC.
- h. **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 BTC 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' BTC holdings on a one-to-one basis.

Accounting analysis

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

- recognizes those BTCs; or
- recognizes a BTC receivable from Custodian that could potentially contain an embedded derivative under Topic 815.

ABC considers all of the facts presented and concludes that it, and not Custodian, 'controls' the custodied BTC in its name. In reaching this conclusion, ABC places the most emphasis on facts (b) and (d), which most directly align to the definition of control (i.e. to ability to direct the use of, and obtain substantially all the remaining benefits from, the asset). Accordingly, ABC recognizes the BTC as a crypto intangible asset.



Accounting ownership of digital assets recognized by the depositor before transfer to a custodian

As stated in the [Introduction](#), a depositor may transfer a digital asset it has appropriately recognized on its balance sheet to a third-party custodian to hold. In that case, the question arises about whether the depositor should derecognize the transferred digital asset.

Crypto intangible assets

Many digital assets (e.g. bitcoin, ether, litecoin, cardano, solana) get classified, and accounted for, as intangible assets (crypto intangible assets). Section 1.3 of KPMG Issues In-Depth, [Crypto intangible assets](#), 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 to derecognize a nonfinancial asset. Under Topic 606's control transfer guidance, 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 crypto intangible assets placed in custody. Therefore, even *if* the custodian can direct the use of the depositor's crypto intangible asset while in its custody, we believe the depositor would not derecognize the custodied crypto intangible asset because its right to withdraw that asset is, in effect, a call option (i.e. a repurchase right) that prevents the custodian from obtaining control of the asset.

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.

Other digital assets

As outlined in Section 1.2 of KPMG Issues In-Depth, [Crypto intangible assets](#), not all digital assets are crypto intangible assets. For example, some 'stablecoins' meet the US GAAP definition of a financial asset, while others

may, in addition to meeting the definition of a financial asset, meet the US GAAP definition of a security. This Hot Topic does not discuss derecognition of digital assets that are not crypto intangible assets.



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 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 asset 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 Financial Reporting View page, [Cryptocurrencies and other digital assets](#), for all of our existing guidance on accounting for crypto and other digital assets. Resources include [Issues In-Depth](#) and [digital assets Hot Topics](#), which delve into issues such as the accounting for NFTs, investment company accounting for crypto intangible assets, applying SAB 121 and lenders' accounting for crypto intangible asset loans.

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