



Corporations investing in crypto

Guidelines and considerations for companies on digital asset allocation

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Introduction

Some operating companies are actively allocating cash to digital assets. We began to see meaningful examples of this dynamic in 2020, and it continues despite the fluctuations and turbulence in the markets.

One early example was MicroStrategy Inc., which in 2020 announced that it had made more than \$1 billion in bitcoin purchases and then continued to acquire more in subsequent years. They characterized it as an investment that would “provide the opportunity for better returns and preserve the value of our capital over time compared to holding cash.”¹ Some companies have followed suit, and others may now be wondering how to invest in bitcoin and other digital assets. There are a variety of reasons for adding digital assets to a company’s balance sheet, whether it’s seeking asymmetric risk return observed over previous years or as a natural hedge against fluctuating fiat currencies; it’s part of a corporate strategy to embrace modern, open technologies; or it’s a complement to an operational strategy that includes accepting digital assets as payments.

This paper focuses largely on bitcoin investments, considering recent increased corporate investments in bitcoin and its common reference as a store of value. It should be noted that there are numerous types of digital assets, each having its own unique characteristics. Ether (ETH) is also viewed as a store of value, with the added use of enabling transactions on Ethereum-based decentralized applications. These contrast with [central bank digital currencies \(CBDCs\)](#) and stablecoins, which are digital representations of fiat currency. Their value is derived from the actual currency in circulation, and, in the case of CBDCs, are issued by a central bank. Equity and derivative tokens are digital assets whose value may represent actual corporate stock or a legal right to another asset or financial instrument. Some digital assets have additional attributes, such as voting rights on a protocol, or they may provide a level of access for participation in a decentralized application. These may provide some commercial or economic

benefit to the holder. Prior to investing in any digital asset, it is important to understand the specific terms, conditions, and characteristics of the investment since those will affect accounting, tax, risk, controls, and legal considerations, among others.

What follows here, then, is some guidance on what undergirds any corporate decision to invest in digital assets like bitcoin. In addition, we set out the ongoing actions that teams across a company should undertake to monitor and go forward with a long-term investment. In other words, our goal is to answer the question “How would you do that?” rather than “Why do it?”

Before proceeding, we want to make one point absolutely clear: There is no playbook or foolproof approach for these kinds of bold moves. There is only painstaking effort, disciplined analysis, fresh thinking and rethinking, dedicated collaboration across competencies, and, above all, rigorous execution. What follows, then, is not a step-by-step prescription but instead a high-level guided tour of the wide terrain companies may cover when they are considering investing in bitcoin. Given the many variables and different characteristics of digital assets, the provisions presented in this POV are not necessarily pertinent or germane to all digital assets. Nonetheless, the broad methodology and considerations set out here may apply to multiple corporate investment scenarios in select digital assets.

The terrain of digital assets is a new frontier of possibilities, so it could require that each corporate department, along with its external advisers, rethink the application of the rules and policies of their respective core competencies.



The high-level view from corporate treasury

Generally, the main purpose of the treasury function is risk management and the preservation of capital. When deciding and executing on digital assets for investment and operational purposes, digital assets governance risk can be key to all activities. More than creating a policy, governance typically includes understanding the types of investment the company is making and where this alternative investment vehicle—digital assets like bitcoin—fits within the broader investment strategy. Leaders should also be comfortable with the characteristics and nature of the vehicle (more on this below in the discussion on controls). Given that it's a financial investment, it's important that the treasurer, CRO, CEO, CTO, CFO, and board of directors all have a clear assessment and understanding of the asset's risk profile, the company's tolerance for risk, and how these two may align or diverge. Ultimately, governance is about monitoring and assuring that the conditions and requirements set by the organization are maintained.

Tolerance for risk, depending on the stake and type of digital asset, may have to be periodically adjusted. Risk tolerance takes several forms and requires decisions on issues such as the following:

- What percentage of the cash on hand, after accounting for operating costs, will be assigned to alternative investments in digital assets?
- What range of risk is the company comfortable with? Governing risk is rarely a matter of “set it and forget it.” Risk is a constantly moving target, and adjustments within an agreed-upon band of risk tolerance may need to be made frequently.
- With digital assets, treasury should consider not just the investment side but also how these assets may figure into daily operations such as payments, debt management, raising funds, IPOs, etc.

There are other key considerations a treasurer should evaluate when adding digital assets to the company's operations. Understanding of the underlying features tied to specific digital assets is important in helping effectively utilize and deploy the asset to its full potential while also implementing a robust control structure to help ensure proper usage. Control and storage are often imperative elements for an organization, whether they intend to manage the asset themselves (self-custody), leverage a third party, or take a hybrid approach. The storage decision can allow an organization to determine its exposure to counterparty risk, as each option varies to the control and ownership of the asset. The failures of certain banks and digital asset exchanges have emphasized the importance of understanding exposures held at external platforms and at institutions. The importance of risk management applies when managing digital assets that are spread across multiple wallets, exchanges, and custodians.

With emerging technologies, a holistic view is likely needed to help an organization review its positions and liquidity across its wallets and exchanges due to the asset's volatile nature when compared to traditional fiat. New technology and vendors have emerged focused on reporting, management, transactional activity, and utilization of digital assets within a single platform. Multiple vendors have built out integrations with leading treasury management systems to enable real-time visibility for liquidity and reporting that supports the treasury function. Treasuries that adopt digital assets should have a risk assessment framework to identify where exposures exist, how the assets are managed, and if the system has adequate controls in place.



Points outlined below highlight key factors for corporates to consider for treasury:

- Overall purpose, function, and how digital assets will be utilized (payments, investments, staking, etc.)
- Establishment of internal and external controls that comply with digital asset specific policies to properly manage digital assets across business units
- Ability to integrate digital assets into key treasury operations to fulfill the organization's objectives and strategy

How can treasury be more strategic in using these assets to advance efficiencies in payroll, vendor payment, trade, customer interactions, and cross-border transactions with subsidiaries and others? (Below, there is more on this last point when we discuss accounting and tax implications as well as controls.) A first and final refrain for treasury should be that the governance of digital assets is a living and adaptive process. It can constantly follow and should adjust to market, regulatory, and risk realities.

Liquidity may not be the prime consideration, especially if the company is adopting a longer-term investment mindset. Nevertheless, there should be appropriate provision for extra cash on hand. And assuming investments are layered in progressively over time, liquidity is likely to be less of an issue. Yet, in the event of the need to liquidate assets, the company may need to know if the facility to do so is available without a premium penalty or the transaction can be executed without a depreciation of the assets' value.

“Global macroeconomic, monetary, and digital evolutions have converged, requiring all forward-thinking corporations to consider alternative assets on their balance sheet. The ecosystem and the regulatory environment for digital assets, especially bitcoin, have matured to the point that this strategy is becoming approachable and mainstream.”

—Phong Le, President and CEO, MicroStrategy Inc.



Digital assets accounting and tax

Potential opportunities for alignment, challenges of divergence

Accounting for digital assets under US Generally Accepted Accounting Principles (US GAAP)

Simply put, the accounting for digital assets will likely be determined by what the company is accounting for. What is it investing in? Under today's US GAAP, an investment in certain digital assets, like bitcoin, is accounted for as an "indefinite-lived intangible asset."² That means it does not meet the accounting definition of cash or a cash equivalent, financial instrument, or inventory. Here's the accounting challenge with digital assets being reflected as intangible assets: According to US GAAP, acquired digital assets (intangibles) should be accounted for at cost, subject to subsequent impairment as appropriate. That means that when the asset is impaired, the company must write down the value on its books. The converse is not true. The value of the asset cannot be written up when (or if) the price goes up or a previously written-down asset subsequently recovers, even if that recovery is within the same day. Consequently, for accounting purposes, it is difficult to book any ROI on digital assets held as investments. Clearly, then, the rules and framework for digital assets present certain important constraints: It is not possible for the company's accounting function to reflect the economics of how it may value its digital assets. For this reason, among others, the Financial Accounting Standards Board (FASB), which sets GAAP in the United States, has a current project on its technical agenda to change this accounting. Its current proposed [Accounting Standards Update \(ASU\)](#), which is now out for public comment, proposes amendments to the accounting standards to measure investments in certain digital assets, like bitcoin, at fair value.

Under today's accounting practices, absent the ability to mark up the value of a company's digital asset holdings, if the company believes fair value to be more reflective of the economics of its investment, it has the flexibility to provide disclosures that it believes are meaningful to its investors. For example, the company can

provide investors with information about the value of one digital asset (say, a bitcoin) by flagging the price of one bitcoin at a given time on a given exchange. But then again, unlike equities, bitcoins are typically traded on multiple exchanges and around the clock, seven days a week. Hence, any snapshot of the price can provide only rough guidance. But with the knowledge of the number of coins or other digital assets held, investors can arrive at an approximate determination of the valuation of the company's digital asset holdings. Note that companies should be mindful of non-GAAP measures when preparing these disclosures.

Under the FASB's [proposed accounting](#), since certain digital assets will be recorded at fair value, such disclosures may not be necessary. However, the current proposed ASU includes many additional proposed disclosures related to a company's holding of digital assets. Those will be required if the proposed amendments are approved.

While feedback to date seems positive on the FASB's proposed amendments to move to a fair value model, a friendly reminder: These are just proposed amendments. They cannot be applied until formally approved by the Board and issued in a final ASU. At that point, companies will be required to adopt the new ASU by its effective date (yet to be determined). The [current proposed ASU](#) permits early adoption. But again, those proposed amendments can be early adopted only once the final ASU is issued. The FASB's proposed ASU has a public comment period deadline of June 6, 2023. And the FASB encourages all stakeholders to submit a comment letter response so it can receive feedback, both positive and negative, on the proposed amendments.



SEC reporting

As we've seen, the accounting function draws on various rules and frameworks under the current US GAAP rubric of intangible assets. Similarly, the related disclosures need to be drawn from various sections within US GAAP to align with the accounting, resulting in a patchwork of disclosures. For example, the disclosure requirements within [ASC 350 Intangibles – Goodwill and Other](#) apply to the digital assets held as an investment. And additional disclosures under [ASC 820, Fair Value Measurement](#) would be required for the nonrecurring fair value measurement used to determine impairment of those digital assets. To the extent the company sells digital assets or uses them in its business transactions, additional disclosures would be required.

These disclosures, drawn from various areas of US GAAP, should articulate the accounting to an investor. Moreover, they should explain why the digital assets and related transactions are presented the way they are in the financial statements. A reader should be able to understand the company's investment in digital assets. That includes the line where the investment figures in the financial statements and the overall investment strategy. Some of these reporting challenges may be solved with the FASB's proposed ASU, as the proposed amendments currently call for additional disclosures related to digital assets held by a company. In the meantime, companies should work to craft appropriate financial statement disclosures related to digital asset investments and be careful about providing non-GAAP disclosures that the SEC may challenge.

Digital assets and crypto tax treatment and challenges from an investment perspective

The rules governing tax treatment of digital assets and crypto do not depend on US GAAP accounting rules and frameworks. One key difference: Under current accounting rules, digital assets and crypto can be marked down only when impaired (impairment accounting) and not marked up when their value increases; but in tax, such a move results only from an election that may be available to dealers or traders whereby the tax function can mark up or down to fair value. For tax purposes, gain or loss is normally recognized only when a digital asset or crypto is sold or exchanged. In the United States, there are two tax accounting methods or treatments that can help account for gains and losses: specific identification (ID) and first in, first out (FIFO).

The specific ID method can be used to determine the cost basis of each digital asset the company is selling or exchanging. That means that every time the company disposes of such an asset, it is specifically identifying the exact units it is selling or exchanging. So how does one specifically identify a digital asset like bitcoin, which is deemed to be a fungible asset? By segregating tranches into distinct wallets. It's common for investors to develop wallet structures to house different tranches of their digital assets with different cost bases and holding periods. Hence, when it comes time to sell, a given wallet or tranche is readily distinguishable from another, and the relevant information is at hand—date and time each unit was acquired or wallet created, cost basis and fair market value of each unit at the time it was acquired or wallet created, and, finally, the fair market value of each unit when it was sold or exchanged.



Absent the use of the specific ID method and wallet structures, there are very limited ways to distinguish the different assets. Hence, taxpayers are likely bound to use a FIFO approach. In other words, absent the specific ID information (time, date, cost basis at time of purchase) and an adequately segregated and identified asset, each time a company disposes of a digital asset, the presumption may be that the company is disposing of the oldest asset or coin(s) it holds. While complex and sometimes messy, tracking the cost basis versus the current market price is likely important for both tax and accounting.

Regarding partnerships: The accounting and tax treatments for digital assets may change if a company invests in these alternative vehicles using a fund versus holding the assets outright.

From a tax standpoint, digital assets held for investment purposes are normally deemed capital assets. In a corporate solution, capital losses can be used only to offset capital gains. So, while a company may mark down to fair value for accounting purposes, tax does not follow that methodology (except in certain limited circumstances relating to an election to mark to market as a dealer or trader in digital assets). Rather, it's a matter of layering in a deferred tax asset, which may require a valuation allowance if there are no other sources of capital gains. So how does this play out in a set of financial statements? Members of a company's tax function should live and abide by the rules and framework of US GAAP first and then layer on the tax treatment in terms of deferred taxes.

Tax treatment and challenges from a business transactions perspective

Let's move now from the investment angle to consider the use of digital assets in business transactions, such as fund transfers, paying vendors, and as an accepted form of payment from customers. When used for such transactions, digital assets should be segregated into separate wallets to maintain a clear distinction between digital assets used in the operation of the business

(ordinary assets) and digital assets held for investment (capital assets). Naturally, if digital assets are being used in place of fiat, such actions will generate a gain/loss recognition event for tax purposes under the umbrella of a barter transaction. That's the case every time digital assets are used in a business transaction. This has a related impact on accounting as well, and the process can become very complex on both fronts.

Accounting for digital assets used for business transactions

When companies use digital assets that are accounted for as intangibles for business transactions, such as paying vendors, these transactions will require a different accounting treatment, which is more complex. That is a consequence of the intangible asset now being used as a tangible one—i.e., a financial versus nonfinancial asset. The resulting financial reporting oftentimes doesn't align, or "make sense." Many have expressed concerns that the financial reporting may be misleading, rather than useful, to investors. Some of these challenges may be alleviated with the FASB's proposed amendments if digital assets are recorded at fair value. That said, more and more mainstream financial services and fintech companies are now offering customers the possibility of holding or exchanging bitcoin.

Cross-border transactions

So far, we've applied a US-centric view to digital assets from both an accounting and tax perspective. Outside the United States, the treatment of digital assets varies substantially. Accounting under International Financial Reporting Standards (IFRS) may similarly view digital assets like bitcoin as intangible assets or sometimes even inventory. However, the intangible asset guidance under IFRS differs from US GAAP. And while the FASB has a current project on its agenda to address the accounting for certain digital assets, for its part, the International Accounting Standards Board (IASB), which sets the accounting standards internationally, does not have such a project on its technical agenda.³ When a company uses digital assets like bitcoin to transfer funds across borders—say, to a foreign subsidiary in Europe—it encounters complexities in other jurisdictions. The transfer process may well involve a number of



steps: converting fiat to a crypto, transferring the crypto, and then reconverting the crypto as a fiat. The benefit, of course, is that such a process avoids bank transfer fees. Yet the act of transferring funds may well have triggered an unrealized gain or loss. And since the subsidiary may not be subject to the same tax and accounting rules as the US parent company, there may be implications in the following areas:

- Gain recognition rules
- Cost basis tracking methods
- Indirect taxes, such as VAT
- Withholding taxes that may apply upon transfer

The bottom line is this: The tax and accounting rules surrounding digital assets are still evolving. This evolution is occurring

simultaneously around the world but with inconsistent conclusions being reached across jurisdictions.

Wallets are typically structured according to the different cost bases at which the digital assets were acquired. Differentials can be set by a range of dollar-denominated cost basis (say, at \$100 or \$1,000), or a new wallet can be created every time a new tranche is purchased.



Controls, governance risk, and compliance

Risk and controls are at the very foundation of any investment project in digital assets. Let's quickly review the main areas that should be on the radar.

Risks unique to each digital asset

The risks underlying digital assets, including crypto, vary considerably. Consequently, companies should conduct rigorous due diligence about how the given asset or coin operates and related market vulnerabilities, as well as terms and conditions. From a technical perspective, companies should understand the blockchain supporting each asset and how the associated governance system works, as this may have a direct bearing on the resilience of the coin system. This can also help to identify the types of events for which companies should be monitoring. For example, the computer code that enables the bitcoin network to process transactions is fundamentally different from the Ethereum code base. Further, as many blockchains enable extensibility in the form of smart contracts (e.g., ERC-20 tokens), mechanisms that allow for the taking of unilateral actions can have a negative impact on the holder of the assets. Other instances where assets can be lost include proof-of-stake blockchains, where assets can be "slashed" for violating network rules. That will result in a reduction of the amount of assets held in a given address. A full appreciation of the technical and business risks associated with each digital asset, and their dimensions, may warrant the assistance of third-party technical help and evaluation.

Custody

Custody raises a number of important questions. Will the company custody the asset itself, or will it rely on third-party vendors? Self-custody may provide easy access to the assets, but it also presents additional risk in terms of accidental loss, transaction authorization, and transaction monitoring and recording. Given the inherent complexity and risk associated with self-custody, more and more companies are resorting to third-party custodians. Then it's a matter of evaluating the strengths and weaknesses of different custody processes and procedures. If the company chooses to

rely on an exchange or custodian to store its digital assets, careful consideration of a large number of potential risk issues and questions is in order. Some of these include:

- How does the third-party exchange or custodian secure private key material?
- Can the company trust the accuracy of account statements furnished by the third-party vendor?
- What plans are in place in the event of a liquidation of the custodial services?
- How does the exchange handle market anomalies, such as flash crashes?
- What is the vendor's hard-fork policy in supporting new digital assets?
- What occurs if private keys and passwords are lost or stolen?

A great way to start addressing these potential issues would be to obtain and review the SOC 1 and/or SOC 2 reports of any potential exchange or custodian.

The recent collapse of a high-profile crypto exchange highlights the importance of conducting rigorous due diligence in terms of counterparty risk, how a given digital asset or coin operates, and related market vulnerabilities. A robust third-party risk management process would likely have identified the exchange's lack of a service organization controls (SOC) report, apparent absence of insurance, receipt of cease-and-desist letters from the [FDIC](#), and the fact that the entity parent was domiciled in a lower-regulation jurisdiction. Such indicators as these can inform the relative level of risk in engaging with a given entity. And in this instance, they would likely have resulted in corporates choosing alternative exchanges.



Authorization risks

Authorizing and executing transactions and transfers (such as the cross-border transfers to subsidiaries and/or loans made to related parties) may well create a host of risks. That's why it is vital for companies to segregate duties in such a way that there is a clear chain of command and documentation regarding who has custody of the assets, the ability to authorize their usage, and responsibility for the recordkeeping of those assets. In the recent market events surrounding the collapse of certain digital asset platforms, it has come to light that there were issues in terms of segregation of duties around authorization of transactions, recordkeeping, and safeguarding of assets.⁴ Mature organizations likely have the necessary controls in place to prevent unauthorized transactions from being broadcast to the public blockchain. Further, it may be common for automated recordkeeping and monitoring to be performed to ensure that the business is not assuming risks beyond its designated risk appetite. There are also third-party tailored custodial solutions that employ, among other devices, automatic alerts—that transactions were, in fact, authorized. Given that there is no FDIC insurance for digital asset holdings, it's important that a company ensures its holdings are segregated from other participants rather than being part of a commingled account in an omnibus fashion and that the custodian carries adequate insurance. That can become very important if an exchange or custodian suddenly goes offline for a time or ultimately fails.

Regulatory compliance

It's important that the company be able to ascertain that the exchange or custodian in question is abiding by all appropriate laws and regulations. Items on the regulatory radar for exchanges and custodians include, among others, compliance with all anti-money-laundering and know-your-customer regulations, measures related to counterterrorism, and rules set by the Office of Foreign Assets Control. As with crypto accounting and tax, the rules and regulations vary by jurisdiction. Hence, to help ensure compliance, it would be wise to seek advice from informed legal counsel.

“Since MicroStrategy launched our digital asset treasury strategy in 2020, the Bitcoin asset class and the community supporting it has continued to grow and mature with further adoption from large sophisticated financial institutions and support from accounting, tax, and legal specialists. We find it to be auspicious that further regulatory clarity, including the expected finalization of fair value accounting rules for digital assets by the Financial Accounting Standards Board could help enable further adoption and support from large institutional and retail investors. These advancements along with additional use cases developed through layer 2 technologies, such as the Lightning network, we believe will further propel bitcoin's importance as a form of digital energy and long-term store of value.”

—Andrew Kang, CFO, MicroStrategy Inc.



Conclusion

Monitoring regulatory and standard-setting changes while realigning for success

As market events and ongoing discussions about regulation and standard setting animate the digital asset ecosystem, it's imperative that corporations investing in these digital assets devote the resources, time, and attention to monitoring the evolving situation. At the same time, they should continue to engage in the necessary transformation of their organization so that, when new regulations and standards are announced, they can pivot to understand their implications and implement their rules.

Any sizable investment in digital assets presents more than just technical or regulatory issues related to treasury, accounting, reporting, tax, and controls. It also involves a significant cultural realignment—internal and external—among the many different groups and departments, including but not limited to the board of directors, the audit committee, risk, corporate reporting, finance, tax, internal audit, operations, controls, technology, and investor relations. Since many of these departments interact with external parties, such as the external auditor, tax, and legal counsel, etc., it is vital that there be a corresponding realignment in thinking when dealing with these external groups.

What does that realignment entail? Typically, the various functions and departments of a company establish procedures and assumptions for collaborating across and outside the organization based on normal-course, well-understood transactions. The terrain of digital assets is still a new frontier of possibilities, so it requires that each corporate department and its external party rethink the application of the rules and policies of its core competency and align

with current and anticipated rules and standards when they are announced. Few of the norms associated with legacy investments in securities, fiat currency, or treasuries may apply. Once each group gains a level of comfort with the application of the evolving rules and standards to digital assets, they then should actively listen to one another, gain an understanding of the sensitivities, evaluate any operational or technical dependencies, and, finally, rethink how they collaborate and tackle challenges together.

Many more operating companies are beginning to evaluate the potential benefits of investing in digital assets like bitcoin. And as their cumulative experience grows and sparks further interest, the more likely strategic investments in digital assets are to become more routine realities. That said, companies should have the right risk measures in place, as well as the right risk tolerance levels, for it to be worthwhile to pursue this type of investment. The realities facing operating companies interested in investing in such assets are complex and ever in flux. But they can be navigable with the right level of commitment from all departments and external parties. And with appropriate attention to issues of rules and standards as well as process, procedures, and risk all along the decision spectrum, digital assets can offer innovative, bold, and dynamic alternatives to traditional investments.

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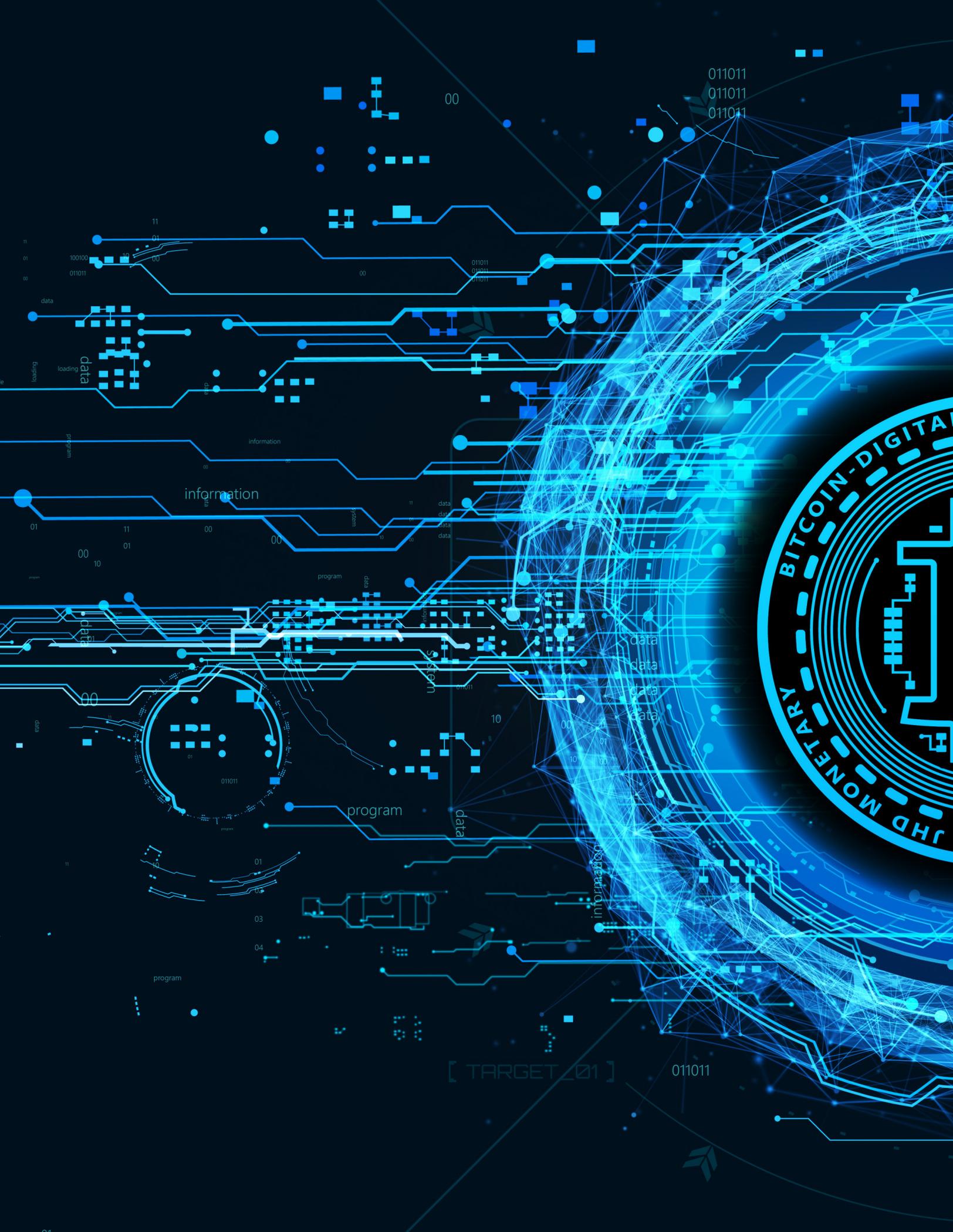


Endnotes

1. Microstrategy Inc., "[MicroStrategy announces over \\$1B in total bitcoin purchases in 2020](#)," press release, December 21, 2020.
2. That assumes that the company is not required to apply specialized industry guidance, such as the guidance in ASC 946 Financial Services – Investment Companies.
3. International Accounting Standards Board (IASB), "[Third Agenda Consultation Feedback Statement](#)," July 2022; IASB, "[IASB Update](#)," April 2022.
4. House Financial Services Committee, "[Testimony of Mr. John J. Ray III, CEO, FTX Debtors](#)," December 13, 2022.

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