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To the Point

FASB — proposed guidance

FASB proposes initial measurement guidance for paid-in-kind dividends on equity-classified preferred stock

The proposal would reduce complexity and enhance the comparability of financial reporting information for entities that issue PIK dividends on equity-classified preferred stock.

What you need to know

- The FASB proposed requiring entities to initially measure paid-in-kind (PIK) dividends on equity-classified preferred stock using the PIK dividend rate stated in the preferred stock agreement.
- The proposal would apply to preferred stock classified as either permanent or temporary equity.
- Entities would apply the guidance either prospectively to PIK dividends recognized on preferred stock on or after the effective date or on a modified retrospective basis for PIK dividends on preferred stock that is outstanding as of the initial application date. Early adoption would be permitted.
- Comments are due by 27 October 2025.

Overview

The Financial Accounting Standard Board (FASB or Board) proposed **amendments** to Accounting Standards Codification (ASC) 505, *Equity*, that would require entities to initially measure PIK dividends on equity-classified preferred stock using the PIK dividend rate stated in the preferred stock agreement. The proposal would apply to equity-classified preferred stock, including preferred stock classified as temporary equity under ASC 480-10-S99-3A.[1]

Issuers typically satisfy PIK dividends by issuing additional preferred stock with the same terms as the original preferred stock or by increasing the value of the original preferred stock in accordance with the preferred stock agreement (e.g., by increasing the original preferred stock's liquidation value).

The proposal, which is based on a recommendation of the Emerging Issues Task Force, is intended to address stakeholder concerns about the lack of authoritative guidance on how an issuer should initially measure PIK dividends on equity-classified preferred stock. The proposal would provide guidance on how to initially measure these dividends, but not on when to recognize them.

Stakeholders have observed that issuers use different methods to measure PIK dividends on equity-classified preferred stock, including:

- At the fair value of the additional preferred stock issuable on the date the dividends are recognized
- At the stated PIK dividend rate, in accordance with the terms of the preferred stock agreement
- At fair value or the stated PIK dividend rate, depending on whether the PIK dividend is discretionary or nondiscretionary

This diversity in practice affects the measurement of equity-classified preferred stock presented in the statement of financial position and, for entities that report earnings per share, the amount of income available to common shareholders. This diversity also reduces the comparability of financial reporting information for entities that issue these dividends.

Key considerations

The proposal would apply to convertible and nonconvertible equity-classified preferred stock, including preferred stock that is classified as temporary equity. However, it is not intended to modify the subsequent measurement of PIK dividends on preferred stock that is classified as temporary equity.

Entities would be required to initially measure PIK dividends on equity-classified preferred stock using the PIK dividend rate stated in the preferred stock agreement. For example, if the agreement specifies that PIK dividends are calculated by multiplying the PIK dividend rate by the liquidation value of the outstanding preferred stock, the entity would measure the PIK dividend at that amount. When preferred stock is not issued at a discount or premium, the liquidation value is generally the stock's original issue price.

The scope of the proposed amendments would be limited to equity-classified preferred stock that meet the following conditions:

- Dividends are satisfied by (1) delivering additional preferred stock to the holder that has the same terms as the original preferred stock or (2) increasing the value of the original preferred stock.
- The monetary value of the PIK dividends varies based on the additional preferred stock issued. The amendments would not apply if the issuer satisfies its dividend obligations by issuing a variable number of shares of the preferred stock for a fixed monetary amount.

The proposal would not apply to (1) preferred stock classified as a liability under ASC 480, *Distinguishing Liabilities from Equity*, (2) dividends on preferred stock payable in equity securities with terms that are different from the original preferred stock (e.g., dividends on preferred stock payable in shares of common stock), (3) nonmonetary distributions of assets accounted for under ASC 845, *Nonmonetary Transactions*, or (4) separate transactions that would represent a deemed dividend (e.g., certain redemptions of preferred stock).

How we see it

The proposal would require a single measurement approach that is expected to enhance comparability across reporting entities and improve the decision usefulness of information provided to investors. The proposal is also expected to reduce complexity, eliminating the need for judgmental estimates, since the issuer would have all the necessary information in the preferred stock agreement to measure the PIK dividend amount.

Effective date and transition

The FASB will determine the effective date after it considers feedback on the proposal.

Entities would have the option to apply the guidance either (1) prospectively to PIK dividends recognized on equity-classified preferred stock on or after the effective date (i.e., regardless of whether the preferred stock was issued before or after the initial application date) or (2) on a modified retrospective basis by recognizing a cumulative-effect adjustment to retained earnings (or other appropriate components of equity) as of the beginning of the earliest period presented. The modified retrospective approach would apply to PIK dividends on preferred stock outstanding as of the effective date.

Early adoption would be permitted in both interim and annual financial statements that have not yet been issued or made available for issuance. An entity that adopts the guidance in an interim period would be required to do so as of the beginning of the fiscal year that includes that interim period.

Transition disclosures

Entities would be required to disclose in both the interim period (if applicable) and the annual reporting period of initial application (1) the nature of the change in accounting principle, including an explanation of the newly adopted accounting principle, and (2) the method used to apply the change.

Under the modified retrospective approach, entities would also disclose the cumulative effect of the change on retained earnings or other components of equity in the statement of financial position as of the beginning of the earliest period presented. In addition, they would disclose the effect of the change on income available to common shareholders (or other appropriate line items of changes in the applicable performance indicator), any other affected financial statement line items, and any affected per-share amounts for the current reporting period and any prior reporting periods that were retrospectively adjusted.

Endnotes:

[1] ASC 480-10-S99-3A — Distinguishing Liabilities from Equity — *SEC Staff Announcement: Classification and Measurement of Redeemable Securities.*