FASB ACCOUNTING STANDARDS UPDATE

No. 2026-01
April 2026

Equity (Topic 505)

Initial Measurement of Paid-in-Kind Dividends on Equity-Classified Preferred Stock

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

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Financial Accounting Standards Board
801 Main Avenue ▪ Norwalk, CT ▪ 06851

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The Board is issuing this Update to provide authoritative guidance on how an issuer should initially measure paid-in-kind (PIK) dividends on equity-classified preferred stock. The amendments do not affect an entity's determination of *when* to recognize PIK dividends.

Stakeholders expressed concerns that current generally accepted accounting principles (GAAP) do not address how an issuer should initially measure PIK dividends on equity-classified preferred stock. As a result, there is diversity in practice, which affects the measurement of the equity-classified preferred stock presented on the statement of financial position and, for entities that report earnings per share, the amount of income available to common shareholders. Stakeholders noted that the diversity in practice reduces comparability of financial reporting information among entities that issue PIK dividends on equity-classified preferred stock.

To address stakeholders' concerns, the amendments in this Update provide authoritative guidance on how to initially measure PIK dividends on equity-classified preferred stock.

Who Is Affected by the Amendments in This Update?

The amendments in this Update apply to all entities that issue PIK dividends on equity-classified preferred stock.

What Are the Main Provisions, How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP), and Why Are They an Improvement?

The amendments in this Update require that PIK dividends on equity-classified preferred stock be initially measured on the basis of the PIK dividend rate stated in the preferred stock agreement. For example, if the preferred stock agreement specifies that PIK dividends are calculated by multiplying the PIK dividend rate by the liquidation value of the preferred stock outstanding, an entity should initially measure the PIK dividend at that amount. The liquidation value (or liquidation preference) of the preferred stock is typically defined by the preferred stock agreement and specifies the value of the preferred stock upon the occurrence of a liquidation event (such as the entity becoming insolvent). When preferred stock is not issued at a discount or premium, the liquidation value upon initial issuance is typically the same as the original issuance price of the preferred stock.

The amendments in this Update improve GAAP by providing authoritative guidance for the initial measurement of PIK dividends on equity-classified preferred stock. Specifically, the amendments improve the decision usefulness of the financial reporting information provided to investors by (1) enhancing the comparability of financial information reported among entities that issue PIK dividends on equity-classified preferred stock and (2) providing additional information about the liquidation value of the preferred stock, which helps investors to understand the amount and preference of relative claims on an entity. The amendments also provide clear, cost-effective guidance that will reduce complexity.

When Will the Amendments Be Effective and What Are the Transition Requirements?

The amendments in this Update are effective for all entities for annual reporting periods beginning after December 15, 2026, and interim reporting periods within those annual reporting periods. Early adoption is permitted in an interim or annual reporting period in which financial statements have not yet been issued or made available for issuance. An entity adopting the amendments in an interim reporting period should apply them as of the beginning of the annual reporting period that includes that interim reporting period.

An entity is permitted to apply the amendments in this Update either (1) on a prospective basis or (2) on a modified retrospective basis for equity-classified preferred stock instruments that are outstanding as of the initial application date.

Under the prospective transition approach, an issuer should apply the amendments in this Update to PIK dividends recognized on equity-classified preferred stock instruments on or after the initial application date.

Under the modified retrospective transition approach, an issuer should recast prior reporting periods presented and recognize a cumulative-effect adjustment to equity as of the beginning of the earliest period presented related to previously issued PIK dividends recognized on equity-classified preferred stock that is outstanding as of the initial application date.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–4. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>.

Amendments to Subtopic 505-10

2. Amend paragraph 505-10-15-2 and add paragraphs 505-10-15-3 through 15-4 and 505-10-30-1 and their related headings, with a link to transition paragraph 505-10-65-1, as follows:

[Note: The definition of preferred stock is shown for convenience.]

Preferred Stock

A security that has preferential rights compared to common stock.

Equity—Overall

Scope and Scope Exceptions

> Entities

505-10-15-1 The guidance in this Subtopic applies to all entities, unless more specific guidance is provided in other Topics.

> Instruments

505-10-15-2 The guidance in this Subtopic applies to all of the following instruments and activities:

a. Transactions in an entity's own common stock
b. Receivables related to the issuance of equity interests and the appropriation of retained earnings

c. Subparagraph superseded by Accounting Standards Update No. 2020-06.
d. Convertible preferred stock, unless the guidance in other Subtopics (such as Subtopic 470-20 on debt with conversion and other options or 480-10 on distinguishing liabilities from equity) requires that the convertible preferred stock be classified as a liability. The relevant guidance in this Subtopic shall be considered after an issuer's determination under Subtopic 815-15 on embedded derivatives of whether an embedded conversion option or other embedded feature in convertible preferred stock should be accounted for separately as a derivative instrument (see paragraph 815-15-55-76B). The guidance in this Subtopic does not apply to convertible preferred stock that is issued as awards to a grantee in exchange for goods or services received (or to be received) that are within the scope of Topic 718 on stock compensation unless the instrument is modified in accordance with and no longer subject to the guidance in that Topic.
e. Paid-in-kind dividends on **preferred stock** (see paragraph 505-10-15-3). The guidance on paid-in-kind dividends on preferred stock applies to preferred stock classified as equity, including preferred stock that is classified as temporary equity in accordance with SEC Staff Announcement, Classification and Measurement of Redeemable Securities (see paragraph 480-10-S99-3A).

> Paid-in-Kind Dividends on Preferred Stock

505-10-15-3 Paid-in-kind dividends are dividends that an issuer satisfies by either:

a. Delivering to the holder additional preferred stock with the same terms as the original preferred stock
b. Increasing the value of the original preferred stock in accordance with the preferred stock agreement (for example, by increasing the original preferred stock's liquidation value).

An entity shall apply the guidance in paragraph 505-10-30-1 on paid-in-kind dividends on preferred stock when the monetary value of the paid-in-kind dividends varies on the basis of the additional preferred stock issued or the increase in the original preferred stock's liquidation value.

505-10-15-4 The guidance in paragraph 505-10-30-1 shall not apply if:

a. The issuer satisfies the dividend obligation by issuing a variable number of shares of the same preferred stock instrument that has a fixed monetary value. For example, a dividend obligation of $1,000 satisfied by delivering a variable number of shares with a current fair value of $1,000 to preferred shareholders would not be within the scope of the guidance in paragraph 505-10-15-2(e).
b. The transaction represents a deemed dividend (for example, certain redemptions of preferred stock).

Initial Measurement

General

> Paid-in-Kind Dividends on Preferred Stock

505-10-30-1 Paid-in-kind dividends on **preferred stock** issued to preferred shareholders shall be initially measured on the basis of the paid-in-kind dividend rate stated in the preferred stock agreement. For example, if the preferred stock agreement specifies that paid-in-kind dividends are calculated by multiplying the paid-in-kind dividend rate by the liquidation value of the preferred stock outstanding, an entity should measure the paid-in-kind dividend at that amount.

3. Add paragraph 505-10-65-1 and its related headings as follows:

Transition and Open Effective Date Information

General

> Transition Related to Accounting Standards Update No. 2026-01, *Equity (Topic 505): Initial Measurement of Paid-in-Kind Dividends on Equity-Classified Preferred Stock*

505-10-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2026-01, *Equity (Topic 505): Initial Measurement of Paid-in-Kind Dividends on Equity-Classified Preferred Stock*:

Effective date and early adoption

a. All entities shall apply the pending content that links to this paragraph for annual reporting periods beginning after December 15, 2026, and interim reporting periods within those annual reporting periods.
b. Early adoption of the pending content that links to this paragraph is permitted in an interim or annual reporting period in which the financial statements have not yet been issued or made available for issuance. If an entity adopts the pending content that links to this paragraph in an interim reporting period, it shall apply the pending content as of the beginning of the annual reporting period that includes that interim reporting period.

Transition method

c. An entity shall apply the pending content that links to this paragraph using either of the following transition methods:
   1. On a prospective basis to paid-in-kind dividends recognized on preferred stock on or after the initial application date of the pending content that links to this paragraph.
   2. On a modified retrospective basis through a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity) as of the beginning of the earliest period presented. Under this transition method, an entity shall apply the pending content that links to this paragraph to paid-in-kind dividends recognized on preferred stock that is outstanding as of the initial application date of the pending content.

Transition disclosures

d. An entity that applies the pending content that links to this paragraph prospectively in accordance with (c)(1) shall provide the following transition disclosures in the financial statements of both the interim reporting period (if applicable) and the annual reporting period in which the pending content is applied:
   1. The nature of the change in accounting principle, including an explanation of the newly adopted accounting principle
   2. The method of applying the change.
e. An entity that applies the pending content that links to this paragraph on a modified retrospective basis in accordance with (c)(2) shall provide the following transition disclosures in the financial statements of both the

interim reporting period (if applicable) and the annual reporting period in which the pending content is applied:

1. The nature of the change in accounting principle, including an explanation of the newly adopted accounting principle
2. The method of applying the change
3. 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
4. The effect of the change on income available to common shareholders, any other affected financial statement line items, and any affected per-share amounts for the current reporting period and any prior reporting periods retrospectively adjusted.

Amendments to Status Sections

4. Amend paragraph 505-10-00-1, by adding the following items to the table, as follows:

505-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	**Action**	**Accounting Standards Update**	**Date**
505-10-15-2	Amended	2026-01	04/23/2026
505-10-15-3	Added	2026-01	04/23/2026
505-10-15-4	Added	2026-01	04/23/2026
505-10-30-1	Added	2026-01	04/23/2026
505-10-65-1	Added	2026-01	04/23/2026

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Richard R. Jones, *Chair*
Hillary H. Salo, *Vice Chair*
Christine A. Botosan
Frederick L. Cannon
Susan M. Cosper
Marsha L. Hunt
Dr. Joyce T. Joseph

Background Information and Basis for Conclusions

Introduction

BC1. The Emerging Issues Task Force (EITF) Agenda Committee added a project to the EITF's agenda to address the initial measurement of PIK dividends issued on equity-classified preferred stock. Stakeholders noted that the lack of authoritative guidance for how an issuer initially measures PIK dividends on equity-classified preferred stock has resulted in diversity in practice.

BC2. The EITF discussed the issue, developed a proposed solution, and recommended that the Board add a project to its technical agenda to add guidance to Topic 505, Equity. The EITF recommended that PIK dividends on equity-classified preferred stock be initially measured on the basis of the PIK dividend rate stated in the preferred stock agreement. For example, if the preferred stock agreement specifies that PIK dividends are calculated by multiplying the PIK dividend rate by the liquidation value of the preferred stock outstanding, an entity should initially measure the PIK dividend at that amount. The liquidation value (or liquidation preference) of the preferred stock is typically defined by the preferred stock agreement and specifies the value of the preferred stock upon the occurrence of a liquidation event (such as the entity becoming insolvent). When preferred stock is not issued at a discount or premium, the liquidation value upon initial issuance is typically the same as the original issuance price of the preferred stock.

BC3. The Board added a narrow-scope project to its agenda on April 30, 2025, to address stakeholder feedback related to how an issuer should initially measure PIK dividends on equity-classified preferred stock.

BC4. On September 30, 2025, the Board issued the proposed Accounting Standards Update, *Equity (Topic 505): Initial Measurement of Paid-in-Kind Dividends on Equity-Classified Preferred Stock*, for public comment with the comment period ending on October 27, 2025. The Board received nine comment letters in response to the amendments in the proposed Update. Outreach also was conducted with investors and the Private Company Council. Overwhelmingly, stakeholders expressed support for the proposed amendments, noting that they (a) would enhance the comparability of financial statements across entities that issue PIK dividends on equity-classified preferred stock, (b) would provide additional information about the liquidation value of the preferred stock, and (c) were operable and auditable.

BC5. The following summarizes the EITF's considerations in reaching its recommendation, the Board's considerations of stakeholder feedback during redeliberations, and conclusions reached by the Board in support of the amendments. Individual Board members gave greater weight to some factors than to others.

Background Information

BC6. Preferred stock is typically classified in equity and represents ownership interests like common stock. It provides preferential rights to cash flows before the rights of common shareholders. Preferred stock with stated, cumulative dividends that accumulate regardless of whether they are declared is similar to certain debt instruments that pay interest and principal in accordance with a fixed payment schedule, although not all preferred stock includes these rights.

BC7. Issuers may satisfy PIK dividend obligations on preferred stock either by delivering to the holder 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 (for example, by increasing the original preferred stock's liquidation value).

BC8. Current GAAP does not provide specific authoritative guidance on how to initially measure PIK dividends on equity-classified preferred stock, which resulted in diversity in how PIK dividends are initially measured. Stakeholders observed that issuers measure PIK dividends on equity-classified preferred stock using various practices, such as:

a. At the fair value of the additional preferred stock issuable on the date that dividends are recognized
b. At the stated PIK dividend rate of the preferred stock calculated in accordance with the terms of the preferred stock agreement
c. At the fair value of the additional preferred stock issuable on the date that dividends are recognized or the stated PIK dividend rate depending on whether the PIK dividend is discretionary or nondiscretionary.

Benefits and Costs

BC9. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the benefits and costs of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC10. In the Board's view, the amendments in this Update will improve the decision usefulness of financial reporting information provided to investors by (a) enhancing the comparability of financial information reported among entities that issue PIK dividends on equity-classified preferred stock and (b) providing additional information about the liquidation value of the preferred stock, which helps investors to understand the amount and preference of relative claims on an entity. The amendments also provide clear, cost-effective guidance that will reduce complexity.

BC11. On the basis of the EITF's discussions and stakeholder feedback received on the amendments in the proposed Update, the Board concluded that entities will not incur significant costs to implement the amendments in this Update because the initial measurement method is objective and straightforward to apply. The initial measurement method does not require an entity to estimate the fair value of the PIK dividends on equity-classified preferred stock or to determine whether the PIK dividends are discretionary, which can be judgmental. In addition, issuers should already have the necessary information to initially measure the PIK dividend payment because it is based on the terms of the preferred stock agreement. As such, entities will not need to engage valuation specialists to calculate the value of a PIK dividend payment.

BC12. Stakeholders that provided feedback on the amendments in the proposed Update did not express concerns about the costs to implement them, and several indicated that the implementation costs were not expected to be significant. Additionally, stakeholders noted that some entities currently initially measure PIK dividends in accordance with the amendments in this Update, and, therefore, adoption costs would be negligible for those entities. Furthermore, comment letter respondents noted that because initial measurement guidance will be more objective, the amendments are expected to reduce audit complexity. For those reasons, the Board concluded that the expected benefits of the amendments in this Update justify the expected costs. The Board's specific considerations about the benefits and costs of the amendments are further discussed in the sections below.

Basis for Conclusions

BC13. The amendments in this Update require that PIK dividends on equity-classified preferred stock be initially measured on the basis of the PIK dividend rate stated in the preferred stock agreement. The amendments do not affect an entity's determination of *when* to recognize PIK dividends.

Scope

BC14. The guidance in Topic 505 applies to all entities. The amendments in this Update apply to all entities, although EITF members noted that it is more common for private companies to issue preferred stock with PIK dividend payment features. As such, in the proposed Update, the Board agreed with the EITF recommendation to apply the guidance to all entities. Stakeholders that provided feedback on the amendments in the proposed Update supported the guidance applying to all entities, and, therefore, the Board affirmed the application of the amendments to all entities during redeliberations.

BC15. The amendments in this Update apply to equity-classified preferred stock (whether convertible or nonconvertible), which includes preferred stock that is classified as temporary equity in accordance with SEC Staff Announcement, Classification and Measurement of Redeemable Securities (see paragraph 480-10-S99-3A). The amendments, which focus on initial measurement, are not intended to modify the subsequent measurement of PIK dividends applicable to preferred stock instruments classified as temporary equity under that SEC guidance.

BC16. In the proposed Update, the EITF recommended and the Board agreed to limit the scope of the proposed amendments to equity-classified preferred stock when specific conditions are met. Comment letter respondents supported the limited scope, and the Board affirmed that scope during redeliberations. Accordingly, the amendments in this Update apply to PIK dividends on equity-classified preferred stock issued to satisfy dividend obligations when the following conditions are met:

a. Additional preferred stock is issued to the holder with the same terms as the original preferred stock or with an increase in the value of the original preferred stock in accordance with the preferred stock agreement.
b. The monetary value of the PIK dividends varies on the basis of the additional preferred stock issued to preferred shareholders with the same terms as the original preferred stock or with an increase in the original preferred stock's liquidation value. However, the guidance does not apply if the issuer satisfies the dividend obligation by issuing a variable number of shares of the same preferred stock instrument that has a fixed monetary value. For example, a dividend obligation of $1,000 satisfied by delivering a variable number of shares with a current fair value of $1,000 to preferred shareholders would not be within the scope of the amendments.

BC17. The amendments in this Update apply to dividends as defined by the preferred stock agreement between an entity and its preferred shareholders and do not relate to separate transactions that an entity has determined would represent a deemed dividend (for example, certain redemptions of preferred stock). The EITF recommended and the Board agreed that (a) dividends on preferred stock that are payable in equity securities that have terms that differ from the original preferred stock instrument (for example, dividends on preferred stock payable in shares of common stock) and (b) nonmonetary distributions of assets accounted for under Topic 845, Nonmonetary Transactions, are not included in the scope of this Update. The amendments also do not apply to preferred stock that is classified as a liability in accordance with Topic 480, Distinguishing Liabilities from Equity. Comment letter respondents agreed with the scope, and the Board affirmed the scope during redeliberations.

Initial Measurement

BC18. EITF members considered the following methods to measure PIK dividends on equity-classified preferred stock:

a. The PIK dividend rate stated in the preferred stock agreement
b. Fair value
c. An effective interest rate method to determine the implicit yield
d. Fair value (if the PIK dividends are discretionary) or the PIK dividend rate stated in the preferred stock agreement (if they are nondiscretionary).

BC19. EITF members recommended to the Board that PIK dividends on equity-classified preferred stock be initially measured on the basis of the PIK dividend rate stated in the preferred stock agreement. For entities that report earnings per share in accordance with Topic 260, Earnings Per Share, the amount at which the PIK dividends on equity-classified preferred stock are required to be initially measured under the amendments in this Update is the same amount used to reduce income available to common shareholders in the earnings-per-share calculation.

BC20. The EITF recommended this initial measurement method because it is objective, straightforward to apply, and less costly than the other alternatives considered. Requiring that PIK dividends on equity-classified preferred stock be initially measured on the basis of the PIK dividend rate stated in the preferred stock agreement provides a single, consistent measurement approach that enhances comparability across reporting entities and periods. This measurement method is objective because an issuer will have the necessary information in the preferred stock agreement to measure the PIK dividend amount without the need to make subjective estimates. Some of the other alternatives considered by the EITF, such as initially measuring PIK dividends using an effective interest rate method or requiring separate measurement methods for discretionary and nondiscretionary dividends, would have required that an entity make more complex judgments or perform challenging calculations to initially measure the PIK dividends and could have resulted in inconsistent application in practice. In addition, the EITF noted that determining the fair value of each issuance of PIK dividends would have been costly and complex, especially when the fair value of the preferred stock is not readily determinable (for example, when the preferred stock is issued by a private company). The EITF's recommended measurement method does not require that entities incur additional costs to estimate fair value, including engaging valuation specialists.

BC21. Furthermore, the EITF observed that the terms of preferred stock agreements often require that PIK dividends on equity-classified preferred stock be calculated on the basis of the liquidation value of the preferred stock. Certain EITF members supported a measurement method based on the stated PIK dividend rate because information on the liquidation value of preferred stock is decision useful for investors, especially since certain entities that issue PIK dividends on equity-classified preferred stock may not be able to pay cash dividends. That information helps investors to understand the obligations of an entity in the event of a liquidation.

BC22. The EITF observed that, under certain other alternatives that it considered, the value of preferred stock on the balance sheet would not reflect the liquidation value of the preferred stock (for example, if the PIK dividends on equity-classified preferred stock were measured at fair value). Under the amendments in this Update, the balance sheet amount will provide investors with information about the amount and priority of the preferred shareholders' claims. Some EITF members stated that they did not view a PIK dividend on equity-classified preferred stock as analogous to a stock dividend on common stock, which is accounted for at fair value in accordance with Subtopic 505-20, Equity—Stock Dividends and Stock Splits.

BC23. During initial deliberations, the Board agreed with the EITF's recommendation that PIK dividends on equity-classified preferred stock should be measured on the basis of the PIK dividend rate stated in the preferred stock agreement. The Board also agreed with the EITF that this measurement method should provide clear, cost-effective guidance that reduces complexity and diversity in practice, while providing decision-useful information to investors.

BC24. Stakeholders, including investors, that provided feedback on the amendments in the proposed Update noted that initially measuring PIK dividends on equity-classified preferred stock on the basis of the PIK dividend rate stated in the preferred stock agreement would reduce complexities since the necessary information is available and does not require subjective estimates. Stakeholders also noted that this measurement approach would be preferable to a fair value measurement alternative because it is more objective. During redeliberations, the Board affirmed its decision to require that PIK dividends on equity-classified preferred stock be initially measured on the basis of the PIK dividend rate stated in the preferred stock agreement.

Other Measurement Methods Considered but Not Recommended

Fair value

BC25. Under the fair value method considered by the EITF, PIK dividends on equity-classified preferred stock would be measured using the guidance in Topic 820, Fair Value Measurement. One EITF member, a financial statement user, supported this alternative and indicated that fair value measurement best reflects the economics of PIK dividend payments because it would best reflect the economic decision being made by the issuer (holder) to issue (receive) additional preferred stock rather than cash when dividends are discretionary. For example, when the issuer (holder) can elect for dividends on preferred stock to be either PIK or paid in cash, the issuer (holder) would generally elect PIK dividends on equity-classified preferred stock when the fair value of such stock is less (greater) than the cash value of the dividends. In addition, that EITF member noted that measurement methods other than fair value would not capture fluctuations in the value of the preferred stock instrument between its original issuance date and the date that a preferred stock PIK dividend was recognized.

BC26. Another EITF member noted that, in certain cases, the fair value of the PIK dividends may be different from the liquidation value and therefore may not provide meaningful information to investors (especially when the fair value is lower than the liquidation value) because it would not reflect the preferred shareholders’ claim on the entity. For example, the fair value of PIK dividends on equity-classified preferred stock could be lower than the liquidation value for private companies or early stage public companies with limited cash on hand. In those cases, the liquidation value of the PIK dividends may provide more decision-useful information to investors.

BC27. Some EITF members also expressed concerns about the potential cost of requiring an entity to determine the fair value of preferred stock instruments that are not publicly traded each time a PIK dividend is recognized. The EITF observed that preferred stock with PIK dividend rights is often issued by private companies. Because those preferred stock instruments typically do not have observable prices, estimating fair value would require significant judgment and may require the use of valuation specialists each time an issuer makes a PIK dividend payment.

BC28. EITF members considered whether PIK dividends on equity-classified preferred stock should be accounted for in the same way as a stock dividend on common stock (that is, at fair value in accordance with Subtopic 505-20). However, those EITF members had concerns that the expected cost of measuring PIK dividends on equity-classified preferred stock at fair value would exceed the expected benefits, especially for private companies.

BC29. The EITF considered a fair value measurement alternative that an issuer could apply if there were no observable orderly transactions (similar to the existing measurement alternative for the subsequent measurement of equity securities under Topic 321, Investments—Equity Securities). The EITF expressed concerns with this alternative, including that (a) it could be challenging to determine when the measurement alternative would be permitted (for example, whether there are observable transactions and whether those transactions are orderly) and (b) there could be a lack of consistency in measuring PIK dividends on equity-classified preferred stock over time depending on whether observable transactions have recently occurred.

BC30. Stakeholders, including investors, that provided feedback on the amendments in the proposed Update noted that fair value measurement would (a) introduce greater subjectivity, (b) increase cost and complexity, especially for private companies whose preferred stock is often thinly traded, and (c) decrease the predictability of estimating income available to common shareholders when PIK dividends are issued.

Effective interest rate method

BC31. The EITF considered an alternative that would have required recognizing PIK dividends on equity-classified preferred stock using an effective interest rate method to determine the implicit yield in the preferred stock by analogizing to Subtopic 835-30, Interest—Imputation of Interest. This approach would have resulted in the same measurement outcome as in the amendments in this Update except for situations in which the preferred stock is initially recorded at a discount. However, EITF members did not recommend requiring that PIK dividends on equity-classified preferred stock be measured using an effective interest method because (a) the perpetual nature of some preferred stock would make it difficult to calculate the implicit yield, (b) it would be inconsistent with the accounting for dividends on preferred stock that are paid in cash, and (c) it would be more complex to apply and less understandable than the amendments.

Separate measurement methods for discretionary and nondiscretionary dividends

BC32. Another alternative discussed by the EITF would have required applying different measurement methods to PIK dividends on equity-classified preferred stock depending on whether the issuer (holder) (a) had the option to issue preferred stock dividends either in cash or in kind (that is, the payment of the PIK dividend is discretionary) or (b) must pay the dividends in kind (that is, the payment of PIK dividends is nondiscretionary). Under this alternative, discretionary dividends would be measured at fair value, and nondiscretionary dividends would be measured at the stated PIK dividend rate. For discretionary dividends, EITF members had concerns similar to those described in paragraph BC27 about the cost of measuring PIK dividends at fair value. In addition, EITF members expressed concern that determining whether a PIK dividend payment is discretionary or nondiscretionary can be judgmental and complex and discussed examples of common fact patterns where significant judgment may be required. For example, an issuer may be allowed to pay dividends in kind only during the first three years after issuing the preferred stock instrument and would be required to pay dividends in cash for the remaining life of the instrument. As another example, an issuer may be required to pay dividends in kind unless it raises a specified amount in a future financing transaction. In addition, one EITF member indicated that even when an issuer has the ability to elect to pay a dividend in cash or in kind, the issuer may not have sufficient cash available to pay the dividend such that the decision to pay the dividend in kind may not be solely based on the economic choice between the value of cash and the value of shares. As a result, the EITF did not recommend measuring PIK dividends under this approach.

Effective Date, Transition, and Early Adoption

Effective Date

BC33. The amendments in this Update are effective for all entities for annual reporting periods beginning after December 15, 2026, and interim reporting periods within those annual reporting periods. Stakeholders that provided feedback on the amendments in the proposed Update generally indicated that the proposed amendments would not require significant time or cost to implement.

BC34. Many stakeholders supported the same effective date for all entities, while a few stakeholders supported additional time for entities other than public business entities to implement the amendments in the proposed Update, especially if those entities elected to adopt the proposed amendments on a modified retrospective basis. The Board considered this feedback and noted that those amendments were straightforward to apply and would not take a significant amount of time to implement (especially for entities already measuring PIK dividends on equity-classified preferred stock at the stated PIK dividend rate) and that modified retrospective application is optional. Consequently, the Board decided to require the same effective date for all entities.

Transition

BC35. EITF members supported applying the amendments in this Update on a prospective basis. In addition, EITF members discussed whether an option for modified retrospective application should be provided but did not provide a formal recommendation to the Board.

BC36. After considering stakeholder feedback during the exposure period, the Board decided that an entity should apply the amendments in this Update using either of the following transition methods:

a. On a prospective basis to PIK dividends recognized on equity-classified preferred stock on or after the initial application date of the amendments (that is, regardless of whether the preferred stock instrument was issued before or after the initial application date)
b. On a modified retrospective basis to PIK dividends recognized on equity-classified preferred stock that is outstanding as of the initial application date.

The initial application date is the date on which an entity begins to apply the amendments. Under a modified retrospective approach, an issuer should recast prior reporting periods presented and recognize a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity) as of the beginning of the earliest period presented related to previously issued PIK dividends for equity-classified preferred stock that remains outstanding as of the initial application date.

BC37. Furthermore, the Board decided that under the modified retrospective approach, an entity does not need to adopt the amendments in this Update for equity-classified preferred stock that is not outstanding as of the initial application date because instruments that are no longer outstanding do not affect an entity's future cash flows. Stakeholders noted the possible complexity and limited benefits to investors in applying new guidance to instruments that were derecognized in prior periods.

BC38. The Board expects that prospective application of the amendments in this Update will reduce the costs associated with applying them. Additionally, the Board observed that some entities already measure PIK dividends on equity-classified preferred stock at the stated PIK dividend rate and, therefore, the Board expects minimal (or no) implementation costs for those entities. The Board decided not to require modified retrospective application because it concluded that the expected benefits would not justify the expected incremental costs. Also, the Board observed that because the amendments should be applied on a modified retrospective basis only to equity-classified preferred stock that is outstanding as of the initial application date, the benefit of comparability that is normally associated with retrospective application will be reduced.

BC39. Stakeholders that provided feedback on the amendments in the proposed Update broadly supported the proposed transition methods. Most stakeholders stated that the proposed transition requirements, either on a prospective basis or on a modified retrospective basis, are clear and operable. Stakeholders noted that prospective application reduces implementation costs by not requiring entities to recast prior periods, while other stakeholders noted that modified retrospective application increases comparability of financial reporting information. A few stakeholders noted that allowing for both transition methods provides flexibility for entities with differing circumstances and information availability. Accordingly, the Board affirmed its decision that entities should apply the amendments in this Update either (a) on a prospective basis or (b) on a modified retrospective basis to equity-classified preferred stock instruments that are outstanding as of the initial application date.

BC40. The Board decided that if an entity elects to apply the amendments in this Update on a prospective basis, the entity should provide the following transition disclosures in the financial statements of both the interim reporting period (if applicable) and the annual reporting period of initial application:

a. The nature of the change in accounting principle, including an explanation of the newly adopted accounting principle
b. The method of applying the change.

BC41. The Board decided that if an entity elects to apply the amendments in this Update on a modified retrospective basis, the entity should provide the following transition disclosures in the financial statements of both the interim reporting period (if applicable) and the annual reporting period of initial application:

a. The nature of the change in accounting principle, including an explanation of the newly adopted accounting principle
b. The method of applying the change
c. 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
d. The effect of the change on income available to common shareholders, any other affected financial statement line items, and any affected per-share amounts for the current reporting period and any prior reporting periods retrospectively adjusted.

Early Adoption

BC42. The Board agreed with the EITF recommendation that early adoption should be permitted in an interim or annual reporting period in which the financial statements have not yet been issued or made available for issuance. An entity adopting the amendments in an interim reporting period should apply them as of the beginning of the annual reporting period that includes that interim reporting period. All comment letter respondents supported early adoption. Therefore, the Board affirmed that early adoption of the amendments in this Update is permitted.

Amendments to the GAAP Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require improvements to the GAAP Financial Reporting Taxonomy and SEC Reporting Taxonomy (collectively referred to as the “GAAP Taxonomy”). Those improvements, which will be incorporated into the proposed 2027 GAAP Taxonomy, are available through GAAP Taxonomy Improvements provided at www.fasb.org, and finalized as part of the annual release process.