

Memo No. **Issue Summary No. 1**

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Issue Name	Accounting for paid-in-kind dividends on preferred stock		
Issue Stage	Initial Deliberations		

Overview

1. On December 12, 2024, the Emerging Issues Task Force (EITF) received an agenda request from Deloitte relating to the measurement of paid-in-kind dividends (PIK dividends) on equity-classified preferred stock. The EITF Agenda Committee added this issue to the EITF's agenda at its January 2025 agenda committee meeting.
2. At the March 25, 2025, EITF meeting, EITF members will discuss this issue and will be asked to vote on whether they recommend that the FASB (Board) add a project to its technical agenda and address the issue using the EITF's recommended approach.
3. This Issue Summary is organized as follows:
 - a) Issue Background
 - b) Alternatives
 - c) Entity Scope
 - d) Optional or Required Application
 - e) Transition and Early Adoption
 - f) Next Steps
 - g) Appendix A: Practitioner Guidance.

The alternative views presented in this Issue Summary are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles. Additionally, the proposed amendments to the Codification included in this issue summary are provided for context and discussion purposes only. Amendments to the Codification are made only after extensive due process and deliberations by the Financial Accounting Standards Board.

Questions

Alternatives

1. Which alternative does the EITF support?
 - a. Alternative A: PIK dividends should be measured at the fair value of the preferred shares issuable as of the date the dividends are recognized.
 - b. Alternative B: PIK dividends should be measured on the basis of the stated dividend rate on the liquidation preference of the preferred stock instrument.
 - c. Alternative C: The measurement of PIK dividends should depend on whether the PIK dividends are discretionary or non-discretionary.

Entity Scope

2. Does the EITF agree that the recommended approach should apply to all entities?

Optional or Required Application

3. Does the EITF agree that entities should be required to apply the recommended approach?

Transition and Early Adoption

4. Does the EITF agree that transition to the amendments discussed should be applied prospectively and that early adoption should be permitted?

Issue Background

4. For some preferred stock instruments, dividends are paid-in-kind rather than paid in cash. The issuer satisfies dividend payment obligations associated with these instruments either by issuing additional fungible preferred securities with the same terms as the original preferred security or by increasing the original preferred security's liquidation preference.¹ Other than with respect to differences in the compounding terms, both payment methods are economically similar and are hereafter simply referred to as dividends that are payable in additional shares of preferred stock.
5. There are two types of PIK dividend payment features, described below:
 - a) Discretionary — The issuer or the holder can elect to have dividends paid in cash or in-kind.²

¹ Some preferred stock instruments with cumulative stated dividends provide that declared but unpaid dividends accrue to the liquidation preference of the preferred stock, while others provide that cumulative stated dividends accrue to the liquidation preference regardless of whether they are declared. For this reason, there is a distinction between declaring PIK dividends that would accrue to the liquidation preference of preferred stock and those that are simply cumulative dividends.

² Although the terms of an instrument could indicate that either the issuer or the holder can elect to receive dividends in-kind, in practice, it is more common for the issuer to make this determination.

- b) Nondiscretionary — Neither the issuer nor the holder can elect to have dividends paid in cash (that is, all dividends must be paid-in-kind).
6. Determining the appropriate measurement of PIK dividends is important because the recognized amount of such dividends (a) affects the carrying amount of preferred stock on the balance sheet and (b) reduces net income in the calculation of income available to common stockholders for entities that report earnings per share.
7. Preferred stock instruments have certain attributes with the characteristics of both debt and common stock. For example, preferred stock is similar to common stock in that both are typically classified in equity (rather than as a liability) and represent ownership interests held by investors. However, common stock typically represents a residual interest in an entity and preferred stock typically has a preference to cash flows before the common shareholders and also has a higher liquidation preference when compared to common shareholders. While not all preferred stock includes stated and/or cumulative dividend rights, preferred stock with stated, cumulative dividends that accrue whether or not declared (a fixed payment schedule) may be considered more similar to debt instruments that pay interest and principal in accordance with a fixed payment schedule. Given that preferred stock may have a fixed return, investors that are seeking a fixed return may invest in either preferred stock or debt instruments (as opposed to common shareholders, who likely are focused on capital appreciation).
8. The issues and alternatives discussed in this paper are not intended to apply to preferred stock that is classified as a liability pursuant to the guidance in Topic 480, Distinguishing Liabilities from Equity.³ That is, the recommended solution is only contemplated to apply to equity classified preferred stock instruments, which would include instruments classified outside of permanent equity pursuant to the SEC's guidance on temporary equity codified in paragraph 480-10-S99-3A, which is the SEC Staff Announcement on classification and measurement of redeemable securities.
9. The scope of the issue is limited to the measurement of PIK dividends on preferred stock (whether convertible or nonconvertible) when both of the following conditions are met:⁴
- a) Dividends either (1) must be paid in additional shares of the same preferred stock instrument or (2) may be paid in either cash or additional shares of the same preferred stock instrument at the option of the issuer or the holder.

³ Preferred stock that is classified as a liability pursuant to the guidance in Topic 480, Distinguishing Liabilities from Equity, would be accounted for at its redemption value or its fair value, depending on the liability type, which would already contemplate any incremental value accruing on PIK dividends.

⁴ This issue does not address when dividends on preferred stock are recognized for financial reporting purposes. Rather, it only addresses the measurement of dividends that meet the conditions to be recognized.

- b) The monetary value of dividends paid-in-kind varies on the basis of the fair value of the additional preferred securities issued⁵ (that is, the issuer of the preferred stock is not satisfying dividend obligations by issuing a variable number of shares of the same preferred stock instrument that has a fixed monetary value).
10. The scope of the issue would exclude the following:
- 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)
 - b) Dividends on preferred stock that are payable in a variable number of shares of the same preferred stock instrument that has a fixed monetary value
 - c) Nonmonetary distributions
 - d) Stock splits or other dilutive-type adjustments.
11. Both public and private entities issue preferred stock instruments with dividends that may be paid-in-kind. However, it is more common for private entities to issue preferred stock with PIK dividend features.

Alternatives

Alternative A — PIK dividends are measured at the fair value of the preferred shares issuable as of the date the dividends are recognized.

12. Under Alternative A, PIK dividends on preferred stock are always measured on the basis of the fair value of the additional preferred securities issuable on the date such dividends are recognized.
13. Proponents of Alternative A observe that this approach is consistent with the accounting for stock dividends. Paragraph 505-20-30-3 states:

In accounting for a stock dividend, the corporation shall transfer from retained earnings to the category of capital stock and additional paid-in capital **an amount equal to the fair value of the additional shares issued**. Unless this is done, the amount of earnings that the shareholder may believe to have been distributed to him or her will be left, except to the extent otherwise dictated by legal requirements, in retained earnings subject to possible further similar stock issuances or cash distributions. [Emphasis added.]

14. Proponents of Alternative A believe that PIK dividends are a form of stock dividend and therefore should always be recognized on the basis of the fair value of the additional shares of preferred

⁵ This is not intended to imply that the PIK dividends issued should be *measured* for accounting purposes at fair value. See Alternatives A and B, below, for discussion of measurement. The discussion here is intended only to identify the types of PIK dividends within the scope of this project.

stock issuable. Proponents of Alternative A assert that this measurement attribute best reflects the economics of these payments because the monetary value of the additional shares of preferred stock issuable is subject to fluctuation after the issuance of the original preferred stock instrument as a result of changes in fair value of the issuer's preferred stock.

15. Opponents of Alternative A acknowledge that while there may be a benefit to recognizing additional shares of preferred stock issued as a result of PIK dividends at fair value consistent with the accounting for stock dividends, they (a) observe that the stock dividend guidance is applied to common stock instruments and (b) have concerns about a requirement to determine the fair value of preferred stock instruments that are typically not publicly traded each time a dividend is declared (whether because they are issued by a nonpublic entity or a public entity whose preferred stock is not a registered class of equity). Therefore, opponents of Alternative A believe that the costs of this approach outweigh the benefits.
16. Opponents of Alternative A would also observe that this model is inconsistent with how paid-in-kind interest (PIK interest) is accrued on legal form debt instruments⁶ as well as dividends that accrue to the redemption value of preferred stock.⁷

Alternative B — PIK dividends are measured on the basis of the stated dividend rate on the liquidation preference of the preferred stock instrument.

17. Under Alternative B, PIK dividends on preferred stock are measured on the basis of the stated dividend rate on the liquidation preference of the preferred stock instrument. For example, if the entity issues 5,000 shares of preferred stock as a PIK dividend, and the liquidation preference is \$10.00 per share, the recognized dividend amount would be \$50,000. See examples with additional details in paragraphs 36 through 41.
18. Proponents of Alternative B think that the guidance on stock dividends (cited in Alternative A) should not apply to PIK dividends. Rather, proponents of Alternative B think that the guidance on accounting for interest on debt instruments provides a better analogy because of the similarity of some attributes, such as a stated dividend amount and (potentially) a fixed dividend payment schedule.

⁶ PIK interest on debt instruments is typically viewed as being akin to a commitment from the lender to extend additional financing to the borrower. As a result, the loan commitment scope exception in paragraphs 815-10-15-69 through 15-71 is commonly applied, which would prevent issuers from accounting for PIK interest at its fair value.

⁷ Entities subject to the SEC's guidance on temporary equity must remeasure preferred stock that is either currently redeemable or probable of becoming redeemable based on its redemption value in applying the SEC's guidance on temporary equity, in paragraph 480-10-S99-3A. That guidance does not require dividends to be recognized at fair value.

19. Proponents of Alternative B believe that a PIK dividend on preferred stock is similar to an interest payment that is capitalized into the principal amount of a debt instrument. Subtopic 835-30, Interest—Imputation of Interest, requires entities to account for debt instruments for which the fair value option is not elected, whether convertible or nonconvertible, at amortized cost, with interest recognized in accordance with the interest method (that is, the effective yield).⁸ Proponents of Alternative B believe that a similar approach should be applied to PIK dividends on preferred stock. That is, since PIK interest on debt instruments is not typically accounted for at fair value, proponents of Alternative B observe that it would be inappropriate to require fair value recognition of PIK dividends on perpetual preferred stock.
20. Alternative B proponents also observe that under GAAP, entities are not permitted (a) under Subtopic 815-15, Derivatives and Hedging—Embedded Derivatives, to bifurcate or account for PIK dividend features within the scope of this issue at fair value or (b) to subsequently recognize preferred securities at fair value. Since the investor makes the decision to accept dividends in-kind as part of the initial investment, requiring entities to recognize the dividends at fair value would be inconsistent with other applicable GAAP.
21. Proponents of this alternative would also observe that the economics of PIK interest are similar to a loan commitment. That is, the issuer effectively borrows from the investor the amount of each dividend that is paid-in-kind. Loan commitments typically qualify for the scope exception in paragraphs 815-10-15-69 through 15-71 and are therefore not typically accounted for at fair value when the loan is drawn.
22. Proponents of this alternative would further observe that there is effectively no economic difference between cumulative dividends that accrue to the redemption value of a preferred stock instrument and dividends that are paid-in-kind. While the accounting for *when* to recognize dividends is outside the scope of this project, in accordance with paragraph 480-10-S99-3A an entity records accumulating dividends to the redemption value of the preferred stock based on their stated dividend rate (that is, not at fair value).
23. Further, proponents of this alternative observe that PIK dividend recognition under this model would be the same as the dividends recognized if PIK dividends were instead paid in cash.⁹ That is, when

⁸ When interest that accrues on a debt instrument is required (or allowed at the option of the issuer) to be added to the debt's principal amount, the interest feature qualifies for the loan commitment scope exception in paragraphs 815-10-15-69 through 15-71. Therefore, the issuer of the debt instrument is precluded from accounting for the PIK interest feature at fair value. As a result, the interest that is capitalized into the debt's principal amount must be accounted for using the interest method.

⁹ It is commonly observed in practice that PIK and cash dividend rates are the same; however, it is also commonly observed in practice that the PIK dividend rate would be higher than the cash dividend rate.

dividends are paid in cash, any issuance discount on the preferred stock is not always accreted (unless another model requires it¹⁰).

24. Alternative B proponents assert that the legacy guidance on beneficial conversion features (see further discussion in Alternative C) that distinguishes between discretionary and non-discretionary PIK dividends is irrelevant because this guidance did not specifically address the measurement of PIK dividends. Instead, a method that recognizes all PIK dividends based on the stated dividend rate is the most appropriate approach.
25. Proponents of Alternative B acknowledge that recognizing PIK dividends on the basis of the stated dividend rate may not best reflect the economic value of PIK dividends when the issuer or holder can choose between a stated cash dividend amount or PIK dividends, which are alternatives that do not have the same monetary value. However, this difference also exists when interest is capitalized into the principal amount of a debt instrument under the amortized cost method of accounting. Proponents of Alternative B assert that this concern is overcome by the reduced complexity and cost of applying that view. In a manner consistent with the conclusions reached in Accounting Standards Update 2020-06, *Debt—Debt with Conversion and Other Options (Subtopic 470-20)* and *Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40)—Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*, such proponents believe that as long as the dividend payment terms are properly disclosed, financial statement users will not be deprived of any relevant financial information if PIK dividends are always recognized on the basis of the stated dividend rate in the original preferred stock instrument.
26. Proponents of Alternative B would observe that PIK dividends may be considered to be economically similar to an equity-classified purchased put option (for non-mandatory dividends) with an exercise price equal to the cash dividends that would otherwise be required to be paid on the dividend date (assuming the cash and PIK dividend rates are the same). When an entity elects to pay dividends in-kind, it settles the equity-classified option by avoiding the cash dividend payment. Therefore, the amount of the avoided cash dividend payment is the amount recognized when the PIK dividend accrues.¹¹ Opponents of Alternative B do not believe that this approach is consistent with the accounting for an equity-classified purchased put option for several reasons. If

¹⁰ Preferred stock classified in permanent equity is not subject to remeasurement. Preferred stock classified in temporary equity based on the SEC's guidance in paragraph 480-10-S99-3A would similarly not be subsequently measured unless it was currently redeemable or probable of becoming redeemable. Therefore, an issuance discount on preferred stock with those characteristics would similarly not require accretion under current GAAP. However, an issuance discount on preferred stock with increasing rate dividends would be accreted over time based on the application of the SEC staff's views under SAB Topic 5.Q.

¹¹ The issuance of shares upon the settlement of an equity-classified put option (based on the guidance in Subtopic 815-40) would not be recognized at fair value. Accordingly, some proponents of View B believe that this supports a PIK dividend measurement model based on the liquidation preference of preferred stock, rather than its fair value on the dividend date.

an entity purchased a put option on its own preferred stock that allows it to force an investor to purchase the preferred stock, it would be expected to pay a premium. Thus, even if the preferred stock is issued at its liquidation preference, the initial carrying amount of the preferred stock is less than its liquidation preference. For example, if an entity paid a third party \$1 in return for an equity-classified option that permits the entity to require the third party to purchase the preferred stock for \$10, the initial carrying amount of the preferred stock issued would be \$9 (that is, \$10 paid by the investor less the \$1 paid by the entity to acquire the put option).

Potential Variation of Alternative B Considered but Rejected (Alternative B' – PIK dividends are measured based on an effective interest rate model)

27. Proponents of Alternative B may prefer it, in part, due to its clarity and simplicity. Others may believe that a more appropriate alternative to a fair value-based measurement described in Alternative A would be to apply the guidance in Subtopic 835-30 by analogy and recognize PIK dividends based on the effective interest rate model (that is, determining the implicit yield in the preferred stock). The effective interest rate model would have the same result as Alternative B, except in scenarios in which the preferred stock is initially recorded at a discount (as contemplated in Example 2 below).
28. Although the effective interest rate model is more aligned with a PIK interest model and interest rate concepts in Subtopic 835-30, this variation of Alternative B was not recommended due to the perpetual nature of preferred stock. That is, in order to determine the effective interest rate in preferred stock, the issuer would be required to estimate the life of the preferred stock and the timing of dividends, which also raises additional complexity with respect to whether and how to determine whether a reassessment of the rate is appropriate.
29. Applying an effective interest rate model would also require accretion of an issuance discount on preferred stock when other GAAP may not require it.¹²

Alternative C — The measurement of PIK dividends should depend on whether the PIK dividends are discretionary or non-discretionary.

30. Under Alternative C, the measurement of PIK dividends on preferred stock should depend on whether the PIK dividends are discretionary or non-discretionary. That is, if they are discretionary, the issuer should apply the measurement concepts in Alternative A and measure them based on the fair value of the dividends on the issuance date. If they are non-discretionary, the issuer should apply the measurement concepts in Alternative B and measure them based on the stated dividend rate on the liquidation preference of the preferred stock.

¹² See footnote 10.

Type	Description	Measurement Approach
Discretionary	Either the issuer or the holder can elect to have dividends paid in cash or in-kind.	Recognize the dividends at their fair value on the date of issuance (that is, the approach described in Alternative A).
Nondiscretionary	Neither the issuer nor the holder can elect to have dividends paid in cash (that is, all dividends must be paid-in-kind).	Recognize the dividends based on the stated dividend rate on the liquidation preference of the preferred stock instrument (that is, the approach described in Alternative B).

31. Proponents of Alternative C believe that while there are merits to the approaches discussed in Alternatives A and B, the proper accounting depends on the type of PIK dividend payment feature. When PIK dividends are discretionary, the payment of the dividend in additional shares of preferred stock is akin to a stock dividend that should be recognized at fair value as of the date the dividends are recognized. That is, if PIK dividends are discretionary, presumably the issuer or holder makes an economic or business decision to choose to issue dividends in-kind, which is analogous to the declaration of a stock dividend on common stock. However, when PIK dividends are nondiscretionary, treating such dividends in a similar manner as a debt instrument that is accounted for at amortized cost is appropriate.

32. Proponents of Alternative C highlight that their view is consistent with the approach recommended by the EITF Issue 00-27 Working Group in Discussion Document 3 (March 8, 2001), which stated, in part:

The FASB staff recommends that for purposes of recognizing a paid-in-kind dividend, the fair value of the paid-in-kind instrument should be determined on the commitment date As a result, the fair value (and deemed proceeds) from the issuance of the paid-in-kind instrument always will be determined on the same date as the fair value of the stock underlying the conversion option in the paid-in-kind instrument. If the issuer is committed to paying dividends in the form of paid-in-kind instruments, the commitment date will be the commitment date for the original instrument. The fair value of paid-in-kind instruments issued as dividends will equal the fair value of the original instruments evidenced in the transaction. If the issuer has discretion to pay the dividends in another form such as cash, the fair value of the paid-in-kind instrument issued as a dividend will be determined on the date the issuer commits to its issuance.

33. Although that approach was not codified, it is consistent with the accounting model for beneficial conversion features that was described in superseded paragraph 470-20-30-16 (which was based on paragraph 30 of EITF Issue 00-27) and superseded by Update 2020-06. That guidance indicated that the commitment date¹³ for PIK dividends in a convertible preferred stock instrument is (a) the

¹³ The “commitment date” for non-discretionary PIK dividends is typically viewed to be the issuance date of the preferred stock. There is diversity in practice and diversity in views amongst practitioners with respect to what it means to measure the fair value of PIK dividends on the issuance date when preferred stock is issued at a discount. Refer to the discussion in Alternative B regarding approaches considered.

issuance date if the instrument contains nondiscretionary PIK dividends or (b) the payment date if the PIK dividends are discretionary.

34. Opponents of Alternative C have concerns about the potential inconsistency with the way that preparers and practitioners determine whether PIK dividends are discretionary or non-discretionary. This is because in some situations, it may not be entirely clear whether PIK dividends are discretionary or non-discretionary. For example, an issuer may be allowed to pay dividends in-kind only during the first three years after issuance of the preferred stock; thereafter, the issuer is required to pay dividends in cash. As another example, an issuer may be required to pay dividends in-kind unless it raises a specified amount from a future equity financing or asset divestiture. In these types of situations, it is not entirely clear whether the dividends are discretionary or non-discretionary in nature. The concerns cited here are similar to challenges experienced with the application of the beneficial conversion features guidance (see paragraph 33). That is, there were challenges with determining whether the dividends or interest on a convertible instrument were discretionary or non-discretionary, which led to diversity in practice.
35. Opponents of Alternative C may be skeptical that any PIK dividends are ever truly non-discretionary and, accordingly, whether that distinction is relevant. That is, even if contractual terms explicitly required the issuer to settle periodic dividends in-kind, it may typically be true that holders of preferred stock would accept cash dividends regardless of contractual terms. Some may believe that an investor's election (or willingness) to receive PIK dividends would always indicate that the value of the shares received in-kind exceeds the value that would otherwise be paid in cash (such that fair value measurement is the most appropriate); however, as PIK dividends are commonly observed in non-publicly traded instruments (whether issued by a public or nonpublic entity), investors may prefer to receive cash dividends rather than PIK dividends due to the lack of ability to easily monetize a nonpublic investment. In addition, unless dividends on preferred stock are mandatory (that is, payable in absence of declaration), they are essentially discretionary since the entity's board of directors can choose not to declare and pay dividends on the preferred stock.

Summary of Alternatives

Type	Description	Alternative A	Alternative B	Alternative C
Discretionary	Either the issuer or the holder can elect to have dividends paid in cash or in-kind.	Fair value on the date the dividends are recognized.	The stated dividend rate in the original preferred stock instrument.	Fair value on the date the dividends are recognized.
Nondiscretionary	Neither the issuer nor the holder can elect to have dividends paid in cash (that is, all dividends must be paid-in-kind).	Fair value on the date the dividends are recognized.	The stated dividend rate in the original preferred stock instrument.	The stated dividend rate in the original preferred stock instrument.

Illustrative Examples of Alternatives Considered

Example 1 — Nondiscretionary PIK Dividends on Preferred Stock Issued at Stated Liquidation Preference

36. An entity issues 1 million shares of convertible preferred stock with a stated liquidation preference of \$10 per share. The shares are issued for \$10 per share for total proceeds of \$10 million ($\$10.00 \times 1,000,000 = \$10,000,000$). Dividends accrue quarterly, whether or not declared, and must be paid-in-kind. The stated annual dividend rate is 6 percent of the liquidation preference (or 1.5 percent per quarter).
37. At the end of the first quarter, the entity recognizes total PIK dividends of 15,000 shares (that is, $\$10 \text{ million [liquidation preference]} \times 1.5\% \text{ [quarterly dividend rate]} = \$150,000 \div \$10.00 \text{ [liquidation preference per share]} = 15,000 \text{ [preferred shares]}$). Assume that the fair value of the preferred share is \$12 on the date the dividends are recognized.
38. The entity recognizes the following amounts under the alternative views:

<u>Alternative</u>	<u>Dividend Amount Recognized</u>	
A	\$180,000	(15,000 shares \times \$12.00 per share)
B	\$150,000	(15,000 shares \times \$10.00 per share)
C	\$150,000	(15,000 shares \times \$10.00 per share)

Example 2 — Discretionary PIK Dividends on Preferred Stock Issued at a Discount

39. An entity issues 1 million shares of nonconvertible callable preferred stock with a stated liquidation preference of \$10 per share along with equity-classified detachable warrants. The preferred stock is initially recorded with a carrying value of \$9 per share ($\$9.00 \times 1,000,000 = \$9,000,000$) due to the allocation of \$1,000,000 in proceeds to the warrants.¹⁴ Dividends accrue quarterly, whether or not declared, and are paid-in-kind unless the entity elects to pay the dividends in cash. The stated annual dividend rate, whether paid-in-kind or in cash, is 6 percent of the liquidation preference (or 1.5 percent per quarter).
40. At the end of the first quarter, the entity did not elect to pay dividends in cash; therefore, it recognizes PIK dividends of 15,000 shares (see the calculation in Example 1). Assume that the fair value of the preferred share is \$9.50 on the date the dividends are recognized.
41. The entity recognizes the following amounts under the alternative views:

¹⁴ The most common reason that preferred stock would be initially recognized at a carrying value below its fair value or stated value is due to the allocation of proceeds to multiple instruments issued at the same time in a bundled transaction. The same consequence results from an issuer that would issue preferred stock at a discount, though this is not commonly observed.

<u>Alternative</u>	<u>Dividend Amount Recognized</u>	
A	\$142,500	(15,000 shares × \$9.50 per share)
B*	\$150,000	(15,000 shares × \$10.00 per share)
C	\$142,500	(15,000 shares × \$9.50 per share)

* Under Alternative B, PIK dividends are recognized on the basis of the stated dividend rate of the liquidation preference of the preferred stock instrument, even though the preferred stock was initially recorded with a carrying value of \$9.00 per share. Therefore, the total amount recognized for the PIK dividends is \$150,000 ($\$10,000,000 \times 1.5\% = \$150,000$). This equates to a price per share of \$10.00 ($\$150,000 \div 15,000 = \10.00).

The variation of Alternative B' discussed in paragraphs 27 through 29 would instead result in the measurement of PIK dividends on the basis of the effective stated dividend rate of the original preferred stock instrument. If the issuer estimated the expected life of the preferred stock to be 10 years, the effective dividend rate on the preferred stock would be 7.4% per annum, or 1.85% per quarter. This would result in the recognition of PIK dividends in the amount of \$166,500 ($\$9,000,000 \times 1.85\% = \$166,500$). This equates to a price per share of \$11.10 ($\$166,500 \div 15,000 = \11.10).

Other Alternative Considered but Rejected

42. We considered but rejected a “cost” basis approach that would measure PIK dividends at the stated dividend rate multiplied by the preferred stock’s initial *carrying value* (even if the preferred stock is issued at a discount). We rejected this view since such measurement would not be economically consistent with the contractual requirement to pay PIK dividends on the stated liquidation preference of the preferred stock (that is, the rate would accrue on the stated liquidation preference of \$10,000,000, rather than the *initial carrying value*, which was recognized at a lower amount due to allocation methodology). This view was considered inappropriate because the initial carrying value of preferred stock that is issued with detachable warrants is the result of an accounting allocation technique (for example, relative fair value), which often does not result in the preferred stock instrument being initially recognized at its fair value. In other words, the initial carrying value of preferred stock that is issued with detachable warrants is merely an amount that results from an allocation technique. In fact, the allocation technique generally results in different amounts being allocated to the preferred stock instrument depending on whether the detachable warrants are classified as equity instruments or as liabilities.
43. In applying this “cost” basis approach, the measurement of the PIK dividends in the Examples introduced in paragraphs 36 through 41 would be as follows:

- a) Example 1: At the end of the first quarter, the entity recognizes total PIK dividends of 15,000 shares (that is, \$10 million [*initial carrying value* of preferred stock] x 1.5% [quarterly dividend rate] = \$150,000 ÷ \$10.00 [*initial carrying value* per share] = 15,000 [preferred shares]). The entity would, in turn, recognize a dividend amount of \$150,000 (15,000 preferred shares * \$10.00 per share).
- b) Example 2: At the end of the first quarter, the entity recognizes total PIK dividends of 15,000 shares (that is, \$9 million [*initial carrying value* of preferred stock] x 1.5% [quarterly dividend rate] = \$135,000 ÷ \$9.00 [*initial carrying value* per share] = 15,000 [preferred shares]). The entity would, in turn, recognize a dividend amount of \$135,000 (15,000 preferred shares * \$9.00 per share).

Recommendation

44. The Lead EITF Member recommends Alternative B.
45. Proponents of the recommended solution believe the simplicity of the model along with the technical merits discussed above result in this being the preferred solution to achieve the objectives of the project, while balancing cost and complexity.
46. Although proponents of Alternative A believe the most appropriate model is to recognize PIK dividends on preferred stock similar to stock dividends, a fair value recognition model is (a) inconsistent with how PIK interest is accounted for on debt instruments, and (b) more complex and costly to apply, especially because PIK dividends on preferred stock are commonly observed to be issued by nonpublic issuers.
47. Proponents of Alternative B note that this approach is the most straightforward to apply and avoids (a) the complexity of determining the expected life of the preferred stock in order to determine the effective interest rate and (b) the need to determine whether or when to reassess those assumptions.

Entity Scope

48. The recommended solution should be applied to all entities, although it is acknowledged that not-for-profit entities typically would not issue preferred stock with PIK dividends.
49. Although PIK dividends are very commonly observed in preferred stock issued by private entities, preferred stock with such features is also issued by public entities.

Optional or Required Application

50. The Lead EITF Member believes that entities should be required (as opposed to elect) to apply the recommended solution. An objective of providing clarifying guidance on how to account for PIK dividends is to reduce the existing diversity in practice. Providing an election or policy choice would not accomplish the goal of achieving greater consistency in the accounting and financial reporting for these types of instruments and provisions.

Transition and Early Adoption

51. Since it is possible that preferred stock instruments with PIK dividends are outstanding for many years, entities may be challenged by a requirement to apply some of the alternatives retrospectively.

52. The Lead EITF Member recommends that entities apply the guidance prospectively from the date of adoption. While this transition approach results in the potential lack of comparability to past reporting periods, the benefits of a retrospective approach (and a modified retrospective approach) do not outweigh the potential costs. For example, consider a preferred stock instrument that paid dividends in-kind in a prior period and recognized historical PIK dividends at their fair value on issuance. If all or a portion of that preferred stock was converted into common stock in a prior period, it would be challenging for an entity to reverse the impact of the fair value PIK dividends to apply Alternative B retrospectively.

53. The Lead EITF Member believes that the application of Alternative A, which involves fair value measurement, would make it more challenging to apply the proposed guidance on a retrospective or modified retrospective basis.

54. Therefore, applying the guidance on a prospective basis in transition appears to be most appropriate, regardless of the alternative selected by the EITF.

55. Early adoption is recommended to be allowed any time after the issuance of the final Accounting Standards Update.

Next Steps

56. If an EITF recommendation is reached for the FASB to add a project to its technical agenda, the FASB staff will prepare an agenda decision memo for the Board to discuss at a public meeting. The agenda decision memo will include the materials discussed by the EITF, a summary of EITF discussions, the basis for the EITF's recommendation, and an analysis of the FASB's agenda criteria. The Board will discuss the issue at a public Board meeting and determine whether to add a project to the FASB technical agenda.

Appendix A: Practitioner Guidance

- A1. This appendix provides the relevant examples of practitioner guidance on accounting for paid-in-kind dividends for preferred stock.
- A2. Deloitte, PwC, and KPMG have issued interpretive guidance that indicates that discretionary PIK dividends should be recorded at the fair value of the preferred stock as of the dividend declaration date and non-discretionary PIK dividends should be recorded at the effective dividend rate in the original preferred stock instrument (Alternative C).
- A3. Section 3.2.2.2.3 of Deloitte's [Roadmap: Earnings per Share](#) (June 2024) states the following:

3.2.2.2.3 Dividends Paid in Shares of Preferred Stock

Dividends on preferred stock may be paid in additional shares of preferred stock; such dividends are referred to as dividends that are “paid in-kind” (PIK). Determining the appropriate measurement of PIK dividends is important because the measured amount of these dividends reduces net income in arriving at income available to common stockholders.

PIK dividends on preferred stock should be measured at fair value as of the commitment date for the payment of such dividends. If PIK dividends are nondiscretionary (i.e., neither the issuer nor the holder may elect to pay dividends in cash or in kind), the commitment date for the original preferred stock instrument is also the commitment date for the PIK dividends. If, however, the issuer or the holder can elect to have dividends paid in cash or in kind, those dividends are discretionary. Therefore, the commitment date for such dividends is the date on which they become nondiscretionary (i.e., the date on which the dividends become payable in kind).

The table below summarizes the measurement guidance related to PIK dividends. See Section 9.5.5.1 of Deloitte's Roadmap *Distinguishing Liabilities From Equity* for additional considerations related to determining whether PIK dividends are discretionary or nondiscretionary.

Table 3-2

Measurement of PIK Dividends That Reduces Numerator in EPS Calculation

Commitment date is the same as the commitment date for the original preferred stock (i.e., nondiscretionary PIK dividends)	PIK dividends should be measured at the fair value of the original preferred stock on its commitment date. Generally, this will be on the issuance date of the original preferred stock.
Commitment date is not the same as the commitment date for the original	For cumulative preferred stock, PIK dividends should be measured at their fair value as of the date they accumulate. If the accumulation date differs from the

Measurement of PIK Dividends That Reduces Numerator in EPS Calculation

preferred stock (i.e., discretionary PIK dividends) declaration or payment date and the entity does not recognize the dividends on the balance sheet as additional shares of preferred stock until that later date, an adjustment to the dividend amount previously recorded should be recognized as of the date the additional shares of preferred stock are recognized on the balance sheet.[footnote redated] This adjustment will affect income available to common stockholders in the period in which it is recognized.

For noncumulative preferred stock, PIK dividends should be measured at their fair value as of the date they are declared.

A4. Section of Deloitte's [Roadmap: Distinguishing Liabilities from Equity](#) (April 2024) also states the following:

9.5.5.1 Paid-in-Kind Dividends

The terms of some redeemable equity instruments (e.g., preferred stock) include a paid-in-kind (PIK) dividend feature that requires or permits the issuer to satisfy any required dividend payments by issuing additional shares of the same redeemable equity instrument. The following are two types of such PIK dividend features:

- On each dividend payment date, the issuer satisfies the dividend payment obligation by issuing additional redeemable equity securities to the holder(s). That is, additional fungible securities are issued.
- On each dividend payment date, the issuer increases the liquidation preference of the original equity instrument to reflect the dividend accrued to the benefit of the holder. Economically, other than with respect to potential differences due to the compounding terms of the instrument, the PIK feature has the same effect as delivering additional instruments.

The initial measurement of the additional shares that are issued as PIK dividends depends on whether the PIK feature is discretionary or nondiscretionary:

PIK Feature	Description	Measurement Date for PIK Dividends
Discretionary	<p>A PIK feature is discretionary if <i>either</i> of the following conditions exist:</p> <ul style="list-style-type: none"> • The issuer or the holder can elect a form of payment other than paid in kind (e.g., the issuer has the option to settle dividend payment obligations by either delivering cash or making a payment in kind). • In cases in which the convertible instrument or a portion thereof is converted before dividends are accrued, the holder will not always receive the number of equity shares upon conversion as if all dividends have been paid in kind. 	The date that the dividends are accrued
Nondiscretionary	<p>A PIK feature is nondiscretionary if <i>both</i> of the following conditions exist:</p> <ul style="list-style-type: none"> • Neither the issuer nor the holder can elect payment of dividends in a form other than in kind. • Regardless of the conversion date (whether converted in whole or in part), the holder will always receive the number of equity shares upon conversion as if all dividends have been paid in kind. 	The measurement date for the original equity instrument

There are two acceptable views on how to interpret the condition that for PIK dividend payments to be nondiscretionary, the holder must always receive the number of equity shares upon conversion as if all dividends have been paid in kind if the original instrument (or part of it) is converted before accumulated dividends are declared or accrued. An entity should select one interpretation and apply it consistently as an accounting policy election:

- *View A — Regardless of when during the security’s term the holder converts the instrument into equity shares, the holder must always receive upon conversion all of the dividends that would have accrued **during the entire life of the security (i.e., to the contractual maturity date)**.*

Under this view, the issuer must know at the inception of the original convertible instrument, regardless of the ultimate conversion date, the exact number of equity shares that will be issued to the holder upon full conversion (i.e., conversion of the original instrument adjusted for PIK dividends or, if PIK dividends are paid through the issuance of additional convertible instruments, conversion of both the original convertible instrument and any additional convertible instruments. Potential contingent adjustments to the conversion rate for other reasons do not necessarily need to be considered). If the issuer cannot determine the number of equity shares that will be issued or if the number of equity shares will differ depending on when the instrument is converted, the PIK feature is discretionary under this view. In most cases, PIK dividend payments would be discretionary under View A since entities typically do not issue convertible instruments that allow the holder to effectively earn future dividends that would not have accrued on an early conversion.

- *View B — Regardless of when during the security’s term the holder converts the instrument into equity shares, the holder must always receive upon conversion all of the dividends that have accrued **during the entire period in which the security has been outstanding (i.e., to the conversion date)**.*

Under this view, the holder always receives upon conversion the number of equity shares as if all dividends that have been earned to date are paid in equity shares (i.e., no dividends are payable in cash). If the conversion date falls between periodic contractual dividend dates (i.e., accrual, declaration, or payment dates) and the holder forfeits any dividends that would have accrued from the last dividend date, this forfeiture does not prevent the dividends from being nondiscretionary since they are still not payable in cash.

The view selected will not affect the conclusion that PIK dividends are discretionary in cases in which a convertible (or nonconvertible) equity instrument allows either the holder or issuer to choose to pay dividends in cash or in kind. In these circumstances, the PIK dividends would be considered discretionary regardless of whether the entity adopted View A or View B above. In applying the above alternatives to a nonconvertible instrument, an entity should substitute the “redemption date” for the “conversion date.”

- A5. Section 7.7.2 *PIK dividends* of PwC’s guide on [Financial Transactions](#) (June 2024) states the following:

Some preferred stock includes a paid-in-kind dividend feature (where dividends are paid in shares of the same class of stock). This preferred stock may either require the issuer to pay the dividend in additional shares of stock (nondiscretionary PIK dividend) or allow the issuer to choose between paying the dividend in additional shares of stock or in cash (discretionary PIK dividend). For example, an issuer may issue 10,000 shares of convertible preferred stock with a liquidation preference of \$1,000/share that carries a 10% stated dividend rate, payable semi-annually. Typically, if the dividend were to be PIK, the issuer would issue on each dividend payment date 500 additional shares of convertible preferred stock with a liquidation preference of \$500,000. We believe the issuer should record the PIK dividend as follows:

- a. If the issuer has the right to decide whether to pay the PIK dividend in cash or in kind (PIK dividends are discretionary), the issuer should record the PIK dividend at the fair value of the preferred stock at the dividend declaration date.
- b. If the issuer is required to pay the dividend in kind (PIK dividends are non-discretionary), the issuer should record the PIK dividend on the declaration date at the contractual rate (\$500,000 in this example). This results in accretion of the dividend similar to the amortization of interest on a zero-coupon bond.

A6. KPMG's [Handbook: Debt and Equity Financing](#) (November 2024) states the following:

Background: Certain convertible instruments have terms that allow for an issuer to pay the interest or dividends with the same convertible instruments as those in the original issuance instead of paying cash. These are referred to as paid-in-kind or PIK instruments.

Question 10A.5.40 How does an entity initially measure PIK instruments newly issued as dividends or interest?

Interpretive response: We believe it is appropriate to measure the newly issued instrument at its fair value on the dividend declaration (or interest accrual date), regardless of whether the convertible instrument is liability- or equity-classified. This is similar to the accounting for stock dividends under Topic 505 (see section 5.7.30). [505-20-30-3]

However, when the original and newly issued convertible instruments are both in the scope of the no proceeds allocated model – and the following conditions are met – we believe it is also acceptable to measure the newly issued instrument based on the originally issued convertible instrument's contractual rate:

- neither the entity nor the holder can elect other forms of payment – i.e. the dividend or interest is nondiscretionary; and
- the originally issued convertible instrument was issued at (or near) the amount on which the PIK dividend or interest is determined and all issuance proceeds were allocated to it. For

example, if PIK interest is determined for a convertible debt instrument based on its principal amount of \$1,000, the instrument is issued for proceeds of (or near) \$1,000 with all proceeds allocated to it.

When these conditions are met, the originally issued convertible instrument is similar to a zero coupon instrument because the issuer does not transfer assets in satisfaction of any contractual dividend or interest amounts until the originally issued convertible instrument is redeemed or matures. Therefore, we believe it is acceptable to measure newly issued PIK instruments (i.e. those issued as periodic dividends or interest) based on their contractual rate, which has a result similar to applying the effective interest method to the originally issued convertible instrument.

An entity with PIK instruments that meet the above conditions should apply its policy for measuring PIK interest or dividends consistently.

Example 10.5.70

Measurement of PIK dividends on equity-classified convertible preferred shares

ABC Corp. issues 1,000 preferred shares at their liquidation preference of \$10 per share. The shares are convertible to common shares on a one-for-one basis and are equity-classified. Dividends must be paid in kind if and when declared by ABC's board of directors at a rate of 10% per annum based on the liquidation preference (i.e. 100 convertible preferred shares of \$10 per share).

The convertible instrument is in the scope of the no proceeds allocated model and all issuance proceeds were allocated to the original convertible instrument.

On the date ABC declares the first PIK dividends, the fair value of the convertible preferred shares is \$16 per share.

Measurement of PIK instrument and related dividend cost on first declaration date

The newly issued PIK instrument is in the scope of the no proceeds allocated model. Because the PIK dividends are nondiscretionary (see Question 10.5.40) and the original convertible preferred shares were issued at their liquidation preference of \$10 per share, ABC may elect to measure the newly issued PIK instruments based on:

- the fair value of the newly issued PIK instrument on the dividend declaration date; or
- the contractual rate of the originally issued convertible preferred shares (10%).

These amounts are calculated as follows.

Fair value of preferred shares as of the date the dividend is declared	\$16	
Number of preferred shares issued in dividend	100	
Total dividend based on <i>fair value</i> of preferred shares on the declaration date		\$1,600
Par value per preferred share	\$10	
Number of preferred shares originally issued	1,000	
Total par value of preferred shares originally issued		\$10,000
Contractual dividend rate	10%	
Total dividends based on <i>contractual rate</i> of preferred shares		\$1,000

- A7. Conversely, EY's [Financial reporting developments, a comprehensive guide, Issuer's accounting for debt and equity financings](#) (September 2024) discusses that PIK dividends may be measured either at the fair value of the instruments issued (Alternative A) or at the contractual rate (Alternative B). This interpretive guidance indicates that entities should make an accounting policy election and apply the policy consistently.

3.4.5.10 Paid-in-kind dividends –

Some preferred shares have dividends that are PIK (e.g., dividends paid in the form of additional shares of preferred stock) or permit the issuer to pay dividends in kind or in cash. If PIK, the issuer would typically issue stock with a liquidation preference amount equal to the dividends payable at the contractual rate. For example, an entity issues preferred stock that pays dividends quarterly at 2% of the liquidation preference (\$1,000,000), when and if declared by the board of directors. To the extent dividends are declared, the issuer can pay the \$20,000 quarterly dividends either in cash or by issuing shares with a total liquidation preference of \$20,000 (e.g., 20 shares of \$1,000 par amount preferred stock).

When determining the amount to accrue for the PIK dividend payable upon declaration, some entities analogize to the guidance for stock dividends in ASC 505-20, which defines a stock dividend, in part, as "An issuance by a corporation of its own common shares to its common shareholders[.]" As discussed in section 3.4.5.4, that guidance requires stock dividends (that are not treated as stock splits) to be capitalized out of retained earnings at the fair value of the shares on the declaration date. We generally believe the issuer may either (1) record the

dividend payable based on the fair value of the instruments issued (the fair value of the \$20,000 par amount of preferred stock in the example) or (2) record the contractual rate (\$20,000 in the example). The approach followed should be consistently applied.

Other PIK dividends may be for a fixed (or predominantly fixed) monetary value, so the number of preferred shares distributed will vary between the declaration date and the payment date based on changes in the fair value of the underlying preferred shares, in which case the declared dividend represents a liability pursuant to ASC 480-10-25-14.