

Snapshot

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ASU 2026-01: Initial measurement of paid-in-kind dividends

Earlier this year, the FASB issued [ASU 2026-01, Equity \(Topic 505\): Initial Measurement of Paid-in-Kind Dividends on Equity-Classified Preferred Stock](#), which amended ASC 505 to require entities to initially measure paid-in-kind (PIK) dividends on equity-classified preferred stock based on the PIK dividend rate stated in the preferred stock agreement. The amendments, which apply to all entities, are expected to improve consistency and comparability in financial reporting.

Background

Preferred stock often entitles its holders to dividends that may be either cumulative (that is, dividends accumulate whether or not they are declared) or noncumulative. Some preferred stock agreements permit or require dividends to be paid-in-kind, meaning the dividends are paid either by issuing additional shares of the same class or by increasing the liquidation preference of the outstanding preferred stock.

Before the issuance of ASU 2026-01, U.S. GAAP did not provide guidance on the initial measurement of PIK dividends on equity-classified preferred stock, resulting in diversity in practice. Some entities initially measured PIK dividends on equity-classified preferred stock at fair value, while other entities measured these dividends based on the stated dividend rate in the preferred stock agreement.

Further, some entities based the initial measurement on whether the PIK dividends are discretionary (when the issuer can choose to settle dividend obligations in cash or in-kind) or nondiscretionary. This diversity in practice led to differences in how amounts are reported in equity and how income available to common shareholders is calculated, which affects earnings per share.

The amendments in ASU 2026-01 address this diversity in practice by providing clear authoritative guidance on how to initially measure PIK dividends on equity-classified preferred stock.

Scope

The amendments apply to equity-classified preferred stock, including preferred stock that is classified as temporary equity under ASC 480-10-S99-3A, but do not apply to preferred stock classified as a liability under ASC 480.

The new guidance applies to both discretionary and nondiscretionary PIK dividend obligations that are satisfied by either (1) delivering additional preferred stock with the same terms as the original preferred

stock, or (2) increasing the value of the original preferred stock (for instance, by increasing its liquidation preference in accordance with the preferred stock agreement).

The amendments do not apply to the following:

- Dividend obligations satisfied by issuing a variable number of preferred shares with a fixed monetary value
- Deemed dividends (for example, certain redemptions of preferred stock)
- Dividends payable in common stock or other equity securities with terms that differ from the original preferred stock
- Nonmonetary distributions of assets accounted for under ASC 845

The amendments only provide guidance on the initial measurement of PIK dividends; entities should refer to other U.S. GAAP for guidance on recognition and subsequent measurement.

Initial measurement

The new guidance specifies that entities should initially measure PIK dividends on equity-classified preferred stock using the PIK dividend rate stated in the preferred stock agreement. This rate is often stated as a percentage of the preferred stock liquidation preference, which is also typically defined by the preferred stock agreement and represents the amount payable to the holder upon a liquidation event. The liquidation preference and original issuance price are often equal but may differ if the preferred stock was issued at a discount or premium.



Illustrative example: Initial measurement of PIK dividends under the amendments

On 1/1/20X6, Entity A issues 100,000 shares of Class B preferred stock for total proceeds of \$500,000 (\$5.00 per share). The preferred stock agreement includes the following terms:

- Upon a liquidation event, the Class B preferred stockholders are entitled to \$5.00 per share (liquidation preference).
- Class B preferred stockholders are entitled to an annual dividend equal to 5 percent of the liquidation preference.
- Dividends must be paid in-kind.

Entity A classifies the Class B preferred stock in equity.

At the end of year one, the fair value of a Class B preferred share is \$6.00 and Entity A declares a PIK dividend of 5,000¹ Class B preferred shares to the Class B preferred stockholders. Entity A recognizes a PIK dividend of \$25,000² by debiting retained earnings and crediting Class B preferred stock for that

¹ \$500,000 liquidation preference × 5 percent annual PIK dividend rate ÷ \$5.00 per share original issuance price.

² \$500,000 liquidation preference × 5 percent annual PIK dividend rate.

amount. Entity A also reduces income available to common stockholders by \$25,000 to reflect the PIK dividend in its calculation of earnings per share.

Effective date and transition

The amendments are effective for all entities in annual reporting periods beginning after December 15, 2026 and in interim periods within those annual reporting periods. Early adoption is permitted in both interim and annual reporting periods. If adopted in an interim period, an entity must apply the amendments as of the beginning of the annual period that includes that interim period.

Entities may choose one of the following transition methods:

- Apply the amendments prospectively to PIK dividends recognized on equity-classified preferred stock on or after the initial application date.
- Apply the amendments retrospectively through a cumulative-effect adjustment to the opening balance of retained earnings as of the beginning of the earliest period presented for PIK dividends recognized on equity-classified preferred stock outstanding as of the initial application date. In other words, the amendments would not apply to preferred stock that was redeemed or otherwise settled before the initial application date.

In the period of adoption, all entities are required to disclose the nature of the change in accounting principle, an explanation of the newly adopted accounting principle, and the method of applying that new principle.

For entities that apply the amendments retrospectively, the following disclosures are also required:

- Cumulative effect of the change on retained earnings or other components of equity as of the beginning of the earliest period presented
- 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

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