Financial Accounting

Accounting Firms Back US Board's Preferred Stock Dividends Plan

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- BDO USA PC and RSM US LLP are among accounting firms supporting a plan to clarify how companies report certain dividends paid to shareholders.
- The Financial Accounting Standards Board's draft plan aims to make it easier to compare financial reporting across companies without imposing substantial costs or compliance burdens.
- The proposal suggests rules on how issuers should initially measure paid-in-kind dividends on equity-classified preferred stock, which are paid by delivering additional preferred stock or increasing the value of the original stock.

BDO USA PC and RSM US LLP are among accounting firms throwing their weight behind a plan to clarify how companies should report certain dividends they pay out to shareholders.

The Financial Accounting Standards Board's draft plan would make it easier to compare financial reporting across companies without imposing substantial costs or compliance burdens, accounting firms and associations wrote in recent comment letters.

The board will discuss the responses at a future meeting, spokesperson Christine Klimek said in a statement.

FASB's proposed guidance is "straightforward, relying on information readily available," CliftonLarsonAllen LLP said in its letter.

The proposal, issued Sept. 30, aims to fill a gap in the accounting rulebook that Deloitte & Touche LLP brought to a FASB advisory panel late last year.

Specifically, the plan suggests rules on how issuers should initially measure paid-in-kind dividends on equity-classified preferred stock.

Companies give holders of preferred stock priority treatment when dividends are paid out. The details vary depending on the agreement between the particular company and shareholder.

Rather than taking the form of cash, the dividends within the scope of FASB's project are paid "in kind." This means companies satisfy the dividends either by delivering additional preferred stock with the same terms as the original stock or by increasing the value of the original stock according to an agreement.

It's a way of giving value to preferred shareholders that still "allows a company to preserve their cash," Scott Ehrlich, founder and managing director of educational organization Mind the GAAP LLC, told Bloomberg Tax.

Private companies being financed through equity rounds and businesses like tech firms in "high growth mode" are among those that can view preferred stock as a favored type of investment—and thus could benefit from accounting clarity, Ehrlich said.

Varied Reporting

Current accounting rules don't address how these types of dividends on preferred stock should be measured initially in corporate financial reports.

That lack of clarity has led to a variety of accounting methods, Deloitte told FASB's emerging issues task force in a December 2024 agenda request.

Some paid-in-kind dividends, for example, are "measured at the fair value of the preferred shares issuable as of the date the dividends are recognized," Deloitte said. Fair value captures current market value.

Others are measured "on the basis of the effective dividend rate of the original preferred stock instrument," Deloitte said.

FASB voted in April to tackle the project based on recommendations from the emerging issues panel.

Varied accounting can affect companies reporting earnings per share, FASB's proposal said. This metric indicates the amount of a business's profit allocated to each share of common stock.

"Anytime you pay dividends to preferred shareholders—whether it's in cash or in other assets or in kind—the value of that dividend reduces the net income available for common shareholders," Ehrlich said. "And so it reduces your earnings per share."

Measurement

Accounting groups broadly agreed with FASB's proposal, which would require paid-in-kind dividends to be measured initially based on the rate stated in the preferred stock agreement.

For example, if the agreement specifies that paid-in-kind dividends are calculated by multiplying the dividend rate by the liquidation value of the preferred stock outstanding, a company would initially measure the dividends at that amount, FASB's plan said.

This approach is "consistent with current practice for many entities," BDO USA's letter said.

It would also avoid the complexity and costs associated with the alternative method based on fair value measurements, RSM US wrote.

Fair value reflects current market conditions, which can be tricky.

"Some of these instruments are going to be very thinly traded—if they're traded at all," Brian Monsen, assistant professor of accounting at the Ohio State University, told Bloomberg Tax.

If a private business issues preferred stock with paid-in-kind dividends, such stock generally "has no readily determinable fair value due to a lack of a market for the instrument," a committee within the Florida Institute of Certified Public Accountants told FASB.

FASB's measurement approach "would avoid the need for recurring valuations," Crowe LLP's letter said.

Accounting firms told the board they don't anticipate any significant auditing challenges if the plan were to be finalized.

Still, though the approach is based on typically well-documented contractual terms, FASB should include illustrative examples in the final update to help companies work through more complex situations, CliftonLarsonAllen wrote.

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