

Innovation in Preferred Stock: Current Developments and Implications for Financial Reporting

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In this paper we investigate a significant innovation in preferred stock securities issued over the 1993–1996 period. We document trends in preferred stock use which indicate that the introduction of a preferred stock variant, trust preferred securities (TPS), is changing the landscape of corporate balance sheets with an increasing number of companies reporting securities in the “mezzanine” section of the balance sheet (between equity and debt). Referred to by many as the “Holy Grail” of financial instruments, TPS are treated as debt for tax purposes, but not for financial reporting or debt-rating purposes. Since their introduction in late 1993, they have quickly become the primary variant of new preferred stock issues, representing the majority of all new issues of preferred stock. We (1) document this trend in preferred stock issues, (2) discuss the resulting financial reporting effects of this new security, (3) identify the motivations for this trend and (4) evaluate a new FASB proposal that addresses these and other redeemable preferred securities.

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