SEC MEMORANDUM CIRCULAR NO. 11
SERIES OF 2008

GUIDELINES ON THE DETERMINATION OF RETAINED EARNINGS AVAILABLE FOR DIVIDEND DECLARATION

Pursuant to Sections 43 and 143 of the Corporation Code of the Philippines and Section 5 of the Securities Regulation Code, the following guidelines are set forth below and adopted in determining the appropriate amount of Retained Earnings available for dividend distribution taking into consideration the effective accounting standards and rules of the Commission.

SECTION 1. These guidelines shall cover the determination of availability of retained earnings for the following dividend declarations of stock corporations organized and existing under the Corporation Code of the Philippines, to wit:

a) Cash dividend;
b) Property dividend; and
c) Stock dividend.

SECTION 2. Definition of Terms.

Retained earnings - the accumulated profits realized out of normal and continuous operations of the business after deducting therefrom distributions to stockholders and transfers to capital stock or other accounts. The Retained Earnings shall be the amount as shown in the financial statements audited by the company’s independent auditor. If applicable, such amount shall refer to the retained earnings of the parent company but not the consolidated financial statements.

Unrestricted Retained Earnings - the amount of accumulated profits and gains realized out of the normal and continuous operations of the company after deducting therefrom distributions to stockholders and transfers to capital stock or other accounts, and which is: (1) not appropriated by its Board of Directors for corporate expansion projects or programs; (2) not covered by a restriction for dividend declaration under a loan agreement; and (3) not required to be retained under special circumstances obtaining in the corporation such as when there is a need for a special reserve for probable contingencies.

Outstanding capital stock - means the total shares of stock issued to subscribers or stockholders, whether or not fully or partially paid (as long as there is a binding subscription agreement), except treasury shares.

Board – Board of Directors.
Dividend – refers to corporate profits allocated, lawfully declared and ordered by the directors to be paid to the stockholders on demand or at a fixed time.

Delinquent subscription – refers to a subscription that has been declared by the Board as such after the subscriber failed to settle the same after a period of 30 days from the date the subscription became due as specified in the contract of subscription or in the call made by the board of directors.

Paid-In Capital - the amount of outstanding capital stock and additional paid-in capital or premium paid over the par value of shares.

SECTION 3. Items affecting the Unrestricted Retained Earnings Account from an accounting purview:

a. Nominal or temporary or income statement accounts closed to Income and Expense Summary at the end of the period to determine actual results of operations during the period and further closed to Retained Earnings Account;
b. Effects of changes in accounting policy;
c. Foreign exchange gains and losses;
d. Actuarial gains or losses;
e. Share in the net income of associates/joint venture accounted under equity method of accounting;
f. Dividend declarations during the period;
g. Appropriations of Retained Earnings during the period;
h. Reversals of appropriations;
i. Effects of prior period adjustments;
j. Treasury shares.

SECTION 4. Prohibition on retention of profits in excess of paid-in capital. Stock corporations are prohibited from retaining surplus profits in excess of one hundred (100%) percent of their paid-in capital stock, except:

a. when justified by definite corporate expansion projects or programs approved by the board of directors; or
b. when the corporation is prohibited under any loan agreement with any financial institution or creditor, whether local or foreign, from declaring dividends without its consent, and such consent has not yet been secured; or
c. when it can be clearly shown that such retention is necessary under special circumstances obtaining in the corporation, such as when there is need for special reserve for probable contingencies.

SECTION 5. Retained earnings available for dividends. Dividends, whether cash, property or stock, shall be declared out of unrestricted retained earnings of the Corporation. Accordingly, a corporation cannot declare dividends when it has zero or negative retained earnings otherwise known as Retained Earnings deficit. For such purpose, the surplus profits or income must be a bona fide income founded upon actual earnings or profits. The existence, therefore, of surplus profits arising from the operation of corporate business is a condition precedent to the declaration of dividend.

For purposes of these Guidelines, the phrase “actual earnings or profits”, as mentioned above shall be the net income for the year based on the audited financial statements, adjusted for unrealized items discussed below, which are considered not available for dividend declaration.
a. Share/equity in net income of the associate or joint venture accounted for equity method as the same is not yet actually earned or realized. It is only after the investee company declares such income as dividend that said income is actually realized or the earnings becomes available for dividend declaration. Due to the effect on the investment account, only cash or property dividends declared by the investee-company shall be considered as earnings declarable as dividends by the investor company;

b. Unrealized foreign exchange gains, except those attributable to cash and cash equivalents, for the time being that they are not yet actual income prior to realization of such foreign exchange gain;

c. Unrealized actuarial gains which is the result when the company chooses the option of recognizing actuarial gains or losses directly to profit or loss statement;

d. Fair value adjustment or the gains arising only from marked-to-market valuation which are not yet realized;

e. The amount of recognized deferred tax asset that reduced the amount of income tax expense and increased the net income and retained earnings, until realized;

f. Adjustment due to deviation from PFRS/GAAP of the audited financial statements which results to gain;

g. Other unrealized gains or adjustments to the retained earnings brought about by certain transactions accounted for under the PFRS such as accretion income under IAS 39, Day 1 gains on initial recognition of financial instruments, reversal of revaluation increment to retained earnings, and negative goodwill on investments in associate;

h. Other adjustments that the Commission may prescribe by amending the Annex “A” of these Guidelines.

The items above are defined in accordance with the financial reporting framework, i.e., Generally Accepted Accounting Principles in the Philippines or Philippine Financial Reporting Standards (PFRS), followed by the company.

Additional Paid-In Capital Stock shall neither be declared as dividend nor shall it be reclassified to absorb deficiency except through an organizational restructuring duly approved by the Commission.

SECTION 6. Reconciliation of Retained Earnings for Dividend Declaration.

a. For listed companies, corporations with registered securities under the Securities Regulation Code, and public companies¹, the reconciliation of retained earnings under Annex “A” of these Guidelines shall be presented as one of the schedules in the audited financial statements and shall be covered by an auditor’s report similar to that provided for Schedules A-I under SRC Rule 68.1. Said entities are likewise required to provide in their financial statements a description of any appropriation or restriction on their retained earnings.

¹ A company with at least P50 Million in total assets or such other amount that the Commission shall prescribe, and with 200 or more holders each holding at least 100 shares of a class of equity securities.
b. For all other corporations not covered by the above-provisions, the reconciliation under Annex “A” of these Guidelines shall not be required except in the following cases:

(1) The amount of unrestricted retained earnings per company’s audited financial statements is in excess of 100% of its paid-in capital as of balance sheet. The company shall in this case attach in its financial statements a reconciliation as prescribed under Annex “A”, and if the adjusted retained earnings still exceeds the company’s paid-in capital, there must be a description in its financial statements of the company’s concrete plan to comply with Section 43 of the Corporation Code;

(2) The company applies for approval by the Commission of its proposed cash and/or property dividends or for confirmation of stock dividends. As one of the supporting documents to the application or request for confirmation, the latest audited financial statements shall be accompanied by a reconciliation of retained earnings in accordance with Annex “A” of this Circular which should be covered by an auditor’s report.

SECTION 7. All existing guidelines of the Commission currently in force and effect that may be in conflict with these guidelines on the determination of unrestricted retained earnings available for dividend declaration are hereby repealed, modified or amended accordingly.


a. Except as provided in item (b) below, these Guidelines shall be effective immediately after its publication in a newspaper of general circulation.

b. Submission of a reconciliation under Annex “A” of these Guidelines:

i. For corporations mentioned under section (6)(a) and (b)(1), the requirements provided in said sections shall be applicable to audited financial statements for the period ended December 31, 2008 and onwards;

ii. For corporations covered under section (6)(b)(2), the requirements of these Guidelines shall be applicable on applications for approval of cash and/or property dividends or for confirmation of stock dividends that will be filed starting December 15, 2008.

c. Any corporation shall be subject to appropriate sanction by the Commission if a review of its audited financial statements will show declaration of dividends out of insufficient retained earnings as described under these Guidelines.

Mandaluyong City, Philippines, December 5, 2008.

For the Commission:

[Signature]

DE B. BAXIN
Chairperson
ANNEX “A”

Name of Company
Address
Nature of Dividend Declared

(Figures based on functional currency audited financial statements)

Unappropriated Retained Earnings, as adjusted to available for dividend distribution, beginning

Add: Net income actually earned/realized during the period

Net income during the period closed to Retained Earnings

Less: Non-actual/unrealized income net of tax
   Equity in net income of associate/joint venture
   Unrealized foreign exchange gain - net (except those attributable to Cash and Cash Equivalents)
   Unrealized actuarial gain
   Fair value adjustment (M2M gains)
   Fair value adjustment of Investment Property resulting to gain
   Adjustment due to deviation from PFRS/GAAP-gain
   Other unrealized gains or adjustments to the retained earnings as a result of certain transactions accounted for under the PFRS

Sub-total

Add: Non-actual losses
   Depreciation on revaluation increment (after tax)
   Adjustment due to deviation from PFRS/GAAP - loss
   Loss on fair value adjustment of investment property (after tax)

Net income actually earned during the period

Add(Less):
   Dividend declarations during the period
   Appropriations of Retained Earnings during the period
   Reversals of appropriations
   Effects of prior period adjustments
   Treasury shares

TOTAL RETAINED EARNINGS, END AVAILABLE FOR DIVIDEND