

Newsletter

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The Securities and Exchange Commission (SEC) has issued Memorandum Circular No. 16 regarding the revised guidelines on the determination of retained earnings available for dividend declaration.

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REVISED GUIDELINES ON THE DETERMINATION OF RETAINED EARNINGS AVAILABLE FOR DIVIDEND DECLARATION

To: All Concerned

The Commission has issued a SEC Memorandum Circular No. 16, series of 2023, to provide guidelines on the determination of availability of retained earnings for the dividend declarations of stock corporations pursuant to the Revised Corporation Code of the Philippines.

The Revised Reconciliation of Retained earnings shall apply to the following:

- Issuers of securities to the public
- Stock Corporation with unappropriated/ unrestricted retained earnings in excess of 100% of its paid-in capital; or
- A company that applies for an acknowledgement from the Commission of its dividend declaration, i.e., cash, stock, or property dividends.

NOTE: The revised/amended portions are highlighted in bold font and strikethrough for ease of reference.

The revised guidelines are as follows:

Guidelines on the determination of Retained Earnings available for Dividend Declaration (MC 2008-11)	Revised Guidelines on the determination of Retained Earnings available for Dividend Declaration (MC 2023-16)
SECTION 2- DEFINITION OF TERMS	
<p><i>Board</i> - Board of Directors.</p> <p><i>Dividend</i> - 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.</p> <p><i>Paid-In Capital</i> - the amount of outstanding capital stock and additional paid-in capital or premium paid over the par value of shares.</p> <p><i>Retained Earnings</i>- 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.</p>	<p><i>Board</i> - Board of Directors (BOD)</p> <p><i>Dividend</i>- refers to corporate profits allocated, lawfully declared by the corporation to be paid to the stockholders on demand or at a fixed time.</p> <p><i>Paid in Capital</i>- the sum of the amount for shares of stock, including the additional paid-in capital (APIC) or premium paid over the par value of such shares.</p> <p><i>Retained Earnings</i>- the accumulated profits realized out of normal and continuous operations of the corporation after deducting therefrom distributions to stockholders and transfers to capital stock or other accounts. For purposes of this Circular, the amount of Retained Earnings of a corporation shall be based on its separate ("stand-alone") audited financial statements.</p> <p><i>Unappropriated/ Unrestricted Retained Earnings</i> - the amount of accumulated profits and gains realized out</p>

<p><i>Unappropriated/ Unrestricted Retained Earnings</i> - the amount of accumulated profits and gains realized out of the normal and continuous operations of the corporation after deducting therefrom distributions to stockholders and transfers to capital stock or other accounts, and which is:</p> <p>(1) not appropriated by the Board of Directors for definite corporate expansion projects or programs;</p> <p>(2) not covered by a restriction for dividend declaration under a loan agreement; and</p> <p>(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.</p> <p><i>Outstanding capital stock</i> - 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.</p> <p><i>Delinquent subscription</i> - 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.</p>	<p>of the normal and continuous operations of the corporation after deducting therefrom distributions to stockholders and transfers to capital stock or other accounts, and which is:</p> <p>(1) not appropriated by the Board of Directors for definite corporate expansion projects or programs;</p> <p>(2) not covered by a restriction for dividend declaration under a loan agreement; and</p> <p>(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.</p>
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SECTION 3. PROHIBITION ON RETENTION OF SURPLUS PROFITS IN EXCESS OF PAID-IN CAPITAL

<p>It was under Section 4;</p> <p>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 capital stock, except;</p> <p>a) When justified by definite corporate expansion projects or programs approved by the board of directors; or</p> <p>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</p> <p>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.</p>	<p>Pursuant to Sec. 42 of the RCC, stock corporations are prohibited from retaining surplus profits in excess of one hundred percent (100%) of their paid-in capital, except;</p> <p>a) When justified by definite corporate expansion projects or programs approved by the board of directors; or</p> <p>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</p> <p>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.</p>
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	<p>For stock corporations with excess retained earnings, their financial statements must contain description of appropriation or restriction on their retained earnings or relevant information in connection with their compliance with the above provisions.</p>
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SECTION 4. RETAINED EARNINGS AVAILABLE FOR DIVIDENDS

<p>It was under Section 5,</p> <p>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 (0) or negative retained earnings otherwise known as Retained Earnings Deficit.</p> <p>For such purpose, the surplus profits or income must be a bona fide income founded upon actual earnings or profits. Therefore, the existence of surplus profits arising from the operation of corporate business is a condition precedent to the declaration of dividends.</p> <p>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.</p> <ul style="list-style-type: none"> a. <u>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 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;</u> b. <u>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;</u> c. <u>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;</u> 	<p>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 (0) or negative retained earnings otherwise known as Retained Earnings Deficit.</p> <p>For such purpose was surplus profits or income must be a bona fide income founded upon actual earnings or profits. Therefore, the existence of surplus profits arising from the operation of corporate business is a condition precedent to the declaration of dividends.</p> <p>Furthermore, the Reconciliation of Retained Earnings shall not be used by the Real Estate Investment Trust (REIT) companies in determining the distributable income must be in accordance with the REIT Act and its implementing Rules and Regulations.</p>
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- ~~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/GAP 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 de 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 5. AMENDMENTS TO THE RECONCILIATION OF RETAINED EARNINGS AVAILABLE FOR DIVIDEND DECLARATION

~~It was under **Section 6,**~~

~~a. For listed companies, corporations with registered securities under the Securities Regulation Code, and public companies, 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.~~

~~b. For all other corporations not covered by the above-provisions, the reconciliation under Annex "A" of~~

It was amended to account the following items:

- **The updates in Philippine Financial Reporting Standards (PFRS), particularly PAS 19, *Employee Benefits* and PFRS 16, *Leases*; and**
- **Financial reporting relief related to COVID-19 provided by the SEC and BSP**

The reconciling items are presented into the following categories:

- a) Unrealized income recognized in the Profit or Loss in the current reporting period;**

<p>these Guidelines shall not be required except in the following cases:</p> <p>(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;</p> <p>(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.</p>	<p>b) Unrealized income recognized in the Profit or Loss in prior reporting periods but realized in the current period; and</p> <p>c) Unrealized income recognized in the Profit or Loss in prior reporting periods but reversed in the current reporting period.</p> <p>In relation to Section 4 above phrase "actual earnings or profits" shall be the net income for the year based on the audited financial statements, it was adjusted for the following unrealized items:</p> <ol style="list-style-type: none"> 1. Equity in net income of associate/ joint venture, net of dividends declared; 2. Unrealized foreign exchange gain, except those attributable to cash and cash equivalents; 3. Unrealized fair value adjustment (mark-to-market gains) of financial instruments at fair value through profit or loss (FVTPL); 4. Unrealized fair value gain of Investment Property; 5. Deferred Tax Asset; and 6. Other unrealized gains and adjustments that the Commission may prescribe. <p>The Reconciliation of Retained Earnings Available for Dividend Declaration shall be filed with the annual audited financial statements and shall be covered by an Auditor's Report. In the case of a parent company, the Reconciliation of Retained Earnings must also be submitted with the consolidated audited financial statements, but the amount of the retained earnings presented therein shall be based on its separate ("stand-alone") financial statements.</p>
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Effectivity and Transitory Provisions

- a) These guidelines shall take effect immediately after publication in two (2) newspapers of general circulation in the Philippines.
- b) The revised Reconciliation of Retained Earnings Available for Dividend Declaration following the format as prescribed under Annex A shall become effective for Audited Financial Statements covering periods ending **31 December 2023** and onwards and, if applicable, for Audited Interim Financial Statements starting the first quarter of 2024, and thereafter.

Our View:

The revised guidelines on the determination of availability of retained earnings for the dividend declarations of stock corporations will help the corporations to determine the actual earnings or profits. All stock corporations

are encouraged to comply with Sec. 42 of the Revised Corporation Code of the Philippines of not having surplus profits in excess of paid-in capital.

For the full text of the Memorandum Circular, refer to the link below.

[*SEC Memorandum Circular No. 16 Revised Guidelines on the Determination of Retained Earnings available for Dividend*](#)

[*See Annex A: Revised Reconciliation of Retained Earnings Available for Dividend Declaration*](#)

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Comments and suggestions are welcome.

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