Republic of the Philippines
Department of Finance
Securities and Exchange Commission

OFFICE OF THE GENERAL COUNSEL

13 March 2019

SEC-OGC Opinion No. 19-05
Re: Declaration of Cash Dividends

SANNO PHILIPPINES MANUFACTURING CORPORATION
Special Export Processing Zone
Brgy. Jalavera, Gen. Trias
Cavite, Philippines

Attention: Pres. Yoshimitsu Sakuma

Gentlemen:

This refers to your letter dated 06 January 2015, requesting confirmation that your company Sanno Philippines Manufacturing Corporation ("SPMC") can declare cash dividends from the Retained Earnings adjusted after the Reconciliation of Retained Earnings Available for Dividend Declaration taking into account unrealized foreign exchange gains and losses, as provided by SEC Memorandum Circular No.11, Series of 2008 (the "Circular")[1].

You mentioned in your letter that in 2007, SPMC adopted Philippine Accounting Standards 21 ("PAS 21") - Effects of Changes in Foreign Exchange Rates in which it changed its functional currency from Philippine Peso (Php) to United State Dollars (USD). Consequently, the unrealized foreign exchange loss and net unrealized foreign exchange gains arising from such action caused balance deficit to the retained earnings of the corporation. You further stated that SPMC is planning to declare cash dividends but due to the deficit, it plans to treat the aforesaid items causing the deficit to be reconciling items in computing retained earnings available for dividend declaration. Thus, you are requesting us to confirm that it can declare cash dividends from the retained earnings adjusted after the reconciliation of retained earnings available for dividend declaration, as provided by the Circular.

Please be advised that the Commission *En Banc*, in its meeting on 18 January 2013, resolved that the Commission shall no longer make any confirmation or denial of a company's computation of retained earnings/deficit available for dividend declaration, due to the fact that the issuance of a confirmation opens the Commission to a possible complaint

[1] SEC Memorandum Circular No. 11, Series of 2008, Guidelines on the Determination of Retained Earnings Available for Dividend Declaration, 5 December 2008

complaint from third parties who might be prejudiced by the dividend declaration out of adjusted retained earnings.[2] Further, as a matter of policy, the Commission refrains from rendering opinion on matters which involve the substantive and contractual rights of private parties who would, in all probability, contest the same in court if the opinion turns out to be adverse to their interest.[3] Thus, we cannot render a categorical or definitive opinion on the matter.

However, for purposes of information only, the following may be imparted:

The Circular provides:

Section 5. Retained earnings available for dividends. Dividends, whether cash, property or stock, shall be declared out of unrestricted retained earnings of the Corporation...xxx... For such purpose, the surplus profits or income must be a bona fide income founded upon ***actual earnings or profits*** (SEC Opinion dated October 2, 1981). xxx (*emphasis supplied*)

For purposes of these Guidelines, the phrase "actual earnings or profits" as mentioned above shall be the net income for the year as determined under Philippine Financial Reporting Standards ("PFRS"), **adjusted for unrealized items discussed below**, which are considered **not available** for dividend declaration.

The following items shall **not be 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;

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[2] Resolution in meeting dated 18 January 2013
[3] Sec.5.2, SEC Memorandum Circular No.15 series of 2003

(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.

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Section 6. Reconciliation of Retained Earnings for Dividend Declaration

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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 exceed 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.

A Pro-Forma Reconciliation of Retained Earnings attached as Annex "A" in the Circular and presented in the Financial Reporting Bulletin No.14, is shown below:

Unappropriated Retained Earnings, beginning	P xxx
Adjustments: (see adjustments in previous year's Reconciliation)	P xxx
Unappropriated Retained Earnings, as adjusted, beginning	P xxx
Net Income based on the face of AFS 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 Equivalent) 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 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)	P xxx
Net income Actual/Realized	P xxx
Unappropriated Retained Earnings, as adjusted, ending	**P xxx**

Given the foregoing, it must be emphasized that among the supporting documents required by the Circular when applying or requesting for approval of cash and/or property dividends or for confirmation of stock dividends is *the latest audited financial statements accompanied by a reconciliation of retained earnings covered by the auditor's report.*

With regard to the treatment of foreign exchange loss as a reconciling item, paragraph 41 of PAS 21 provides:

"These exchange differences are not recognized in profit or loss because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations. The cumulative amount of the exchange differences is presented in a separate component of equity until disposal of the foreign operation."

Please be guided accordingly.

CAMILO S. CORREA
General Counsel