Jihočeská univerzita
v Českých Budějovicích
University of South Bohemia
in České Budějovice

FINANCIAL STATEMENTS
- Study Text

CLOSING (BALANCING) OF ACCOUNTING BOOKS

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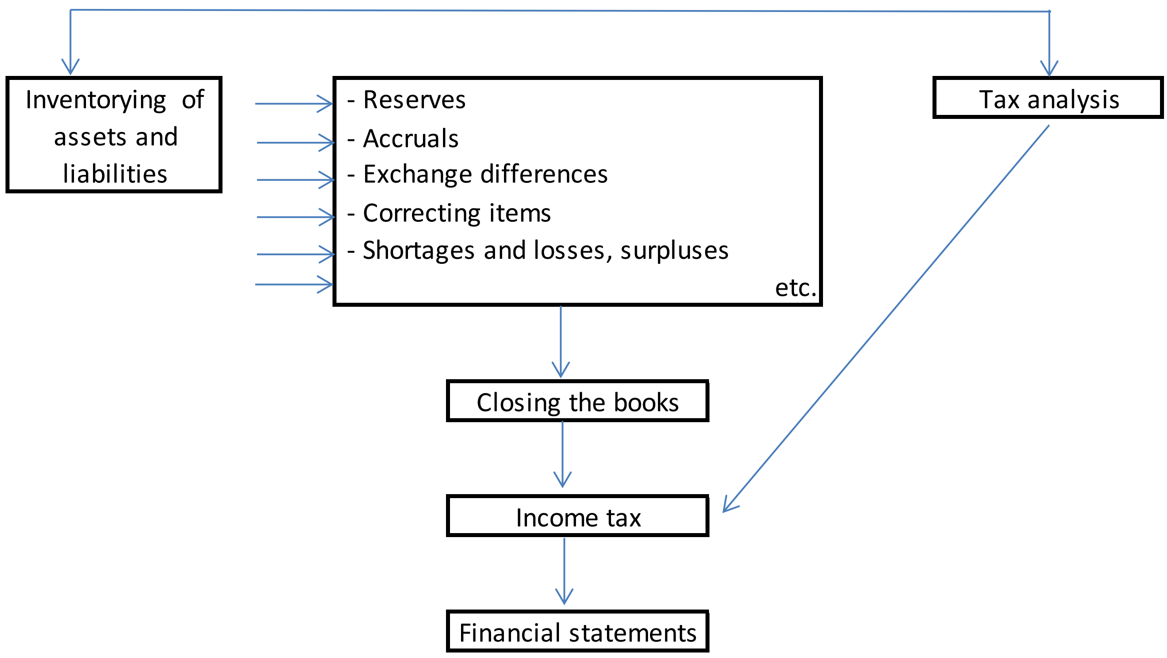
1 CLOSING OF ACCOUNTING BOOKS

Accounting work and procedures that take place at the end of the accounting period and at the start of the next period can be called balancing (closing accounting books). This is based on the requirements of:

- law regulation (Act no. 563/1991 Coll., On Accounting; Order no. 500/2002 Coll.; Czech Accounting Standards for Businesses),
- the accounting procedures (internal directives).

Figure Closing of accounting books



Source: author

It is therefore a **sequence of works that guarantee**:

1. Compliance with the assumptions on which accounting is based = <u>accuracy and completeness</u> of accounting books during the reporting period through:
    - accrued costs (expenses) and revenues (accrual accounting principle),
    - billing accruals,
    - billing adjustments,
    - repair of account balances based on inventory,
    - settlement money on the way (transferred cash), etc.

2. <u>Calculation and accounting for income taxes:</u>

The system of taxation of the Czech Republic resembles the systems of taxation of other European countries. Generally, taxes can be divided into direct taxes, related to the level of income of the subject, and indirect taxes, related to consumption, or the purchase of goods and services. Each type of tax is defined in a specific piece of legislation. The administration and collection of individual taxes falls under the Ministry of Finance of the Czech Republic and its subordinate administrative bodies, but above all, the local tax authorities.

The most typical and the most common class is the classification according to tax impact. We may distinguish between **direct taxes** and **indirect taxes**. The difference between direct and indirect taxes depends on whose incomes are influenced by tax, and may be described as follows:

- Direct taxes are assessed on every taxpayer according to his/her incomes and property, and usually respect the personal situation of the taxpayer. Direct taxes influence directly the income of the payer (corporation, employee, employer, consumer, etc.) which pays the tax simultaneously to a financial agency.
- On the other hand, indirect taxes are paid and collected on the prices of goods, services, etc. and do not respect the personal situation of the taxpayer. In practice, it works in the system that, the indirect tax is collected by the seller from the customer in the price of goods, products, etc., and the amount of tax is sent to the financial agency by the seller. The most important indirect taxes are value added tax and excise taxes.

Income tax is undoubtedly one of the most complex forms of tax that exists. The document is based on Act No. 586/1992 Coll., that had been revised by the end of 2013. Income tax represents the main tax duty. It is divided into the income tax on a natural person and the income tax of legal entities, with different tax rates. The income tax on a natural person has a flat 15% rate. The rate is the same for wage earners and self-employed people. The current income tax of legal entities is 19 %. Pension and investment funds pay 5% corporate tax. Since January 2014 an inheritance tax and gift tax is a part of the income tax which were originally separate taxes.

a) Personal Income Tax

- The payor – the accounting unit (employer).
- The taxpayer – the subject other than the accounting unit (employee).
- These forms of income of natural persons are subject to taxation:
    - Personal Income Tax from dependent activity (employment) and emoluments of office-holders (function benefits), e.g. wages.
    - Income from business and other self-employment.
    - Income from capital assets, e.g.: interests, dividends.
    - Income from leasing.
    - Other forms of income, e.g.: occasional income, income from the sale of property and movable assets, winnings
- Personal income tax – withheld in the form of advances or deductions from employees.
- Personal income tax – is not charged to the costs of the accounting unit.

b) Company Income Tax

- The taxpayer – entities, i.e. the accounting unit, e.g. companies, civil corporations, political parties, interest corporations, foundations, municipalities, state corporations, banks, insurance companies, organizational components of the State, etc.
- Two types of taxpayers liable to corporate income tax:
    - Tax residents – entities having their seat or head office in the Czech Republic.
    - Tax non-residents – entities not having their seat or head office in the Czech Republic.
- Paying advance payments – amount and frequency depends on the last known tax liability.
- Taxable period – a choice between calendar year (beginning on the first day of the first month, twelve months long) or an economic year (twelve months long, beginning on the first day of any other month than the first month of the year).

The transformation of gross profit for the tax base and after applying the appropriate tax rate – see on next figure. The tax base, rounded down to thousands, is calculated according to a set percentage, which for legal persons is 19% and natural person 15%. Calculated income tax is considered income tax payable.

Figure Tax system and accounting system

Tax system	Accounting system
	Revenue of the accounting period (6th class) - Cost of the accounting period (5th class) = Gross profit or loss
Gross profit or loss +/- Costs and revenues tax-included = Tax base - Items decreasing tax base = Tax base after adjustments Income tax - Tax credits ------------------------ Tax liability	Income tax payable 591/341 = Available economic result +/- Deferred income tax 592/481 = Profit for distribution (710)

Source: author

The transformation of Gross Profit/loss into the tax base is carried out in particular in costs and revenues tax-included:

- amounts that cannot be recognized under the Income Tax Act as an expense (expenditure) incurred to achieve, secure and maintain taxable income
- amounts that are included in the costs incorrectly
- all amounts unduly reducing revenue
- income already taxed by the payer (tax at source)

For example, in a specific form in the tax base cannot be included:

- creation of non-statutory reserves
- creation of non-statutory adjustments
- contributions to legal entities that do not result by law
- expenditure exceeding the limit set by the relevant legislation
- representation costs
- remuneration to members of statutory bodies
- a technical improvement exceeding a set limit
- mankind and damage over and above compensation for damages,

The next main items decreasing income tax base can be:

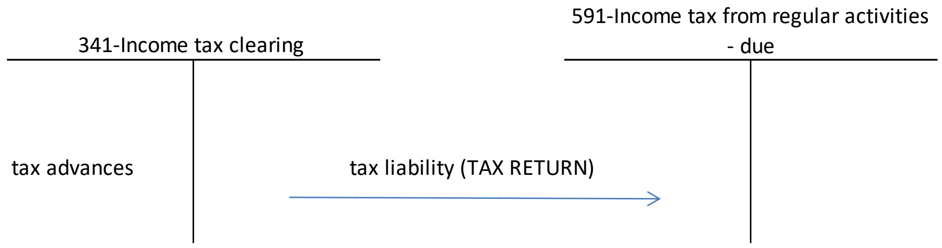
- loss from previous periods
- costs of research and development
- donations, etc.

From the calculated tax can be deducted further (tax credit), eg: fixed amount for each disabled worker depending on the grade his disability.

Tax accounting - for billing income tax in accounting is used class 5 and 3:

- 591- Income tax on regular activities – due,
- 341- Income tax clearing.

Figure Charging about Income Tax

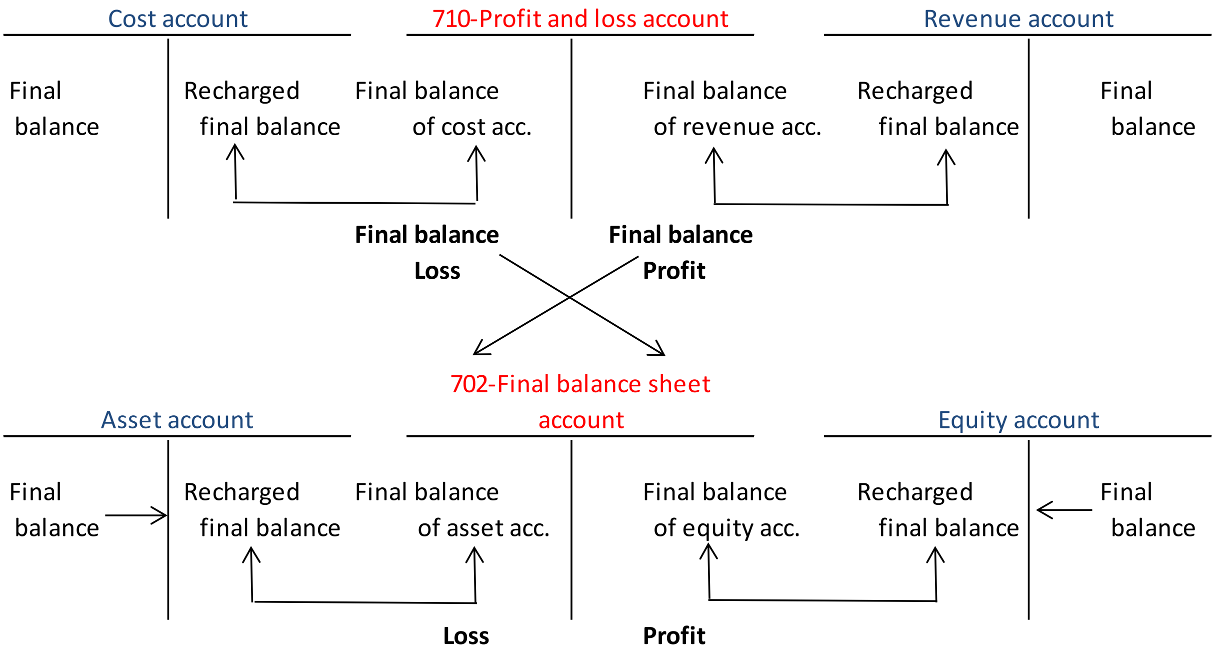


Source: author

3. Closing the books:

- After all activities to ensure the veracity of the accounts may become formal stage of accounts - closing the books on the last day of the accounting period, i.e. the balance sheet date:
    - finding turnovers of parties credit and debit individual ledger accounts,
    - final states of active and passive accounts and their transfer to 702 – Final balance sheet account,
    - finding final states of costs and revenues accounts and their transfer to 710 – Profit and loss account, where are also found:
        - Profit/loss operation (the difference between revenues billed in Gr. 60-64 and costs in Gr. 50-55, 58)
        - Profit/loss financial (the difference between revenues billed in Gr. 66-67 and costs in Gr. 56).
- Determination of total profit for the period on account 710 - Profit and loss account in the form of the difference between total revenues and total costs and transfer to a 702 – Final balance sheet account. There is profit/loss listed as a differential value, without account number.

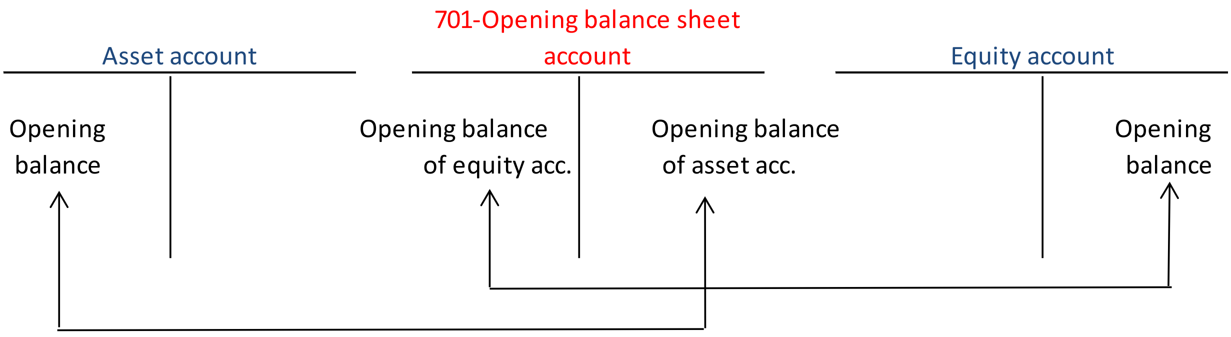
Figure Closing accounts



Source: author

4. Ensure balance continuity:
   - General ledger accounts are closed on the basis of the closing Account 702 – Final balance sheet account. Acceptance of initial states is performed through double-entry book entry 701 – Opening balance sheet account (which account for the mirror 702).
   - Profit/loss in the new period with a corresponding entry account 431 – Economic result for distribution and is ready for distribution by the legal rules of the Commercial Code, the General Meeting, etc.

Figure Opening accounts



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