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Abstract	<p>The basic principle of the creation of accounting provisions and allowances is the principle of prudence and a true and fair view of the entity. The allowances are used to express a temporary reduction in the value of assets, while the provisions are a source of increasing costs intended to cover future debts or expenses, of which purpose is likely to incur but the amount or the date on which they arise are uncertain. There was a questionnaire survey, which was attended by 673 enterprises. The goal was to determine whether the size and scope of enterprises are linked to the creation of provisions and allowances. It was not found out that the creation of provisions and allowances depends on the size and industry of enterprises. The different types of provisions and allowances and their representation in enterprises were also examined. It was found out that 39% of businesses have never created any provisions and allowances. Most often nontax provisions (21%) are created. As a result, insufficient creation of provisions and allowances was found out.</p>
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Keywords (separated by '-')	Accounting provisions - Allowances - Czech GAAP
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The Use of Tax and Nontax Provisions and Allowances

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Introduction

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The business is naturally connected with a certain degree of uncertainty and potential as well as very real risks. A sensible entrepreneur is aware of this and creates financial and other provisions during relatively better times for overcoming less favorable times. The situation is similar for allowances which also result from rational concern about future results. Provisions and allowances are mostly divided into legal alias tax, pursuant to the law on provisions for determining the income tax base no. 593/2002 Coll. as amended (LoR), and other alias accounting. The basic principle of the creation of accounting provisions and allowances is the prudence

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28 principle and a true and fair view of the accounting unit. This paragraph should
29 contain literature review or review of conducted research.

30 Literature Review

31 *Allowances in Czech Accounting*

32 Allowances (AE) correct the original value of impaired assets to lower current
33 market value. This is a temporary reduction in assets value. The task of allowances
34 is to adjust the valuation of the relevant assets in the event it is proved during
35 inventorying at the latest that there has been a temporary reduction in value
36 (Kovanicová 2008). Allowances are used to express a temporary reduction in the
37 assets value that is proved during inventorying, is sufficiently important from the
38 perspective of the accounting unit, is not permanent, and is not expressed in other
39 way, e.g., by real value of securities (Poradce 6/2016). The creation of allowances
40 to individual asset categories (long-term assets, stock, short-term financial assets,
41 receivables) must be economically justifiable (Ryneš 2013). Reduction in assets
42 value by AE is only an indirect valuation change; the original accounting valuation
43 does not change, and the created AE is monitored on a separate assets account,
44 which is subject to the correction (Poradce 6/2016). Legal allowances can be
45 created only for receivables. Allowances for receivables enable to capture reduction
46 in receivables for a temporary period. Thus they are the tools enabling a temporary
47 solution which precedes a final solution (execution, assignment, receivable write-
48 off) (Hnátek and Zámek 2014). Allowances for receivables are according to
49 Poradce (6/2016) in practice widespread. According to the LoR as amended, it is
50 possible to create six kinds of legal AE, most of which are three (Poradce 6/2016):
51 insolvency AE for receivables of debtors in insolvency proceedings (§ 8 LoR), time
52 AE for receivables due after 31 December 1994 which are not out-of-date (§ 8a
53 LoR), and the prescription period is of 3 years according to § 629 LoR, “small AE”
54 for relatively small receivables up to 30,000 (§ 8c LoR). Once the AE is created, it
55 is possible to write this receivable off in a tax effectively way (Křemen 2010).

56 As we have already mentioned, the creation (or increase) of legal allowances is a
57 tax-effective expense of the taxpayer pursuant to § 24 para. 2 letter i of the Act
58 no. 586/1992 Coll., the Income Tax Act (ITA), as amended. Also the cancellation
59 (or reduction) is a tax-deductible record under the general provisions of § 23 para.
60 2 and 10 of the Income Tax Act. Although the AE are only temporary, they have
61 three significant tax benefits: they reduce the tax base by the formation
62 non-collected claims (§ 24 para. 2 letter i) of the ITA, legal AE increases the tax
63 value of receivables when being assigned (§ 24 para. 2 letter s) of the ITA, and the
64 receivable write-off is a tax cost up to the amount of its legal AE (§ 24 para. 2 letter y)
65 of the ITA. General rules for creating legal AE are set out in § 2 and § 4 LoR as
66 amended. Dealing with problematic receivables is usually one of the most difficult

tasks in accounting practice. The accounting practice includes the following: to deal with correct accounting and tax context, it is necessary to have the knowledge of numerous legal regulations and as a follow-up to it to create an internal regulation, in which the enterprise provides options and procedures in dealing with problematic and irrecoverable receivables (Poradce 11/2016). The internal regulation should cover not only procedures for provisions having the support of the Income Tax Act but mainly for provisions, which the accounting entity creates on the grounds of correct statement of assets and liabilities value in accordance with the principle of prudence (Koch 2016).

Provisions in Czech Accounting

Pursuant to § 57 of the Accounting Act no. 563/1991 Coll. as amended (AA), provisions are the source increasing costs intended to cover future debts or expenses, of which purpose is known; it is probable that they will occur but the amount or the date on which they arise is uncertain. Provisions are treated as a liability. Their use is related to the accounting and economic effort to evenly spread the higher expected future one-off costs (expenses) at a time. Provisions are accrued expenses by their nature (Poradce 6/2016). Synek (2006) defines provisions as provisions for unforeseen needs arising from timing differences of costs, occurring continuously, and from expenses that will arise in the future. They are reported as a separate liability item. A reserve is a liability of uncertain timing and amount (Jilek and Svobodová 2013). It is often uncertain if the expense, for which the reserve is created, will certainly occur, but its realization is probable (Sramkova and Křivánková 2008). A reserve is reported in accordance with IAS 37, if an enterprise has a present liability, for which settlement resources outflow will be necessary and the liability reliably realizable (Dvořáková 2008). This is why a reserve is considered a liability (Ryneš 2013): it is a potential liability to third parties, e.g., to product purchasers due to repairs under warranty, and expenses are expected in future periods (internal debt of an accounting entity), e.g., repairing tangible fixed written-off assets. A reserve is reported in the balance sheet within liabilities, because it represents recognition of current liability (Kovanicová 2008).

An accounting entity shall provide in its internal rules (Koch 2016): for what expenses it will form a reserve, under what conditions, how it will determine the amount of these provisions, at what point it will draw it, or cancel it.

As with AE, provisions are also mostly divided into legal (tax) and other (nontax). The most common provisions in business practice are legal (tax), of which creation is set by the LoR as amended, bank provisions § 5 LoR, insurance provisions § 6 LoR, a reserve for tangible assets repairs § 7 LoR, a cultivation activity reserve § 9 LoR, a reserve for electrical waste handling § 11a-11c LoR, and other legal provisions, e.g., for pond sludge removal and land remediation, § 10LoR.

107 The reserve for tangible assets (HM) repairs pursuant to § 26 par. 2 of the ITA is
108 the most widespread legal reserve, of which tax writing-off period is 5 years or
109 more. The reserve must be created in at least two consecutive tax periods. The
110 expected year of repairs launch is not included in the number of years of reserve
111 formation (Vančurová and Láchová 2008). The reserve for tangible assets repairs
112 shall not be created (Koch 2016): if it is a technical evaluation, for tangible assets
113 intended for disposal, for tangible assets if the repair is carried out repeatedly every
114 year, and for tangible assets to which a taxpayer in bankruptcy and settlement
115 proceedings has a right of ownership. The enterprise must be able to prove the
116 amount and the creation method (Koch 2016). Provisions can be generally formed
117 in two ways: depending on time or depending on performance (Hnátek and
118 Strouhal 2010).

119 The accounting entity should consider related risks associated with estimating
120 the amount of future payments at the creation of provisions. It should be based on an
121 analysis of various options of potential future development, and, in line with the
122 principle of prudence, it should be rather based on higher estimated amounts
123 (Dvořáková 2008). The enterprise is required to keep a book inventory of pro-
124 visions (Strouhal 2007). A deposit condition was introduced for provisions for TA
125 repairs, of which production began after January 1, 2009. The taxpayer must deposit
126 an amount corresponding to the reserve creation on a special tied account, until the
127 deadline for submitting tax returns for income tax for the corresponding tax period
128 (Poradce 6/2016).

129 Creating other provisions is in accordance with the accounting principle of
130 prudence, because the creation of other accounting provisions is not a tax expense;
131 thus, logically their use is not relevant for tax purposes. AA defines these kinds of
132 accounting provisions (Koch 2016): provisions for risks and losses (e.g., legal
133 actions, guarantee repairs, environmental damages), provisions for income taxes,
134 provisions for pensions and similar obligations, and provisions for restructuring.

135 **Data and Methodology**

136 Seven hundred two legal entities – accounting entities, which were categorized
137 pursuant to Regulation No. 250/2015 Coll. – were surveyed during February–May
138 2016 in a questionnaire survey. Twenty-nine questionnaires were excluded from
139 this amount, because they failed to answer all three questions. Six hundred seventy-
140 three questionnaires were therefore included in the questionnaire survey analysis.
141 The questionnaire construction was very simple and contained the aforementioned
142 three questions. It was necessary to categorize the accounting entity pursuant to the
143 new Regulation No. 250/2015 Coll. in the first question. A note was available to
144 respondents with the information of the limit amount of assets, net turnover, and the
145 number of employees for each accounting entity category. The respondents were
146 asked to state the prevailing industry in which they operate by the CZ NACE
147 (section A-U) (CZ NACE 2016) classification, in the second question. The third

question concerned the creation of provisions and allowances. The respondents 148
were asked to comment here as to whether their accounting entities created pro- 149
visions and allowances and what type of provisions/allowances they created. 150

This question was half-open, and had variants (a–g), while the respondents were 151
to note the type nontax provisions. The questionnaires also contained information 152
about the enterprise registration number, which was used for checking the ques- 153
tionnaires validity. The questionnaires were collected in paper form, and they are at 154
the author’s disposal. The questionnaire results were processed by the method of 155
statistical test of independence and descriptive statistics in Statistica software. 156

Results and Discussion 157

The area of provisions and allowances is analyzed with the help of hypotheses: 158

- H1: The accounting entity size does not affect the creation of provisions and 159
allowances. 160
- H2: The accounting entity field of activity does not affect the creation of 161
provisions and allowances. 162

The questionnaire results are analyzed by descriptive statistical methods. The 163
last part of result survey dealt with the analysis of two types of nontax provisions. 164

The Effect of the Entity Size 165

Hypothesis H1: The accounting entity size that does not depend on the creation of 166
provisions and allowances was proved (Table 1). 167

Hypothesis H2: The accounting entity field of activity that does not depend on 168
the creation of provisions and allowances was proved as well (Table 2). 169

Statistical Evaluation of the Creation of Provisions and AE 170

The fundamental part of the questionnaire survey was the third question, which 171
inquired the creation of provisions and allowances: (a) the enterprise does not make 172
any provisions, (b) it creates legal (tax) provisions for tangible assets repairs (§ 7 of 173
the Act no. 593/1992 Coll., as amended), (c) other legal (tax) provisions, e.g., for 174
pond sludge removal, sanitation and cultivation activities, electrical waste han- 175
dling, or bank provisions and insurance provisions (§ 5, 6, 9, 10, 11 of the Act 176
no. 563/1992 Coll. amended), (d) tax allowances for receivables of debtors in 177
insolvency proceedings (§ 8 of the Act no. 593/1992 Coll., as amended), (e) tax 178
allowances for receivables which are not out-of-date (§ 8a of the Act no. 593/1992 179

t1.1 **Table 1** The dependence of
t1.2 accounting entity size on the
t1.3 creation of provisions and AE

Statist.	Statistical summary; ZP: Prom1 (Chart1)
	Value
R	0.249
R ²	0.062
Modified R ²	0.060
F(1669)	44.437
p	0.000

t1.8 Source: Own calculations

t2.1 **Table 2** The dependence of accounting entity field of activity on the creation of provisions and AE

Statist.	Statistical summary; ZP: Prom2 (Chart1)
	Value
R	0.080
R ²	0.006
Modified R ²	0.005
F(1669)	4.382
p	0.036
Sm. Error of estimate	4.689

t2.10 Source: Own calculations

180 Coll., as amended), (f) nontax allowances for receivables, and (g) other nontax
181 provisions. The evaluation of this issue is contained in Table 3. Significant fre-
182 quencies are in bold.

183 Table 4 was further modified in order to find out the total amount of individual
184 variants.

185 *The Creation of Other Nontax Provisions*

186 As already mentioned, it was possible to state the purpose for which the reserve is
187 formed for the response variant (g) “the creation of other nontax provisions.” The
188 results are shown in Table 5.

189 It was confirmed that the creation of provisions and allowances does not depend
190 on the size and the entity field of activity by the hypotheses H1 and H2 test. The
191 survey revealed no combination of provisions and allowances that would be
192 significant. As a result of this, companies use only one type of these items. Next,
193 it was found out that about 40% of companies do not use provisions and allowances
194 at all. Twenty-one percent of companies account for nontax provisions, and 16% of
195 companies account for tax provisions for tangible assets repairs. On the contrary,
196 the least used tools for the principle of prudence are tax and nontax allowances for
197 receivables. Concerning the creation of other nontax provisions, provisions for

Table 3 Variants of the creation of provisions and allowances

Variant	Abs. frequency	Rel. frequency	Variant	Abs. frequency	Rel. frequency
a	300	44.58%	c,g	12	1.78%
b	101	15.01%	d	14	2.08%
b,c	4	0.59%	d,e	4	0.59%
b,d	1	0.15%	d,e,f	1	0.15%
b,d,e,f	4	0.59%	d,e,f,g	4	0.59%
b,d,g	2	0.30%	d,e,g	2	0.30%
b,e	4	0.59%	d,g	1	0.15%
b, g	9	1.34%	e	20	2.97%
c	35	5.20%	e,f	4	0.59%
c,d	2	0.30%	e,f,g	3	0.45%
c,d,g	3	0.45%	e,g	3	0.45%
c,e	1	0.15%	f	12	1.78%
c,f	2	0.30%	f,g	2	0.30%
c,f,g	3	0.45%	g	120	17.83%

Source: Own calculations

Table 4 The overall representation of the creation of provisions and allowances

Question variants	Absolute frequency	Relative frequency
a	300	38.76%
b	125	16.15%
c	62	8.01%
d	38	4.91%
e	49	6.33%
f	35	4.52%
g	165	21.32%

Source: Own calculations

unexpended leave (23%), income tax (17%), bonuses (11%), and warranty repairs (10%) are mostly created.

Conclusion

Given the above, it is possible to say that companies do not use allowances. This reduces, to some extent, the true accounting presentation, as assets are overvalued and their reporting is not in line with the principle of prudence. As for the provisions, companies use nontax provisions as resources for future liabilities, usually for unexpended leave payments (23%). However, unexpended leave should be paid out only in exceptional cases of employees' leaving, so the creation of this reserve is misleading, to some extent. On the contrary, the creation of provisions for warranty repairs was found out only in 10%, which is totally insufficient and,

t5.1 **Table 5** The creation of other nontax provisions

t5.2	Reserve purpose	Freq.	Rel. freq.	Reserve purpose	Freq.	Rel. freq.
t5.3	Unexpended leave	54	22,78%	Waste disposal	3	1,27%
t5.4	Income tax	40	16,88%	Credit losses	3	1,27%
t5.5	Bonuses	27	11,39%	Guarantee commitments	3	1,27%
t5.6	Warranty repairs/ service	24	10,13%	Unprofitable rent	3	1,27%
t5.7	Business risks	20	8,44%	Exchange rate and price differences	2	0,84%
t5.8	Pension	10	4,22%	Disposal of assets	2	0,84%
t5.9	Litigations	9	3,80%	Restoration	2	0,84%
t5.10	Benefits	6	2,53%	Environmental damages	1	0,42%
t5.11	Redundancy payment	6	2,53%	Unclaimed gift vouchers	1	0,42%
t5.12	Work/life anniversaries	6	2,53%	Risk for violation of budg. Discipline	1	0,42%
t5.13	Future losses	5	2,11%	Returned goods	1	0,42%
t5.14	Unreturned packaging	4	1,69%	Purchase of vehicles	1	0,42%
t5.15	Audit	3	1,27%			

t5.16 Source: Own calculations

209 e.g., international financial reporting standards, in particular IAS 37, expressly
 210 require the creation of this type of reserve. Legal provisions for tangible assets
 211 repairs are also uncommon, which is accounted for by only 16% of companies. A
 212 possible reason could be the tightening of rules for their creation, so the companies
 213 are obliged to deposit the amount of the reserve on a special bank account. It is
 214 possible to conclude that the use of provisions and allowances is inadequate, not
 215 respecting the principle of prudence and a true and fair view of assets and liabilities.

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Uncorrected Proof

Author Queries

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