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## YEAR END ACCOUNTS AND TAX REVIEW FOR COMPANIES

Spain is not like the UK, and many other countries, in that almost all businesses have a calendar year accounts cycle. In fact, it would be true to say that only businesses with foreign head offices have accounting periods that do not match the calendar year.

Consequently, this cause January to April to be a period of intense work for businesses and especially their advisers, who need to concentrate on closing the previous year of accounts. The work cycle for the accounting profession is therefore seriously skewed in Spain with the first half of the year having one deadline after the other. Professional accountancy firms have to wait until the 25 July before they can take a decent break from work.

It is fairly typical for small business owners to leave it to their asesoría or gestoría to deal with these matters and trust them to get everything right. **However, company accounting and tax regulations put all the responsibilities exclusively on company directors.** If mistakes are made the company will be sanctioned and responsibility passes to the directors personally if the company does not pay any fines that are assessed.

Also, there are significant tax risks in not having correct bookkeeping, all explained below.

The review we propose in this article should really be started in October or November of the year in progress but human nature being what it is, matters are usually left until the next year.

As the directors must formulate the annual accounts by 31 March, and file in the mercantile registry the company's official books by 30 April, this review should be concluded no later than 31 March so that the accounts can be finalised within the legal timescales.

This article provides a guide for business managers to understand the key issues that they should consider during these important months to ensure that the affairs of their companies are in good order.

It should be said that the professionals doing the accounting and tax work welcome the input and interest of their clients in the accounts and tax affairs of the company. The input of clients helps them do their job properly, especially because it is so difficult for many professionals to invest enough time during these difficult months to make sure that everything is, indeed, right.

In this article we have also tried hard to demystify accounting for the directors of small businesses. We have explained the basics of the Spanish accounting structure and how to get the right information to check up the company accounts. We have also examined the areas where we have seen, over 35 years in Spain, the greatest problems areas.

As always, if you have concerns with the accounts of your business, we are happy to conduct a desktop review and give preliminary guidance free of charge and with no obligation. Obviously, we are interested in finding new clients, but we also have a genuine interest in helping the expat community with doing business in Spain.

Some may find the comments about the standard of bookkeeping in Spain less than complimentary. But what we have described is our experience, not 35 years ago when accounting regulation in Spain was in its infancy, but as recently as last year. In fact, whenever we acquire a new client, the first job we undertake is a thorough review of the past as we don't want unexpected problems to raise their ugly head unexpectedly.

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## Annual general meeting and company accounts filing

Company law requires that the company accounts should be closed by the end of March\*\* ready to be approved by the shareholders on or before 30 June at the annual general meeting and then published in the mercantile registry within a month of the meeting.

## The basic structure of company accounts

Without going into a lot of technical detail, all Spanish companies must record financial transactions in a double entry bookkeeping system.

All Spanish companies use similar systems that analyse income and expenses, assets and liabilities using standard code numbers. Here is a simplified explanation of the accounts coding system so you can find the concepts you are interested in.

The standard codes are divided into 7 main groups, as follows:

- 1 Company basic financing, share capital long term loans
- 2 Fixed assets and depreciation
- 3 Stock and work in progress
- 4 Customer debtors and supplier creditors
- 5 Financial accounts, banks etc
- 6 Expenses for the year
- 7 Income for the year

These groups are further subdivided by adding three further digits so that the standard codes become like the following examples:

1000.0000	Share capital
4300.0000	Customer balances
5720.0000	Bank account
6250.0000	Insurance
6260.0000	Bank charges
7050.0000	Sale of services

So, the first four digits are the standard codes, and the second four digits are optional sub codes. Example, if you have several bank accounts they would be like the following:

5720.0001	Banco Sabadell acc. 0123456789
5720.0002	Banco Santander acc. 6666666666

## What documents do you need to check the company's accounts?

The best way to make sure that the accounts of a company make sense is to focus on these account numbers. You need to ask your adviser to supply you with a report called the 'Sumas y Saldos', in English this is the Trial Balance. This report totals the movements in each account during the year as well as providing the balance on each account.

This report lists the account balances on a particular date so ask your adviser for a Sumas y Saldos as at 31 December.

If your review of these balances gives you confidence that all is well, but you want to delve more deeply into the detail or you find balances that seem odd or are downright nonsense, then you need to ask for the "Mayor" for the offending accounts. The 'Mayor' in English is the nominal or general ledger and it lists all the transactions in an account.

In this guide, in the title of each concept that we discuss, we will provide the standard account codes.

It is most important to understand that the balances on the accounts must represent REALITY. Example: the real balance of your bank account on 31 December should appear as the balance of the corresponding account starting with 572. Do not be put off by technical gobbledegook or excuses that don't make sense. The accounts must make sense to you as being a director, you will be taking 100% responsibility for their detail by signing them off.

### Sales and other income (Codes starting with 7)

This is a reasonably obvious section, and most business owners will be able to look at the sales and income figures and know immediately that they are correct. Nevertheless, check that different types of income are shown separately, for example the sales of goods belong to the codes starting with 700 and sales of services should be recorded in accounts starting with 705.

### Costs (Codes starting with 6)

The same applies to costs which are all recorded in accounts starting with 6. Most bookkeepers will make correct allocations of costs and a business owner will readily understand the totals that are being reported.

### Profit margins from the sale of goods (Codes starting with 70/71 and 60/61)

This is a bit more complicated. First obtain the sale value of the goods (70 codes) and deduct the corresponding cost value of codes (60 codes). This will give you the gross profit on the sale of the goods.

However, if you maintain a stock of goods then gross profit needs to be adjusted by the increase (71 codes) or decrease of stock value (61 codes) over the year. If the stock value has increased add this to the gross profit and if stock has reduced, deduct this from the gross profit.

Now divide the adjusted gross profit by the total sales of goods and this will give you the gross profit margin.

If you maintain a sock of goods and you are not asked its value each year, then this could result in a serious defect in your accounts and tax filings.

The gross profit margin is one of the most important metrics in a business that sells goods and one that every business owner should monitor. The tax office certainly does, and an abnormally low gross profit margin would cause serious problems in the event of a tax inspection, as the inspector would suspect that you have unrecorded cash sales.

### Fixed assets (codes starting with 2 and 21)

Over the years the business will have purchased various assets, property, vehicles, computers, software, etc.

As these costs relate to assets that will be used by the business over several years, they are treated as fixed assets when purchased and not treated as a cost in the 6 group.

Each year, part of their cost will be amortised or depreciated, over their useful life. The depreciation is accounted for with codes 280 and 281 as explained next.

All too often these balances just seem to continue to exist forever, even though the vehicle was sold, the computers replaced, the desk thrown away, etc. It is an error for assets that have ceased to exist to be shown in the company's bookkeeping.

It may seem unbelievable, but we have even come across companies whose accounts omitted substantial real estate that cost millions of Euros and had been acquired years ago!

### Amortisation of fixed assets (Codes starting with 280 and 281)

Each year a proportion of the cost of fixed assets is treated as having depreciated. For example, a desk might be regarded as having 7 years of life, so one-seventh is treated as an expense each year.

This expense is recorded by making a bookkeeping entry to the 280/2681 code each year that matches the 20/21 fixed asset code. The counterpart of this entry is put in the cost code 680/681.

Sometimes we see that the amortisation code in the 280/281 code actually exceeds the original cost. This is an error.

### Stock (codes starting with 3)

If you sell goods, at the end of the year you are meant to make an accurate count of your stock. If you don't do this it will distort your company profits and your profit margins.

The tax office started sending letters to small businesses in 2019 explaining that they have compiled data with typical gross profit margins and other ratios and warning businesses that they were monitoring profit margins with the intention of carrying out tax inspections.

Basically, their letters said, "you have been warned" and if you receive such a letter, it is best to take this seriously. As a minimum you should work out your gross profit margin as indicated above, to make sure you don't have a potential problem.

If you, the directors of the company, don't check these balances once a year then you could be missing the fact that expenses invoices haven't been entered into the books, payments have been misallocated, and you could be paying too much tax.

These accounts are the biggest problem for external accountants because they take a lot of work to check. All too often we find that no one has bothered to make sure the balances have anything to do with reality, year after year, which causes a lot of work and real problems.

## Customer accounts (Codes starting with 43) and supplier accounts (Codes starting with 40 and 41)

Bookkeeping balances must reflect reality and, inevitably for a trading company, the accounts that get the most use are the customer and supplier accounts, and they are often the most incorrect balances of all.

Check the balances as at 31 December and ask yourself did such and such owe the company this the stated balance or did the company owe the supplier the stated balance.

Often, invoices have gone missing, so payments/receipts have been made with no corresponding invoice with the result that there is a nonsense balance.

Payments and receipts get misallocated too.

The skill of a bookkeeper is in getting all these minutiae right, and they should be obsessive about it, which is what makes them such interesting people....!

If the balances are wrong, they must be corrected, even if this is a tedious and time-consuming process. Of course, it is easy to fix problems like this if it is done each month when the incorrect balance appears, and everything is fresh in the mind. Sadly, it often happens that the bookkeeper does not have enough time or interest or finds it difficult to communicate such matters to a foreigner.

If the directors do not pick up these errors and ask questions, then they will be allowing the bookkeeper to get away with a rushed and badly done job.

## Bank accounts (Codes starting with 572)

You would expect the balances on these accounts to match the bank statements, all through the year. Sometimes not.....

Beware of the very bad practice of some bookkeepers to ignore the payments and receipts during the year (unbelievable but true!) and instead making a single adjustment to fudge the bank balances so that they match the bank statements on 31 December. This is done with an entry transferring the difference to another, less obvious account.

The fudge counter entry in the double entry bookkeeping systems is often the Directors accounts or Cash accounts. More on this below!

## Directors/shareholders accounts (Codes starting with 550/551/552)

Next to the cash accounts (more about these later), these are probably the most abused accounts in Spanish accounting practice. These balances should equal the amount of money lent to the company or taken out of the company as loans by the directors or shareholders.

In practice these accounts are often used as 'dump accounts' or in Spanish bookkeeping vernacular 'cajón desastres'. If the reason for a payment is not known by the bookkeeper, then this is one of the accounts used to 'lose' the entry. This creates enormous problems down the line because you will be treated as having taken money from a company, which is regarded as salary or dividend.

The salary and dividend will be subject to income tax and the company should have paid withholding tax.

We have come across companies where these incorrect balances amount to literally hundreds of thousands of Euros, with the directors not having a clue that they had a serious problem. The very bad news was that they had to pay about 20% of the balances in tax. A lot of money if you haven't planned for this.

Directors must absolutely make sure that these accounts represent reality.

Directors and shareholders cannot take out money from a company without paying personal tax and it is far better to pay the tax as you are going along, than having to face an unexpected and indigestible tax bill a few years later.

## Cash accounts (Codes starting in 570)

We've kept the best till last.

You might well ask "what cash" which is exactly what so many new clients have asked us, indignant that they should have been handling cash when their business involved no cash at all!!

This bad practice ranks right up there with the fudged bank account balances and directors accounts being treated as a dump for unidentified payments.

The bookkeeper's idea is this: If you can't dump any more payments in the directors' accounts, let's pretend that the bank payment that we can't identify was cash withdrawn and put in the petty cash box.

The problem is that this is done year in year out and we have seen cash accounts with imaginary balances of hundreds of thousands of Euros.

Often, we find a meaningless cash balance combined with meaningless director accounts.

If you see such a balance, ring the alarm bell and call for help! We are great at sorting out imaginary accounts. Not Ghostbusters but Accountsbusters!

## Other accounts not mentioned

We have only discussed the most frequent and obvious problems that we encounter but other problems occur with other accounting concepts and balances.

The trick is to look at the Sumas y Saldos and ask yourself "What does this balance mean?". If it doesn't make sense to you then don't be afraid of asking the bookkeeper what it means. If the explanation doesn't make sense, then there may be a problem. Most likely, there is a simple explanation.

Remember this rule and you won't go far wrong:

"The company accounts balances must reflect reality – they must show a true and fair view"

**And remember, the responsibility for having correct accounts is that of the directors, and the directors alone.** You can try to sue the accountants but its not much fun.