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Q. Budgeting and recording property tax revenue has become more difficult, given the number of taxpayers contesting assessments through the board of review and Michigan Tax Tribunal, and the ‘charge backs’ we received from the county from prior tax rolls for uncollectable real property taxes, due to bankruptcies and other issues. Do you have any suggestions for budgeting for these tax refunds?

Until the recent collapse of real estate values in the state, many townships followed a simple model for recognition of property tax revenues. They budgeted and recorded the gross levy (taxable value times tax rate), because the number and size of subsequent adjustments to the tax roll were generally minor. Delinquent taxes purchased by the county and receipted within 60 days of year-end were then recorded as current-year revenue (as a receivable), and delinquent personals, if small in relation to the financial reporting model, were recorded on a cash basis. This methodology generally worked well, given many communities’ past history of nearly 100 percent collection of real property taxes.

However, in the “new normal,” where many experts believe that real estate values haven’t yet found bottom, different approaches are necessary to properly reflect these transactions in your township’s financial reporting model.

We suggest that property tax revenues shift to the net method, when the gross method results in over-recognition of income. When used correctly, the modified accrual basis of accounting—a required generally accepted accounting principle for governmental fund types—eliminates the overstatement of revenues and the subsequent budgeting of prior-year tax refunds.

This method will require that your township develop estimates of uncollectable taxes (based on recent history), and budget and record revenues on the net of expected refunds and adjustments to the tax roll. This is accomplished through the use of an accounts receivable valuation account, called “allowance for doubtful accounts.” The receivable for taxes due to the township are recorded at the gross amount (the taxes due), and the allowance values the gross amount to reflect the next expected collections. Refunds paid after settlement are charged to the allowance account, rather than to expenditure (tax refund expense).

Q. How would these entries be made in our books?

One method is to record the levy at billing date by:

		Debit	Credit
101-000-026	Property tax receivable	600,000	
101-000-027	Allowance for uncollectable		18,000
101-000-402	Property tax revenues		582,000
to record property tax levy net of anticipated uncollectables, 3%			

At year-end or settlement, the property tax receivable balance should be reconciled and adjusted to property tax settlement records, and revenue should be adjusted up or down, depending on the necessary adjustment to the tax receivable account.

Unpaid real property taxes, which are “purchased” by the county’s delinquent revolving fund, should be recorded by debiting the accounts receivable account, and crediting cash. The allowance for uncollectable taxes would not be adjusted by the county’s purchase as they are subject to “recourse”—meaning that any amounts they cannot collect will be charged back to your township.

Unpaid personal and real property taxes not “purchased” by the county, if significant, would require additional entries for two fiscal years. Townships should seek consultation and guidance from their accountant.

Information provided in Financial Forum should not be considered legal advice, and readers are encouraged to contact their township auditor and/or attorney for advice specific to their situation.