

STATE OF IOWA TAX ACCRUALS

October, 2001

THE TAX ACCRUALS PROCESS

The practice of accruing tax revenues began in the early 1980s. The process has changed over the years to address the taxes included, length of the hold open period, and expenditures.

60 Day Hold Open Period

Tax receipts deposited by the State during July and August each year that are for a tax period ending June 30 or prior are subject to accrual. Beginning July 1, all tax payments are deposited to the current fiscal year since not all payments received during the hold open period will be subject to accrual. Revenue from all taxes administered by the Department except the cigarette tax is subject to accrual.

Tax Amounts Subject to Accrual

At the end of the hold open period, the Department begins a process to determine the amount of receipts that will be accrued to the prior fiscal year. Because both current and prior year revenues are being received during the hold open period, it is necessary in some cases to analyze the data on the accompanying tax document to determine if the receipt is subject to accrual. Two of the largest sources of accrual revenue, the sales/use tax and withholding tax are subject to this process. Since returns received on August 31 may be subject to accrual, it is ten to fourteen days into September before the preliminary information on accruals is known. For other taxes where it has been determined that all revenues received during July and/or August are subject to accrual based on the reporting requirements, the accrual amounts are determined from the monthly Department financial statements which are generally available by the middle of the following month.

Verification

The preliminary information is reviewed to determine consistency with prior periods. A review of accounting entries in the Iowa Financial Information System (IFAS) is conducted to determine if any adjusting entries are needed to the accrual values to assure accuracy. For example, state agencies make their Iowa withholding payments by accounting transfer rather than state warrant. The associated tax returns would be identified as being subject to accrual. However, if the state agency had transferred the money to the prior fiscal year when they initiated the transfer, then the accrual for withholding would be lowered to reflect the funds that were already credited to the prior fiscal year.

IFAS Update

Once all accrual values have been determined and verified the Iowa Financial Accounting System is updated to reflect the transfer of the accrued revenue from the current fiscal year to the prior fiscal year. This transfer generally takes place the last week of

September. The accrual information and supporting documentation is provided to the State Auditor as part of their regular audit of Department activity.

Adjustments

Unlike revenues, tax refunds and other payments from the tax receipt accounts during the hold open period are charged to the appropriate fiscal year. For example, the July payment of local option taxes to the schools and local governments which represents receipts from June is charged to the prior fiscal year. The August payment of local option taxes, which represents July collections, is charged to the current fiscal year.

JULY - SEPTEMBER TAX RECEIPTS

Each month the Department prepares a monthly tax receipts and refunds report for the Department of Management. The analysis presented in the report is on a cash basis. No distinction is made during July and August for receipts that should be accrued back to the prior fiscal year. However, information presented in each report is reported by revenue class.

Review of Major Revenue Sources

Although tax revenues showed a slowdown during the last quarter of FY 2001, the downturn in revenues became significantly more severe during July and August. For example:

Withholding tax receipts processed during the April-June quarter of FY 2001 increased by 4.94% (\$21.8 million) over the same quarter the prior fiscal year. Withholding tax receipts processed during the July-September quarter of FY 2002 increased by only 2.40% (\$11.0 million) over the same period the prior year. In comparison withholding tax receipts during July-September of FY 2001 had increased by 7.81% (\$33.1 million) over the same quarter the prior year. Thus, the State has experienced a sudden and significant decrease in withholding tax payments in recent months. When the Revenue Estimating Conference met in March a much more moderate slowdown in employment and withholding taxes was anticipated. If withholding taxes had increased at 4.50%, which is about what was expected, receipts would have increased by \$9.6 million more than what occurred. Excepting FY 1999, which was the year the 10% individual income tax rate reduction took effect, withholding tax revenues increased at the lowest rate of any fiscal year first quarter going back fifteen years.

Corporate income taxpayers that file on a calendar year basis are required to make first quarter estimate payments by April 30 and second quarter estimate payments by June 30. About half of all corporate income taxpayers file on a calendar year basis. This year first quarter estimate payments that were processed during April and May totaled \$64.3 million. This equaled a \$4.7 million (6.8%) decrease from the same period the prior year. This year second quarter estimate payments that were processed during June and July totaled \$37.4 million. This equaled an \$18.7 million (33.4%) decrease from the same

period the prior year. If the decrease experienced with the second quarter payments had been at the same rate as experienced for the first quarter, corporate estimate payments would have been \$14.9 million higher than was actually received.