

## How to account for construction retentions

When a client withholds part of the payment to be released once work has been fully completed, it is called retention.

This is common in construction projects where the customer will require you to fully complete the job and fix any defects before they release the funds.

Typical retention is 5-10% of the contract amount and the standard wait period is 6 - 12 months from the end of the contract.

If your business deals with projects that have retention, it's important to ensure that the details of the retention are clearly stated in the contract.

## How to record retentions

Accounting for retention can be confusing, especially when the waiting period spans financial years and VAT periods. However, they must be recorded correctly to avoid unnecessarily paying tax on income that is not guaranteed.

Retentions should be held in the balance sheet accounts because they shouldn't be invoiced to the client or paid out to subcontractors.

On the balance sheet, they should be recorded under the 'sales and sub-contract costs' section. This can be recorded in one of the following ways:

1. Include the retention in the turnover amount and estimate how much it will cost to do remedial works. Make sure to consider any possible debt impairment.

2. Defer recording the retention until the retention payment has been received.

Recently, construction industry customers have been less willing to pay out retentions. This means that even if there are defects that need to be fixed, they are less likely to pay for them. In these cases, there will be no change in the net profit figure on your balance sheet.

## VAT on retentions

In regards to VAT reporting, the tax point for retentions is when the VAT invoice is issued or when the payment has been received, whichever happens first.

It's important to note that this tax point rule only applies to the retention portion of the contract. The standard project costs are subject to the standard tax point rules.

## Example

Your construction company has completed some work for a customer in which the total cost of the work amounts to £20,000. You have agreed with the customer that they will pay you 90% (£18,000) now and retain 10% (£2,000) for 6 months.

In your invoicing software, you will have to raise 2 invoices - one for the initial amount, and another for the retention. On the balance sheet, you can either:

- a) Add the £2,000 within turnover, include the estimated cost of remedial work and make provision for debt impairment (in case the customer doesn't pay the retention).
- b) Delay recording the £2,000 until the receipt becomes virtually certain (i.e., it has been paid).