

# Retention money accounting

Frequently asked questions

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# Retention money accounting

## Introduction

The [Construction Contracts \(Retention Money\) Amendment Act 2023](#) received the Royal Assent on 5 April 2023. It clarifies and strengthens the [Construction Contracts Act 2002](#) retention money regime, including how retention money must be handled. See **Appendix 2** for the full history of the Act.

These changes may be within the finance team's responsibility to implement. These frequently asked questions (FAQs) respond to questions members have asked Chartered Accountants Australia and New Zealand (CA ANZ) in relation to accounting for construction contract retention money. We appreciate the assistance of members who have contributed to these responses.

To ensure consistency and comparability between financial statements there are rules – which have force of law – around how transactions and balances should be accounted for. This includes how retention money should be accounted for in the financial statements of the entity holding the retention money. In these FAQs we cover key terms, the key changes, accounting implications and implementation considerations.

## Currency of information

The responses to these FAQs are based on information available at the time of publication to assist members of CA ANZ obtain an understanding of the new requirements, and therefore be better placed to comply. At the time of publication the [Construction Contracts \(Retention Money\) Amendment Act 2023](#) had not been incorporated into the [Construction Contracts Act 2002](#) so both Acts need to be referred to.

*“The changes ... provide important protections for subcontractors so they can be certain their payment is kept safe, cannot be used for any other purpose, and will be paid out should the head contractor's business fail”*

– Hon Megan Woods

# Frequently asked questions

Question	Response												
Key terms													
1. What is retention money?	<p>Most commercial construction contracts contain a clause whereby an amount of money is withheld by a party from another party as security, typically between 2%–10% of the amount of the contract value. This is to ensure that the other party meets their obligations under the contract – to provide building work that is free of defects.</p> <p>The intention is that if those obligations are met, the retention money will be released. However, if those obligations are not met then the retention money can be used to remedy defects.</p> <p>Retentions are generally paid out in two stages:</p> <ul style="list-style-type: none"> <li>• 50% of the retentions will normally be paid at the date of practical completion, and</li> <li>• 50% once the defects liability period has ended and any defects have been remedied, usually 6–12 months after practical completion.</li> </ul>												
2. What is a commercial construction contract?	<p>It is a contract for carrying out construction work in which none of the parties is a residential occupier of the premises that are the subject of the contract. Therefore, all subcontracts are commercial construction contracts.</p>												
3. Who must comply with the new retention money regime?	<p>The new retention money regime must be complied with if:</p> <ul style="list-style-type: none"> <li>• There is a commercial construction contract in place, and</li> <li>• Retention money is withheld.</li> </ul> <p>Party A must comply with the requirements, that is Party A that will be liable for non-compliance. Party B has the retention money withheld from them. Examples of Party A and Party B include:</p> <table border="1"> <thead> <tr> <th>Party A</th> <th>Contract between</th> <th>Party B</th> </tr> </thead> <tbody> <tr> <td>Principal</td> <td>→</td> <td>Head Contractor</td> </tr> <tr> <td>Head Contractor</td> <td>→</td> <td>Subcontractor</td> </tr> <tr> <td>Subcontractor</td> <td>→</td> <td>Subcontractor(s)</td> </tr> </tbody> </table>	Party A	Contract between	Party B	Principal	→	Head Contractor	Head Contractor	→	Subcontractor	Subcontractor	→	Subcontractor(s)
Party A	Contract between	Party B											
Principal	→	Head Contractor											
Head Contractor	→	Subcontractor											
Subcontractor	→	Subcontractor(s)											

<p><b>4. When does the new retention money regime apply from?</b></p>	<p>It applies to commercial construction contracts entered into, or renewed, on or after 5 October 2023.</p>
<p><b>5. Why has a new retention money regime been introduced?</b></p>	<p>There have been instances under the extant regime where retention money has not been correctly held on trust, and misused as working capital, by Party A. This poses a credit risk to Party B because they rank alongside all other unsecured creditors and may receive nothing in the event Party A becomes insolvent.</p> <p>The primary purpose of this new regime is to ensure that retention money is paid to Party B in the event Party A becomes insolvent.</p>
<h2>Key changes</h2>	
<p><b>6. How is retention money protected?</b></p>	<p>Retention money is automatically held on trust by Party A.</p> <p>Retention money must be held separate from Party A's other money and assets.</p>
<p><b>7. How must retention money be kept?</b></p>	<p>Party A must deposit retention money into a compliant bank account as soon as practicable, unless there is a complying instrument in force.</p>
<p><b>8. What is a compliant bank account?</b></p>	<p>The bank account must be at a registered bank in New Zealand and comply with subsection (2) or (3) of <a href="#">section 18E of the Act</a>.</p> <p>Party A must inform the bank that the account is to hold retention money on trust under the <i>Construction Contracts Act 2002</i>.</p> <p>Party A can have one trust account for multiple Party B's and multiple construction contracts.</p>
<p><b>9. Can I keep the retention money in my lawyer's/accountant's trust account?</b></p>	<p>Retention money can be held in a bank account that is ordinarily used to hold trust money and the account holder is listed under subsection (3)(b) of <a href="#">section 18E of the Act</a> e.g., a chartered accountant, a licensed auditor, a registered audit firm, a lawyer, an incorporated law firm, the Public Trust, a trustee company.</p> <p>However you will need to speak to your lawyer/accountant to see if they offer this service, and then agree on the terms of engagement including fees.</p>

<p><b>10. What is a complying instrument?</b></p>	<p>An instrument may be of any kind (for example, insurance, a bond, or a guarantee) as long as it complies with the requirements in subsections (2)–(4) of <a href="#">section 18FB of the Act</a>.</p> <p>We are only aware of one such instrument in New Zealand and that is the <a href="#">Retention Instrument</a> offered by AON that is issued by QBE.<sup>1</sup></p>
<p><b>11. What happens to interest earned on retention money?</b></p>	<p>Interest earned on retention money is not part of the retention money and can be kept by Party A, unless:</p> <ul style="list-style-type: none"> <li>• the construction contract provides otherwise, or</li> <li>• there is a delay between the date on which the retention money is payable and the date on which it is paid.</li> </ul>
<p><b>12. How can retention money be used?</b></p>	<p>Party A cannot use the retention money for any purpose other than to remedy defects in the performance of Party B's obligations under the contract.</p> <p>If Party A proposes to use the retention money to remedy defects it must give Party B 10 working days' notice to allow them an opportunity to remedy the relevant defect in the performance of their obligations, or to dispute Party A's claim.</p>
<p><b>13. What are the record keeping requirements?</b></p>	<p>Party A must keep proper accounting records identifying all retention money for each Party B and each construction contract in accordance with <a href="#">section 18FC of the Act</a>.</p>
<p><b>14. What reporting must Party A provide to Party B?</b></p>	<p>Party A must give the information required by subsection (2) of <a href="#">section 18FD of the Act</a> to Party B:</p> <ul style="list-style-type: none"> <li>• as soon as practicable after an amount becomes retention money, and</li> <li>• at least every three months until the retention money ceases to be trust property (see <b>Appendix 1</b> for an illustrative report).</li> </ul>
<p><b>15. What are the penalties for non-compliance?</b></p>	<p>There are penalties of up to \$50,000 for a director, and up to \$200,000 for a company for each offence. So, for example, failure to report to 10 Party B's becomes 10 separate offences.</p>
<p><b>16. Who enforces the requirements?</b></p>	<p>The Ministry of Business, Innovation and Employment (MBIE) has new powers to investigate compliance and require parties to provide information as part of its investigations.</p>
<p><b>17. What happens now in the event of Party A becoming insolvent?</b></p>	<p>If Party A becomes insolvent, the receiver or liquidator becomes trustee of the retention money for the purpose of distributing it. The receiver or liquidator is entitled to be paid reasonable fees and costs for doing so.</p>

<sup>11</sup> This should not be regarded as an endorsement by CA ANZ.

## Accounting implications

### 18. Does retention money meet the definition of an asset?

For-profit companies that have a [statutory requirement](#) to prepare general purpose financial reports (GPFR) must apply the IFRS-based [Tier 1 and 2 for-profit standards](#) issued by the External Reporting Board (XRB).

The definition of an asset in paragraphs 4.3–4.25 of the [Conceptual Framework](#) is: a present economic resource – a right that has the potential to produce economic benefits (even if the probability is low) – controlled by the entity as a result of past events.

- Right – Party A has the right to use retention money to remedy defects.
- Potential to produce economic benefits – the retention money enables Party A to avoid cash outflows by using it to remedy defects.
- Control – Party A can direct the use of the retention money.

Therefore, retention money does meet the definition of an asset.

### 19. Does retention money meet the criteria to be recognised as cash?

'Cash' is defined as comprising cash on hand and demand deposits (NZ IAS 7.6). There are no other requirements on whether an item can be recognised as cash beyond the definition itself. Party A is not prevented from accessing the retention money. However, Party A would be in breach if it uses retention money for any purpose other than to remedy defects. Therefore, retention money is restricted cash and presented as 'cash and cash equivalents' in the statement of financial position (NZ IAS 1.54(i)).<sup>2</sup>

### 20. Should retention money be classified as current or non-current?

Retention money would be classified as 'current', unless it is restricted from being exchanged, or used to settle a liability, for at least twelve months after the reporting period (NZ IAS 1.66(d)).

### 21. How should retention money be presented and/or disclosed?

The nature and liquidity of retention money (i.e., being held on trust) differs to other cash (NZ IAS 1.58). Therefore, to enable users to understand Party A's financial position, retention money should be presented separately in the financial statements, either in the statement of financial position or in the notes (NZ IAS 1.77).

<sup>2</sup> See [IFRIC Agenda Decision](#): Demand Deposits with Restrictions on Use arising from a Contract with a Third Party (IAS 7 *Statement of Cash Flows*) (28 April 2022)

<p><b>22. What about the treatment in special purpose financial reports (SPFR)?</b></p>	<p>The accounting treatment in SPFR is essentially the same as for GPFR in this regard. This is because companies must comply with the Inland Revenue (IR) minimum financial reporting requirements in the <a href="#">Tax Administration (Financial Statements) Order 2014</a> which requires accrual accounting.</p>
<p><b>Implementation considerations</b></p>	
<p><b>23. What are the key things I need to do to be ready for the new regime?</b></p>	<ul style="list-style-type: none"> <li>• Do you already have a bank account that you can use for retention money, or do you need to open a new one?</li> <li>• Have you informed the bank that the account is to hold retention money on trust under the <i>Construction Contracts Act 2002</i>?</li> <li>• Do you need to set up any new trial balance codes in your general ledger e.g., for a new bank account, or interest received on that bank account?</li> <li>• Have you got a policy and procedure to deposit retention money into the bank account as soon as practicable?</li> <li>• Are your contract administrators' portfolios divided in the most effective way?</li> <li>• Do you have systems and processes that enable you to record retention money by sub-contractor and by contract e.g., software such as <a href="#">Construction Administration Tools (CAT)</a>, <a href="#">Cheops</a>, <a href="#">CostCon</a>?<sup>3</sup></li> <li>• Do you have systems and processes that enable you to track the current/non-current classification split of retention money?</li> <li>• Have you reviewed and updated your future construction contracts (i.e., template) to cover the treatment of interest received on retention money?</li> <li>• Where do the fees charged for having the bank account get taken from, and where does the interest received on retention money in the bank account go?</li> <li>• Who is responsible for the required reporting to Party B e.g., finance or construction?</li> </ul>

<sup>3</sup> The options here are by no means exhaustive. A products inclusion should not be regarded as an endorsement by CA ANZ.



# Appendix 1 – Illustrative report

## Report on retention money

To: [Party B]

From: [Party A]

Date: \_\_\_\_\_

## Retention money held

Contract identifier	Retention amount	Date of retention
[Contract A]	\$	
[Contract A]	\$	
<b>Total retention money for [Contract A]</b>	<b>\$</b>	
[Contract B]	\$	
[Contract B]	\$	
[Contract B]	\$	
<b>Total retention money for [Contract B]</b>	<b>\$</b>	
[Contract C]	\$	
<b>Total retention money for [Contract C]</b>	<b>\$</b>	
<b>TOTAL RETENTION MONEY HELD FOR [PARTY B]</b>	<b>\$</b>	

## Bank account details in which retention money is held

*[If the account holder is Party A]*

Bank name: \_\_\_\_\_

Branch at which the account is held: \_\_\_\_\_

Name of the account: \_\_\_\_\_

Balance in the bank account that is held for [Party B]: \$ \_\_\_\_\_

[Party B] may inspect the accounts and records that [Party A] is required by section 18FC to keep in relation to retention money held for [Party B].

## Appendix 2 – The history

- 2002 – The *Construction Contracts Act 2002* received the Royal Assent.
- 2010 – A review into the *Construction Contracts Act 2002* commenced.
- 2013 – Mainzeal Property and Construction Limited went into liquidation which illustrated the insecurity of retention money under the *Construction Contracts Act 2002*.
- 2015 – A new regime governing retention money was introduced through the *Construction Contracts Amendment Act 2015* effective for contracts entered into, or renewed, on or after 31 March 2017.
- 2017 – The *Regulatory System (Commercial Matters) Amendment Act 2017* made some additional changes to the retention money provisions to support the sector's ability to comply with the new regime.
- 2018 – Ebert Construction Limited went into liquidation which exposed shortcomings around key aspects of the new retention money regime.
- 2021 – The *Construction Contracts (Retention Money) Amendment Bill* was introduced to Parliament on 1 June 2021 to amend the retention provisions in the *Construction Contracts Act 2002*.
- 2023 – The *Construction Contracts (Retention Money) Amendment Act 2023* received the Royal Assent on 5 April 2023.

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