

RICS PRACTICE INFORMATION

# Final account procedures

UK

1st edition, December 2015



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# RICS standards framework

RICS' standards setting is governed and overseen by the Standards and Regulation Board (SRB). The SRB's aims are to operate in the public interest, and to develop the technical and ethical competence of the profession and its ability to deliver ethical practice to high standards globally.

The RICS [Rules of Conduct](#) set high-level professional requirements for the global chartered surveying profession. These are supported by more detailed standards and information relating to professional conduct and technical competency.

The SRB focuses on the conduct and competence of RICS members, to set standards that are proportionate, in the public interest and based on risk. Its approach is to foster a supportive atmosphere that encourages a strong, diverse, inclusive, effective and sustainable surveying profession.

As well as developing its own standards, RICS works collaboratively with other bodies at a national and international level to develop documents relevant to professional practice, such as cross-sector guidance, codes and standards. The application of these collaborative documents by RICS members will be defined either within the document itself or in associated RICS-published documents.

## Document definitions

Document type	Definition
RICS professional standards	<p><b>Set requirements or expectations for RICS members and regulated firms about how they provide services or the outcomes of their actions.</b></p> <p>RICS professional standards are principles-based and focused on outcomes and good practice. Any requirements included set a baseline expectation for competent delivery or ethical behaviour.</p> <p>They include practices and behaviours intended to protect clients and other stakeholders, as well as ensuring their reasonable expectations of ethics, integrity, technical competence and diligence are met. Members must comply with an RICS professional standard. They may include:</p> <ul style="list-style-type: none"> <li>• mandatory requirements, which use the word 'must' and must be complied with, and/or</li> <li>• recommended best practice, which uses the word 'should'. It is recognised that there may be acceptable alternatives to best practice that achieve the same or a better outcome.</li> </ul> <p>In regulatory or disciplinary proceedings, RICS will take into account relevant professional standards when deciding whether an RICS member or regulated firm acted appropriately and with reasonable competence. It is also likely that during any legal proceedings a judge, adjudicator or equivalent will take RICS professional standards into account.</p>
RICS practice information	<p><b>Information to support the practice, knowledge and performance of RICS members and regulated firms, and the demand for professional services.</b></p> <p>Practice information includes definitions, processes, toolkits, checklists, insights, research and technical information or advice. It also includes documents that aim to provide common benchmarks or approaches across a sector to help build efficient and consistent practice.</p> <p>This information is not mandatory and does not set requirements for RICS members or make explicit recommendations.</p>

# 1 Introduction

This practice information summarises what a final account is and how they are used to establish a final adjustment to the contract price. The practical issues of how to prepare a final account in accordance with the contract and the process of cooperation between the parties and negotiation will also be discussed. Practical consideration such as advising on the structure of a final account and how to prepare a statement for final account (including examples) will also be considered.

This practice information does not provide a detailed guide to disputes, although they can sometimes be a feature of a final account process. This practice information deals with the practical issues of agreeing a final account and some of the important issues that may emerge as part of that process. For the purposes of giving guidance, the employer is referred to as the 'employer' and the main contractor as 'contractor.' However, much of the guidance can equally be applied to a contractor/subcontractor or supplier arrangement.

Guidance is given in relation to the main forms of contract and main procurement routes, under the following headings, which map to the Assessment of Professional Competence:

- General principles (level 1: knowing)
- Practical application (Level 2: doing)
- Practical considerations (Level 3: doing/advising).

## 1.1 Minimum level of service

The quantity surveyor (or any consultant fulfilling the role of administering the contract with regards to final accounts) is expected to fulfil the following duties, notwithstanding the detailed terms of any appointment or contractual obligation:

- preparing the final account and reporting against the last cost/financial report
- engaging in final account meetings with contractors
- valuing variations to the contract with the contractor to enable agreement of the final account
- advising on the cost implications of loss and expense claims – when so instructed
- preparing the statement of final account
- advising on costs associated with any defects
- engaging in any meetings relating to the agreement of the final account
- advising the employer on calculations for withholding liquidated damages – when so instructed and
- preparing final account documentation for auditing purposes.



## 2 General principles (Level 1: knowing)

Guidance is given in this section about what a final account is. It explains the common definitions within the major contracts and how the contractual procedures may differ.

### 2.1 What is a final account

The final account is the conclusion of the contract sum (including all necessary adjustments) and signifies the agreed amount that the employer will pay the contractor.

It includes any works that are paid to the contractor through the main contract.

Typically, the final account includes any loss and expense associated with any extensions of time and any other claims the contractor feels they are due under the contract. It also indicates the finalisation of any disputes that may have arisen and in that sense draws a line under the financial obligations of both parties, save in respect of defects. The final account will not typically include items such as liquidated damages, VAT or interest on overdue payments.

### 2.2 Contractual definitions of final account

The procedures, as set out in the various forms of contract, contain slight differences in terminology and procedure (i.e. between the JCT and the NEC contracts), but essentially they produce the same result. Most contracts require the contractor to substantiate their accounts to the employer so it can be properly assessed.

The NEC forms of contract do not refer to final accounts as it is assumed that the final account is adjusted as the project proceeds on the basis that the compensation event procedure is followed.

The JCT defines the process for final accounts and final payments under clause 4.12 of the Design and Build Contract or Clause 4.5 of the JCT Standard Form. Note that the timelines are different between the Standard Building Contract and the Design and Build Contract.

The FIDIC suite of contracts, which are mainly used for the international market all have their own timescales. Clause 14 refers to payment and subclause 14.11 spells out the final account process and timescales.

## 2.3 Rolling final accounts

The term 'rolling final accounts' is often used, but it is not always properly adhered to. Rolling final accounts will ensure that all instructions and cost effects to a project are agreed and up-to-date at the point of the latest financial report. This relies on an organised quantity surveyor and contractor and willingness of the parties to make agreements on a regular on-going basis.

The NEC contracts put more emphasis on the timescales related to agreeing individual variations (known as compensation events). Time bar penalties are also included for not agreeing compensation events within the contractual timescales. In theory this forces a rolling final account to be maintained but unfortunately, this does not necessarily mean that all NEC contracts are used as they should be. The NEC is designed to agree cost and time simultaneously.

Conversely it doesn't necessarily mean that other contracts don't have a long final account process. The reality is that the contract can only provide the framework for final accounts to be agreed throughout the contract period. It still relies on the hard work, organisation and willingness by both parties to make agreements as they go along.

Remember that it is not the role of the QS to agree variations or final accounts. The QS's role is to value variations in accordance with the contract and adjust the final account as necessary.

Appendix A shows an example statement of final account.

# 3 Practical application (Level 2: doing)

This section covers how general principles are put into practice to satisfy the 'doing' requirements of the Level 2 APC competency. It looks in more detail at the practical issues relating to final accounts and how to prepare a final account statement.

## 3.1 Preparing for final account

The preparation of the final account occurs throughout the contract period. Financial statements prepared by the quantity surveyor will generally serve as the starting point for final account discussions. As a matter of preparation, the professional quantity surveyor (PQS) should ensure that all contracts instructions have been accounted for and that all other potential cost-related items are scheduled out. This may include, but not be limited to:

- provisional sums (which can only be expended by issue of a contact instruction)
- agreeing prime cost sums (where applicable)
- any loss and expense associated with extensions of time
- adjustment of provisional/approximate quantities
- fluctuations
- any set-off/contra charges (typically a subcontractor issue) or
- any other items affecting total cost.

Note that standard building contracts do not contain any express provision for dealing with contra charges, therefore, if agreed between the contractor and employer they should be instructed as a variation to the contract. If the contractor does not agree then any off-sets/ contra charges must go through the 'pay less notice' process outlined in the *Local Democracy, Economic Development and Construction Act 2009* (which will be referenced as 'the *Construction Act*' in this practice information).

From the contractor's perspective, they will also go through a similar exercise in preparation for the final account, but also ensuring that all possible variations from subcontractors and suppliers are picked up and reported to the employer. The contractor will not want to enter final account negotiations without having accurate costs from their supply chain, although there may be no direct contractual link between the contractor's entitlement to be paid by the employer when compared with an obligation to pay their subcontractors.

## 3.2 Linking the last formal cost report to final account

The last formal cost report presented by the PQS should provide a very good indication of where the final account is likely to be settled. If costs have been tracked properly throughout the duration of the project then the only difference between the last formal costs report in the final account should be any changes or variations in the period between the last forecast reports in the final account.

Suitable project documentation and well-followed contract administration procedures should make the task of preparing a final account more straightforward in the long run. Good documentation is easily auditable and the importance of this is highlighted when proper records are not available.

Disputes can occur where key members of either the employer's or contractor's team changes throughout the project duration.

At the commencement of the project, the project manager should produce a project execution plan (PEP), and within this plan, there should be a procedure set out for contract administration of the project. This should include the change control mechanism and the procedure for contract instructions. This helps to provide a framework for auditability to keep good contract documentation, which can be referred to during the final account negotiations.

## 3.3 Importance of change control

Change control is the administrative process that implements the contract mechanisms for instructing change. The process must adhere to the contract requirements for notification and approval of change by the identified parties.

Change control is also a critical part of a well-run and audited project. Any potential changes should go through this process before an instruction is given so that the employer feels they are able to make informed decisions. It also ensures that the contractor is not going ahead and acting on changes that they believe they've been instructed to do, only to find out that they were not actually communicated to the employer.

The change control system should not be too cumbersome so that it deters the project team from using it. All parties should want to use it, as it will provide security, auditability and clarifications of any changes or rejections of any changes. Without a well-managed change control process, the final account negotiations may be more difficult. There may be a difference of opinion between what the contractor believes they were instructed compared to what they were actually instructed.

## 3.4 Final account meetings – preparation and procedure

The final account meetings are generally held between the contractor and the quantity surveyor, although it is not unusual for the project manager, the designer, or a representative

from the employer to also attend. It is an opportunity to exchange information and present methodologies for valuation of each variation in accordance with the contract. It is not a forum to make agreements on the valuation of variations beyond the contract conditions.

Most of the preparatory work should have been carried out ahead of time so that the final account meeting can focus on agreeing the few outstanding items that may be still in abeyance. If there is a difference of opinion between the contractor and the employer's quantity surveyor then it is suggested that further work is done to close the gap using telephone calls and more informal meetings between the employer and contractor. The final account meeting should certainly not be the first time that parties have seen each other's positions; this would indicate that the change control process has not been working properly.

### 3.5 Structure of the final account

There are no firm rules about how a final account should be structured and as long as both parties agree, then a structure for the final account can take whatever form is sensible for the contract. The structure may also be dictated by employer requirements, particularly when seeking to apportion costs between different cost centres or departments.

The document may follow the original pricing document – so if, for example, there was a bill of quantities it might be adjusted section by section or it might be more appropriate to deal with variations in total. This would depend on what the changes are, and how they are instructed.

Summarised in this subsection are a list of typical final account headings and descriptions:

#### Variable costs

Variable costs are sums included within the contract sum that may be subject to change. These may be included because the extent of the work was not entirely known at the contract stage or perhaps because the specifications were not at an advanced enough level for a fixed price to be ascertained. There are four main types of variable costs:

#### 1. Provisional sums

Provisional sums are often included within a contract for elements of the works that have not been fully designed. Provisional sums can be split into two main categories:

- defined provisional sums and
- undefined provisional sums

The definition of defined and undefined provisional sums can be found in the RICS New rules of measurement 2: Detailed measurement for building works (NRM 2).

Technically the NEC suite of contracts does not recognise provisional sums, although it is not uncommon for 'Z' clauses to be included to allow for their inclusions.

Provisional sums should be distinguished from prime cost.

It is good practice that any provisional sums have a design deliverables date agreed so that they can be converted into fixed prices at an opportune time during the contract period. If this happens properly, then at final account stage most of the provisional sums should have already been converted into fixed prices and instructed as such.

There may be a few provisional sums outstanding at the conclusion of the contract; these can often be items such as statutory utilities, provisional sums associated with external works, provisional sums associated with furniture fittings and equipment. In these instances, the agreement of these provides provisional sums that may be a part of the final account process. Any unused provisional sums should be formally omitted by instruction.

It is crucial that earlier provisional sums agreed throughout the contract period and are reported and communicated to the employer in the monthly financial reports.

## **2. Approximate quantities**

If the contract is a remeasurable contract then the final account should deal with changes in quantities. This should be an academic exercise, as the bills of quantities would have already prescribed which quantities are to be remeasured.

Remeasures should generally be taken from drawings or a digital model. Only in exceptional circumstances should quantities be remeasured from site works.

Approximate quantities should be avoided if possible as they provide a greater uncertainty to the employer.

## **3. Prime cost sums**

Prime cost sums may be included for items of work when the final specification of the work item has not been decided at contract stage. An example of a prime cost sum might be a carpet (i.e. the cost of the material), the contract may allow for the laying of a carpet to the designated areas at a prime cost sum of £25/m<sup>2</sup>. The laying of the carpet cost is usually fixed irrespective of the cost of the carpet (although this might also change if the prime cost is for 'flooring' and the choice is made between, for example, carpet or vinyl). Care is needed to understand the basis of the prime cost sum.

When a final specification of the carpet is decided any variants to a prime cost sum will be reflected in the final account, so for example, if the final selected carpet is £30/m<sup>2</sup>, but the contract states a prime costs sum of £25/m<sup>2</sup> then the £5/m<sup>2</sup> difference over the designated area will be the adjustment to the contract sum.

## **4. Daywork allowances**

Daywork allowances are monetary allowances made for the costs of labour, plant and materials, against which percentage uplifts are priced against the base rates of labour and prime cost of materials and plant. These allowances are for work for which the quantity and specification is unknown and whose instruction is likely to be on an ad-hoc basis, where the valuing of the work by reference to contract rates would be inappropriate. This is, in effect, a

contingency allowance for any ad-hoc work that may be required throughout the contract. It is not uncommon for daywork clauses in contracts to be struck out or non-existent.

At final account stage, the contractor will be entitled to an element of the daywork allowance that equates to the signed daywork sheets. Daywork sheets must be signed off by the contract administrator. Progress on the status of the dayworks allowance should be reported via monthly financial reports at regular intervals. Therefore, the final account should be just picking up the worksheets that haven't been reflected in the latest financial report.

It would not be acceptable to reach final account stage and only then be presented with the extent of the day worksheets for the project.

### Variations

The definition of a variation in terms of final accounts is any change to the contract specifications or drawings (whether that be a set of employer's requirements or traditional specification and drawings).

Adjustments for contract variations should be calculated using bill rates and star rates wherever possible. The current edition of RICS' [Valuing change](#) deals with variations in more detail and should be consulted for full understanding of variations. In terms of the final account, the only contractually entitled change to the contract sum will be for variations, which have been formally instructed under the contract.

There are different procedures in terms of instructing variations depending on the contract type but the principles remain the same. If there are any changes, which are agreed by both parties but have not been formally instructed then strictly contract instruction should be issued for that particular change to ensure all the necessary paperwork is in place so that that the relevant monies can formally be paid.

### Contract instructions

All agreed changes should have a contract instruction, which formally records that change. It is not unusual at final account stage to have a number of items, which are either being claimed by the contractor, which they consider being a variation but have not formally been instructed, or for new variations, which has only recently been agreed but have not been formally instructed.

As a part of the final account procedure, it is good practice to ensure all variations claimed by the contractor have been considered by the architect/contract administrator.

### Loss and expense

Loss and expense associated with any delay or disruption to the contract is the subject of the current edition of RICS' [Ascertaining loss and expense](#), however, it is still appropriate to have an understanding of the contractual procedures for agreeing any loss and expense and the mechanisms for awarding them.

If the contract administrator has awarded an extension of time for a relevant matter, which would entitle the contractor to loss and expense, then that loss and expense should be formerly recorded as part of the final account settlements, when so instructed formally by the employer.

Often the extension of time and associated loss and expense has been agreed earlier in the contract and the final account statement will simply formalise this process. It is also not unusual for the entitlement to an extension of time and associated loss and expense to be delayed until the end of the contract.

Once the entitlement to an extension of time is agreed and instructed then the costs associated with loss and expense can sometimes become part of the final negotiations.

### Fluctuations

Fluctuations are financial adjustments made to the original contract prices to compensate for changes in pricing levels at a macro-economic level by reference to input costs, price indices and price adjustment formulae.

The contractor may be expected to include for all necessary inflation allowances on smaller or shorter duration projects, but on large projects contracts may allow for uplifts to the contract sum based on the following:

- changes in taxation and
- changes in the cost of labour, transport and materials.

The contractor is usually not entitled to fluctuations after the completion date.

Calculation for fluctuations will be based on agreed programme dates and industry data for calculating inflation (or labour rates etc.).

As with all other changes to the contract sum any fluctuations should be communicated by the monthly cost report to the employer at regular intervals. The final account should be the formalisation of fluctuation calculations under the contract.

It is not unusual for the fluctuation clauses to be struck out of construction contracts.

### Risk allowances

There are three main methods for dealing with risk within a construction contract:

#### 1 Risk fully owned by employer:

The risk allowance is identified and maintained by the employer and controlled by the PQS. This is then offset against valid variations throughout the construction period. This is the usual method of dealing with risk on traditional contracts.

#### 2 Risk owned and bought by contractor:

Fixed risk allowances, which have been identified as being owned by the contractor, and paid for upfront as part of the overall contract sum (usually on a Design and Build contract). With



this method it is still advisable to have some risk allowance on the employer's side (although usually at a reduced amount compared to the first method).

### 3 A transparent variable risk allowance within the contract sum

Some contracts may include a risk allowance within the contract sum for any unforeseen events these may be linked to a risk register. These may often be used in open book transparent contracts where the level of employer's contingency is included within the contract so that parties will understand the amounts available on the project.

The advantages of a transparent risk allowance are that all parties are fully aware of the overall financial position of the project and will work in a mutually beneficial way to ensure that the project is delivered within the contract sum. However, the disadvantage is that the contractor may see this risk allowance as an entitlement and find reasons (spurious variations etc.) for offsetting against it. It is therefore relatively uncommon for contracts to include transparent risk allowance.

## 3.6 Final account adjustments

### Statement of final accounts

There is no standard 'statement of final account' form. Most forms will follow a similar format. Appendix A shows an example statement of final account. The principle information to include in a statement of final account is:

- adjustment of provisional sums
- adjustment of prime cost sums
- adjustment of provisional quantities
- contract instructions
- anticipated instructions (which must be formalised before agreeing the final account)
- fluctuations and
- loss and/or expense.

The statement will also include clear information as to limitations of the agreement and any caveats that may be included. It will often include words similar to 'full and final settlement' to ensure that the statement cannot be opened up at a later date. There may also be spaces for both parties to sign the agreement.

Legal professionals in the construction industry may draw up a robust statement of final account or settlement agreement. However, this is only normally necessary where there has been a complicated conclusion to the final account. If the final account has been straightforward and within the terms of the contract then a more straightforward statement of final account may suffice.

Note that the statement of final account might not include any deductions for liquidated damages (delay damages) that are due. The employer can deduct these from the final payment certificate, in line with the *Construction Act* provisions for pay less notices.

If it is agreed that the final account statement should include a deduction for liquidated damages then the wording should very clearly state that the signed statements concludes the employer's entitlement to deduct any further liquidated damages.

### 3.7 Release of retention

The issue of the practical completion or the completion certificate dictates the release of retention in most standard forms of contracts.

If the final account has been agreed at the point of practical completion then the employer can release 'the part of the retention (typically a percentage) stated in the contract up to the final account settlement figure.

However, if the final account has not been agreed and a difference of opinion remains then the employer is entitled to release retention only up to the amount they believe is payable under the contract. When the final account is agreed it is not uncommon for another payment certificate to be issued.

#### Final certificate

The second release of retention occurs at the end of the defects liability period. In the event that the final account is still not agreed at this point in time then a similar principle applies, full retention can be released on the amount agreed between the two parties but the value of disputed items is not released. The final certificate cannot be issued until the final account is agreed.

### 3.8 Dealing with defects as part of the final account

Most standard forms of contract are prescriptive about how to deal with defects in the works. The difference between patent and latent defects must also be understood:

- Patent defects can be discovered by reasonable inspection.
- Latent defects cannot be discovered by reasonable inspection.

It is good practice to alert the contractor to the defect and allow them the opportunity to make good the defect. If this is carried out to the employer's satisfaction then the final account can be agreed as if the defect had not occurred, however, if the defect is either not fixed to the employer's satisfaction or not carried out at all by the contractor then most standard forms of contract enable the employer to engage another contractor to make good the defect and deduct that value from the contractor's final account. This can be a sensitive issue and it will be common for a difference of opinion to occur.

If this difference of opinion cannot be settled amicably, then some form of dispute resolution maybe necessary. For the purposes of the final account it would not be possible to agree the final account while a dispute is apparent.

Where a defect is rectified by an alternative contractor and is accepted by the contractor then the value of the adjustment to the final account must be agreed between the employer and the contractor and will form part the statement of final account.

### 3.9 Defects during the defects/ rectification period

If the final account is agreed at practical completion and then a defect emerges during the defects period, then the contractor is entitled to attempt to make good those defects at their own cost. Various contracts have different timescales and mechanisms for dealing with them but, in essence, the contractor should be notified of the defect and then have a set amount of time to rectify that defect. If they are not dealt with in the allocated timeframe, then the employer will become entitled to make good the works at their own cost and deduct the cost from the retention still held.

Difficulties emerge when there is a dispute about the liability of the defect and whether it is actually a defect.

### 3.10 Loss and expenses and liquidated damages

For the purposes of the agreement of the final account it is important to understand that loss and expense is instructed and included within the final account statement but the employer deducts liquidated damages.

If during the course of the project any relevant matters affect the contractor then they may be due loss and expense. It is good practice to ensure that the amount due to the contractor is agreed between the contractor and PQS as soon as possible following the event.

The subject of ascertaining loss and expense claims is beyond the scope of this practice information (see the current edition of RICS' [Ascertaining loss and expense](#)). In the scenario that the amount has been agreed, then this simply gets added to the final account calculation. As both parties had previously agreed, this should create no major surprises.

Unfortunately, it is common in the industry for any potential loss and expense to not be agreed at practical completion. This complicates matters as the very factual part of the agreeing the final account based on instructed variations becomes confused with a sometimes more subjective view when dealing with loss and expense.

Good practice would suggest that the best course of action would be isolate the loss and expense calculation from the remainder of the account, ensuring that it is agreed in a fair and reasonable manner and then turn the attention towards the rest of the account. The previously agreed loss and expense figure can then be included at the end.

Note that one of the major advantages of the NEC suite of contracts is that it dictates that all associated loss and expenses is agreed as part of the compensation event as the project proceeds. If the NEC contract is used properly then, in theory, it should lead to fewer disputes at final account stage, but this is on the understanding that all parties actually engage in the NEC process.

If the contractor has finished late on the project and missed the completion date (with a certificate of non-completion issued by the contract administrator), then liquidated damages (delay damages) become due, this should not impact the final account procedure as the damages are deducted from the agreed final account by the employer (by use of a pay less notice).

However, in reality if a contractor knows that liquidated damages are going to be deducted from their final account then it will almost certainly affect their judgment and negotiating position in the final account discussions.

### 3.11 Set-off/contra charging

Contra charging can be described as where the employer recovers costs from the contractor, that the contractor has caused the employer to incur. This could equally apply in a main contractor subcontractor relationship also.

The *Construction Act* (2011) makes it very clear that any contra charging must comply with the pay less mechanisms of the contract.

The official advice from the National Specialist Contractors Council (NSCC) is as follows:

'... the Pay Less Notice has to state the amount that will be paid as well as what will be withheld. The benefit of this is that you will now know whether an underpayment is because of a dispute over valuation, a claim for contra charges or both.'

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So in terms of the final account it is the employer's responsibility to deduct the amount that is being contra charged from the final account settlement.

### 3.12 Timescales – contractual and non-contractual

It is a critical issue to understand what information should be in the adjustment of the final account and the timescales involved. If the timescales are not adhered to then there is a risk of this leading to a formal dispute.

Timescales related to the agreement of the final account vary from contract to contract with some being very prescriptive and others less so.

The standard JCT contract (for example) states that the final account should be ascertained no later than 3 months after receipt by the architect/contract administrator of information

supplied by the contractor (which itself should not arrive any later than 6 months after issue of the practical completion certificate). However, each individual contract should be checked for their specific timeframes (and note that some contract amendments may change these timescales).

The type of information that should be presented by the contractor should include the following:

- substantiation to variation figures
- subcontractor quotations where applicable
- daywork sheets
- loss and expense claims made with relevant heads of claim and
- build up to fluctuations.

In essence the contractor should include any information, which will help the contractor substantiate their claims for additional monies under the contract.

Conversely, the NEC suite of contracts expects that all issues related to the final account be agreed on an on-going basis. Therefore, there is no need for a final account period as such. The final account should be agreed by the time the timescales for the last instructed compensation event has elapsed.

It must be recognised that each form of contract and variant form will have different timescales. Furthermore, solicitors' amendments may change the timescales. It is therefore important that the timescales associated with the particular contract being used are understood and adhered to.

It should be recognised that adherence to the timescales within a contract is also important to employers and contractors as a measure and a key performance indicator (KPI). Sign-off of the final account can sometimes be more important to the employer or contractor than arguing over any minimal remaining costs.

## 4 Practical considerations (Level 3: doing/ advising)

This section covers the more common difficulties or complexities, which may influence advice regarding final account procedures. A chartered surveyor should consider the following when advising about final accounts, and, in particular, when making recommendations about settlements for final accounts.

Any adjustment to the final account should be in accordance with the contract terms. However, where complicated final accounts are being handled a degree of negotiation or co-operation may be preferable to the employer rather than entering a formal dispute.

Negotiation or agreements outside of the contract terms should only be carried out where formally instructed to by the employer.

### 4.1 Disputes (adjudication/ arbitration/litigation)

In the event that a final account cannot be settled amicably and only once all other options have been exhausted, then it could be stated that the parties are in dispute. Most construction contracts will have necessary provisions for settling disputes, and there is also the *Housing Grants, Construction and Regeneration Act 1996*, amended by the *Local Democracy, Economic Development and Construction Act 2009* which governs the procedures for statutory adjudication.

A typical first formal step is adjudication but there are other alternative dispute resolution options such as mediation and conciliation. To explain each type of dispute resolution is beyond the scope of this practice information but more information on this topic can be found in the current edition of RICS' [Conflict avoidance and dispute resolution in construction](#).

It is strongly advised that if a resolution to the final account cannot be reached then mediation or conciliation may be effective – the presence of a third party can sometimes help and enable people to put perspective on issues. If a resolution is still not reached then adjudication will require both parties to submit all their information to the adjudicator in accordance with the relevant timescales. This is where keeping a proper audit trail of all variations and changes are vital.

It would be almost impossible to pull together all necessary backup and evidence in the tight timescales of adjudication if it is not already in a good order. All companies should ensure that their documentation and files are 'audit ready.'

## 4.2 Negotiation as an alternative to dispute resolution

The process of agreeing a final account inevitably involves some degree of cooperation and negotiation. Even if a project has been well set up with agreed rates or change control mechanisms there is usually an element of outstanding items that need to be agreed. It should be remembered that all parties involved in the negotiation of the final account are merely protecting their company's financial position.

Where the employer has instructed negotiation, to avoid a lengthy formal dispute, the process should be carried out professionally and calmly and not become personal between the parties involved. This usually increases the chances of any dispute becoming legal.

Relationships are key to a successful outcome, and the principles of fairness and reasonableness should always apply. Above all else, parties must act ethically.

Any negotiation will be aided by the preparation of both parties. When both parties arrive at the negotiating table, the due process of preparation should have been done. This will aid a successful and meaningful discussion.

As part of the preparation for the negotiation, both parties should clarify the goals. Ultimately this will be a settlement that both parties are content with but there will be other specific goals from each party, and these should be understood before full negotiation begins. Both parties should feel as though they have a reasonable outcome. This does not mean there needs to be a 'loser' in the negotiation. It is perfectly possible for both parties to win as their specific goals maybe different.

For example, the employer may have a maximum figure that they are prepared to extend to – that may be their goal, however, the contractor's most pressing concern may be the liquidated damages that may be deducted from the agreed final account. It is by understanding these concerns that a reasonable settlement can be made. In this example, the contractor may be prepared to accept a lesser figure if there is an agreement that only a portion of the due liquidated damages are taken.

Successful negotiation will only be achieved if there is willingness on both sides to try and reach an agreement. Whatever happens once an agreement is reached it must be formalised with a course of action to arrive at a final account.

## 4.3 Dealing with items not formally instructed

One of the common reasons that items aren't agreed is because they haven't been formally instructed. This is also relevant for loss and expense claims (which may not have a formal extension of time issued) as it is for variations.

The reason for items not being formally instructed may be because they were in dispute for a period of time, or there might be some late changes, (sometimes even occurring post-practical completion). For a well-run project, this will be straightforward to deal with by

issuing a 'wrap-up' instruction to formalise these few outstanding items. These should be clearly categorised as subsections within one instruction.

However, if a contract is more problematic with lots of variations that have not been formally instructed then it is even more important that the contract administrator is present at the final account negotiations to ensure that values being agreed are for real and agreed variations. There is little point in spending time agreeing final account figures and a proposed settlement only for the contract administrator or employer to maintain that the items are not true variations.

If the difference of opinions is so fundamental then a separate meeting to discuss the validity of the variations should be held before the final account can be discussed. This doesn't need to change the advice included in financial report as they can still be dealt with as potential variations or early warnings but the final account cannot agree until these have been formally instructed.

The JCT contract enables verbal instructions to be issued using confirmation of verbal instructions (CVI's) under clause 4.3.2 of the JCT contract.

However, it is suggested that all verbal instruction are backed up with a formal written instruction.

## 4.4 Agreeing the final account

It should be remembered that other parties could affect the final account discussions as this may affect one of the negotiating party's positions. For example, a contractor's QS would in some circumstances be dependent upon their subcontractor and suppliers before any agreements can be reached. Conversely, the professional quantity surveyor (PQS) may have to consult with other members of the design team or employer team.

However, to enable a swift resolution to a final account the parties should be prepared to make decisions where they are able to and to seek permission where necessary to act on their behalf and given appropriate delegated powers.

If there are some big items or issues that involve a third party, then the suggestion is that they are invited in to be part of the negotiation. It is likely that they would only need to be there for the part of the meeting that concerns them.

Both parties in the negotiating process should avoid being a 'post box.' For a smooth negotiation, the work of discussing with upstream or downstream parties should be done beforehand.

Just because a subcontractor or supplier has a claim or variation with the contractor that does not necessarily mean that the contractor has a claim with the employer. The word of the contract cannot be forgotten during the negotiating process. Each party should listen to the others point of view, but it is not always the cast that the contractors are back to back.



Remember that although the QS may be negotiating the final account figure, the final agreement is between the parties to the contract (i.e. employer and contractor). This needs to be recorded as do any other terms of the settlement (such as the inclusion of LADs etc.).

## 4.5 Adjustment of the final account

Each form of contract has different timescales related to the provision and timing of information. For example, the NEC is very prescriptive about timing of information and doesn't define a final account period, with the date of the last variation and the timescales governing that being the status of the final account. However, the JCT sets down very specific timeframes for receipt of information from the contractor (six months) and if it is not provided in a timely manner then the employer can issue the necessary information. The PQS then has three months to respond and issue the final account.

If the information is not provided within the defined timescales then by the contract the obligation falls to the employer (by the PQS on their behalf) to ascertain the final account based on the information provided. The different forms of contract deal with this differently and the timescales involved:

- JCT Design and Build Contract states that two months after the three-month period the employer can make their own assessment
- NEC sees that the final compensation events timescales govern and
- FIDIC states that 56 days after receiving the performance certificate the contractor submits their draft final account to the engineer.

If the contractor disagrees at this stage then they would have to go through formal dispute resolution in theory but it is still suggested that a period of discussion and cooperation is carried out first, even if the contractor has indeed weakened their position by not issuing their information in line with the agreed timescales.

## 4.6 Bespoke and amended contracts

It is not uncommon in the construction industry for bespoke contracts to be used or heavily amended standard forms. These may include amendments of differences to the way that standard forms deal with final account procedures.

The most important point to understand is that any amendments or bespoke contracts cannot and must not contradict the common law position and especially that of the *Construction Act*. It is therefore not permissible to introduce 'pay when paid' clauses or withholding unreasonable amounts. In any event, this shouldn't be done as it would not be within the spirit of the contract.

Bespoke contracts and amendments may also be made to reinforce a partnering approach and may include provisions for shared savings, which may be dependent upon the final account figure. Therefore a bespoke or amended contract may include a more detailed process arrangement of how this might be dealt with. For example, a contractor may be

entitled to a bonus should they complete within a certain timeframe or within a certain cost envelope. This will affect the final account and should be set out.

Any specific changes to the final account procedures should be properly communicated to the contractor at the tender stage so they understand the implications of the contract, as contractors can be apprehensive of bespoke or heavily amended contracts.

Due to their nature, bespoke contracts are also untested in court and, therefore, should any disputes arise the legal position would be less clear.

## 4.7 NEC procedures (early warnings, etc.)

The method of valuing variations, which make up the final account, is governed by the use of a schedule of cost components (or shorter schedule). The added benefit of the NEC is that all loss and expense and extensions of time (and other claims) are dealt with as compensation events and should be included within the final account.

It should be remembered that the latest *Construction Act* states that the contract shall contain an 'adequate mechanism' showing how stage payments and final account are to be calculated and when payment is to be made. For the JCT and FIDIC contracts, this process is clearly set out. The NEC contract runs on the assumption that the final account will be agreed by the completion date if the timescales covering compensation events are adhered to.

The NEC contract contains many processes designed to avoid or resolve disputes as the works proceed but does not have a final account or final statement type process.

There is no such thing as a final account application under NEC contracts. The final payment has to be certified within four weeks of the supervisor's defects certificate (clause 11.2(6)).

The time and cost impact of compensation events are deemed to be included in the agreed compensation event, therefore there is no additional final account time allowance post completion for agreeing for final account, as it is assumed that all compensation events have been agreed as the contract proceeded.

## 4.8 Patent and latent defects

### Patent defects

Any patent defects (which were observed before the final certificate), are usually rectified by the contractor within a reasonable period (dictated by the form of contract). If the contractor does not carry them out then they can be carried out by another contractor and contra-charged as part of the final account settlement.

### Latent defects

The agreement of the final account does not affect either party's rights under the contract when it comes to latent defects.

If the defect occurs during the defects liability period then the defects liability period then the contractor should be given the opportunity to rectify the defect.

Once the defects liability period has expired then any further defects will be subject to a separate claim for damages and for breach of contract, or for negligence.

These are usually time barred anytime up to six years from the date of breach, see section 5 of the *Limitation Act 1980*.

For a contract under seal, the period is extended to 12 years (see section 12 of the *Limitation Act 1980*).

Therefore, it is advisable that all contracts are made under seal.

Latent defect insurance can be taken out for extra peace of mind if the employer wishes.

## 4.9 Settlement agreements

It is inevitable that occasionally final account negotiations will get to a point where the two parties are still some way off agreement. This might be for a number of reasons:

- Validity of claimed variations disputed – the contractor/ subcontractor may claim for an item they deem to be a variation, but the employer's surveyor does not deem it a variation to the contract and therefore not payable.
- Value of variation – while the validity of the variation may agree the parties cannot come to an agreement on the value of that variation.
- Loss and expense – even if the principle of loss and expense has been agreed there may still be a dispute over the value and the heads of claim used.
- Extension of time – If an extension of time has been claimed for there may be a dispute as to the entitlement of the employer to claim liquidated damages.

Rather than enter into legal proceedings (which can be time consuming and costly to both parties) they may agree on a settlement. However, the quantity surveyor is not empowered to negotiate unless instructed the employer.

Whatever is agreed must be a 'full and final' settlement and the payment thereof in full to ensure the deal is binding and all parties' written agreement to the final certificate before it is issued. The full and final settlement should contain as few caveats/conditions as possible as they increase the chance of a further dispute arising in the future. If there are any outstanding defects or maintenance issues, they should be wrapped up in the final account.

The final account settlement should not change the parties' obligations to each other in terms of the contract conditions in respect of issues such as latent defects, warranties and bonds.

For larger contracts or particularly complicated accounts, it is suggested that a construction solicitor draws up an agreement, which spells out exactly the terms of the agreement.

Settlement agreements should not be treated as standard practice and are not without risk, final accounts should be agreed using the terms and mechanisms of the contract. They may also affect the employer's ability to take legal proceedings against members of their design team, as the defendant would simply state that they didn't agree or were party to the final account settlement.

## 4.10 Auditing of accounts

Auditing of final accounts should be a standard part of the final account process, especially if the companies want to comply with the management systems standards of ISO 9001:2008, which some public sector employers will insist on. However, there is more to auditing than just ticking a box. Internal audits of accounts provide the company with some comfort that their assessment and agreement of final account is fair and reasonable and that there are no obvious errors. Peer reviews by other qualified professionals reduce the risk of oversights or errors.

Most large companies have a quality management system (QMS) in place that contains detailed instructions on how the final account should be audited and processes for dealing with non-conformance or errors. Smaller companies or sole practitioners, therefore, need to ensure they are providing their employers with a similar level of protection even if it means outsourcing the audit checks.

It is also very important to check the maths and carry out adequate computation checks as soon as the draft final account is received and before the final version is presented for conclusion.

An example of a type of audit checklist:

- project control plan
- contract documents examined to determine:
  - the period for final measurement of the works
  - responsibility for preparing the final account
  - if not specified, agreed with the contractor
- staff resources to prepare final account agreed with team manager/partner
- register maintained of architect/contract administrator
- instructions
- final account calculation assembled
- including, as appropriate:
  - the summary page
  - adjustment of prime cost and provisional sums
  - adjustment of provisional items

- adjustment of approximate quantities
- valuation of variations, dayworks
- fluctuations
- loss and expense incurred by the contractor
- adjustment of overheads and profit

adjustment of any other amount required by the contract.

- before the summary and statement were printed, were the following checked:
  - pages numbered correctly
  - pricing document rates and references correct
  - were pencil figures inked in
  - were all calculations arithmetically checked
- statement of final account prepared:
  - submitted by the contractor for agreement and signature
  - checked on its return to ensure no amendments made prior to signature
- statement of final account approved by partner/ director before the issue, approval recorded by partner initialling office copy
- signed statement of final account issued to architect or contract administrator under a covering letter
- disputes regarding the final account resolved, disputed points recorded
- where the contractor prepared the final account sufficient checks carried out to ensure its correctness, all checks recorded on office copy
- necessary deductions made (when permitted by the form of contract) if defective or non-compliant work identified
- any variations issued after practical completion evaluated and included under a separate heading
- if the employer required final account to be audited, was the auditor supplied with a copy of all backup information required.

As well as internal audits some employers will demand an audit of the final account, sometimes by an independent auditor.

It is advised that audits are carried out before the final account is agreed and a statement of final account signed. This way if any discrepancies are found they can be addressed with the other party before the account is agreed.

Audits are a powerful tool and should be encouraged both internally and externally. They provide accountability and a safety net. They should not be seen as a criticism of work

carried out but simply as a way to reduce mistakes, misunderstandings and crucially to learn to ensure weaknesses or shortcoming are addressed.

## 4.11 Items that the QS may be asked to advise on

There are often items, which form part of the overall project budget but are not part of the contractor's final account. However, it is not uncommon for a final account report to be issued at the same time as the final account. The PQS may, therefore, need to advise on items or costs, which sit outside of the contractor's account. These may include (but are not limited to the following):

- Loose furniture, fittings and equipment: it is not unusual for fixed goods to be included within the building contract (i.e. fixed wardrobes or shelves) but any loose furniture (i.e. chairs, beds, tables etc.) are not usually part of the contractor's contract. The loose furniture, fittings and equipment budget may be a separate contract (administered in its own way) or may be a direct order from the employer. Either way the PQS needs to understand how this relates to the overall budget.
- Professional fees: while the professional fees budget may not be administered by the PQS, they will often need to have a good understanding of the budget and ensure it is tracked throughout the course of the contract. Any shortfall in this budget is often made up by offsetting against the construction budget, so it is important that this is reviewed throughout the course of the contract, otherwise when it comes to the final account stage there could be a significant discrepancy.
- Section 106/278: any section 106 or 278 contributions are often subsumed into the contract, but they may also be provided by means of a separate contract. Therefore, this must be reviewed.
- CIL (Community Infrastructure Levy): where CIL applies the PQS may have to advise on the implications for the budget and ensure that any charges are included within the overall project budget.
- VAT: this is a complex issue and the amount of VAT liable on any project should be calculated and advised by a VAT specialist. However, the PQS may have to report these figures and ensure they are up-to-date.
- Employer internal costs: some employers will have their own internal costs (such as finance costs, legal costs, etc.). These can vary a great deal and are obviously not a part of the contractor's final account, but they should still be included in the overall financial report.

## 4.12 Possibility of the agreed final account being used in disputes

When a project doesn't go according to plan, the employer can often suffer a financial setback. The reasons for a project not going as planned can vary enormously and can include the following:

- the contractor is overrunning due to being badly resourced
- employer-owned risks coming to fruition
- significant variations due to design development or employer change or
- errors in the design (particularly on traditional contracts).

Where the employer considers that the problems in the project were caused by the design team (i.e. errors in the initial design requiring significant variations) then they may choose to take this up with the member(s) of the design team that they view to be responsible for these issues.

Initially, this may be informally but can sometimes lead to legal action. In these instances of dispute, the final account documentation can be an important forensic tool if it has been ordered properly. From the final account information the employer (or dispute resolution practitioner) may be able to ascertain the value of works over and above the contract sum, which they consider to be the fault of the design team. However, on the other hand, a badly organised and recorded final account can weaken the employer's position (and could implicate the quantity surveyor in the dispute).

While most employers and contractors do not set out for a dispute at the beginning of a project all final account documentation should be treated as though it could be used as evidence in a court of law.

Issues become a little more difficult where a deal has been reached as the member of the design team involved in the dispute could simply state that their opinion does not represent a good deal and as there is a degree of subjectivity it makes things difficult. It is therefore vital that the build-up to the deal, demonstrating that it does represent the employer's liability to the contractor (and that they could have paid more if the dispute continued) must be kept to counter any of these sorts of criticisms.

## 4.13 VAT on final payments and interim valuations when damages/contra charges have been applied

In most normal circumstances, VAT is applied at the standard rate. However, there are some circumstances when VAT is either exempt or zero-rated and even more confusingly there are plenty of circumstances where there is a partial exemption.

The topic of VAT on construction projects is a complex issue and outside the scope of this practice information but, as a general principle, surveyors should be aware that final account decisions can impact VAT paid on a project and, therefore, the overall project budget.

As an example, if a building is partially VAT exempt and VAT is calculated based on the proportions of the building used for a given purpose, then how do variations to the building contract affect that calculation? If a variation impacts the entire building (i.e. if a new heating system is instructed for the entire building) then the logical effect is a pro-rata update to the VAT calculation.

However, a surveyor needs to be alert to whether a variation only impacts the proportion of the building that is liable for VAT (e.g. the ground floor retail unit in a student accommodation scheme). In this case, the surveyor should advise their employer to seek expert VAT advice to review the implications of the change.

There is also the question of VAT on damages. VAT Notice 708: buildings and construction states that:

‘Liquidated damages are agreed pre-estimated sums to be paid in the event of a breach of contract by one of the parties. The amount is either a set figure or determined by a formula.

If you receive liquidated damages, you are not receiving payment for a supply by you and no VAT is due on that amount.

If you are due to make a payment for liquidated damages and due to receive from the other party a payment for a supply made by you, you cannot reduce the value of your supply (and therefore cannot reduce the amount of VAT chargeable) even if you set the amounts off against each other.’

The guidance is, therefore, clear that VAT is not to be paid on liquidated damages and the same principle applies to any contra charge. See the current edition of RICS’ [Interim valuations and payment](#).

## 4.14 Insurance recovery

It is important that risks in the contract are owned by the party best able to manage that risk and they will usually attempt to take out insurances to cover this risk. In a construction contract, the most common insured risks are all-risk insurance for the works on site, insurance of the works, public liability insurance and professional indemnity insurance.

These insurances will sit outside of the final account negotiations and should not affect the methodology previously discussed to arrive at the agreed figure. If liquidated damages are to be applied, then the contractor may have taken out an insurance policy against this. While this is not a concern for the employer who will levy damages in accordance with the terms of the contract it is a concern for the contractor, as their insurers may want to see justification for the claim. This, therefore, goes back to the rationale of ensuring that accounts are properly kept and audited as it is protection for both parties to the contract.



If there are any variations in the contract, which were as a result of an insured risk on the employer's site (i.e. if there was a flood which caused damage), then the employer's insurers may not pay unless their specific procedures are followed. In this circumstance, it is crucial that the contractor, employer and insurance company representative liaise to make sure the insurance company's provisions are being followed. The contractor will still be paid by the employer (as if it were normal variations) and included in the final account statement but the specific cost should be identified so that the employer can then recover this cost from their insurers.

## 4.15 Full development costs

The agreement of the final account of the main contract is only part of the overall budget for the employer. They will be interested in the full development costs and how that translates into their budget.

This will be different depending on the type of project, but it may be made up of a number of different accounts such as an enabling works contract, furniture, fittings and equipment contract, or landscaping contract.

There will also be other cost centres to tie up, such as agreement of all fees (including any fee claims submitted for prolongation, etc.), it is therefore very important that before the development cost final account is submitted to the employer that those responsible for other cost centres have closed out their accounts.

For example, the main contract final account may show that not all of the contingency was spent. However, before this is reported it is important to check that there is not another cost centre (such as professional fees) which has been overspent (perhaps due to fee claims etc.) which will need to offset some of those savings.

The final VAT calculation will also have an important impact and often this cannot be fully calculated until all the other elements have been closed out. It should also be the VAT specialist that does this calculation as there is always a risk associated with VAT calculations.

Before any remaining risk allowance is returned to the employer's budget, all cost centres must be closed down.

## 4.16 'Notional' final accounts caused by the contractor going into liquidation or administrative receivership

In most cases, final accounts represent the end of a project and occur when the employer is taking possession of their new building. However, there are also occasions when final accounts have to be settled in the middle of a project. This can be due to one of the following reasons:

- the contractor or employer going into liquidation or administration

- the contract being terminated due to performance or other reasons in accordance with the contract by the employer or
- the contract being terminated by the contractor.

The issues surrounding liquidation and administration are covered more extensively in the current edition of RICS' [Termination of contract, corporate recovery and insolvency](#), but in terms of final account it is important that the agreed value of works carried out at the date of termination is determined as soon as possible so that negotiations with the new contractor 'stepping in' can begin. This is why it is vital that interim valuations are as accurate as possible, if a contractor does go into administration it may be very difficult to reclaim for any over payment.

The insolvency practitioner will be a party to the negotiations, and it will be in their interests to agree the highest value possible on the works carried out to protect the creditors to the company in administration.

There is also likely to be a premium to be paid to the contractor stepping in to take over the works, to be deducted from the contractor. The final account should also clarify the scope of work remaining to complete the work to the contractual obligations. The final account must also take into account any pay less notices issued by the client.

If the contract is terminated due to a reason outlined in the contract then the rules in most forms of contract are clear and will stipulate the types of loss that can be claimed and, possibly, the limits on recovery.

If the contract isn't prescriptive then the common law remedies are wider, and will look to put the innocent party into a position they were in prior to the termination and this may include loss of profit.

If an employer terminates before the end of the contract then they must realise the implications and that they may be forgoing any liquidated damages that are owed.

If the contract is terminated due to force majeure (i.e. if it is neither party's fault) then the same procedures apply but there will be more of a willingness from both parties to reach an acceptable agreement due to the circumstances.

# Appendix A: Example statement of final account

## Statement of final account for the contract

**Dated:** .....

**Between:** .....

**For:** The design and construction of: .....

**At:** .....

		£
1	Contract sum	10,000,000
2	LESS risk allowances	0
	<b>SUBTOTAL</b>	<b>10,000,000</b>
3	Net omissions/additions (compensation events, early warning notices and adjustment to provisional sums up to and including the project manager's instruction (PMI))	50,000
	<b>Final account TOTAL (exclusive of VAT)</b>	<b>10,050,000</b>

We hereby agree to accept the sum of £10,050,000 (ten million and fifty thousand pounds) (excluding VAT) in full and final settlement of the final account for the above contract.

This sum is in full and final settlement of the amount claimable under the final account including all sums claimable by the main contractor ConBuild or by any subcontractor engaged by a contractor or any suppliers to ConBuild or their subcontractors.

This settlement does not in any way affect the contractual obligations of either party in relation to other matters that might arise under the terms of the contract including but not limited to defects, warranties and retention.

**Signed:** .....

**Position:** .....

**Dated:** .....

**For and on behalf of:** .....

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