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BOSTON, MASSACHUSETTS 02108

OPERATIONAL SERVICES DIVISION
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BOSTON, MASSACHUSETTS 02108



Contract Retainage Policy

Effective: July 1, 2004
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Executive Summary

This policy is issued jointly by the Office of the Comptroller (CTR) and the Operational Services Division (OSD). Retainage is defined as a contractually agreed upon dollar amount or percentage of a payment(s) to be withheld from periodic payments as security for the contractor's performance over the life of a contract or until specific terms or milestones are met. Retainage allows departments and contractors to negotiate a holdback as an option within a contract. It is the portion of the contractor's funds withheld for the purpose of providing leverage for the department to ensure all items of work are completed satisfactorily. Payments are processed over the life of the contract and retainage amounts that are withheld from each payment accumulate according to terms of the agreement (amount or percentage). Depending upon the terms of the contract and phases of completion, departments may determine that the entire retained amount should be released, a portion should be released, or nothing should be released.

Considerations

Departments must treat retainage with the same importance as any other contractual term. Retainage amounts should be withheld from periodic payments in accordance with the terms of the contract. Retainage amounts cannot be increased or decreased unilaterally by a department without a formal contract amendment. Retainage should be released upon successful completion and acceptance of performance. Retainage may only be revoked (not released) when the department can document proof of substandard or incomplete performance, which the contractor has not cured after written notice of breach and a reasonable period to cure. If litigation or disputes over the performance or the retainage are threatened, the department may not un-encumber or use the retainage funds for any other purpose until the dispute is resolved.

Policy

The statewide enterprise accounting and financial reporting system ("the system"; "Mosaic") includes the ability to set up, at the encumbrance level, retainage withholdings based on provisions of the contract. Any contract may have retainage terms, but it is expected that only certain service/activities are appropriate for retainage clauses. These include situations where progress payments are made because of the length of time between contract initiation and completion of contract performance (i.e., multi-year construction or systems development projects, environmental clean-up, etc).

Retainage may also be negotiated in other situations when the Commonwealth wants to leverage or ensure complete performance. For example, a department has a service maintenance contract, which requires quarterly payments at the beginning of each quarter to reserve the availability of on-call service. The department could negotiate a 10% retainage from each quarterly payment to ensure timely performance during the quarter. If performance is unsatisfactory, the retainage would be

revoked, plus any additional amounts if the performance was substantially deficient. If performance was satisfactory for the quarter, the contractor would receive the retainage in the following quarter.

Terms may be set in dollar or percentage ranges. If a retainage has not been negotiated as part of the initial contract, terms may be negotiated at any time during the period of the contract by completing a contract amendment and adding the retainage terms.

The retainage terms are established on the encumbrance transaction. As payments are processed against the encumbrance, retainage is automatically withheld according to the terms set in Mosaic and moved to a separate "Retainage Payable" account. Once the Department determines that the contract terms have been satisfied, the retainage funds are scheduled for release or forfeited, per the terms of the contract. See "[Forfeiture of Retainage](#)" below.

The Retainage Detail (RTGDET) page provides a detailed view of the amount of retainage withheld for each Payment Request commodity line. Each time a Payment Request is processed that references an encumbrance with retainage terms, the Payment Request number is updated to the Retainage Detail page, with the corresponding commodity line, accounting line, and Pending Retainage amount. When an Automated Disbursement (AD) transaction is processed, the retainage amount that is actually withheld from the payment is updated to the Retainage Withheld field. Finally, when retainage is paid out, the amount paid for each accounting line is recorded. Retainage can be paid out throughout the life of the contract or upon completion of the contract. The accounting entries posted will vary depending on the payout method selected.

The funding elements on the Payment Request are based on the original expenditure and/or the information stored on the Post Award transaction. This process will use the FIFO (First In, First Out) method of retrieving the original expenditure accounting line. The first expenditure accounts in the retainage bucket are the first ones out of the bucket.

All expenditures related to a contract award with Retainage Terms are maintained in the system until the contract award is closed. A contract award is not considered closed until the terms have been satisfied and retainage has been fully paid out (or the contract has been terminated and the retainage revoked). All Payment Requests that reference a contract award are linked to the award, as long as the contract award is still open. This will allow Departments to access the Payment Request for inquiry, as well as provide the payout process to retrieve the original expenditure and the retainage held against it. Each payout against the original expenditure should reduce the retainage withheld and the difference is stored for the next payout cycle.

The retainage payout must be to the original expenditure accounts. When the vendor invoice is received, a Payment Request transaction is entered into the system. If the Payment Request references a contract Award, the Award number and commodity line number are entered on the commodity line of the Payment Request transaction. When the Payment Request is validated, the system verifies all information related to the Award. If the referenced Award commodity line is subject to retainage, the amount is automatically calculated on the Payment Request based on the retainage terms entered on the Award. If the contract is also subject to a prompt pay vendor discount, the retainage is applied first and the prompt pay discount is applied to the remaining payment amount. For Example:

1. A Contract with a Retainage Terms of 20%
2. A PRC for \$500.00 referencing a CT with discount terms of 10% net 15 day was processed.
3. Automated Disbursement (AD) was created referencing PRC. The AD contains the following amounts:
 - Gross amount = \$500.00
 - Retainage amount = \$100.00
 - Discount Amount = \$40.00
 - Net pay amount = \$360.00

Retainage is taken on the Gross amount and discount is taken on the Net amount.

Forfeiture of Retainage (treated as breach of contract)

Retainage is based upon negotiated contract terms. A retainage may be forfeited only in circumstances where less than full performance has been delivered by a contractor, based upon the specific terms of the contract. In some circumstances, the parties mutually agree to less than full performance. Sometimes, the department is satisfied that the job or project is satisfactorily completed at an earlier stage. In others, fewer goods or services were actually needed to complete performance than originally anticipated. In these circumstances, retainage should be pro-rated and released based upon the performance accepted by the department.

However, in other circumstances, the contractor may be unable or unwilling to complete full performance or there may be disagreement as to the quality of delivered performance. Final payments, including retainage, should not be made until the department has first verified that performance has been completed in accordance with the terms of the contract.

The Chief Fiscal Officer (CFO) and department General Counsel should be notified immediately whenever it appears that a contractor has halted or suspended performance or whenever it appears that the contractor has breached or failed to fulfill contract terms. The timely and appropriate response to an alleged contract breach is important not only to preserve Commonwealth contract rights and funds, but also to ensure that the response does not result in avoidable disputes, litigation or an irreconcilable breakdown in the contractual relationship. If a legal dispute or litigation is threatened, the department is required to immediately notify the Office of the Attorney General (Government Bureau), which is responsible for providing legal representation to departments.

Sometimes, contractors and department staff develop close working relationships, which encourage informal resolution outside the terms of the contract. Such resolutions, although efficient in the short term, create a dangerous precedent in the event of larger disputes or a serious breach in performance. Staff must understand that, irrespective of their professional working relationships with contractors, they have been entrusted with an independent fiduciary obligation to manage Commonwealth funds properly in accordance with the terms of the contract. This responsibility includes knowing the terms of the contract and providing prompt notice to the CFO, other appropriate department staff, and the contractor whenever performance is disputed.

Failing to provide prompt and suitable notice may result in escalation of a bad situation, additional costs to the department, and delays in performance. However, under Section 12. Waivers in the

Commonwealth Terms and Conditions, “...forbearance or indulgence in any form or manner by a party shall not be construed as a waiver, nor in any way limit the legal or equitable remedies available to that party. No waiver by either party of any default or breach shall constitute a waiver of any subsequent default or breach.” Just because a department accepts less than full or satisfactory performance at any point in the contract does not waive the department’s right to demand full or satisfactory performance during the remainder of the contract.

Recommended Steps Prior to Forfeiture of Retainage

The grounds for forfeiture of retainage are the same or similar to the grounds for any contract breach, including contract termination or suspension “for cause”. Retainage can only be forfeited if the department can prove that the contractor failed to perform under the terms of the contract. The retainage is held as security to leverage full contract performance. A breach in contract performance can result in forfeiture of final payments and retainage. Therefore, departments need to be familiar with the terms of a contract and the performance threshold, expectations and requirements that could trigger a breach or a loss in retainage. It is helpful to outline what types of performance problems or contract breaches would warrant a forfeiture of all or a portion of a retainage, and negotiating these performance expectations as part of the contract is encouraged.

If performance is **in any way** substandard or incomplete, the department contract manager is responsible for taking the following steps:

1. Immediately notify the CFO, department legal counsel and/or other appropriate staff in accordance with internal protocol.
2. If a legal dispute or litigation is threatened, the department is required to immediately notify the Office of the Attorney General (Government Bureau).
3. Review the policy chapter “Contracts – Amendments, Suspensions and Terminations” for recommendations related to amending, suspending or terminating a contract.
4. Document the breach (if not done already). The breach must be documented and verifiable. If a breach or incomplete performance cannot be documented or verified or if the department fails to document or verify the breach, there is a weaker basis for forfeiting a retainage, suspending or terminating performance or the contract.
5. Documentation should be verified by more than one individual, preferably by the CFO, in consultation with legal counsel, to ensure that a claim of breach or incomplete performance is justified under the terms of the contract and reasonable. Sometimes, staff has performance expectations that are not memorialized in the contract terms and, therefore, the failure to meet these unwritten expectations cannot be used as a basis for forfeiture of a retainage, suspension or termination of contract performance.
6. Draft written notice of breach or notice of rejection of substandard or incomplete performance, specifically identifying the reason(s) for the rejection and what is necessary to cure the breach. The notice must be professional, impartial and must match the level of the breach. The notice should contain any time period for cure and the repercussions for failure to timely cure (i.e., suspension, termination and replacement).
 - a. Provide notice to the contractor.

- i. Notice may be made orally, but written notice must be provided in the format authorized under the contract, provided that actual receipt is confirmed. For the purposes of time periods for notice, the time clock does not begin to tick until actual receipt of notice by the contractor. See contract for details. The Standard Contract Form allows email delivery to listed Contract Manager provided there is confirmation of actual receipt.
 - ii. Any notice provided to a contractor should be made by an authorized signatory of the department head in consultation with the CFO and department legal counsel.
 - iii. Any notice shall be deemed delivered and received when submitted in writing in person or when delivered by any other appropriate method evidencing actual receipt by the Department or the Contractor.
 - iv. Any written notice of termination or suspension delivered to the Contractor shall state:
 - a) the effective date and period of the notice,
 - b) the reasons for the termination or suspension, if applicable,
 - c) any alleged breach or failure to perform,
 - d) a reasonable period to cure any alleged breach or failure to perform, if applicable, and
 - e) any instructions or restrictions concerning allowable activities, costs or expenditures by the Contractor during the notice period.
- b. If the breach is resolved, release the portion of final payments and retainage owed for the completed performance.

If performance is partially but not fully completed by the close of the fiscal year (by June 30th) and the performance is severable and capable of being paid for in subsets, all performance capable of being accepted should be compensated using current fiscal year funds. For appropriated funds in non-continuing accounts, the resolution of final contract payments must be completed no later than August 15th for performance delivered by June 30th in any fiscal year in order to enable retainage payments to be released by the end of the accounts payable period on August 31st.

If resolution of final contract payments cannot be completed by the end of the accounts payable period, the department may take the appropriate steps to include the final payments on APEN to extend the period for payment until September 15th. Payments must be made within the accounts payable period or the amounts appropriated for final payment and retainage will lapse (revert) unless the department obtains a PAC – prior appropriation continued. If a PAC is not obtained, the amounts for final payments or retainage will have to be paid as prior year deficiencies (PYD) which will be charged back to the next fiscal year's funds.

Any remaining performance made in a subsequent fiscal year must be paid using that subsequent fiscal year's funds, including retainage payouts connected to this performance. A department may pursue legislation as part of the GAA or a supplemental budget that enables a PAC (prior appropriation continued) which is the ability to use prior year funds for the services completed in the subsequent fiscal year.

Internal Controls

Departments should identify internal protocol for negotiating retainage for department contracts and handling retainage in the event of a contract breach or any substandard performance. Staff should review the [CTR Bill Payments Policy](#) and the [CTR/OSD Amendments, Suspensions, and Terminations Policy](#).

Records Management

In accordance with [815 CMR 10.00](#), the department is the keeper of the official record copy of the contract documents and the contract/procurement file. Mosaic is the official record of the encumbrance and payment documents and will supersede any paper copies of the same information. The contract/procurement file must contain, or refer to the location of, all documentation related to a procurement and resulting contract(s), including all information and supporting documentation related to retainage. A department is responsible for retaining and archiving contract records in accordance with the disposal schedules issued by the Secretary of State Records Conservation Board. See the [CTR Fiscal Records Management Policy](#).

Information Sources

Related Policies

- CTR Key State Finance Law Compliance Appointments and Responsibilities Policy
- CTR Department Head Signature Authorization Policy
- [CTR Contracts Policies](#)
- [CTR Accounts Payable Policies](#)
- [CTR Records Management Policies](#)
- OSD [Procurement Information Center \(PIC\)](#)

Legal Authority

- [Expenditure Classification Handbook](#)
- [M.G.L. c. 7A](#) (Office of the Comptroller)
- [M.G.L. c. 29](#) (State Finance Law);
- [M.G.L. c. 110G](#) (Uniform Electronic Transactions Act)
- [M.G.L. c. 30 § 65](#) (Legal Services);
- [M.G.L. c. 29 § 29D](#) (Debt Collection);
- [M.G.L. c. 29 § 29E](#) (Revenue Maximization);
- [M.G.L. c. 30 § 27](#) (Revenue Receipt)
- [M.G.L. c. 10 § 17B](#) (Revenue Receipt);
- Massachusetts Constitution [Article LXIII Section 1](#) (Revenue Receipt);
- [M.G.L. c. 7 § 22](#) (OSD – Commodities);
- [M.G.L. c. 30 § 51](#); (OSD – Services)
- [M.G.L. c. 30 § 52](#); (OSD – Services)
- [M.G.L. c. 29 § 29A](#) (Consultants) (Level III – Executive only);
- [M.G.L. c. 29 § 29B](#) (Human/Social Services) (Level III - Executive only)
- [M.G.L. c. 15A](#) and [M.G.L. c. 73](#) (state and community colleges);
- [M.G.L. c. 75](#) (UMASS); General or special laws governing expenditures;

- [Massachusetts Executive Orders](#) (Level III – Executive Only);
- [Administrative Bulletins](#) (Level III – Executive Only);
- [Comptroller regulations](#) (815 CMR 2.00 10.00);
- [M.G.L. c. 29 § 66](#) (State Finance Law Violations)
- [COMMBUYS](#)
- [801 CMR 21.00](#)
- [808 CMR 1.00](#)

Attachments

- [Transaction Records Management / Signature Authorization Form](#)
- [Attorney General Review Form for Attorneys Providing Legal Services](#)
- [Attorney General Policy for Prior Review of Attorneys](#)
- [Quick Reference – State Grants and Federal Subgrants](#)
- [Quick Reference – Commodities and Services](#)
- [Quick Reference – Subsidies](#)
- [Quick Reference – Interdepartmental Chargebacks](#)
- [Quick Reference – Commodities and Services, Grants, Subsidies, ISAs and Chargebacks](#)
- [Commonwealth Terms and Conditions Form](#)
- [Commonwealth Standard Contract Form](#)
- [Commonwealth Terms and Conditions for Human and Social Services](#) (Level III - Executive Only)
- [Standard Contract Form and Instructions](#)
- [Purchase Order for Commodities and/or Services](#)
- [Change in Contractor Identity Form](#) (Change in business structure or contract assignment)
- [Interdepartmental Service Agreement Form](#)
- [Subsidy Agreement](#)
- For Standard Contracts for Construction (See Policy Chapters on Vertical and Horizontal Construction Contracts under construction)
- For Standard Contracts for Real Property Leasing (See Policy Chapter on Real Property Leasing Contracts – under construction)
- [Contractor Authorized Signatory Listing Form](#)
- [Electronic Funds Transfer \(EFT\) Authorization Form](#)
- [Form W-9 \(Massachusetts Substitute Form W-9\)](#) (if not listed as vendor in the Mosaic Vendor / Customer File)
- [Consultant Contractor Mandatory Submission Form](#)
- [Table of Departments by Procurement Level](#)

Contacts

- [CTR Solution Desk](#)