

Provisions for Dilapidations – A true and fair view?

Greater transparency and accountability – The Higgs Review continues to emphasise corporate governance but where are we going to see its practical application? We already have a wealth of statute, codes of practice and reporting requirements so perhaps we should look for a better understanding and application of the detail of these standards.

One such area is in making appropriate provisions in the P&L for your property dilapidations.

“COULD IT BE YOU?”

We recently heard of a multinational whose auditors quizzed the EMEA finance team on the accuracy of the property provisions. They were not able to validate the figures and so were advised to commission independent property advice on an on-going basis. Many companies carry no provision at all. Apart from potentially not complying with financial reporting standards, these companies might also be incurring larger corporation tax bills.

THE RELEVANT REPORTING REQUIREMENTS – FRS 12

The treatment of provisions is covered by FRS12 and there are three key factors to ensure that your provisions are going to be accepted first by your auditor and secondly by the Inland Revenue. They are:

- A “legal or constructive obligation as a result of a past event”. *Eg* a lease requirement to reinstate the premises to the style and standard at which you took them over.
- A probable “transfer or economic benefit”. It is probable that you will incur a cost to carry out the reinstatement works.
- A “reliable estimate of these costs”. This would need to be provided by someone with appropriate knowledge and skill.

MAKING PREPARATIONS AND PROVISIONS

It is possible that unless you can demonstrate, and provide evidence to support the fact that your situation meets the criteria, you may experience difficulties in [agreeing a provision with your auditors](#).

- Before taking on a lease, a schedule of condition should be compiled and agreed between you and your potential landlord. This becomes your benchmark against which reinstatement works can be assessed.
- During the lease term, you can carry out planned maintenance, budgeting for and incurring actual costs year by year. Although this hits the cash flow, it can help reduce the end of lease disruption and void time – *ie* where you have to leave the premises early in order to return them to the landlord on the lease end date with the works completed.
- To make provisions in your accounts during the lease term, these should be sufficiently reliable, determined either within the entity or by a qualified party, and re-assessed periodically to ensure that they keep pace with changing costs and the condition of the premises.
- At the end of the lease, there is often a degree of discussion with the landlord on precisely how the property is going to be returned to them and although the lease may stipulate “full reinstatement”, this is an opportunity for negotiation and savings.

LOOKING AFTER THE BOTTOM LINE

Most Boards will know that they can protect the company’s profitability with careful planning to deal with these issues. Few companies, however, are likely to have the necessary skills to evaluate their property liabilities and thereafter undertake landlord negotiations.

If you would like further guidance or an independent assessment from a property view point, please call 01494 488 493

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