

# Accounting for Business Combinations within the Public Sector

## **Application Guidance**

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# Guidance on Accounting for Business Combinations within the Public Sector

## Summary

1. The purpose of this guidance is to advise those public bodies to whom the Government Financial Reporting Manual (FReM) applies of the correct accounting treatment for business combinations under common control<sup>1</sup> and to draw together guidance on other linked financial reporting requirements.
2. A Machinery of Government (MoG) change is defined within the [HM Treasury Supply Estimates Manual](#) as '*responsibility for a continuing function transferred from one government department to another, or where a department is broken up*' (Supply Estimates Manual paragraph 2.98).
3. Paragraph 9.1.2 of the FReM defines a function as '*an identifiable business operation with an integrated set of activities and recognised assets and/or liabilities that are capable of being conducted and managed to achieve the objectives of that business operation*.'
4. A transfer of function may not always include all of these features, and where there is uncertainty, both parties, auditors and the Relevant Authority should be involved in discussions to determine the classification.
5. IFRS 3 excludes from its scope business combinations involving entities or businesses under common control (IFRS 3 paragraph 2(c)). Public sector bodies are deemed to be under common control per FReM 9.1.1. Business combinations between public bodies are therefore outside the scope of IFRS 3.
6. The FReM states that: '*The combination of two or more public sector bodies into one new body, or the transfer of functions from the responsibility of one part of the public sector to another, will be accounted for as either a Transfer by Merger or as a Transfer by Absorption*'. (FReM paragraph 9.1.1).
7. Other transfers of function under common control, including those resulting from a public service reform agenda where service

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<sup>1</sup> Common control for the public sector context refers to the European System of Accounts (ESA 10) term 'general government'. This is applied by the ONS for national accounts purposes and it is used by HM Treasury to define control for budget purposes. General Government includes those bodies classified to central government, local government and Public Corporations.

functions continue to be performed within the public sector are also MoG changes within scope of this guidance.

8. Public bodies that are incorporated as companies or that have charitable status should follow this guidance in so far as it is consistent with statutory guidance.
9. The **'Transfer by Merger'** accounting treatment should be applied for transfers of function between departmental groups within central government, but not between a Westminster Department and the Welsh Government, Northern Ireland Assembly or Scottish Government. That is, for transfers at the group-level, whose income and expenditure is controlled directly by Parliamentary Supply processes (departmental group accounts), or the devolved equivalent Supply process. The treatment requires the transfer to be accounted for as if the function had always taken place in the transferee's accounts.
10. The accounting for all other public sector business combinations should be as a **'Transfer by Absorption'**, whereby transferor and transferee financial statements are adjusted at carrying value from the date of transfer. This adjustment represents a non-operating gain or loss on transfer.
11. A decision-making flow chart is provided at **Appendix 1** to clarify the treatment where a transfer does not meet the definition of a function or is not under common control, and under what circumstances a transfer of function under common control should be accounted for as a Transfer by Merger or by Absorption.

## Clarification of key principles

12. The decision for business combinations between public sector entities to be accounted as transfers by merger or absorption was a historic judgement made by HM Treasury in 2012 with a cross-government technical working group.
13. The agreed principle was that the type of accounting applied depended on the accountability of the entity before and after the business combination. This is stated in FReM paragraph 9.1.5: *'The accounting treatment for transfers of function under common control should be determined by aligning the reporting with the accountability for financial performance. The underlying objective is to ensure the financial reporting supports the accountability for the transferring function, and to do so in a symmetrical way to ensure there is no transparency gap. A transfer may require both treatments at different levels.'*
14. For transfers of functions between central government entities (except for the devolved governments as set out above) merger accounting reflects the substance that overall government control

over the function is unchanged. It was decided to limit the application of merger accounting to transfers between non-devolved central government departments as other types of public sector entities (e.g. local government entities, devolved governments) have different accountability structures.

15. Limiting merger accounting to the scenarios described above was also done as certain bodies have statutory frameworks which may limit the use of merger accounting.
16. All other transfers of function relating to entities under common control are accounted for using absorption accounting. Absorption accounting is applied as at the date of the transfer.
17. The other key principle for public sector combinations is that transfers of assets and liabilities are at book value and not fair value. This is the case for transfers by absorption and transfers by merger.
18. The reason book values are used rather than remeasuring to fair value is that there is no interruption to the provision of services after the business combination. The accounting reflects this by transferring assets and liabilities at book values rather than revaluing to fair value on combination.

## Accounting and verification of accounting data

19. Irrespective of whether a business combination (transfer of function) under common control has been accounted for as a Transfer by Merger or Transfer by Absorption, at the whole of government level, the function is still undertaken; it is the entity that performs the function that has changed.
20. The following sections outlines the verification work necessary to ensure that accounting data transferred under a Transfer by Merger or Transfer by Absorption change are complete and accurate. For comparison, the accounting requirements of a Business Combination not under Common Control (i.e. acquisition accounting under IFRS 3), are also provided.

## Comparison of accounting treatments

21. The following table provides a summary of the respective accounting treatments. This should assist entities in identifying what information the transferor (the entity transferring the function) and transferee (the entity receiving the function) will need to obtain for the transferring function(s).

Accounting Impact	Acquisition accounting	Transfer by Merger	Transfer by Absorption
Summary of treatment	Accounts reflect the acquired entity's	Group accounts reflect the combined entity's results as if	A new/renamed entity is created or an existing entity or

	results from the date of acquisition only.	they had always been combined.	function transfers to the other entity. The transferor and transferee account for the function up to/ from the point of transfer.
Valuation of assets/ liabilities	Acquiring entity must attribute 'fair values' to the identifiable assets and liabilities of the acquired business at the date of acquisition and use these as the initial carrying values (or 'cost') in the group SoFP. Any gains or losses arising from this revaluation are recognised in the acquired entity's SoCNE or reserves prior to consolidation and thus are not recognised as a gain or loss in the combined entity's post acquisition SoCNE or reserves.	<p>No restatement of the value of assets and liabilities is required. The existing values (carrying values) retrospectively reported in the group SoFP, adjusted only to harmonise accounting policies.</p> <p>Revaluation reserves and accumulated depreciation should also be transferred to the transferee.</p>	<p>No restatement of assets and liabilities is required. The existing carrying values are reported in the transferee's SoFP and adjusted (through reserves) only to harmonise accounting policies with those of the new entity.</p> <p>Revaluation reserves and accumulated depreciation should also be transferred to the transferee.</p>
Impact on income/ expenditure	Any difference between the fair values of the acquired entity's net assets and the consideration given for them by the acquiring entity will give rise to Goodwill on consolidation. Any positive goodwill must be recognised as an asset on the SoFP and reviewed annually for impairment. Negative goodwill, or bargain purchase, must be recognised	No goodwill arises in merger accounting as there is retrospective restatement.	No goodwill arises in absorption accounting. The net movement is accounted for as non-operating gains/losses from the transfer of function, through the SoCNE/ I&E.

	immediately as a gain, with positive goodwill amortised over a suitable period.		
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## Restatement of comparative information

22. Where comparative restatement is required under merger accounting, this should be done in accordance with IAS 1 as adapted and interpreted by the FReM. IAS 1 (paragraph 40A) requires as a minimum, three statements of financial position, two each of the other primary statements, and related notes. The statements of financial position should be presented as at the end of the current period, the end of the previous period and the beginning of the earliest comparative (i.e. previous) period in line with IAS1.40A.
23. The FReM adapts IAS 1.40A to not require a 3<sup>rd</sup> SoFP to be presented when merger accounting is applied and:
  - a. There are no accounting policy alignment adjustments or retrospective changes.
  - b. There are no corrections of prior period errors.
24. However, where a MoG change happens and merger accounting applies, if there are any accounting policy alignment adjustments, retrospective accounting policy changes or prior period error corrections, regardless of whether the changes were made due to the MoG change, a 3<sup>rd</sup> SoFP must be presented, which will include any transfers in/ out of assets and liabilities due to the MoG change. A scenario analysis of when a 3<sup>rd</sup> SoFP is required is included in **Appendix 3**.
25. In addition to the restatement of comparative information in the financial statements, the information required in the accountability report must also be restated when merger accounting is applied and where prior year comparative information is required, with the exception of FReM paragraph 6.2.1h. covering fair pay ratios.
26. Instead of restating the information required by FReM paragraph 6.2.1h, entities must instead cross reference to the fair pay ratios in the prior year annual reports and accounts of the individual entities prior to combination.
27. Consideration should be given to the **materiality** and **cost-benefit** of producing performance information. Specific issues should be discussed with the relevant HM Treasury contacts and agreed with the NAO.



28. A scenario analysis is provided at **Appendix 2** to provide practitioners with a guide to the expected accounting treatment. This list is not absolute and practitioners should contact the Relevant Authority if they are uncertain of the treatment.

## Impact of transfers

29. Transfers of function under common control can have a significant impact on the accounts, budgets and estimates of the transferee if the data pertaining to the assets and liabilities of the transferring function are not accurate. It is in the interests of both the transferor and the transferee to ensure such data are accurate to prevent post-transfer disputes between the two parties.
30. Both the transferor and the transferee should disclose in the financial statements that the transfer has taken place, the date of transfer, the name of the transfer party and the effect on the financial statements.

## Sharing Information

31. For Transfers by Merger:

- The transferor should provide to the transferee a Statement of Financial Position (SoFP) for the transferring function as at the 1st April of the financial year of transfer, a statement of financial position for the function as at the date of transfer and prior year comparatives (including a SoFP as at the beginning of the previous reporting period), as required by IAS 1, *Presentation of Financial Statements*;
- The transferor should reconcile the balances in the closing SoFP with those in the opening SoFP, detailing the transactions and cash flows that have occurred between the two dates; and
- Both parties should note that the assets and liabilities stated in the 1st April SoFP will be those included in/excluded from the transferee's/ transferor's audited accounts.

32. It would be most advantageous for the transferor to provide a trial balance to the transferee of the transactions and balances transferred for the prior year and current year. This should show the opening balance, in year transactions and closing balances rather than a 'rolled-up' trial balance showing closing balances only.

33. Entities should also consider processes for obtaining disclosure information which sits outside of the trial balance, for example:

- Contingent assets and liabilities.
- Commitments.
- Maturity analyses of lease liabilities and provisions.
- Impairment analyses.

- Losses and special payments.
- Staff numbers and other staff information included in the remuneration report.

34. For Transfers by Absorption:

- The transferor should provide to the transferee a SoFP for the transferring function as at the date of the combination.
- To ensure transfer information is applied correctly, both parties should reconcile the balances in the closing SoFP with those absorbed into the SoFP of the transferee, detailing the transactions and cash flows.
- The transferor should present additional information in the SoFP to provide clarity of the impact of the transfer on its assets, liabilities and equity. For example, the transferor could provide an additional statement of financial position to enable reporting of the pre and post-transfer (i.e. nil balance sheet) position in closing audited accounts or provide additional narrative to explain the impact of the transfer.
- The transferor should also make available comparative information to the transferee if the transferee considers it necessary to report historical service performance to enable users to understand operational performance.

## Statement of Financial Position

35. The transferee should satisfy itself that the data provided by the transferor relating to the assets and liabilities being transferred are complete and accurate. As a general rule the transferee should satisfy itself that:

36. For assets:

- All assets exist;
- Their values are based on International Financial Reporting Standards (IFRS), adapted and interpreted for the public sector context and promulgated in the FReM; and
- The values assigned to such assets are materially correct.

37. For liabilities:

- All liabilities are stated;
- Their values are based on IFRS, adapted and interpreted for the public sector context and promulgated in the FReM; and
- The values assigned to such liabilities are materially correct.

38. Some balances may require judgement to be exercised to apportion them between transferees. There may be additional complexities with splitting cash and general fund reserves, particularly where an entity is dissolved and split into different parts. This is because cash and general fund reserves are rolled up balances over time, and may not be directly allocated to specific functions. In these instances

judgement is required to determine an appropriate apportionment methodology. Early engagement with the audit committee and external auditors is recommended to discuss the areas which may be subject to significant judgement.

39. Where merger accounting is applied and prior year comparatives are required to be restated, the transferor should also provide the required information to the transferee for the transferee to show in-year movements for SoFP notes to the accounts. For example, if the transferor has PPE to transfer, they should provide opening cost, opening depreciation, additions, disposals, impairments, revaluations, transfers, in-year depreciation charges etc to the transferee to enable the transferee to prepare their prior year comparative PPE note.
40. For absorption accounting, there may be SoFP items where more granular information is required. For example, if PPE is transferred as part of a transfer by absorption the transferor will still need to provide gross values for cost and depreciation not just net book values as the history of the asset needs to be maintained. Related revaluation reserve historical information for each asset transferring is also required to ensure subsequent valuations are treated correctly.
41. Transferees should consider what specific checks might be necessary. Some guidance on the sort of issues that should be considered is included in the checklist below.

## Statement of Comprehensive Net Expenditure and cash

42. For **Transfers by Merger**, the transferee will be required to remit to the transferor the net cash expended by the transferor on the function during the financial year. It is important that the transferee satisfies itself that it is only settling in cash the net amount paid out to date by the transferor in respect of the function by ensuring that the transactions and cash flows for the year to date are accurate.

## Accounting for assets in a transfer by absorption

43. For **Transfers by Absorption**, where an entity is the recipient in the transfer of a function, it recognises the assets and liabilities received as at the date of transfer. The assets and liabilities are not adjusted to fair value prior to recognition. The corresponding net credit/debit reflecting the gain/loss is recognised within income/expenses, but outside of operating activities.
44. The pre-transfer income, expenses, assets and liabilities of the reporting entity are not adjusted to include any pre-transfer activity of the function.

45. For property, plant and equipment assets and intangible assets, the cost and accumulated depreciation/ amortisation amounts from the transferring entity's accounts are preserved when the assets are recognised in the reporting entity's accounts.
46. Where any assets received had an attributable revaluation reserve balance in the transferring entity's accounts, this is preserved in the reporting entity's accounts by it transferring the relevant amount from its general fund reserve to its revaluation reserve.

**Example:**

During the financial year, an ALB (A) is the recipient of a transfer of a function from another ALB (B), which meets the definition of a machinery of government change. The function is received on 1 February. The net assets received are £40m. These net assets have an associated revaluation reserve balance in ALB B's accounts of £12m.

On 1 February ALB A recognises the £40m net assets in its Statement of Financial Position. It also recognises a gain of £40m which it records as income.

This income is material and therefore the ALB A presents it in the Statement of Comprehensive Net Expenditure as a separate item within the overall net expenditure (i.e. above Other Comprehensive Expenditure).

ALB A then transfers £12m from its general fund reserve to its revaluation reserve, and reports this transfer in the Statement of Changes in Taxpayers' Equity.

47. Where, instead the reporting entity is the body transferring the function, the opposite accounting entries apply. It de-recognises the assets and liabilities as at the date of transfer and recognises the corresponding net debit/credit as a loss/gain in expenses/income but not within operating activities. Any revaluation reserve balances attributable to the assets transferred are removed from the revaluation reserve and transferred to the general fund reserve.

## Timing of data verification work

48. The transferor and transferee should agree the asset and liability balances being transferred as quickly as is reasonably possible. The transferor should provide access to information, staff and premises as necessary. Ideally, the transferee should aim to complete its due diligence work within two months of the date the transferor provides the necessary data (opening and closing SoFP etc.). The transferor should in turn provide this data as quickly as it is reasonably possible. Regardless, the transferee's due diligence work will need to be completed in time for any Supplementary Estimates to be prepared to affect a MoG change or other budget changes.

## Involving auditors

49. The whole of the MoG change and any restatement of prior year comparatives will be included in the financial statements and subject to audit. Entities should seek the involvement of their auditor at the earliest possible stage of the process to discuss timescales, key milestones and key risk areas for the entity and the auditor.

## Further guidance

50. Further guidance on reporting Transfers by Merger (including Machinery of Government Changes) on OSCAR is available in PES (2016) 05 on OneFinance.
51. Further HM Treasury guidance on the budgetary and Estimates requirements of business combinations under common control, and how these requirements should be met, should be sought from the relevant HM Treasury representative.

## Checklist for MoG changes and other transfers of assets and liabilities

Asset/ Liability	Checks for Transfers by Merger and Transfers by Absorption (including all MoGs)
Tangible Non-current Assets	<ul style="list-style-type: none"> <li>• Are book values accurate?</li> <li>• What was the result of the last Non-current asset verification?</li> <li>• For all material items (and all land and buildings) consider undertaking external professional valuation (internal valuers could be employed).</li> <li>• Are all reserves and accumulated depreciation relating to transferring assets identifiable and transferred separately to the general fund reserve?</li> </ul>
Intangible Non-current Assets	<ul style="list-style-type: none"> <li>• Are book values accurate?</li> <li>• Do assets exist (i.e. development assets – is process/product still in use? Software licences – is software still used?)</li> <li>• For difficult valuations (i.e. income model) consider external valuation.</li> </ul>
Financial assets and financial liabilities	<ul style="list-style-type: none"> <li>• Assets should be assessed against financial instrument reporting standards as interpreted in the FReM.</li> <li>• Is the asset held on behalf of government?</li> </ul>

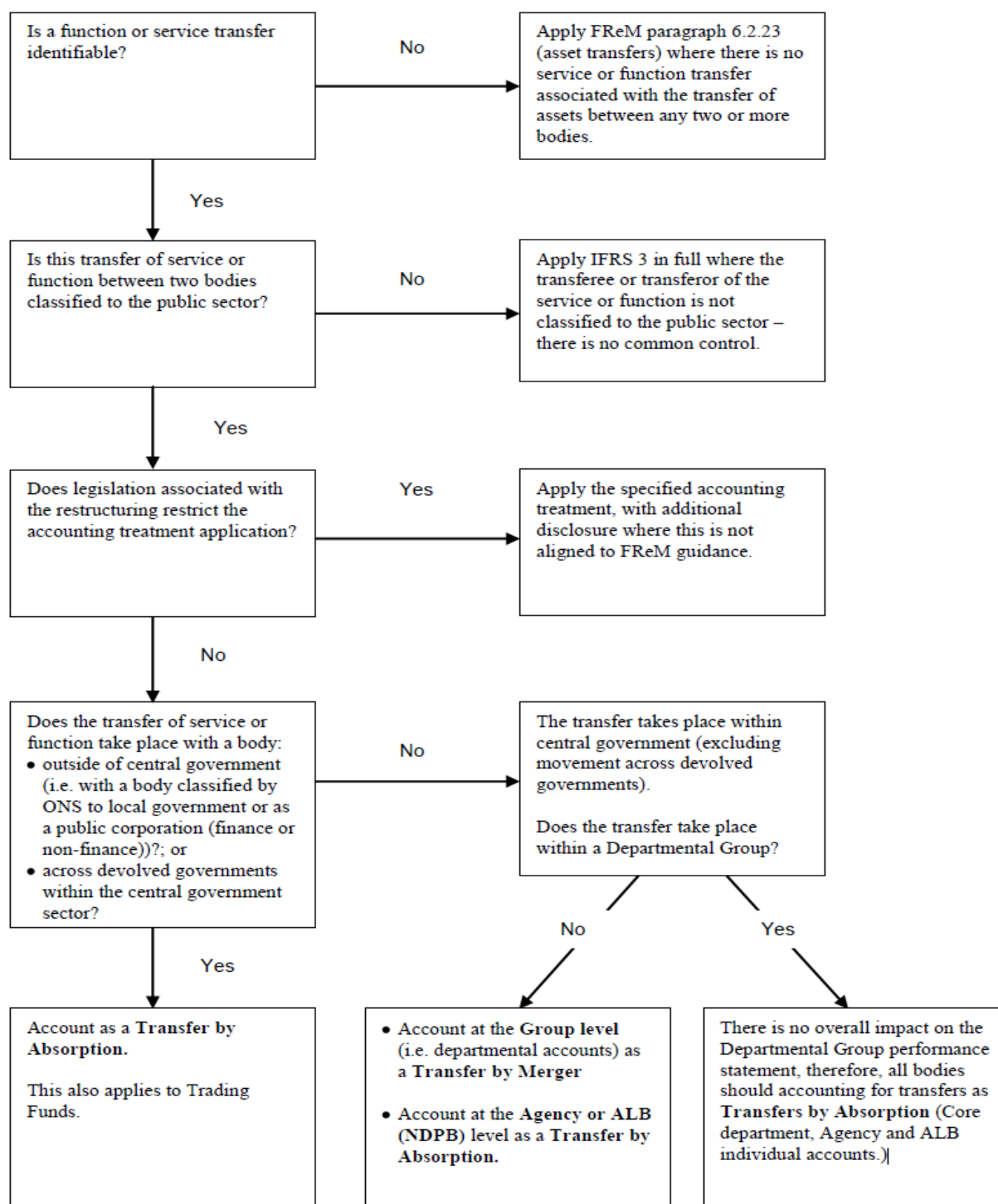
	<ul style="list-style-type: none"> <li>• Is the asset or liability a loan, PDC or interest in a public body outside the departmental boundary?</li> <li>• Is the liability a financial guarantee contract or an insurance contract?</li> <li>• Have financial instruments valued at fair value been discounted correctly?</li> <li>• Has the asset or liability been assessed for embedded derivatives?</li> <li>• Are all reserves relating to transferring assets identifiable?</li> </ul>
Inventories	<ul style="list-style-type: none"> <li>• Are inventory values accurate?</li> <li>• Does inventory exist?</li> <li>• Is there any obsolete or slow moving inventory impacting on inventory provisioning?</li> <li>• What condition is it in / is it still useful?</li> <li>• What was the result of the last inventory stock take?</li> </ul>
Trade and other receivables	<ul style="list-style-type: none"> <li>• Are receivables recoverable?</li> <li>• What percentage of debt is irrecoverable?</li> <li>• Is the process for recognising and derecognising receivables sound?</li> <li>• Is there a bad debt provision, if so, is it reasonable?</li> <li>• What is the ageing profile of receivables?</li> <li>• Is the transferor in dispute with any of its receivables?</li> </ul>
Trade and other payables	<ul style="list-style-type: none"> <li>• Is the payable figure accurate and complete?</li> <li>• Is the process for recognising and derecognising trade and other payables sound?</li> <li>• Is the transferor in dispute with any of its trade and other payables?</li> </ul>
Provisions	<ul style="list-style-type: none"> <li>• Is the process for recognising and measuring provisions sound - present obligation as a result of a past event, probable outflow and reliably estimated?</li> <li>• Is the process for capturing provisions sound?</li> </ul>

	<ul style="list-style-type: none"><li>• Consider external valuation of material provisions.</li></ul>
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## Appendix 1- Decision tree

### Appendix 1

#### Decision-making flowchart – FReM Accounting for Business Combinations



Note – The accounting should prescribed in this flowchart should be applied by both parties involved in the transfer, in accordance with the guidance issued by the Relevant Authority.



## Appendix 2- Scenario analysis

The table below provides a summary of the expected accounting treatment when applying MoG change requirements in the FReM. The underlying objective is to ensure the financial reporting supports the accountability for the transferring function, and to do so in a symmetrical way to ensure there is no transparency gap. A transfer may require both treatments at different levels.

Type of function transfer	Accounting treatment for the transferor	Accounting treatment for the transferee
Dept A is transferred into Dept B & C	<b>Transfer by Merger</b> under a MoG change – Dept A will not produce closing accounts. Accounting responsibilities are transferred to Dept B & C.	<b>Transfer by Merger</b> under a MoG change – Dept B&C will report the performance of the transferred function from the beginning of the reporting period, with retrospective restatement.
A function of Dept A is transferred to ALB* A	<p>The Departmental Group position is unchanged as a result of the transfer.</p> <p><b>Transfer by Absorption accounting</b> should normally be applied by the Core Department to identify the change within the Group and ensure accounting entries are pragmatic.</p> <p>Performance recognition in the Core Department column should cease on transfer.</p>	<p><b>Transfer by Absorption.</b> Prospective performance recognition by ALB A from the date of transfer, with net assets/liabilities recognised at carrying value in full through income/expenditure.</p> <p>Revaluation reserves and accumulated depreciation should be transferred, with corresponding adjustments to the general fund reserve.</p> <p>The symmetrical application should ensure the Group Statement of</p>



		Financial Position is unaffected by the transfer.
A function of Dept A is transferred to ALB B, controlled by Dept B	<p><b>Transfer by Merger</b> under a MoG Transfer of Function order where statutory responsibilities have changed.</p> <p>The financial statements will be restated to remove the service performance, with additional disclosure explaining the transfer.</p>	<p><b>Transfer by Merger</b> applied by Dept B. Whilst the ALB will only report prospectively, to ensure consistency at the departmental level and with budgets and Estimates, restatement is required to reflect the opposite entries to Dept A.</p> <p><b>Transfer by Absorption</b> by the ALB. Prospective performance recognition by ALB B from the date of transfer, with net assets/liabilities recognised at carrying value in full through income/expenditure. Revaluation reserves and accumulated depreciation should be transferred, with corresponding adjustments to the general fund reserve.</p> <p>Dept B will need to ensure that sufficient data is available from Dept A and ALB B to carry out merger accounting at the group level.</p>



ALB A is transferred into parent Dept A	<p><b>Transfer by Absorption.</b></p> <p>ALB Closing accounts will be required disclosing performance up to the date of transfer, unless the transfer and closure occur at 31 March. For closures at 31 March, the transferee and transferor should prepare financial statements as normal.</p> <p>The Departmental Group position is unaffected by the transfer so a symmetrical accounting treatment should ensure the Group Statement of Financial Position is unaffected by the transfer.</p>	<p>The Departmental Group position is unchanged as a result of the transfer. <b>Transfer by Absorption</b> should normally be applied by the Core Department to identify the change within the Group.</p> <p>Performance recognition in the Core Department column should be prospective on transfer, with net assets/liabilities recognised at carrying value in full through income/expenditure. Revaluation reserves and accumulated depreciation should be transferred, with corresponding adjustments to the general fund reserve.</p>
ALB A is transferred into ALB B, both within Department A	<p><b>Transfer by Absorption.</b></p> <p>Closing accounts will be required for ALB A, disclosing performance up to the date of transfer, unless the transfer takes place at 31 March. For closures at 31 March, the transferee and transferor should prepare financial statements as normal.</p> <p>There will be no overall impact on Dept A financial Statements, with consolidation of ALB A's closing accounts (with a nil Statement of</p>	<p><b>Transfer by Absorption.</b></p> <p>Prospective performance recognition from the date of transfer, with net assets/liabilities recognised at carrying value in full through income/expenditure. Revaluation reserves and accumulated depreciation should be transferred, with corresponding adjustments to the general fund reserve.</p> <p>There will be no overall impact on Dept A financial statements, with</p>



	Financial Position) or year-end position for transfers at 31 March, and additional disclosure to explain the restructuring of controlled ALB's,	consolidation of ALB's accounts and disclosure needed to explain the restructuring of controlled ALB's.
ALB A is transferred from Dept A's control to Dept B's control	<p><b>Transfer by Merger</b> under a MoG Transfer of Function order where statutory responsibilities have changed.</p> <p>The financial statements will be restated to remove the service performance, with additional disclosure explaining the transfer.</p> <p>There is no impact on the ALB performance statements.</p>	<p><b>Transfer by Merger</b> under a MoG Transfer of Function order where statutory responsibilities have changed.</p> <p>The financial statements will be restated to include the retrospective service performance, with additional disclosure explaining the transfer.</p> <p>There is no impact on the ALB performance statements.</p>
ALB A is closed and service split between Dept A and Dept B	<p><b>Transfer by Merger</b> will apply to Dept A, retrospectively transferring part of the service out of the Departmental Group performance to Dept B.</p> <p><b>Transfer by Absorption</b> will apply to the ALB and service remaining within the Dept A group. ALB Closing accounts will be required disclosing performance up to the date of transfer, unless the transfer and closure occur at 31 March. For closures at 31 March, the</p>	<p><b>Transfer by Merger</b> will apply to Dept B, reporting the performance of the transferred function from the beginning of the reporting period, with retrospective restatement.</p> <p>All parties will need to agree that the ALB provides appropriate information to enable the transfer by merger to be accounted for correctly, where material.</p>



	transferee should prepare financial statements as normal.	
Some of an ALB's functions are transferred to local government	<b>Transfer by Absorption.</b> Prospective performance de-recognition in both the ALB and parent Department from the date of transfer, with net assets/liabilities recognised at carrying value in full through income/expenditure. Revaluation reserves and accumulated depreciation should be transferred, with corresponding adjustments to the general fund reserve.	In accordance with the CIPFA Code, <b>a symmetrical accounting treatment</b> will apply to the local authority, with prospective performance recognition from the date of transfer, with net assets/liabilities recognised at carrying value in full through income/expenditure. There should be no impact on local taxation.
A Trading Fund (Public Corporation) is transferred to a Department	<b>Transfer by Absorption.</b> Closing accounts will be required (under Trading Fund Act 1973) disclosing performance up to the date of transfer. Transferred assets and liabilities will be derecognised at carrying value resulting in a nil-balance closing SoFP except for transfers and closures occurring at 31 March.  For closures at 31 March, the transferee should prepare financial statements as normal.	<b>Transfer by Absorption.</b> Prospective performance recognition from the date of transfer, with net assets/liabilities recognised at carrying value in full through income/expenditure. Revaluation reserves and accumulated depreciation should be transferred, with corresponding adjustments to the general fund reserve.



<p>An ALB is transferred from Department A to a Devolved Administration</p>	<p><b>Transfer by Absorption.</b> Prospective performance de-recognition in parent Department from the date of transfer, with net assets/liabilities recognised at carrying value in full through income/expenditure. Revaluation reserves and accumulated depreciation should be transferred, with corresponding adjustments to the general fund reserve.</p> <p>The financing provided by the Westminster Office of the Devolved Administration to the Devolved Administration is likely to change prospectively.</p>	<p><b>Transfer by Absorption.</b> In accordance with guidance from the Relevant Authority, prospective performance recognition from the date of transfer, with net assets/liabilities recognised at carrying value in full through income/expenditure.</p> <p>Revaluation reserves and accumulated depreciation should be transferred, with corresponding adjustments to the general fund reserve.</p> <p>The ALB will continue to report as normal, noting the change in sponsoring body.</p>
<p>Combinations of the above</p>	<p>Where transfers of service or function involve several restructuring processes, those significant to each body, within practicability constraints, should be recorded in accordance with the above treatments.</p>	

## Appendix 3 – 3rd SoFP scenario analysis

The table below provides a scenario analysis of when a 3<sup>rd</sup> SoFP is required after a MoG change happens.

Scenario (merger accounting is used in all of these scenarios)	3 <sup>rd</sup> SoFP required
Department A is the receiving entity of a function. There are no material accounting policy alignment adjustments, changes to accounting policies or prior period errors corrected.	No
Department A is the receiving entity of a function. The assets transferred to department A were valued using a different accounting policy to department A. These accounting policies need aligning, with the alignment adjustments material.	Yes. 3 <sup>rd</sup> SoFP is required and will need to include restatements for: <ul style="list-style-type: none"> <li>- The accounting policy alignment adjustments.</li> <li>- All balances transferred into Department A.</li> </ul>
Department A is the receiving entity of a function. In the same financial year Department A identified a material error in its prior period financial statements unrelated to the balances being transferring into Department A.	Yes. 3 <sup>rd</sup> SoFP is required and will need to include restatements for: <ul style="list-style-type: none"> <li>- Correction of the prior period error.</li> <li>- All balances transferred into Department A.</li> </ul>
Department A is the receiving entity of a function. In the same financial year, a new accounting standard is	Yes. 3 <sup>rd</sup> SoFP is required and will need to include restatements for:



<b>Scenario (merger accounting is used in all of these scenarios)</b>	<b>3<sup>rd</sup> SoFP required</b>
implemented, which requires retrospective restatement of its financial statements.	<ul style="list-style-type: none"><li>- Restatements for implementing the new accounting standard.</li><li>- All balances transferred into Department A.</li></ul>
<p>Department A is split into two new departments, being Department B and Department C.</p> <p>Department B has no prior period errors to correct or accounting policies to align at all.</p> <p>Department C now has a lower level of materiality and therefore has a prior period error to correct in its financial statements.</p>	<p>Department B: no 3<sup>rd</sup> SoFP required.</p> <p>Department C: 3<sup>rd</sup> SoFP required including requirements for:</p> <ul style="list-style-type: none"><li>- Correction of the prior period error.</li><li>- All balances transferred from Department A.</li></ul>



## **HM Treasury contacts**

This document can be downloaded from [www.gov.uk](http://www.gov.uk)

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