Financial Reporting Advisory Board

Machinery of government (MoG) change technical working group findings

Issue:	This paper provides a summary of the output from the machinery of government (MoG) change technical working group meetings held this year. The paper proposes new adaptations to IFRS and changes in guidance as outlined below.
Impact on guidance:	Changes will need to be made to chapters 8 and 9 of the FReM and the business combinations application guidance.
IAS/IFRS adaptation or interpretations for the public-sector context?	This paper proposes: • a new adaptation to IAS 1 to be included in the 2025-26 FReM; • to include transferor accounting in the list of adaptations to IFRS in the 2025-26 FReM. This paper also proposes accounting for the gain/loss on absorption through reserves rather than income and expenditure when absorption accounting is applied.
Impact on WGA?	None as MoG changes are all within the government boundary.
IPSAS compliant?	No, public sector business combination accounting does not fully align with IPSAS 40.
Impact on Estimates/budgetary regime?	None.
Alignment with National Accounts	N/A for this workstream.
Recommendation:	The Board support the proposed changes to the MoG change accounting requirements in 2025-26 and 2026-27.
Timing:	The updated 2025-26 FReM, 2026-27 FReM and business combinations application guidance to be published in December 2025.

DETAIL

Background

1. At FRAB 155 in March 2025, HM Treasury outlined a plan to the Board, considering whether further changes could be made to the business combinations under common control (BCUCC) accounting framework in the FReM. The Board wanted to explore in more detail whether it would be possible to simplify the MoG change accounting regime without compromising the quality of financial reporting. The paper can be seen here: FRAB_155__12__MOG_workstream_update.pdf.
2. HM Treasury set up a cross-government technical working group (TWG) to discuss what changes could be made to the MoG accounting framework. The TWG included representatives from 14 different organisations. Two TWG meetings were held.
3. The questions discussed at the MoG change technical working group (TWG) meetings were as follows:
    a. Is the requirement for entities to disclose a SoFP as at the beginning of the previous reporting period (sometimes referred to as a 3rd SoFP) after a MoG change still appropriate?
    b. Is the use of merger accounting (and restatement of prior year comparatives as if the newly combined entity had always been operating) still appropriate or would accounting for all BCUCCs using absorption accounting provide better information to users?
    c. Should gains or losses recorded following use of absorption accounting be recorded in reserves, rather than going through profit or loss?
    d. When merger accounting is applied, should the Statement of Outturn Against Parliamentary Supply (SOPS) also be restated?
    e. Should the requirement for symmetrical accounting for the transferor and transferee remain? Is the requirement for the transferor to apply symmetrical accounting an adaptation to IFRS?

Outcomes

4. The table below summarises the outcomes of the questions discussed at the TWG meetings and our proposals going forward:

Question	Outcome	Financial year changes to be made
Should the 3rd SoFP remain when merger accounting is applied?	**Changes to FReM**- remove 3rd SoFP requirement if no accounting policy changes, accounting policy alignments	2025-26

	or prior period errors corrected in the same financial year.	
Should merger accounting remain?	No changes to FReM- use of merger and absorption accounting remains the same.	N/A
Should gains/losses when absorption accounting is used be recognised in I&E or reserves.	Changes to FReM- account for gains/ losses through reserves rather than I&E.	2026-27
When merger accounting is applied, should the SOPS also be restated?	No changes to FReM- SOPS will still be restated when merger accounting is applied.	N/A
Should the transferee and transferor apply symmetrical accounting? Is this an adaptation to IFRS?	Changes to FReM- symmetrical accounting remains, but this is an adaptation to the FReM for the transferor. This will be made clear in section 8.2 of the FReM.	2025-26

Q1: Is the requirement for entities to disclose a SoFP as at the beginning of the previous reporting period (sometimes referred to as a 3rd SoFP) still appropriate?

5. There were some mixed views about whether the costs of preparing a 3rd SoFP due to a MoG change exceeded the benefits. In the BEIS MoG change example, the view was that the benefits of a 3rd SoFP did not outweigh the costs, though for other MoGs the view was that the requirement to prepare a 3rd SoFP was not excessively onerous.
6. The TWG acknowledged that a 3rd SoFP would still need to be prepared internally to support certain notes to the accounts, e.g. the PPE opening balances for the previous reporting period would need to be included in the prior year comparative PPE note. However, the view of the TWG was that, by including a 3rd SoFP, these balances are subject to much more audit scrutiny and there is an additional note to the accounts which needs to be prepared and audited.
7. A TWG member commented that, if the requirement to prepare a 3rd SoFP due to a MoG change was withdrawn, clarity would need to be provided on whether a 3rd

SoFP for prior period adjustments due to accounting policy changes would still be required:

a. For example, part of government department A is moved to government department B. Government department A has different accounting policies in respect of PPE. Government department A therefore needs to restate the PPE balances from government department B to ensure accounting policies for all of their PPE are aligned. This requires restatement of prior year comparatives under IAS 8.19 and a 3rd SoFP in line with IAS 1.40A.

8. A similar issue can happen if there are uncorrected misstatements which need to be restated. For example, say the former BEIS department had a £100m uncorrected misstatement in provisions- it was uncorrected as it was immaterial to BEIS. After the BEIS MoG, the provision this misstatement relates to is allocated to DESNZ. DESNZ financial statement materiality is £50m. The uncorrected provisions misstatement of £100m is therefore material to DESNZ. Under IAS 1, DESNZ restates their prior year comparatives under IAS 8.42 and presents a 3rd SoFP in line with IAS 1.40A.

9. Presenting a 3rd SoFP due to accounting policy changes and/or material prior period errors would appear unavoidable under IFRS. Not requiring a 3rd SoFP after the restatement of accounting policies or correcting material prior period errors would appear to be a significant divergence from IAS 1 and without a clear rationale.

10. The TWG discussed a small number of options and concluded a possible option could be a 3rd SoFP is only presented when there is a change in accounting policies and/ or material prior period errors, with the 3rd SoFP including all MoG restatements (e.g. including restatements due to accounting policy changes, prior period errors and bringing in balances from other departments). If an entity undergoes a MoG change but there are no restatements for accounting policy changes or prior period errors a 3rd SoFP is not presented in this scenario.

11. HMT agree with the view that the benefits of presenting a 3rd SoFP, where there are no changes to accounting policies or material prior period errors to correct, is limited. As such the benefits are not sufficient to justify including a 3rd SoFP in scenarios where there are no changes to accounting policies or material prior period errors to correct.

12. Where there are accounting policy alignment adjustments required and/ or there are material prior period errors to correct, a 3rd SoFP is still presented, which will include restatements to the 3rd SoFP for:

    a. Any accounting policy alignments or changes in accounting policies.

    b. Any prior period errors corrected.

    c. The transfer in of all balances from the transferor.

    d. The transfer out of all balances to the transferee.

13. This requires an adaptation to IAS 1 in the FReM. The proposed text is as follows:

'*where an entity applies merger accounting after a machinery of government (MoG) change and:*

- makes no material retrospective accounting policy alignment adjustments or retrospective changes to any SoFP balances (regardless of whether the adjustments relate to the MoG change); and
- corrects no material prior period errors to the SoFP (regardless of whether the errors relate to the MoG change)

then a SoFP as at the beginning of the previous reporting period is not required. (IAS 1.40A).'

14. In terms of timing, HMT propose to include this change to the 2025-26 FReM.

Question for the Board: do you support including this new adaptation to IAS 1 in the 2025-26 FReM? Do you have any comments on the drafting of the adaptation?

Q2: Is the use of merger accounting (and restatement of prior year comparatives as if the newly combined entity had always been operating) still appropriate or would accounting for the combination under absorption accounting provide better information to users?

15. The TWG preferred using absorption accounting for all MoG changes as this was potentially more understandable to users of the accounts could be easier to implement.

16. That being said, another TWG member commented that using absorption accounting may not be easier to implement for department level transfers. The TWG member commented that for department level transfers of function, these are often announced with no warning and can be in the middle of the month. For example, on 3 June 2025 it was announced responsibility for government cyber security is moved from the Cabinet Office to DSIT with immediate effect. As government departments did not know about this MoG change before it was announced, it is unclear how government departments could apply absorption accounting to these types of MoG changes. Merger accounting allows entities to apply the change for the full financial year in which the MoG change happens, which means full year balances are restated and transferred rather than calculating part-year balances.

17. Additionally, HMT discussed the possibility of using absorption accounting for all MoG changes with teams in HM Treasury responsible for providing statistical data to the Office for National Statistics (ONS) and Office for Budget Responsibility (OBR). Concerns were expressed that abolishing merger accounting could result in HMT being unable to collect the correct statistical data to provide to the ONS and OBR. It could result in difficulties with spending review negotiations as HMT and entities will not have a clear run of data over a number of years showing spending by function.

18. There could be accountability issues, for example if there is a prior period adjustment in a department's accounts, is this recognised in the new or old government department and in which estimate is the prior period adjustment included in? Merger accounting means accountability for past performance for a single function stays in one place and not split amongst several entities and Accounting Officers.

19. **For these reasons HMT do not think abolishing merger accounting for department level transfer of function is viable.**

20. This left the question of whether absorption accounting should be abolished and all MoG changes accounted using merger accounting. A concern raised by a member was that ALBs may not have the capacity to apply merger accounting, which is generally seen as more complex than absorption accounting. This is a conclusion which was reached when the MoG change accounting requirements were first discussed in 2012.

21. For this reason, HMT do not think absorption accounting should be abolished in the FReM.

22. **Overall, HMT have concluded that the scenarios where merger accounting and absorption accounting are used as set out in the FReM should not be amended.**

HM Treasury request the Board note the conclusion.

Q3: Should gains or losses recorded following use of absorption accounting be recorded in reserves, rather than going through profit or loss?

23. When accounting for a transfer under absorption accounting, FReM 9.1.14 requires the net asset/liability carrying value to be treated as a non-operating gain/loss, recorded through net expenditure, with the transferor recording symmetrical entries.

24. The TWG felt that accounting for the gain/loss on absorption was better reflected within reserves rather than through net expenditure. This was because the gain/ loss on absorption was as a result of a non-operating activity and did not represent income or expenditure. HMT agrees with this conclusion. **The FReM requirements for the accounting treatment of gains/ losses on absorption therefore need to be changed.**

25. The proposed updated FReM wording in 9.1.14 is as follows: '*The net asset/liability carrying value should be recorded as a gain/loss from the transfer of function, through reserves, with the transferor recording symmetrical entries. Revaluation reserves should be transferred in full, with the remaining balance transferred to the General Fund (or equivalent component of equity).*'

26. The TWG discussed timing for implementing this change. It was agreed that it was too late in the 2025-26 financial year to implement this change as it may require changes to ledgers and data structures. **HMT therefore propose to include this change in the 2026-27 FReM.**

Question for the Board: do you support including this change to account for the gain/ loss on absorption through reserves rather than income and expenditure in the 2026-27 FReM?

Q4: When merger accounting is applied, should the Statement of Outturn Against Parliamentary Supply (SOPS) also be restated?

27. When merger accounting is applied, the SOPS is also restated. This requirement is in paragraph 9.1.10 of the FReM.
28. The overall conclusion from TWG discussions was that:
    a. If the financial statements are restated then the SOPS should also be restated to ensure the financial statements and SOPS are consistent.
    b. As the SOPS flows from the financial statements, the costs of restating the SOPS are not so high that they outweigh the benefits.
29. Therefore, HMT have concluded that the SOPS restatement requirement after a MoG change in the FReM should be maintained.

HM Treasury request the Board note the conclusion.

Q5: Should the requirement for symmetrical accounting for the transferor and transferee remain. Is the requirement for the transferor to apply symmetrical accounting an adaptation to IFRS?

30. Paragraph 9.1.19 of the FReM states: 'Both the transferor and the transferee of a business combination under common control should apply a symmetrical accounting treatment for the transfer, though a transfer can involve both merger accounting and absorption accounting at different levels'.
31. This is a divergence from IFRS. IFRS already includes the accounting requirements for a business combination from the transferor's perspective, e.g. assets being disposed of, consideration received for the business combination, liabilities being derecognised etc.
32. There was support to keep symmetrical accounting between transferee and transferor as it best reflects the substance of the transfer (one part of government being moved to another rather than it being an acquisition or takeover).
33. The TWG agreed the transferor applying symmetrical accounting to the transferee is a departure from IFRS in the FReM.

34. To improve clarity in the FReM, a separate section will be added to section 8.2, setting out that the transferor applies symmetrical accounting to the transferee when a MoG change happens and link to Chapter 9 in the FReM.
35. HMT propose to include this change in the 2025-26 FReM.
36. Please see drafting below for the section to include below table 2 in section 8.2 of the FReM:

Machinery of government change – transferor accounting	
Adaptations	Chapter 9 of the FReM requires entities who undergo a machinery of government (MoG) change apply symmetrical accounting to ensure there is no transparency gap. This applies to both the transferee and transferor. The FReM therefore adapts IFRS standards to require the transferor in a MoG change to apply symmetrical accounting to the transferee.

Question for the Board: do you support including this requirement in the list of adaptations to IFRS in Table 2 in section 8.2 of the 2025-26 FReM? Do you have any comments on the drafting of the adaptation?

Updated business combinations application guidance

37. As a result of the changes proposed above the business combinations application guidance has also been updated. The updated guidance for 2025-26 and 2026-27 can be found in the Annexes to this paper.
38. The changes made to the application guidance largely conform to the changes outlined above. A significant change is a scenario analysis has been included in the application guidance, detailing whether a 3rd SoFP is required. The scenario analysis can be seen in Appendix 3 of the application guidance.

Question for the Board: do you have any comments on the changes made to the business combinations application guidance?

HM Treasury

20 November 2025