

# **Machinery of Government Changes**

## **Verification of Accounting Data**

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### **General**

1. Transfers of functions from one part of the public sector to another in the UK (known as Machinery of Government Changes or MoGs) are accounted for using merger accounting, as applied by the Government Financial Reporting Manual ([FReM](#)). Under merger accounting, the transferor and transferee account for the function as if the transferee had always undertaken it. As such, income and expenditure for the year and asset and liability balances relating to the functions are removed from the books of the transferor and recreated in the books of the transferee, adjusted to achieve uniformity of accounting policies.
2. MoGs are accounted for as mergers as, at the whole of government level, nothing has changed. The function is still undertaken; it is only the entity that performs the function that has changed.
3. This document outlines the verification work necessary to ensure that accounting data transferred under a MoG change are complete and accurate. Further general guidance on the MoGs process is detailed below.

### **Verification of Data**

4. MoGs 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 so as to prevent post-MoG disputes between the two parties.
5. 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.
6. The transferor should provide to the transferee a statement of financial position for the transferring function as at the 1<sup>st</sup> April of the financial year of transfer and a statement of financial position for the function as at the date of transfer. The transferor should reconcile the balances in the closing statement of financial position with those in the opening statement of financial position, detailing the transactions and cash flows that have occurred between the two dates. The assets and liabilities stated in the 1<sup>st</sup> April statement of financial position will be those included in the audited accounts. Where a transfer of functions occurs on the 1<sup>st</sup> April, the transferor will only need to provide a statement of financial position for the transferring function at this date.

### **Statement of Financial Position**

7. 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:

For assets

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

For liabilities

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

8. Transferees should consider what specific checks might be necessary. Annex A provides some guidance on the sort of issues that should be considered.

### **Statement of Comprehensive Net Expenditure and Cash**

9. 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.

### **Timing of data verification work**

10. 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<sup>1</sup> work within two months of the date the transferor provides the necessary data (opening and closing statement of financial position 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 effect the MoG.

### **Involving Auditors**

11. Accounting issues resulting from MoGs will require audit, you should seek the involvement of your auditor at the earliest possible stage of the process.

### **Further Guidance**

12. Further guidance on accounting for MoGs is provided in the FReM and PES (2004)<sup>14</sup> [http://www.hm-treasury.gsi.gov.uk/psd/pes\\_papers/pespaper/pespaper\\_2004/pes0414.htm](http://www.hm-treasury.gsi.gov.uk/psd/pes_papers/pespaper/pespaper_2004/pes0414.htm)

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<sup>1</sup> Due diligence in this context is information gathering to assess risks inherent within individual organisations party to a merger or to the merged organisation itself.

13. The Cabinet Office's Machinery of Government: Best Practice Guide (<http://www.cabinetoffice.gov.uk/media/332838/mog-handbook.pdf>) provides guidance on the MoG process, the work necessary to ensure a successful MoG and suggests a time frame for the completion of this work.

14. HM Treasury's General Expenditure Policy Team's Machinery of Government Checklist (hyperlink when available) provides detailed guidance on the budgetary and Estimates requirements of a MoG and how these requirements should be met.

**Assurance and Financial Reporting Policy**

**HM Treasury**

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**Details Checklist for MoG transfers of Assets and Liabilities**

Asset/Liability	Checks
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></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><li>• Is the asset or liability a loan, PDC or interest in a public body outside the departmental boundary? If so, it should be held at historical cost less impairment.</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>• Does the asset or liability been assessed for embedded derivatives?</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></ul>

- What condition is it in / is it still useful?
- What was the result of the last inventory stock take?

#### Trade and other receivables

- Are receivables recoverable?
- What percentage of debt is irrecoverable?
- Is the process for recognising and derecognising receivables sound?
- Is there a bad debt provision, if so, is it reasonable?
- What is the ageing profile of receivables?
- Is the transferor in dispute with any of its receivables?

#### Trade and other payables

- Is the payable figure accurate and complete?
- Is the process for recognising and derecognising trade and other payables sound?
- Is the transferor in dispute with any of its trade and other payables?

#### Provisions

- Is the process for recognising and measuring provisions sound - present obligation as a result of a past event, probable outflow and reliably estimated?
- Is the process for capturing provisions sound?
- Consider external valuation of material provisions.