

OCAG insights: Bodies due to be dissolved or merged

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This guidance note has been developed to assist management and those charged with governance of a body being dissolved or merged in managing risks to their control environment and financial reporting.

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From time to time, Government or Ministers may decide to make changes to the manner in which public services are delivered necessitating an alteration in the status of a public body by dissolving it or merging it with another entity.

Where bodies are established by statute, this will usually require a change in the legislation.

Decisions made to dissolve or merge bodies can often give rise to challenges in financial reporting and increased risk to the effective operation of controls for the body.

This guidance provides useful information for management and those charged with governance (TCWG) in managing risks to their control environment and financial reporting that can arise in such situations. It also explains areas of likely audit focus and attention.

Audit insights

This guidance is part of a programme of work to identify and share learning opportunities for bodies by providing information on common recurring issues and good practice examples, identified through our financial audit and reporting work.

Dissolving or merging public bodies

Rationale for dissolution/merger

The dissolution of a non-commercial public body or its merger with another entity generally arises from a Government decision to reform the nature or mechanism for delivery of specific public service(s) or programme(s).

Reforms can arise from a wide variety of circumstances including where

- functions could be more efficiently or effectively delivered through another public body(bodies)
- functions or programmes are no longer required or have come to their natural end
- certain functions or activities of a body are determined to be incompatible with others and need to be separated.

Less frequently, the Government may privatisate a public body or decide that its functions would be better delivered by the private sector.

Where a decision on a dissolution falls to government then a Memorandum for Government will be prepared by the relevant Minister which will set out the policy rationale and key information relating to the proposal. When a decision is made by Government there will be a formal record (Government Decision) setting out the key elements of the decision.

In other cases, the decision may rest with a Minister and a business case is prepared.

Legal basis for dissolution/merger

As most bodies audited by the Comptroller and Auditor General (C&AG) have been established by legislation, any decision to dissolve or merge¹ a body will require primary or secondary legislation. The legislation will normally have the following key elements

- requirement for the preparation of the final account including the period of account
- audit arrangements of the body to be dissolved or merged
- transfer of functions to a new or another body, including formal assignment of responsibility for preparation and presentation of the final account of the dissolved/merged body
- transfer of staff (including pensions arrangements)

¹ Mergers will normally result in the legal dissolution of one of the bodies.

- transfer of land and other property, rights and liabilities, preservation of contracts, etc.
- transfer of records
- provisions consequent upon transfer of functions, assets and liabilities to another body such as continuity of business transactions or fulfilment of commitments entered into before the dissolution
- the dissolution date (usually the Minister has the power to set the date by order under the legislation).

Dissolution of a company

Where the body has been established under company law (without any other primary legislation) then the provisions of the Companies Act 2014 in respect of liquidations will apply². The most common form of liquidation in the non-commercial public sector is a members' voluntary winding up where the winding up is undertaken in accordance with the Summary Approval Procedure³.

Once the winding up process has commenced there is no requirement for the preparation of financial statements for audit. Instead, the provisions of the Act require the directors to make a declaration within a prescribed period of the total of the company's asset and liabilities. The declaration must be accompanied by a report in the prescribed format by the auditor which states whether in his/her opinion the "declaration is not unreasonable".

Risks arising from a dissolution or merger

General risks arising with a dissolution or merger

There are a variety of risks and challenges facing a body where a decision has been made to dissolve or merge it. These can include complex matters such as legal, industrial relations, continuity of operations and financial.

This guidance document focuses solely on risks to financial controls and financial reporting.

Some of the more significant issues that have arisen for bodies audited by the C&AG include

- Length of time to complete and finalise a dissolution
- Delay in preparation of final accounts

² The Act also sets out provisions where the company is to be merged with another.

³ Chapter 7 of Part 4 of the Act.

- Inadequate or incomplete records
- Lack of clarity regarding responsibilities
- Lack of due diligence in assessing legal risks or regulatory issues⁴.

Careful management of the dissolution process including clear assignment of responsibilities and ring-fencing of accounting resources would have addressed most of these issues.

Managing risks arising from a dissolution/merger

In addition to these issues there are a number of other financial control and reporting risks which can arise. Set out below are examples of those risks together with questions which management or TCWG might consider in addressing them.

Example risk	Points of management focus
Is the control environment continuing to operate in an effective manner?	<p>Sometimes where a decision is made to dissolve/merge a body it can negatively impact on the control environment (e.g. lack of motivation by management/staff giving rise to lapses in control).</p> <p>Issues to consider might include</p> <ul style="list-style-type: none"> ➤ Has there been consistent and appropriate tone-at-the-top and effective communication throughout the organisation? ➤ Is there clarity of responsibilities between outgoing and new board (or equivalent)? ➤ Is the monitoring of controls by management and TCWG continuing throughout the period? ➤ Is there greater scope for management override of controls? ➤ Has the work of internal audit continued up to date of dissolution? ➤ Do individual control activities continue to operate in an effective manner (e.g. staff changes or departures resulting in replacement staff being unfamiliar with key controls or not being replaced at all leading to absence of controls or weak segregation of duties)?

⁴ Where the body being dissolved is a regulated entity such as a charity, there may be particular issues to be addressed with the regulator as part of the dissolution. The body should liaise on a timely basis with the relevant regulator or other appropriate authority such as the Revenue Commissioners.

Example risk	Points of management focus
Has management devised and implemented a business wind-down/transfer plan?	<p>Dissolving a body or merging it with another is a complex process with various stakeholders involved. A failure to properly plan can impact on the success of the dissolution and the effectiveness of financial controls.</p> <p>Issues to consider might include</p> <ul style="list-style-type: none"> ➤ Is there a comprehensive plan to manage the dissolution process (including actions to manage the risks)? ➤ Has an evaluation been carried out of the key risks and challenges from the dissolution/merger including the adequacy of staffing and resources, legal risks, etc.? ➤ Have business continuity arrangements been reviewed including effective management of key suppliers/ customers? ➤ What arrangements were made for the transfer of assets including bank accounts and for the review by legal staff of key areas (contracts, outstanding litigation, etc.)? ➤ Are adequate oversight arrangements in place? ➤ Are there appropriate and timely reporting arrangements to stakeholders?
Is there an increased risk of fraud or loss?	<p>The opportunity, motivation or rationalisation for fraud may increase where a body is being dissolved. For example, deficiencies in controls may allow for greater opportunities for fraud. Such risks can be pervasive (i.e. across all financial areas) or specific to an area.</p> <p>The heightened fraud risks may include the following</p> <ul style="list-style-type: none"> ➤ organisation-wide controls to prevent and detect fraud and cybersecurity breaches may have been weakened due to staff shortages, other priorities or supplier disengagement ➤ likewise, anti-fraud and compliance concerns may have been downgraded in light of the impending dissolution ➤ reliance on staff to comply with policies and operate controls may be under strain, for example staff may become disengaged and their actions subject to less scrutiny and oversight. Similarly, financial and other concerns may cause those in key oversight roles to be less vigilant.

Example risk	Points of management focus
Are there specific accounting or financial risks (i.e. areas that have a higher level of potential error or weakness)?	<p>In most bodies audited by the C&AG, accounting adjustments due to a merger or dissolution are infrequent due to the fact that functions or activities rarely cease upon a dissolution.</p> <p>Nevertheless, there are still financial and accounting risks which will need to be considered. Set out below are examples of the types of issues that might arise</p> <ul style="list-style-type: none"> ➤ fixed assets and/or inventory becoming impaired through obsolescence or change of use ➤ income raising or billing mechanisms may weaken due to resource pressures or staff departures ➤ rights to income under contract terms may be extinguished resulting in an obligation to repay revenue/fees already received ➤ receivables may become uncollectible or prepayments may not attain their full value ➤ contractual commitments including leases may give rise to ineffective expenditure or crystallise into liabilities ➤ there may be pressure to spend quickly leading to payment errors or poor value ➤ new liabilities may arise that need to be provided for (e.g. where a redundancy programme has been agreed).
Is the going concern basis of accounting still appropriate?	<p>Management and TCWG are required to consider the going concern implications arising. In most cases, the functions will continue (e.g. transferred to another entity) and therefore going concern issues will not arise.</p> <p>In cases where the functions cease then the accounts will usually be prepared on a wind-up basis. The impact on the financial statements will need to be considered for example the valuations of fixed assets or inventory.</p>
Is there appropriate sanction in respect of staff transfers including terms and conditions?	<p>A dissolution can lead to pressure on management to make decisions which do not have the appropriate sanction and may therefore be irregular (i.e. payment in excess of entitlement).</p> <p>Issues which might be considered include</p> <ul style="list-style-type: none"> ➤ has appropriate sanction been sought and received from sponsoring department/DPER in relation to staff transfer arrangements (including a redundancy programme, if any)?

Example risk	Points of management focus
	<ul style="list-style-type: none"> ➤ are there any unusual or abnormal transfer/redundancy terms which may give rise to additional burdens on the exchequer? ➤ are pension transfer arrangements approved and documented? ➤ has appropriate provision been made in the financial statement for all dissolution costs (see FRS 102.21 – <i>Provisions and contingencies</i>)?
Has relevant information been appropriately presented and disclosed in the financial statements?	<p>A dissolution or merger will result in a variety of information in the financial statements changing from the standard disclosures, so that users of the financial statements have a clear understanding of the change in status and its impact.</p> <p>The appendix to this guidance gives examples of such disclosures including</p> <ul style="list-style-type: none"> ➤ the explanation of the changes in responsibilities between TCWG prior to and subsequent to the dissolution ➤ any changes to the accounting policies and explanation of same ➤ explanation of the going concern basis assessment ➤ information in the notes to the financial statements which explains the dissolution.
Are appropriate accounting arrangements in place for the body to be dissolved?	<p>Timely financial reporting to the Oireachtas is a key element of public accountability. There can sometimes be pressures on the body to complete the dissolution which can lead to key accountability aspects being overlooked.</p> <ul style="list-style-type: none"> ➤ Has an appropriate period of final account been set and sanctioned by the Minister (if appropriate)? ➤ Has the deadline for submission of the final account and arrangements for audit been agreed? ➤ Is there clarity as to the board or person responsible for approving and signing the final account? ➤ If an annual report is required for presentation with the audited final account, have the timelines been agreed with the auditor?
Is the body established under company law?	<p>As the decision to wind up a company will result in the appointment of a liquidator it is important that appropriate steps are taken in advance by the body to ensure the process is as efficient and expeditious as possible. For example, have all assets and other transfer arrangements been concluded before the winding-up process has commenced? If not, this could lead to a longer liquidation process and additional costs.</p>

Preparation of the final financial statements and other information

Information for the reader

Changes arising from a dissolution/merger will require additional disclosures in information accompanying the financial statements for the reader. In some instances, the dissolution may impact on the recognition of amounts and balances in the financial statements.

The most common areas which give rise to difficulties for the preparers of the final account and communicating to the reader are

- explanation of the respective responsibilities for the final financial statements
- explanation of the respective responsibilities in relation to the system of control and how those responsibilities were discharged
- explanation of the impact of the dissolution/merger on the financial statements.

These issues are discussed in more detail below together with additional guidance on the period of the final account.

Responsibility for the final financial statements

A consequence of the dissolution/merger of a body is that the members of the outgoing board usually no longer hold office and have no function in relation to the account preparation after the dissolution date⁵. Up to that date they had responsibility, *inter alia*, for keeping proper books of account, safeguarding assets and the prevention/detection of fraud and other irregularities. The legislation dissolving the body normally provides that a successor body or a Minister has responsibility for preparing the final account.

The respective responsibilities of the successor and dissolved bodies needs to be explained in the Statement of Responsibilities (and also in the Governance Statement/Board Members Report) by distinguishing between

- the responsibility for the preparation of the final financial statement (successor body)
- the responsibilities for keeping proper books, safeguarding assets, etc. (dissolved body) which is expressed in the past tense.

An example disclosure is set out in the Appendix.

⁵ In some instances and subject to the specific legal provisions, arrangements may be made for a person to have transitional or continuing responsibility for governance of the body until the dissolution is complete.

Statement on internal control

The statement describes the system of control in place for a specific period. In a dissolution/merger situation, the successor body is describing the system covering the period of the final financial statements up to the date of their approval. It also confirms certain compliance matters (e.g. procurement) for which the successor body did not have responsibility at the time. Therefore, the successor body must take steps in order to be in a position to make the statement, for example by conducting enquiries with management in the dissolved body and examining relevant reports and other material.

The statement will normally distinguish between the respective responsibilities of the successor and dissolved bodies in relation to the system of control. It should make clear the basis upon which the successor body can make the statement, including its reliance on representations from management in the dissolved body. Finally, the statement should disclose who undertook the annual review of the effectiveness of internal controls and how that review was carried out.

An example disclosure is set out in the Appendix.

Financial statements – accounting policies and disclosures

The primary financial statements cover the period up to and including the dissolution date. The notes should clearly explain the accounting policies for recognising income and expenditure up to the date of dissolution.

As the transfer of any remaining assets or liabilities effectively takes place at midnight on the dissolution date the statement of financial position will show those balances being transferred (or in rare cases to be realised). It should set out the policy for recognising assets and liabilities and those to be transferred to another entity (or to be realised). Where assets are to be transferred the caption over the reserves will normally be titled “Reserves - representing Net Assets Transferred to [name of successor body]”.

The notes should clearly explain the dissolution, other transfers (e.g. functions or activities, staff, contracts, commitments) and continuation provisions (e.g. legal proceedings).

An example of extracts from a final set of financial statements is set out in the Appendix.

Period of the final financial statements

The final financial statements will cover the period up to the date specified by law for the dissolution of the body. Most legislation requires the relevant Minister to set this date which allows for operational flexibility as to the timing of the dissolution. This enables the final period of account to extend to less or more than the normal 12 month financial year.

From a public accountability perspective the final period of account should not extend for too long.

Preparation of the financial statements where the dissolution has been announced (i.e. not the final financial statements)

Where it is proposed to dissolve a body but the legislation has not yet been enacted, the accounts should contain a note clearly explaining the proposal, what stage the legislation is at and when the dissolution is scheduled to take place. The note should disclose the basis on which going concern has been adopted, for example

"As it is proposed to transfer all functions, operations, staff, assets and liabilities to X, the [Board or equivalent] believes that no material adjustment is required to the carrying value or classification of the assets and liabilities and that, therefore, it is appropriate to continue to prepare the accounts on a going concern basis."

Engaging with the external auditor

Areas of audit focus

Effective audit planning includes the identification of potential problems to the conduct of the audit in a timely manner. This is particularly important when it comes to bodies being dissolved or merged as there can often be a variety of challenges such as, resource and other pressures on the body, the potential complexity of the legislation dissolving the body and a shorter time period for the audit to be completed.

Initial audit planning will focus on

- understanding the rationale for the dissolution/merger for example by examining the business case and decision
- understanding the legislative amendments required to give effect to the dissolution
- understanding management's or TCWG assessment of the risks arising and how these have been managed
- in the case of complete cessation of the body's functions or activities, understanding the legislative or other mechanisms which provide for some form of enduring arrangements (e.g. responsibility for outstanding legal actions, retention of records).
- preparation of the final financial statements and additional information disclosures.

The auditor's primary focus is whether the financial statements give a true and fair view (or are properly presented) in accordance with the applicable financial reporting framework. An audit of a dissolving/merging body is no different to other audits but additional audit risks and challenges may arise. The auditor identifies and evaluates the audit risks, based on the facts of the particular situation. As with any audit risk assessment risks can be pervasive (i.e. affecting the financial statements as a whole) or specific to an

account area or financial statement assertion. An understanding of the body's system of internal control assists the auditor when identifying potential misstatements. In a dissolution situation the auditor will focus on changes to the control environment and how management have maintained effective controls as any deficiencies may lead to audit risks. The auditor also considers whether additional fraud risks arise and how the body is managing these.

Communicating to those charged with governance

Clear and timely two-way communication enables both the auditor and TCWG share an understanding of the risks and challenges arising from the dissolution and enables TCWG take action to address any issues. The issues for both the auditor and TCWG may include

- information from TCWG on how the dissolution has impacted on the body (e.g. what were the major financial implications and business impacts)
- how has the dissolution impacted on the body's risk profile (e.g. were there significant changes in its assessment of business risks, what actions were taken in response, how effective have the responses been, etc.)
- information from TCWG on any known or suspected frauds
- serious deficiencies in the operation of controls (e.g. weaknesses or errors identified in the design or implementation of controls)
- the auditor's assessment of audit risks arising and the proposed audit approach
- areas of concern that TCWG may wish to highlight for specific audit attention
- the impact of the dissolution on the audit process and timing
- steps which TCWG might take to address any shortcomings to supporting the audit.

It is also important for TCWG to consider how the accounting arrangements of the dissolved body will impact on the successor body and subsequent financial statements in order to avoid accounting and audit difficulties in future years. Issues might include

- How will financial information be incorporated or merged in the successor body?
- How are the values on transferred assets/liabilities agreed?
- How will comparative amounts be presented⁶?

⁶ FRS 102 (PBE34.84) states that for business combinations of public benefit entities the comparative amounts are restated by including the results for the previous accounting period and their statement of financial positions for the previous reporting date (comparative figures are titled 'combined' figures). Difficulties may arise for example where different classifications of expenditure have been used by the entities. Where comparative amounts are not entirely comparable then this should be disclosed.

Appendix – example disclosures in final accounts

Statement of Responsibilities

Responsibilities of the [Successor Body or Minister]

Under [specify the legislation], the [successor body or Minister] is required to prepare final financial statements for the [title of dissolved body].

In preparing those financial statements, the [successor body or Minister] is required to

- select suitable accounting policies and then apply them consistently
- make judgements and estimates that are reasonable and prudent
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the [dissolved body] will continue in operation
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements.

Responsibilities of the [board or TCWG of dissolved body] [past tense]

The [board or TCWG] was required to keep adequate accounting records that enabled it to disclose with reasonable accuracy at any time the financial position of the [dissolved body] and enabled it to ensure that the financial statements complied with [specify legislation for accounts preparation for the dissolved body].

The [board or TCWG] was also responsible for safeguarding the assets of the [dissolved body] and for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Signed [successor body]

Extracts from the Statement on Internal Control [generally in the past tense]

Responsibility for the System of Internal Control

The [dissolved body] was dissolved on [dissolution date] and all assets, rights, obligations and staff were transferred to [title of successor body or Minister]. Up to the date of dissolution, the [board or TCWG of the dissolved body] was responsible for ensuring that an effective system of internal control was maintained and operated.

As [board or TCWG of the successor body] we have relied on [e.g. representations by the management, the work of the Audit and Risk Committee... of the dissolved body] in making this statement.

....other elements of the statement....

Annual Review of internal controls

During the period to the dissolution date, the [board's or TCWG of the dissolved body] monitoring and review of the effectiveness of the system of internal control was informed by the work of [specify – for example the CEO and the senior leadership team within dissolved body], who had responsibility for the development and maintenance of the framework of internal control, by the work of the internal audit function and by the Audit Committee which oversaw the work of internal audit and agreed the audit plan for each year.

A formal review of the effectiveness of the system of internal control was completed by the [specify whether successor or former board; if successor board, specify how the annual review was undertaken].

Signed [successor body]

Extracts for the financial statements [generally in the past tense]

Notes to the financial statements

1. Accounting policies

(i) *Dissolution of [body]*

The [dissolved body] was dissolved on [dissolution date] under the [specify the legislation]. The Act sets a range of transfer provisions which include inter alia, the transfer to the [successor body] of all property which, immediately before that day was vested in the [dissolved body]. All rights and liabilities of the [dissolved body] arising by virtue of any contract or commitment (express or implied) entered into before that date stand transferred to the [successor body].

The Act also contains provisions whereby all staff of the [dissolved body] transferred to the [successor body] on terms and conditions no less favourable than heretofore.

Other provisions included in the Act relate to the continuation after dissolution of anything commenced and not completed, in so far as it relates to a function conferred on the [successor body], and provisions with regard to liability for losses (including claims for loss or injury) occurring before the date of dissolution

As all of its functions, operations, assets and liabilities were transferred to [successor body], these financial statements have been prepared on a going concern basis.

(ii) *Period of Account and Transfer of Balances*

These financial statements have been prepared for the period from [date] to the date of dissolution.

The financial statements recognise:

- all income and expenditure up to the date of dissolution
- all assets and liabilities at the date of dissolution which are set out in the Statement of Financial Position and which transferred to [successor body] upon dissolution.

(iii) *Statement of Compliance*

The financial statements have been prepared in accordance with [specify legislation] and FRS 102, the financial reporting standard applicable in the UK and Ireland issued by the Financial Reporting Council (FRC).