

**SSRO**

Single Source  
Regulations Office

*Assuring value, building confidence*

**SSRO Answers**

28 July 2016

Version 14

# Disclaimer

The answer(s) provided do not constitute a formal opinion or determination under the Defence Reform Act 2014 (DRA) and the Single Source Contract Regulations 2014 (SSCRs), and are not designed to replace a party's need to make a formal referral on specific areas under relevant sections of the DRA and SSCRs. The answers do not take priority over statutory guidance or other SSRO publications. The SSRO reserves the right to modify its position, having considered all the evidence, or in the event of a referral for an opinion or determination by committee.

To the extent the answer(s) seek to interpret provisions of the DRA and SSCR, they should serve as a guide only. Each party should seek its own independent legal advice as required regarding the interpretation of the DRA and SSCR, and their application to its business.

If you cannot find the answer to your specific question or would like any further information on any of the topics listed here please e-mail the SSRO helpdesk: [helpdesk@ssro.gov.uk](mailto:helpdesk@ssro.gov.uk).

**New and amended entries are highlighted in yellow**

---

# Contents

1. General	4
2. Allowable Costs	15
3. Qualifying sub-contracts (QSCs)	19
4. Contract Profit Rate	22
5. Defined Pricing Structure (DPS)	27
6. User guides and reporting templates	29
7. Interpretation of PART 6	34
8. Referrals	35

# 1. General

## 1.1 Where can I find courses on the Single Source Contract Regulations?

MOD training on the Single Source Contract Regulations is provided by the Defence Academy of the United Kingdom.

MOD staff members can log on to the academy portal at <https://online.dacmt-acquisition.org.uk/>.

Details of the courses are also available on the Academy's external website: <http://www.da.mod.uk/>.

There are currently two courses available:

- SSPR Awareness - SSPR-A: <http://www.da.mod.uk/Courses/Course-Details/Course/467>; and
- SSPR Contract Let Practitioner: <http://www.da.mod.uk/Courses/Course-Details/Course/124>.

## 1.2 Does an amendment to an existing single source contract with a value over £5 million automatically make it a QDC?

No. If an amendment to an existing single source contract signed before 18 December 2014 meets the requirements of a QDC, it only becomes a QDC if the MOD and the contractor agree that it should, pursuant to Section 14(4)(d) of the Act. We encourage the MOD and contractors to agree to existing contracts becoming QDCs, and subject to the Regulations, wherever possible. We have explained in Answer 1.27 how sunk costs already incurred in such contracts can be dealt with.

## 1.3 Is an overseas group sub-contract with a value below £25 million a qualifying sub contract?

No. Group sub-contracts are not automatically qualifying sub-contracts (QSCs) unless they meet the criteria set out in Regulation 58. For example, the value of the contract is of or above £25 million.

## 1.4 What is the 'Yellow Book' and where can I find it?

The Yellow Book was the Annual Review of the 'Government Profit Formula and its Associated Arrangements', published by the Review Board for Government Contracts.

For QDCs and QSCs signed on or after 31 March 2015 this has been replaced by the Defence Reform Act and Single Source Contract Regulations.

## 1.5 What is the 'Orange book'?

The term 'Orange book' has been loosely used by some to describe the single source procurement framework that came into force in 2014. The previous framework was known as the 'Yellow Book'. The SSRO does not use this term. There is no single 'handbook' that covers the entire framework. The single source procurement framework draws on multiple documents that can be found on the [SSRO's website](#).

## 1.6 Do the Single Source Contract Regulations apply to overseas companies?

Yes. There are no exclusions to the Single Source Contract Regulations for contracts with overseas contractors and contracts placed under the law of other countries. Therefore all the Regulations and requirements apply to overseas companies.

## 1.7 What is the role of the SSRO in negotiating contracts?

The SSRO has no role in negotiating either QDCs or QSCs.

## 1.8 To what extent does the US-UK Reciprocal Defence Procurement MOU affect the need for US companies to comply with the transparency and other requirements set out in the Defence Reform Act and Single Source Contract Regulations?

The MOU does not take precedence over domestic law in the UK, and US companies party to qualifying defence contracts or qualifying sub-contracts are subject to the same transparency and reporting requirements in the single source defence procurement legislation.

## 1.9 Would a contract, under which the price from the relevant contractor is compared against the price of sourcing from an in-house MOD team only, be a QDC?

This contract would be a QDC under the single source defence procurement legislation, provided that all other requirements (value thresholds, date, and not within the exclusions in the Regulations) are met. Benchmarking against an in-house comparator does not amount to a competitive process, as:

1. a qualifying defence contract under the legislation is one where the MOD procures defence goods, works or services 'from another person';
2. services, works or supplies from an in-house unit are not regarded as 'contracts' under other public procurement legislation in force in the UK; and
3. the legislation does not define a 'competitive process'. It merely provides guidance in two sets of circumstances (one of which being where there is only one bidder in a competitive tender. It is a QDC if that sole bidder knows theirs was the only offer from that competitive tender).

## 1.10 Does the single source procurement framework apply to a PFI/PPP contract?

A public finance initiative (PFI) is a procurement method where the private sector finances, builds and operates infrastructure and provides long-term facilities management through long-term concession agreements. A Public private partnership (PPP) is a contract between a public and private body.

The framework does apply to PFI/PPP contracts. A PFI/PPP contract could still be a 'contract to procure goods or services for defence purposes' (Section 14 of the Act) and it does not fall within one of the carve outs in Regulation 7. It will be a QDC provided all other requirements in the single source defence procurement legislation are met (value thresholds, date of contract/amendment and not within the exclusions in the Regulations).

## 1.11 Does equipment for use in space (i.e. beyond the atmosphere of Earth) fall under the single source procurement framework?

The framework covers all MOD procurement that is for 'defence or related purposes' (Regulation 3 of the Single Source Contract Regulations) that meets the other requirements of a QDC or QSC (value thresholds, date, and single source requirements).

### 1.12 Is there a definition of what constitutes 'intelligence activities' under the single source procurement framework?

The Regulations do not define 'intelligence activities'. The MOD guidance from the Commercial Toolkit on its AOF website at Chapter 2 Paragraph 15(3) (c) says intelligence activities:

"Could include collection, communication and processing of information required to maintain and defend the security and resilience of the procurer's activities, infrastructure and economic wellbeing, and influence and deter those who are hostile to that requirement."

### 1.13 Would the manufacturing aspect of a pre-existing contract constitute a QDC where the manufacturing aspect appears as an option to extend the contract without entering into a new contract, once the design aspect is completed?

The manufacturing phase of a pre-existing contract could still be a QDC by virtue of Section 14(5) of the Act, but only if MOD and the contractor agree that it is to be a QDC (and other requirements are met). However we would normally expect to see a new QDC signed for manufacturing if the pre-existing contract is for design aspects only.

### 1.14 How do contractors notify changes to a QDC/QSC post-contract signing?

For contracts with a value of £50 million or more, any changes that arise after the contract was entered into should be reflected in the Quarterly Contract Reports (QCRs) or Interim Contract Reports (ICRs).

Where the contract value is less than £50 million, changes should be reflected in Interim Contract Reports. It is not necessary to report changes to the contract value more frequently than this.

Changes to the contract value should be described and explained. If it aids the explanation supporting information can be submitted with the QCRs or ICRs. An amended Defined Pricing Structure is required to be submitted with an ICR. If it would also assist understanding, it can be submitted with a QCR.

The MOD may request, under Regulation 30(3), that a contractor resubmit the Contract Pricing Statement (CPS), Contract Reporting Plan (CRP), ICR, and or the Contract Costs Statement (CCS).

### 1.15 How does the SSRO handle confidential information? Who in the SSRO will have access to this information? Can it be requested under a Freedom of Information (FOI) request?

Schedule 5 of the Defence Reform Act and Part 10 of the Regulations make unauthorised disclosures of information a criminal offence. A person committing an offence will be liable to imprisonment or a fine or both. Under the terms and conditions of employment on joining the SSRO, employees commit to strict obligations for the protection of confidential information received during the course of their employment. In particular, they are expressly reminded that unauthorised disclosures of information under Schedule 5 of the Act and Part 10 of the Regulations is a criminal offence and are required to familiarise themselves with the relevant sections of the Act and Regulations.

The SSRO has strict policies and procedures relating to information security. All users of SSRO equipment are required to help protect the information held on them and breaches will result in disciplinary action being taken. SSRO equipment may only be operated by users approved and trained to use them, and only for those purposes and in accordance with SSRO policies. Strict controls are in place to govern the use of SSRO equipment and to protect when equipment is not in use. Compliance is monitored by the SSRO for prohibited or unauthorised use.

The SSRO has in place policies and procedures for the declaration of interests. In its Code of Conduct and staff handbook, the SSRO sets out the conduct expected of members and staff and prohibits them from using information gained in the course of their duty for personal gain. We require the same standards and conduct of our SSRO Referrals Committee panel members.

The terms and conditions of appointment for non-executive SSRO Board Members requires compliance with the SSRO Code of Conduct for Board Members, which prevents the use, copying or disclosure of confidential information. The latter term is broadly defined in the Code of Conduct and includes anything marked 'confidential'.

Commercially sensitive information is ring-fenced within the SSRO and in its secure data handling system. Government security classifications are applied and access is strictly limited on a need to know basis to the smallest number of dedicated employees and Board Members necessary for the performance of SSRO statutory functions. All software, applications and information technology support purchased or subscribed to by the SSRO is required to comply with industry best practice security levels and is subject to security classification and access controls. Users are appropriately trained and are required to comply with SSRO handling instructions.

The SSRO has arrangements in place for dealing with government classified information developed in line with the HMG Security Policy Framework, the Government Security Classification and CESG Cloud Security Principles.

The SSRO will also require any third parties engaged to provide services to the SSRO to adhere to the same standards and procedures in the handling and treatment of any confidential and commercially sensitive information the SSRO receives and that it is necessary for the third party to access in the course of providing services to the SSRO. Information security is a key consideration when the SSRO carries out procurement and providers are required by contract to comply with appropriate security conditions. The Defence Contracts Analysis and Reporting System (DefCARS) received full security accreditation from the MOD on 30 September 2015.

Further information can be found at the link below:

<https://www.gov.uk/government/news/handling-commercially-sensitive-information>

#### 1.16 Who will have access to QDC and QSC reports?

QDC reports provided to the SSRO are used by the MOD's Single Source Analysis Team (SSAT) for analysis and validation purposes. Individual QDC reports are disseminated by the SSAT to the relevant individual MOD project teams for verification and project management, and MOD's Cost Assurance & Analysis Service (CAAS) for analysis purposes.

#### 1.17 Can confidential information be requested under a Freedom of Information (FOI) request?

As expressly provided at paragraph 21 of Schedule 4 to the Act, the SSRO is subject to the Freedom of Information Act 2000 (FOIA). As such, the public may request to see information held by the SSRO.

While the SSRO advocates transparency in its activities and operations, it is mindful of the commercial sensitivity of the information it receives from contractors and the MOD in furtherance of its statutory functions. For the SSRO to succeed in its mandate, it is paramount that it both merits and maintains the confidence of its stakeholders. The SSRO will rely on relevant exemptions under the FOIA as necessary in order to deny inappropriate disclosures. In particular, Section 41 of the FOIA provides an absolute exemption in respect of information supplied and held under a legal duty of confidence. In addition, Section 43 provides a qualified exemption (subject to a public interest test) in respect of trade secrets and other commercially sensitive information where disclosure is likely to prejudice the interests of any person.

An equitable obligation of confidence (and therefore an exemption to the FOIA) may apply where information has the necessary quality of confidence and is provided in circumstances importing an obligation of confidence.

A contractor may specify why it considers information submitted to the SSRO to be confidential and state in its request that it should be treated as such by the SSRO. We would give due weight to the contractor's explanation and request for confidentiality when handling the information. Contractors should note, however, that information required by the Act and Regulations must be handled by the SSRO in accordance with the relevant legislative provisions.

In instances where the SSRO is subject to the FOI Act and must deal with requests for information in accordance with the requirements of that Act, and to the extent permitted by the time for compliance under the FOIA, the SSRO will consult the contractor where the SSRO is considering the disclosure of information which the contractor has provided to the SSRO under Part 2 of the Defence Reform Act 2014 and Single Source Contract Regulations 2014. The SSRO will provide prior notification to the contractor of any decision to disclose information under the FOIA. Any representations on disclosure made by the contractor during consultation may not be determinative and the decision whether to disclose information in order to comply with the FOIA is a matter in which the SSRO will exercise its own discretion, subject always to the provisions of the FOIA.

The SSRO is confident that the exemptions to the FOIA, as well as our commitment to consult with contractors prior to the disclosure of any information under the FOIA, are sufficient to protect the confidential and commercially sensitive information it holds and will defend that position by any means necessary if required.

The SSRO holds its employees and officeholders to the highest standards of professional conduct and integrity at all times. It is mindful of the responsibility that the performance of its functions under the Defence Reform Act and Regulations carries. The interests of its stakeholders are paramount and appropriate policies, procedures and controls are in place and are monitored and reviewed in order to ensure that is and remains the case.

#### 1.18 [Is the SSRO involved in determining whether UK defence contracts should be single source?](#)

The SSRO has no statutory role in determining whether the MOD should contract on a single source basis.

#### 1.19 [How is the SSRO funded?](#)

As provided for by the Single Source Contract Regulations 2014 (Regulation 11(5)), from 1 April 2017 a funding adjustment on contract profit for QDCs will be implemented, which will result in the SSRO being equally funded by the MOD and industry. Until that time, an interim arrangement applies whereby the SSRO is funded entirely by the MOD in the form of grant-in-aid.

#### 1.20 [How do we obtain an exemption for our contract from being a QDC regulated by the SSRO?](#)

The Defence Reform Act 2014 (Part 2 Section 14 (7)) gives the Secretary of State powers to exempt from QDC status contracts that would otherwise meet the criteria for being QDCs. We would anticipate very few such exemptions being applied.

---

### 1.21 The Regulations allow in some circumstance for the MOD to require contractors to provide reports to 'on demand' – how does the SSRO envisage this will operate under a firm price contract when this could be unbounded?

Before the contract completion date, the Secretary of State may by written direction require the primary contractor to provide: a contract pricing statement, a contract reporting plan, an interim contract report or a contract cost statement. The Secretary of State may make more than one written direction in relation to the contract.

For a firm price contract, where the contract costs will not change, we would not envisage the Secretary of State would request further contract pricing statements or contract notification reports, as the reports will be the same as those already submitted. However, these could be requested if there has been a contract amendment. The interim reports are submitted on dates agreed between the primary contractor and the Secretary of State, if no date is agreed, then the default date will apply. The Secretary of State could require additional interim contract reports, again on an agreed date.

In addition, within one month of the initial reporting date of the qualifying defence contract, the Secretary of State may by written notice require the primary contractor to provide a contract cost statement for one or more specified periods, each such period ending on a date before the contract completion date. This is at the Secretary of State's discretion.

### 1.22 Is there a limit to the level of loss that would be accommodated under PEPL?

PEPL refers to protection against excess profit and loss and is a term used by the MOD for the final price adjustment by which gain/pain may be shared for the fixed, firm and volume pricing methods.

Regulations 16 and 17 specify the circumstances in which qualifying contracts may be subject to final price adjustment, the procedure by which such an adjustment may be applied and how the adjustment should be calculated.

Regulation 16 provides for final price adjustment on QDCs in excess of £5 million and QSCs in excess of £50 million, where those contracts, or defined components of those contracts, have been priced using the firm, fixed or volume driven pricing method. For such QDCs, a final price adjustment may be applied by one of the parties to the contract where either the total value of the contract equals or exceeds the price payable under the contract according to one of the specified pricing methods; or the total value of a defined component or components equals or exceeds the price payable for that component or those components as determined according to one of the specified pricing methods. A final price adjustment may only be made where the amount of adjustment would be at least £250k but there is no upper limit on the adjustment that can be made.

The Secretary of State may direct that the final price adjustment procedure does not apply to QDCs valued at less than £50 million. This is a discretionary decision taken on advice from MOD. There is no power, however, to make a similar direction in respect of QSCs.

### 1.23 When we sign a QDC will we have a dedicated case officer allocated within the SSRO to allow for consistency and a level of understanding of that Company?

The SSRO is a relatively small organisation with a small sub-set team that assess compliance. The members of that team will always adopt a consistent approach with contractors and we will ensure that the team has a common level of understanding of each contractor.

1.24 How would the SSRO define an international cooperative defence programme (defined under the Single Source Contract Regulations 2014 (7 (b))) as one of the grounds under which a contract may be excluded from being a QDC as there is no definition given in the Regulations? There are examples in the MOD's 'The Commercial Toolkit' ('North Atlantic Treaty Organisation (NATO) Eurofighter and Tornado Management Agency (NETMA), but there are international programmes that may not conform to the examples (i.e. they are not NATO based).

A programme would not have to be NATO based in order to be an international cooperative defence programme. An essential element, however, is that the cooperative programme is established or mandated by more than one government.

1.25 What are the reporting and notification implications if DEFCON 813 (12/14) is applied to a contract?

DEFCON 813 (12/14) is an MOD contract clause that applies QDC and QSC reporting and notification requirements to contracts and sub-contracts that are not QDCs or QSCs. Such contracts do not fall under Part 2 of the Defence Reform Act or the Single Source Contract Regulations. The reports or notifications are a requirement of the MOD and are not submitted to the SSRO.

Further details can be found in the MOD's Commercial Toolkit on its AOF website.

1.26 What are the implications if DEFCON 815 is applied to a contract?

DEFCON 815 (04/15) is an MOD contract clause that may be applied to single source defence contracts that are not qualifying contracts under the Defence Reform Act and the Single Source Contract Regulations. The SSRO has no role in the negotiation of such contracts and the information which DEFCON 815 refers to is not submitted to the SSRO.

Further details can be found in the MOD's Commercial Toolkit on its AOF website.

1.27 Do costs already incurred (sunk costs) become subject to the Regulations in circumstances where a contract becomes a QDC on amendment?

Sunk costs will become subject to the Act and the Regulations if they are used to determine the contract price in an amended contract that both the MOD and contractor agree should become a QDC on amendment. (The amended contract would also have to satisfy the other criteria for being a QDC set out in Section 14 of the Act.)

In such a case, the MOD and the contractor should agree between themselves whether the sunk costs are Allowable Costs and may set out the agreed position in the amended contract. If it has been agreed by the parties that the sunk costs are Allowable Costs, there should be no need for either of them to make a referral to the SSRO in respect of those costs. It is also open to the MOD and the contractor to specify in the amended contract that they agree that they will not seek to reclaim costs or to claim additional costs in respect of the period before the amended contract became a QDC.

Where the MOD and the contractor reach agreement that sunk costs are Allowable, or where the sunk costs do not form part of the contract price under the QDC, the SSRO would not assess these costs for compliance with its Single Source Cost Standards guidance on Allowable Costs as part of its analysis of the QDC reports that the contractor is required to submit. Where either the MOD or the contractor cannot reach agreement on the treatment of sunk costs when agreeing that a contract should become a QDC, there is scope for the matter to be referred to the SSRO.

The SSRO will in due course update its Single Source Cost Standards guidance to reflect this position on sunk costs.

### 1.28 Is a competitively procured contract which is later amended on a non-competitive basis a QDC?

A competitively procured contract which is subsequently amended on a single source or non-competitive basis is a QDC if this is agreed by the “Secretary of State and the primary contractor” under Section 14(5)(d) of the Act.

### 1.29 Should the value of options be included in the total contract value, even if they haven't been exercised?

In accordance with Regulation 5(4)(a)(i) the contracting authority must determine the value of a contract and in making that determination they must, where appropriate, take into account any option contained in the contract and the likelihood that it will be exercised.

Under this Regulation, we would expect options that have been included in the contract to be included in the contract price, even if they have not been exercised. If, during the course of the contract, it becomes certain that any options will not be exercised, the contract value should be amended accordingly and the variance detailed in the “variance” section of the Quarterly Contract Report or Interim Contract Report, whichever is due first. If, by the end of the contract, any option has not been exercised, the final contract value should be updated for this and the change should be detailed in the “variance” section of the Contract Completion report.

### 1.30 Does an amendment to an existing QDC or QSC trigger any additional reporting requirements?

There are no additional reports that are automatically required for submission as a consequence of amending an existing QDC or QSC. However, an updated Defined Pricing Structure should be submitted with future Interim Contract Reports, or Quarterly Contract Reports if it would assist understanding, and the amendments need to be reflected in future reports (see entry 1.14). Under Regulation 30(3), the MOD can request that a contractor resubmit the Contract Pricing Statement, Contract Reporting Plan, Interim Contract Report, and/or the Contract Costs Statement.

### 1.31 Where a QDC or QSC is placed with a contractor whose functional currency is other than GBP how are contract costs to be converted into GBP?

Regulation 5 states that, in determining the contract value, the contracting authority must “convert any amounts payable under the contract in a foreign currency to sterling, using a rate consistent with the contracting authority’s accounting policies.” For QDCs, the relevant contracting authority will be the MOD. For first tier QSCs, the relevant contracting authority will be the primary contractor.

Regulation 22(8) states that “Except where otherwise provided in this Part, any reference to money in a report must be expressed in sterling”. Contract reports on contracts priced in foreign currencies must apply the same conversion rate as was determined by the contracting authority.

### 1.32 Should contract amendments between the end of a quarterly period and the Quarterly Contract Report (QCR) due date for that period be reflected in that report?

No, a Quarterly Contract Report should be up to date only as at the end of the quarter that it reports on. Any contract amendments that occur after the end of the quarterly period should be reflected in the following QCR or Contract Completion Report.

### 1.33 Can an Intention to Proceed (ITP) arrangement constitute a valid QDC or QSC?

An Intention to Proceed (ITP) communication or letter is not something defined by the Defence Reform Act 2014 or Single Source Contract Regulations 2014. The term is commonly used where a formal contract is under negotiation and work relating to the subject matter of the contract has been, or is to be, carried out before the execution of the contract. Other terms used to describe such communications are “comfort letter” and “memorandum of understanding”, where work is genuinely carried out at risk.

ITPs that do not have effect as binding legal contracts do not constitute QDCs or QSCs under the Act and Regulations.

However, not all ITP arrangements are entirely at risk and a contract may in fact arise in some cases, depending on the particular circumstances. This will be where the required elements for a contract exist: an offer, acceptance, consideration, intention to create legal relations, and certainty of terms. Such ITP contracts may be a QDC or QSC if the other requirements for a QDC or QSC are present.

If an ITP arrangement is a contract and a main agreement is later signed, then a question will arise as to whether the ITP is incorporated into the main agreement, or the main agreement is treated as an extension of the ITP, or whether the two agreements are treated entirely separately. If the agreements remain separate but they fulfil the same requirement for goods, works or services, the value of each may need to be determined by aggregation with the other (Regulation 5).

See (4.12 and 4.13) for two other entries on ITP.

### 1.34 Does the SSRO assess QDC and QSC costs for value for money?

The SSRO monitors whether QDCs and QSCs comply with the requirements of the Defence Reform Act 2014 and the Single Source Contract Regulations 2014, including its statutory guidance on Allowable Costs (the Single Source Cost Standards) and its guidance on Adjustments to the Baseline Profit Rate. The SSRO also runs a full programme of [Value for Money Studies](#), which use a range of evidence to generate comparative management information and defence benchmarks to help drive improvements.

### 1.35 Does the SSRO set pay or general and administrative rates?

The SSRO has no role in setting pay or general and administrative rates. Such rates are agreed between suppliers and the Ministry of Defence and both parties should have regard to the SSRO’s statutory guidance on Allowable Costs, the Single Source Cost Standards. If the supplier has deviated from our guidance they must report it.

### 1.36 What is a compliance notice?

The Secretary of State may issue a compliance notice, under Section 31 of the Defence Reform Act 2014. A compliance notice can be issued to a contractor if they contravene Section 31, and if there are “steps that can be taken by the person to remedy” the contravention in question (Section 31(1)). Breaches of Section 31 constitutes where a contractor:

- fails to comply with the specified reporting duties or the duty to keep accounting and other records;
- provides a QDC/QSC report that it either “knows that the report is misleading”, or is “reckless as to whether the report is misleading”;
- fails to comply with the duty to notify the Secretary of State of relevant events, circumstances or information under Section 26 and Section 31(3)(c);

- fails to make an assessment of whether a sub-contract is a QSC;
- makes a sub-contract assessment that the Secretary of State believes to be incorrect; or
- fails to give notice in section 29(2)(b) or (4)(b) in respect of a proposed contract where it is required to do so.

A compliance notice will specify the steps necessary to remedy the contravention, and direct the contractor to take such steps (Section 31(2)). It must also “give details of the contravention”, “specify the period within which the steps specified in the notice must be taken”, and state that if the contractor “fails” to take those steps, the Secretary of State for Defence may issue a penalty notice (Section 31(6)).

### 1.37 What is a penalty notice?

The Secretary of State may issue penalty notices under Section 32 of the Defence Reform Act 2014. A penalty notice can be issued to a contractor in two circumstances. The first is where the Secretary of State considers the contractor to have “failed to take the steps specified in a compliance notice” and “does not have a reasonable excuse for the failure” (Section 32(2)). The second is where the contractor has contravened Section 31 and the Secretary of State does not consider there to be “steps that can be taken by the person to remedy the contravention” (Section 32(3)).

A penalty notice is a notice that requires the contractor to “pay a penalty to the Secretary of State before the end of the period of six months beginning with the date on which the notice is given” (Section 32(4)).

A penalty notice must specify:

- the contravention to which the notice relates;
- state the amount of the penalty;
- specify the date by which the penalty must be paid;
- specify how the penalty may be paid;
- give details of the interest that would be payable by virtue of Section 34(2) in relation to any part of the penalty that is unpaid after the date specified; and
- explain how the person may apply to the SSRO, within six months of the notice being given, for a determination on whether the contractor (1) contravened section 31 or failed to take the steps specified in a compliance notice (or both), (2) whether the contractor had a reasonable excuse for contravening section 31 or failing to take the steps specified in a compliance notice (or both); and (3) the amount of the penalty.

### 1.38 Can contractors be requested to resubmit reports with corrections or amendments?

The SSRO reviews submitted reports for compliance issues. Where necessary, we may contact contractors for clarification or to request further documentation to support the inclusion of costs or adjustments to the baseline profit rate. The contractor may then decide that they wish to resubmit their report or the SSRO may request that certain reports should be resubmitted with corrected information.

The Secretary of State may issue a compliance notice that requires the submission or resubmission of reports.

See entry 1.36 for information on compliance notices.

### 1.39 Does the SSRO approve company forward bid rates?

The SSRO does not approve any rates that contractors present to the Ministry of MOD for QDCs or QSCs. Forward bid rates may be used in some contracts. Rates are approved by the MOD as part of the contract agreement process. Contractors are required to have regard to the Single Source Cost Standards (statutory guidance on Allowable Costs) and include the facts, assumptions and calculations used in the cost build-up and describe any deviations from the SSRO's statutory guidance. These are to be included either in the Contract Pricing Statement (CPS) or to be cross-referenced to supporting documentation submitted with the CPS.

## 2. Allowable Costs

### 2.1 Does the Questionnaire: Method and Allocation of Costs (QMAC) determine if a cost is Allowable?

No. The QMAC has no relevance in determining if a cost is Allowable. Although the QMAC is completed by the contractor and describes how they will allocate and apportion costs, this does not mean that costs included in the QMAC are automatically Allowable.

Indirect costs included in the QMAC will only be Allowable if they meet the principle of being 'appropriate, attributable and reasonable' and are agreed between the contractor and the MOD, who will have regard to our guidance on Allowable Costs.

### 2.2 Is rework an Allowable Cost?

The cost of rework will similarly be Allowable if it meets the principle of being appropriate, attributable and reasonable and is agreed between the contractor and the MOD, who will have regard to our guidance on Allowable Costs.

For example:

1. **First in Class** - rework which occurs during the process of manufacturing an item for the first time would generally be considered Allowable.
2. **Re-specification** - rework which occurs due to a change in design specification from the MOD would generally be considered Allowable.
3. **Faulty Workmanship** - the costs of rework due to faulty workmanship or the consequences that result from faulty workmanship are generally non-Allowable. Similarly, rework that is a result of a contractor not delivering a specification would generally be non-Allowable.

To demonstrate that re-work is appropriate, attributable and reasonable the contractor will clearly need to be able to measure reliably how much re-work falls into the various categories outlined above.

### 2.3 How are redundancy costs incurred on a MOD contract following expiry or early termination recovered?

Redundancy costs can be recovered as an Allowable Cost if they meet the principle of being appropriate, attributable and reasonable and is agreed between the contractor and the MOD, who will have regard to our guidance on Allowable Costs.

The relevant extract from our guidance is set out below:

“Redundancy payments made in the normal course of business, and which are in accordance with the rates laid down by statute, may be included in Allowable Costs. If payments are made in excess of such rates then these may also be included, if agreed between the contractor and employees and approved by the MOD, and notified to the SSRO as part of the reporting process.”

## 2.4 If I own a building used on a QDC, can I still recover the cost?

Yes. The capital costs of owning a building (instead of other options such as renting), will be recovered through depreciation and the capital services adjustments included within the contract profit rate mechanism.

The relevant extract from our guidance is set out below:

“Any expenditure of a capital nature will not be Allowable as capital costs are recovered through depreciation (which is classified as Allowable) and the contract profit rate mechanism.”

## 2.5 Are marketing costs Allowable?

Costs included in QDCs and QSCs (must be appropriate, attributable and reasonable if they are to be ‘Allowable’ under the Defence Reform Act 2014 (Section 20(2)(a)- (c)). The SSRO’s guidance on Allowable Costs states that marketing costs can only be considered Allowable if they are ‘demonstrably linked to a qualifying defence contract’ (10.14). Additionally, marketing costs must be incurred in the delivery and conduct of the QDC in question for the costs to be appropriate and attributable (9.2 and 9.3).

We would not normally regard as Allowable marketing costs incurred on export campaigns in anticipation of potential future sales of the same product or services being delivered to the MOD under a QDC. We would however expect the MOD to be interested in securing some of the benefits of future sales to other customers for the UK taxpayer. This can be achieved through contract terms that provide for rebates to MOD contingent upon future sales. It is not a requirement of such arrangements that marketing costs should be paid for upfront by MOD. Furthermore, it is a better allocation of commercial risk for the marketing costs to be borne by the party directly incurring those costs, incentivised to secure further sales both for its benefit and for the benefit of its major UK customer.

## 2.6 Are contingency costs Allowable?

Where a contingency arises and as a result a contractor incurs an expense, the expense may be an Allowable Cost if it follows the SSRO’s statutory guidance on Allowable Costs and meets the Appropriate, Allowable and Reasonable criteria.

Contingency cost can be included within a contract price, but cannot be an Allowable Cost in non-firm price contracts if the contingency has not arisen and therefore the contractor has not incurred an expense. For a cost to be Attributable the contractor must have incurred an expense in the delivery of the qualifying defence contract.

## 2.7 In order to demonstrate that an indirect cost is directly associated with the output of a QDC do we need to calculate new overhead rates each time a contract is awarded?

It is acceptable to use the same agreed overhead rates on a number of QDCs provided that they satisfy the test in section 20(2) of the Act of being:

- (a) appropriate;
- (b) attributable to the contract; and
- (c) reasonable in the circumstances.

In making that assessment, the parties must have regard to the SSRO’s Single Source Cost Standards, which provide guidance on Allowable Costs.

## 2.8 What level of cost risk adjustment should be made to the Contract Profit Rate when the contract costs already account for an element of risk?

The SSRO's Contract Profit Rate Guidance, which is statutory guidance setting out the general approach to cost risk and principles to consider, already states that the cost risk adjustment should take into account:

- any cost risk exposure which has been mitigated through contract terms and conditions;
- any contractual terms that pass on some or all of the cost risks onto a party other than the contractor; and
- the extent to which the cost risk has been mitigated, for example through good business practices or insurance.

When considering what adjustment to make the contractor and MOD must have regard to the principles set out in the Guidance.

We are currently consulting on changes to the SSRO's Contract Profit Rate Guidance. The revised section on the Step 2 Cost Risk Adjustment clarifies further that if a contract price already includes cost risk then there should be no positive cost risk adjustment, to reflect that the cost risk has already been considered (see para 7.9 <https://www.gov.uk/government/consultations/consultation-on-contract-profit-rate-guidance>).

## 2.9 Industry's understanding is that, under the Yellow Book system, adjustments were made across comparable companies for amortisation/impairment of intangibles before their profitability was taken into account. Will this also be done under the new methodology in order to ensure the baseline profit is consistent with Allowable Costs?

The SSRO did not make any adjustments to the comparable company profit data to take into account costs that would generally not be Allowable. The SSRO does not believe that an adjustment should be made to account, for example, for amortisation or sales and marketing costs as the methodology is not dependent on whether costs in individual contracts are Allowable. Any calculation that derived a profit margin before non-Allowable Costs would effectively make them Allowable.

The Single Source Cost Standards state that some forms of amortisation can be treated as Allowable Costs (as set out in section 10 of the Single Source Cost Standards).

On a practical level, there are also data constraints. For example, data on amortisation may not be available for every company in the financial database.

## 2.10 How do you ensure that costs included in a QDC are Allowable?

In order to determine whether costs are Allowable, the parties must have regard to the SSRO's statutory guidance (the Single Source Costs Standards). The guidance is principles-based and the SSRO has provided more information on this in other queries in this section of SSRO Answers.

The inclusion of costs should be explained and documented in QDC reports with sufficient information and descriptions. Any Allowable Costs used to determine the contract price must be set out in the Contract Pricing Statement (CPS), including "facts, assumptions and calculations relevant" to each element of costs included (Regulation 23(e)). Included costs should also be mapped and submitted through a Defined Pricing Structure template. Any known deviation from statutory guidance must also be described in the CPS (Regulation 23(c)). For contracts with a value of £50 million or more, any changes that arise after the contract was entered into should be reflected in the Quarterly Contract Reports or Interim Contract Reports. Examples of supplementary documentation and information that can be useful in explaining or supporting the inclusion of costs are included in SSRO Answer 6.6.

The SSRO can give an opinion on whether specific costs are Allowable or can definitively determine that question if a referral is made to it under the Act. The SSRO has published guidance on the procedures it follows when considering referrals for opinions and determinations, which can be viewed at: <https://www.gov.uk/government/publications/guidance-on-the-ssros-referrals-procedures-under-the-defence-reform-act-2014-and-single-source-contract-regulations-2014>.

## 3. Qualifying sub-contracts (QSCs)

### 3.1 How should QSCs be priced?

Qualifying sub-contracts are priced in the same way as qualifying defence contracts (through the Contract Profit Rate formula). However, the prime contractor and QSC have to agree the incentive adjustment and Capital Services Adjustment, instead of the MOD and prime contractor. This is stated in Regulation 65(1) and 65(4):

65( 1) In their application to qualifying sub-contracts (and to sub-contractors) by virtue of section 30( 1), these Regulations are modified as described in this regulation.

65(4) Regulation 11 (steps in determining profit rate) has effect as if—

(a) in paragraph (6), for each ‘Secretary of State’ there were substituted ‘contracting authority’; (this relates to the incentive adjustment)

(b) in paragraph (8), for ‘Secretary of State’ there were substituted ‘contracting authority’. (this relates to the Capital Servicing adjustment).

Therefore, the Capital Servicing Adjustment will still need to be agreed while having ‘regard to the capital servicing rates at the time of agreement’. Visibility of the QSC’s financial information is not required by the QDC prime contractor, as the QDC does not determine the Capital Servicing Adjustment rate for the QSC.

Additionally, the QSC will submit reports to the SSRO and MOD and these will then be assessed for compliance to ensure the contract profit rate has been calculated correctly.

### 3.2 How do the Regulations apply where a prime contractor wins a contract under competition, but there is a single source sub-contract and its value is bigger than £25 million?

Most of the time the Regulations will not apply under these circumstances. If the contract between the primary contractor and the MOD is not a QDC, the sub-contract cannot be a QSC.

However, in limited circumstances the sub-contract itself could be a QDC if it is placed on behalf of the Secretary of State, even though MOD or the Secretary of State is not directly a party to the contract. The Act describes a qualifying defence contract as a contract ‘under which the Secretary of State procures goods, works or services...’ and this means that QDCs are not limited only to those that the Secretary of State is party to.

Chapter 2 of the MOD internal guidance from the AOF Commercial Toolkit states in paragraph 8 that a contract can be a QDC if the contract ‘is placed on behalf of the Secretary of State’ including:

“by trading funds and by Non-Departmental Public Bodies (eNDPBs) which contract on behalf of the Secretary of State.”

### 3.3 What information is a prime contractor required to obtain for a new Qualifying Sub-contract (QSC)?

It is the prime contractor's responsibility to inform the Secretary of State for Defence and the SSRO that there is a QSC and provide the information set out in Regulation 25 in the Contract Notification Report.

The required information includes the sub-contractor's name; whether they are associated with the primary contractor and if they are an SME; a brief description of the goods, works or services to be provided; the contract signature and completion dates; and the actual or estimated prices payable under the QSC.

The qualifying sub-contractor will then be required to report directly to the SSRO.

### 3.4 What is the prime contractor's responsibility if the sub-contractor fails to comply with the regulations?

If the sub-contractor has obligations under the Act and the Regulations in respect of a qualifying sub-contract (e.g. reporting obligations), then it is the sub-contractor's obligation to comply. The prime contractor is not required by the Act or the Regulations to enforce or deliver obligations which have been imposed on a sub-contractor. The prime contractor may, however, have its own obligations in relation to the sub-contract, such as the requirement to assess whether it is a qualifying sub-contract and to give notice in writing of a positive assessment.

### 3.5 How do we treat sub-contracts placed with companies who offer 'commercial off the shelf' products where the price is fixed for all customers either through a catalogue or some other published price list when they refuse to enter into a QSC?

If the sub-contract meets the criteria for being a QSC in the Act and the Regulations then it is a QSC, regardless of the type of product being procured. The prime contractor must give written notice of its assessment that the contract is a QSC. The sub-contractor is then responsible for reporting direct to the SSRO on their own costs, profit etc, in accordance with the requirements of Part 5 of the Regulations.

### 3.6 Does an amendment to an existing single source sub-contract with a value over £25 million automatically make it a QSC?

The effect of agreeing to significantly amend the terms of an existing contract is to enter into a new contract on the amended terms. As such, an assessment as to whether a sub-contract is a QSC should be undertaken under Regulation 61 if a sub-contract is proposed to be amended, providing that the amendments are material.

### 3.7 What are the reporting requirements for a sub-contractor party to a Qualifying Sub-contract?

The reporting requirements for sub-contractors party to Qualifying Sub-Contracts (QSCs) are broadly the same as for contractors party to Qualifying Defence Contracts (QDCs), detailed in Part 5 of the Regulations. However, QSC reporting requirements differ from QDC requirements with regards to the following:

- QSC reports are not required to include the name, position and contact details of the civil servant who is responsible for managing the contract on behalf of the Secretary of State (Regulation 65(10)).
- The Contract Pricing Statement must describe any fact or assumption provided by the contracting authority and used in calculation of the Allowable Costs, in addition to those provided by the Secretary of State (Regulation 65(11)).
- Regulations 65(12)-(14) stipulate that QSC Contract Notification Reports (CNR), Interim Contract Reports (ICR) and Contract Completion Reports (CCR) are exempt

---

from having to include the following information:

- a list of all payments exceeding £100,000 or 1 per cent of the contract value (whichever is the greater) that have been or are expected to be made (depending on the report) by the Secretary of State under the contract, including:
  - the amount (for ICR and CCR), or expected amount (for ICR, CCR and CNR), of each payment;
  - the date on which each payment did (for ICR and CCR) or is expected to fall due (ICR, CCR and CNR); and
  - if the contract requires the payment to be made in any currency other than sterling, the currency in which the payment was or is to be made;
- if the contract requires payment to be made in sterling, an annual profile of all such payments made, or which the contractor expects the Secretary of State will make; and
- if the contract requires payment to be made in any currency other than sterling, an annual profile for each such currency of all payments made, or which the contractor expects the Secretary of State will make.

## 4. Contract Profit Rate

### 4.1 Can more than one regulated pricing method be used when pricing a contract?

Yes. Regulation 10(3) states that:

“The parties to a qualifying defence contract may agree that different regulated pricing methods are to be used for defined components of that contract.”

### 4.2 Can a pricing method outside the six regulated pricing methods be used when pricing a contract?

No. The Defence Reform Act and Single Source Contract Regulations do not include any provision for a pricing method outside the six regulated pricing methods.

### 4.3 When determining the contract profit rate, what capital servicing rates should be applied on a multi-year contract?

The capital servicing rates published at the time of agreement (the date the contract is entered into) should be applied.

Regulation 11 states that:

“In agreeing the capital servicing adjustment, the primary contractor and the Secretary of State must have regard to the capital servicing rates in force at the time of agreement.”

The time of agreement is interpreted in the Single Source Contract Regulations as:

- (i) the date the contract is entered into; or
- (ii) if the price payable under the contract is re-determined under regulation 14, the date of that re-determination.

### 4.4 When will the baseline profit rate for 2016 be published?

The baseline profit rate for the 2016 financial year will be published by the Secretary of State no later than 15 March 2016.

The SSRO is currently developing the methodology to calculate the baseline profit rate that it will recommend to the Secretary of State by 31 January 2016.

The methodology and proposed approach will be communicated to stakeholders in Autumn 2015, which will precede a period of public consultation.

### 4.5 In applying the POCO adjustment, how does this affect the tax to be applied to the prime contractor and group sub-contractor (especially if they are based overseas)?

How contractors choose to allocate their profit within a group is a matter for them to decide. Providing guidance on tax issues is outside the scope of the SSRO. However, the appropriate tax legislation for the relevant country of the group sub-contractor should be adhered to.

#### 4.6 What level of cost risk adjustment should be made to the Contract Profit Rate when the contract costs already account for an element of risk?

The SSRO's Contract Profit Rate Guidance, which is statutory guidance setting out the general approach to cost risk and principles to consider, already states that the cost risk adjustment should take into account:

- any cost risk exposure which has been mitigated through contract terms and conditions;
- any contractual terms that pass on some or all of the cost risks onto a party other than the contractor; and
- the extent to which the cost risk has been mitigated, for example through good business practices or insurance.

When considering what adjustment to make the contractor and MOD must have regard to the principles set out in the Guidance.

We are currently consulting on changes to the SSRO's Contract Profit Rate Guidance. The revised section on the Step 2 Cost Risk Adjustment clarifies further that if a contract price already includes cost risk then there should be no positive cost risk adjustment, to reflect that the cost risk has already been considered (see para 7.9 <https://www.gov.uk/government/consultations/consultation-on-contract-profit-rate-guidance>).

#### 4.7 The median value appears to be used twice in the methodology, once when calculating the underlying profit rates for 'develop and make' and 'provide and maintain' and once after adjusting for capital servicing. Would it be possible for the SSRO to provide a step-by-step overview of the process for removing capital servicing, together with example calculations across a sample of, say, ten anonymised companies?

The median value is determined based on the profit data for each comparable company, adjusted for capital servicing. This is used to determine the underlying profit rates for 'develop and make' and 'provide and maintain'. These underlying profit rates are used in the calculation of three year rolling averages for each activity type (using the underlying baseline profit rates from previous years). The single composite baseline profit rate is then calculated by taking a simple average of the two resulting profit rates for the 'develop and make' and 'provide and maintain' activity types.

A separate median value is also determined based on the underlying unadjusted profit rate for the 'develop and make' and 'provide and maintain' activity types, (i.e. without adjusting the profit data for capital servicing). This median rate is currently for information only but may be used in future if a greater number of baseline profit rates associated with more specific activities are recommended in future, which could allow capital servicing rates to be set to zero. The SSRO will explore options for making the cost of servicing capital and Allowable Cost and setting capital servicing rates to zero as part of its review of Part 2 of the Defence Reform Act 2014 and the Single Source Contract Regulations 2014.

The capital servicing adjustment (CSA) is carried out at the company level, and therefore uses company specific financial data. Each comparable company's result is adjusted using the method set out in the guidance for the Step 6 capital servicing adjustment calculation (see the SSRO's Contract Profit Rate Guidance).

The adjustment calculation uses the capital servicing rates (for fixed capital, positive working capital and negative working capital) recommended by the SSRO. These are not published at this time, but will be following the Secretary of State's announcement in March. Therefore we cannot provide examples of this adjustment for anonymised company results. This approach is similar to that adopted by the Yellow Book review panel.

**4.8 Can the SSRO clarify why median (unweighted) average profit rates have been used rather than weighted (i.e. for volume of cost of production) average profit rates in the methodology, and can the SSRO confirm whether sensitivity analysis has been undertaken to ensure that this will not result in substantial change or disruption for industry?**

The median is widely recognised as an appropriate measure to use according to transfer pricing principles, and the best practice approach set out by the OECD and supported by HMRC.

The previous methodology was calculated using a 'mean' average and therefore larger companies had a higher weighting in the final results, and the overall results were more sensitive to the profitability of these companies. The use of a median should result in less disruption as it is unlikely to be significantly affected, by unusual results of a few companies. Our analysis indicates a broad consensus around the median value.

The median will always be representative of the centre of the range of profit data, whereas the mean can be highly influenced by outliers.

The SSRO will continue to use three year rolling averages in the baseline profit methodology which has the effect of smoothing changes in the annual figures. This is consistent with the previous Yellow Book approach.

**4.9 The majority of QDC activity involves high-tech, prime contract, system integrator work. What assurances can the SSRO provide to demonstrate that this type of activity is reflected in the comparator classes listed in Appendix B?**

The SSRO is satisfied that appropriate comparator companies are selected on the basis that they share similar risks, assets and characteristics to work undertaken on QDCs.

Section 4 of the methodology document (paragraphs 4.21 and 4.22, along with Appendix B of the methodology document) sets out how the NACE industry codes are used to identify an initial sample of potentially comparable companies. Paragraphs 4.24 – 4.27 describe the process of reviewing these companies in detail to confirm they are appropriate comparable companies. Appendix A sets out the characteristics of the comparable companies analysed.

The outcome of the comparables search is a set of comparable companies which are specific to the activities involved in undertaking defence contracts. The SSRO is confident that this results in the selection of appropriate comparators and a significantly better comparator group than under the previous 'Yellow Book' approach.

**4.10 When will the SSRO publish full details of its calculation of the recommended baseline profit rate and will it provide sufficient data as to enable an independent third party to fully understand the calculations?**

The SSRO has already published the characteristics of contracts identified for 'develop and make' and 'provide and maintain' defence contract activities used to determine the search criteria for selecting comparable companies from a company database (Appendix A of the methodology). The company search criteria and list of NACE industry codes and text search terms used in the company search process has also been published (paragraphs 4.9 to 4.23 and Appendix B of the methodology), and the SSRO has described in detail the company review process for finalising the set of comparable companies (paragraphs 4.24 – 4.27 of the methodology).

To provide additional transparency the SSRO will publish the list of companies in the comparator reference group. The SSRO will do this after the Secretary of State has published the baseline profit rate in the London Gazette in March 2016.

This is far more information than has previously been made available.

4.11 Industry's understanding is that, under the Yellow Book system, adjustments were made across comparable companies for amortisation/impairment of intangibles before their profitability was taken into account. Will this also be done under the new methodology in order to ensure the baseline profit is consistent with Allowable Costs?

The SSRO did not make any adjustments to the comparable company profit data to take into account costs that would generally not be Allowable. The SSRO does not believe that an adjustment should be made to account, for example, for amortisation or sales and marketing costs as the methodology is not dependent on whether costs in individual contracts are Allowable. Any calculation that derived a profit margin before non-Allowable Costs would effectively make them Allowable.

The Single Source Cost Standards state that some forms of amortisation can be treated as Allowable Costs (as set out in section 10 of the Single Source Cost Standards).

On a practical level, there are also data constraints. For example, data on amortisation may not be available for every company in the financial database.

4.12 Where an Intention to Proceed (ITP) falls under the Act and Regulations, and takes place in a different financial year to a where a main contract is signed, which base profit rate should be applied?

The applicable baseline profit rate is the rate in force at the time of the agreement (Regulation 11(2)). The time of agreement is, relevantly, the date the contract is entered into or the date the price payable is redetermined (Regulation 2(1)).

Where a main contract is entered into during a different financial year to the ITP, the baseline profit rate that should be applied will depend on the nature of the relationship between the main contract and ITP. However, it will generally be the baseline profit rate that applies at the time the main agreement is entered into.

If the ITP is not a contract, then there is only one agreement to apply the baseline profit rate to (i.e. the main agreement). In that case the baseline profit rate will be that which applies when the main agreement is entered into.

If the ITP is a contract, then the main contract could be treated as an extension of the ITP contract. If the price is redetermined at the time the main agreement is entered into, then the baseline profit rate would be the one applying at the time of the main agreement. Where an ITP is incorporated into a main contract, the baseline profit rate will be that of when the main contract was entered into.

If the ITP is a contract but is not incorporated into the main agreement, then the two contracts remain separate and different baseline profit rates will apply to each.

See (1.33 and 4.13) for two other entries on ITP

4.13 Where an Intention to Proceed (ITP) falls under the Act and Regulations, how should costs incurred "at risk" be treated once the main contract is signed?

Work undertaken pursuant to an ITP may be genuinely at risk and not strictly subject to the single source regulatory framework at the time when it is carried out. However, when incurring costs at risk, contractors should remember that if those costs are later to be incorporated into the price of a QDC or QSC, then they will become subject to the regulatory framework. This means the costs will have to be Allowable, records will need to be kept in relation to them and they will need to be included in reports to the SSRO.

In order to be Allowable, the costs must satisfy the test that they are appropriate, attributable to the contract and reasonable in the circumstances. In determining whether the costs are Allowable, the parties must have regard to the SSRO's Single Source Cost Standards: Statutory Guidance on Allowable Costs. It is possible for costs to still be "attributable" to the main contract, as required by the guidance, even though they were incurred during an ITP.

See (1.33 and 4.12) for two other entries on ITP.

#### 4.14 What are the consequences for a contractor if a QDC/QSC fails to apply the six steps for profit calculation?

It is a legal requirement for QDCs and QSCs to follow the six-steps for calculating the contract profit rate. This is provisioned by Section 17(2) of the Defence Reform Act 2014 and Regulation 11 of the Single Source Contract Regulations 2014. The SSRO monitors adherence to these requirements and will report any compliance issues to the contractor and the Ministry of Defence.

The Secretary of State may issue a compliance notice to a contractor where it has breached its reporting duties (Section 31(3)(a)(ii)), including the requirement in the Contract Pricing Statement to "describe the calculation that was made under Regulation 11 to determine the contract profit rate, including all adjustments that were made under steps 1 to 6" (Regulation 23(2)(d)). The Secretary of State may issue a penalty notice to a contractor where it has "failed to take the steps specified in a compliance notice" and "does not have a reasonable excuse" for the failure to comply (Section 32(2)).

The parties to a qualifying defence contract may make a referral to the SSRO to determine the amount of the appropriate adjustment under steps 2, 3 and 6.

See entries 1.36 and 1.37 for information on compliance and penalty notices.

---

## 5. Defined Pricing Structure (DPS)

### 5.1 Where is the provision for Research and Development costs within the DPS?

All DPS templates published after September 2015 will include Research and Development (R&D) as a single Level 2 line item. In the interim R&D costs should be recorded under 'Project Management - Other' and annotated so that it is clear that it relates to Research and Development.

### 5.2 Where do contractors take account of contingent risk (and costs associated with) within the DPS and wider reports?

There are three potential options for the inclusion of contingent risk (and costs associated with) within the DPS and wider reports.

Where a contingent risk is directly linked to an element within the DPS, and is reported as such internally, then that line item within the DPS should include the contingent risk and be detailed as such.

Where the contingent risk is not directly linked to an element of the DPS, then the contingent risk can be included with an 'other' category in the appropriate section of the DPS, and detailed as such.

Where the contingent risk is general and is not reported internally against any element of the DPS, then it can be excluded from the DPS and instead reported in row 22 on '08-Price' worksheet within the contract notification report, interim contract report or contract completion report. This will ensure that the analysis of price agrees back to the contract value.

### 5.3 Will SSRO be publishing a separate In-Service DPS template at the end of September 2015?

Following helpful feedback from suppliers, we have decided to integrate the in-service elements within the individual platform/equipment type DPS templates. As such at the end of September, we will reissue both the Submarine and Surface Ships DPS' with the in-service elements included as well as the DPS for Ordnance. The remaining DPS templates will be published by the end of December 2015, but should you need a specific DPS before then, please contact the Reporting Helpdesk and we will be happy to help you.

### 5.4 Where a contingent risk is directly linked to an element within the DPS, and is reported as such internally, then that line item within the DPS should include the contingent risk and be detailed as such. Does this mean risk is included, and what constitutes a sufficient level of detail?

Where there is a contingent risk, it should be included in the cost for that particular line item. The 'additional information' section should be used to provide additional detail if appropriate. Although we do not currently have an example, in this situation a comment such as 'the cost at this level includes contingent risk of £x' would suffice.

**5.5 How do we complete a DPS if the DPS template for the equipment we will supply under our QDC has not yet been published?**

Where a DPS for a platform has not yet been published, only Level One (Total Cost) needs to be completed. The remaining platform and equipment DPS templates will be published by 16 December 2015, but should you need a specific DPS before then, please contact the Reporting Helpdesk and we will be happy to help you.

**5.6 What are the SSRO's expectations regarding the completion of reports if a DPS template was not available upon contract award, but is later issued during the contract performance period?**

An updated DPS should be provided when a Quarterly or Interim Contract Report is submitted.

**5.7 On the existing examples we have we are providing a comprehensive CPS with levels of detail applicable to a DPS template. Will the contract award be delayed while we retrospectively apply the DPS and its guidance?**

The DPS needs to be submitted to the SSRO as part of the Contract Pricing Statement which are required within 30 days after the QDC has been signed. As such this will not delay contract award.

**5.8 The user guides for completing the DPS state that we should submit mapping documents from our work breakdown structure to programme management costs and to the DPS. Is this a regulatory requirement and why is it needed?**

This is not a requirement imposed by the Regulations. The information is requested as it helps the SSRO to see how the cost model has been mapped to the DPS. This enables us to establish if consistent mapping has been carried out when the DPS is updated in the interim contract reports and completion report.

**5.9 How can a DPS template be completed when the costs have not been finalised?**

Contractors should complete DPS templates as far as possible. This requires a description of the facts, assumptions and calculations relevant to each element of the Allowable Costs used to determine the contract price. If only provisional rates are available or contractual items are to be priced at a later time, the required description must still be provided. In such cases a more detailed description of the facts, assumptions and calculations may be required in order to assess how the costs used in the contract price have been arrived at.

## 6. User guides and reporting templates

### 6.1 What are the requirements of completing the Strategic Industry Capacity report?

The Strategic Industry Capacity report should be provided as a narrative text document and the requirements for it are detailed in the user guide published on our website.

Due to the bespoke nature of the Strategic Industry Capacity report there is no report template.

The [User Guide for Strategic Industry Capacity Report can be found on the SSRO website](#).

### 6.2 How would the person ('P') know if the ongoing contract condition is met in relation to the financial year such that PART 6\* of the Regulations applies to the ultimate parent undertaking in relation to P?

The requirement to provide these reports\* only applies where P or an associated person is a party to a QDC over the value of £20 million for the financial years ending on 31 March 2016 and 31 March 2017 and £50 million for subsequent years.

The requirement to provide these reports will only apply in financial years where the ongoing contract condition is met. The ongoing contract condition is met in relation to a financial year if at any time in that year obligations relating to the supply of goods or services under one of [those high value contracts] are outstanding.

There is no value attached to the outstanding obligations, it is simply a question of whether obligations under those high value contracts are still outstanding in each financial year. P would need to work out whether P itself or an associated company is party to one of these high value QDCs. If so, the designated person must provide reports for each year that there are obligations outstanding under that high value QDC.

\* Actual rates claim report, QBU actual cost analysis report, Estimated rates claim report, QBU estimated cost analysis report, Estimated rates agreement pricing statement, Rates comparison report, Strategic industry capacity report and Small or medium enterprises ('SME') report.

### 6.3 What is a Qualifying Business Unit (QBU) for the purposes of the Supplier Reports?

A qualifying business unit carries out activities for the purposes of an undertaking which is associated with the designated person and has separate financial statements and provides anything for the QDC or QSC.

A QBU is essentially a business unit that is providing activities with a total value of at least £10 million for the purposes of a QDC or QSC to an undertaking which is (or is associated with) a party to or the ultimate parent undertaking of a party to the QDC or QSC. For the purpose of defining a QBU, a business unit in a corporate group is considered:

- a) a unit with separate management accounts; or
- b) an undertaking with separate accounting statements; or
- c) a group of two or more undertakings for which a single set of financial accounting statements is produced.

Regulation 37 stipulates that for each relevant financial year, a QBU estimated cost analysis report must be submitted for each QBU that was a QBU of the designated person in the relation to the financial year immediately preceding the relevant financial year.

#### 6.4 Will QBUs (both direct and indirect) for completion of BUECAR/BUACAR reports cover a specific requirement to report CHQ separately OR ONLY at business unit as a recharge in?

The reports are required for each QBU.

#### 6.5 How can assumptions of inflation in a fixed price contract over multiple years be documented in the reports?

There is no specific section in the QDC reports that allows the SSRO to capture data on inflation. However, it is important for this information to be included in the reports to demonstrate the assumptions and calculations behind the contract price. The best place to record the inflation indices would be in the 'Assumptions' tab in the Contract Pricing Statement. You can either provide supporting material related to this, and list it in the assumptions tab, or provide the details in the subsequent four tabs.

#### 6.6 What supplementary documents and information should be provided with the reports?

The SSRO welcomes any supplementary documentation that would assist us in assessing whether a QDC adheres to our statutory Single Source Cost Standards and the QDC profit rate requirements. This additional information could include a copy of the contract; a description and overview of costs included; a mapping of the contractors work breakdown structure to the DPS; or a paper explaining the nature of amendments to the contract that have resulted in a change to the value reported in a Quarterly or Interim Contract Report. The SSRO has also in the past been provided with a slide pack overview explaining how the QDC will operate and what the contractor is required to deliver or provide, which has greatly aided our understanding.

#### 6.7 What is the purpose of completing the Actual Rates Claim Report and the Estimated Rates Claim Report if we are already required to demonstrate that the cost is directly attributable to a QDC in our tender proposal?

The Actual and Estimated Rates Claim Reports provide details on the estimated and actual recovery rates used on each QDC or QSC held by a Qualifying Business Unit. The information will be used to establish if there is any systematic over and under recovery of overhead costs in relation to the rates system.

#### 6.8 How are QDC and supplier reports submitted to the SSRO and MOD?

Reports are submitted through a secure online portal, to which the SSRO administers access. To be provided with secure access to submit information, contractors need to contact the SSRO Reporting Helpdesk ([helpdesk@ssro.gov.uk](mailto:helpdesk@ssro.gov.uk)) and provide the name of the person responsible for uploading reports and other additional security information. It is important to provide this information to the SSRO as soon as possible after contract award to allow sufficient time to arrange access to the portal before QDC reports are due. The MOD has access to these reports, so there is no need for separate submission to the MOD.

#### 6.9 How can mistakes be corrected in reports that have already been submitted to the SSRO?

Should an error in a report need to be corrected, a new version of the report must be uploaded to DefCARS. Instructions on how to do this are set out on page 8 of the portal submission User Guide.

Additional documentation can be uploaded and linked to existing reports for the relevant QDC or QSC. Further information is available on additional data uploads on page 9 of the portal submission User Guide.

#### 6.10 Are QDC/QSC report submission due dates affected if a contract is backdated to start before the contract award date?

Reports for the Contract Pricing Statement, Contract Reporting Plan and Contract Notification Report are due within one month after the contract award or signature date, and this requirement remains unchanged if the contract is backdated to commence before the award date.

The Contract Reporting Plan template currently generates report due dates based on the contract start date. In circumstances where the contract award date is after the contract start date, the report due dates can be amended manually in the sections beneath where the contract start date is inputted.

#### 6.11 Is information given in report 'annual profiles' required to be from the financial year of the contract start date or the financial year prior to the contract start date?

Regulation 22(5) requires annual profiles to be “of financial years from that in which the contract was entered into until that in which the contract completion date falls or is expected to fall”. The first annual profile is therefore required for the financial year in which the contract was awarded or entered into, and not necessarily the financial year of the contract start date, if there is a discrepancy between the two dates.

#### 6.12 The QBU Actual and Estimated Cost Analysis Report only allows for 20 lines of data under Tab 12 (Agreed Rates). How should the template be completed if a QBU has more than 20 lines?

Currently the templates do not allow for the number of lines to be increased. A future update to the template planned to be issued on 31 March 2016 will correct this. Version 2 of the template will have in excess of 80 lines. In the interim, multiple templates can be completed and submitted to accommodate any QBUs with more than 20 lines. Additional templates should be referenced in the comments sections of Tab 12 in the first template.

#### 6.13 How can foreign currencies be added to reports templates where required?

The Regulations require that Contract Notification Report (25(2)(i)), Interim Contract Reports (27(4)(l)) and Contract Completion Reports (28(2)(n)) contain annual profiles of all contract payments made or that will be made that are priced in currencies other than GBP.

Relevant currencies can be inserted into the “Not used” headings under “02 Pricing Analysis – Currencies and Commercial Constructs” in the “Contract” tab in report templates. This will be reflected in tabs that require annual profiles to be inputted.

#### 6.14 What is a “cost recovery rate” for the purposes of reporting?

Regulation 2(b) defines the “cost recovery rate” as the “rate calculated for a business unit that is used to determine a cost payable under a contract, being a rate per unit of a cost recovery base that is multiplied by the quantum of that cost recovery base to determine the cost”. The Regulations also state that a “cost recovery base” is “the unit of measure to which a cost recovery rate is applied in order to calculate a cost under a contract”.

Regulation 24(f) requires the Contract Reporting Plan to include a “list of the cost recovery bases, (i) that were used, or are expected to be used, in the determination of the contract price; and (ii) that the contractor will use in making the reports required by this Part.”

### 6.15 Can provisional rates be used in reports?

Contractors may include provisional rates in reports, notably the Contract Pricing Statement (CPS), when confirmed rates are not available. Provisional rates should be supported by the inclusion of assumptions about what the rates are based on, and should be replaced in reports with confirmed rates at the earliest reporting opportunity. This change is normally shown in Quarterly Contract Reports (QCRs) or in Interim Contract Reports (ICRs). Where significant time periods exist between reports due, notably between the CPS and ICR submission for QDCs under £50 million where QCRs are not required, it may be appropriate to resubmit an updated CPS with confirmed rates.

### 6.16 What are 'delivery milestones' in reports?

The Regulations require the Contract Notification Report (CNR), Quarterly Contract Report (QCR), Interim Contract Reports (ICR) and the Contract Completion Report (CCR) to provide a list of 'all delivery milestones set out in the contract'. Each report must include a list of the milestone delivery dates set out in the contract, where available. The QCR, ICR and CCR must include the 'actual or expected date for each delivery milestone'. The CCR must include a 'description of the causes of any variance between the expected date for a delivery milestones set out in the contract and the actual or expected completion date'. The Strategic Industry Capacity Report must include a list of 'key delivery milestones for all work currently being undertaken by the designated person (or any person associated with the designated person) for qualifying defence contracts, qualifying sub-contracts or other defence contracts ("current committed work")'.

### 6.17 When resubmitting a corrected reports should C1 or S2 be used to name the report?

The SSRO uses C (correction number) and S (submission number) to identify submitted reports. The S number refers to the version of the report being submitted. For instance, the submission of a second Quarterly Contract Report should be named QCR\_S2.

The C number should be used to name reports where a corrected or amended version is being uploaded, which is still regarded as part of the submission to which it relates. For example, where a corrected Contract Pricing Statement is being uploaded, it should be CPS\_S1\_C1. Should a further correction to that report be needed, the report should be named CPS\_S1\_C2.

### 6.18 Is there an SSRO template for a supplier's cost buildup that is required to be completed prior to contract award?

The SSRO does not prescribe the format for documenting and supporting the inclusion of Allowable Costs, and no such information is required prior to submitting the first three reports. Suppliers are responsible for determining how to demonstrate compliance with the SSRO's statutory guidance on Allowable Costs, the Single Source Cost Standards and for telling us if they have deviated from our guidance. However, suppliers are required to include the facts, assumptions and calculations used in the cost build-up. These are to be included either in the Contract Pricing Statement (CPS) or to be cross-referenced to supporting documentation submitted with the CPS.

SSRO Answer 6.6 provides examples of appropriate formats for supporting documentation.

**6.19 Where should programme management costs be reflected in Business Unit Estimated Cost Analysis Reports?**

We recommend that programme management costs should be reflected in Tab 02 Cost Analysis BU HQ Other column.

**6.20 What version of the guidance does the section 'Remove disallowed costs' in the 02 Pricing Analysis table of the Business Unit Estimated Cost Analysis Reports relate to?**

The relevant version of the Single Source Cost Standards to be considered is that which was in place at the time of contract award. As defined in Regulation 2(1) of the Single Source Contract Regulations 2014, the time of agreement will change if the contract price is re-determined.

## 7. Interpretation of PART 6

### 7.1 What is the SSROs definition and interpretation of designated person (responsible officer) in Regulations part 6, 31/32 in relation to Reports on Overheads and Forward Planning etc.

The designated person is a person or supplier that is party to one or more qualifying defence contracts (QDCs). However where that supplier is associated with one or more other suppliers or entities the designated person is the ultimate parent undertaking of those persons or entities.

### 7.2 What does 'what it provides' contained in regulation 32(4) comprise?

1. Regulation 32(5)(e) offers an interpretation of 'what it provides'. It:

“provides anything for the purposes of any qualifying defence contract or qualifying sub-contract to which the designated person, or any person associated with the designated person, is party.”

### 7.3 If the £10 million is only exceeded for some of the relevant accounting periods, does the obligation under Part 6 apply to the relevant accounting period to which the costs relate or to the period when the reports are due?

An accounting period is relevant if it ends on a day within a relevant financial year (Regulation 32(2)). The reporting obligations apply for accounting periods where what the unit or undertaking or group of undertakings has provided for the purposes of a QDC exceeds £10 million in that accounting period (Regulation 32(3),(4),(5)).

### 7.4 Strategic Industry Capacity report - If the value set out within the regulation ceases to be exceeded during a financial year, when does the obligation to produce reports set out in Part 6 cease to apply?

The value for these obligations to be triggered applies to the QDC as a whole and not the ongoing contract condition. Therefore, the obligation to produce reports applies to each financial year where there are still obligations outstanding under the contract.

## 8. Referrals

### 8.1 If a contracting authority and its qualifying sub-contractor are unable to agree whether 'the Allowable Costs relating to the amendment are severable from the Allowable Costs before the amendment', will the SSRO be willing to take a referral from the contracting authority?

Yes. This would be a referral for an opinion and not a determination.

The SSRO's authority for accepting such a referral would come from either Section 35(1)(a) or Section 35(3) (on a joint referral).

Under section 35(1)(a) the SSRO must give an opinion on matters relating to a QDC where that matter is specified in the Regulations on referral by the Secretary of State, a primary contractor (for QDC) or contracting authority (or person proposing to enter into QSC) for sub-contracts.

Alternatively, the SSRO would require a joint referral from the MOD and primary contractor or MOD and sub-contractor under Section 35(3) to give an opinion on this.

### 8.2 Can a request be made to the SSRO for determinations on older extant contracts that were previously referred to the Review Board for Government Contracts (Profit Review Board)?

Yes, the SSRO is required under the DRA 14 Section 35 (7) to make determinations or give opinions on these referrals.

### 8.3 Does the SSRO accept that whatever is agreed by both the MOD and the contractor to form the final contract price is a commercial negotiation and 'final'?

The Act and the Regulations make clear that single source defence contracts must be priced in accordance with the formula: price = AC + (CPR x AC). The profit rate must be calculated in accordance with the prescribed six-step process and costs must be Allowable Costs. The parties must have regard to the SSRO's statutory guidance.

The SSRO will see details of the pricing structure when reports are provided in accordance with Part 5 of the Regulations. The SSRO will prepare compliance reports in accordance with its published methodology which mark a contract as non-compliant if it has not been correctly priced under the scheme.

The parties may seek specific guidance from the SSRO in the course of negotiations by making a referral for an opinion. If both parties make the referral then there is no limit to the questions which can be raised. If a single party makes the referral, then the questions which can be raised are:

- (a) the appropriate amount of adjustment under steps 2, 3 or 6 of determining the contract profit rate;
- (b) the appropriate amount of group cost risk adjustment, group POCO adjustment or group capital servicing adjustment;
- (c) any question relevant to the cost recovery rates that should be used to estimate likely Allowable Costs;
- (d) the extent to which a particular cost would be an Allowable Cost.

Obtaining an opinion prior to signing the contract may provide a degree of certainty for the parties regarding the agreed price.

If a pricing issue arises after the contract is signed, the parties may still seek an opinion from the SSRO. Alternatively, a determination may be sought from the SSRO on prescribed matters, such as: the extent to which a particular cost is an Allowable Cost; and whether the amount of an adjustment agreed under step 2, 3 or 6 is appropriate.

If the matter is referred for a determination once a contract has been signed, the SSRO may determine that the price is to be adjusted by a specified amount. Determinations are final, in that parties to a referral are legally obliged to follow the instructions contained in the determination. In these circumstances the SSRO could retrospectively over-rule and disallow costs agreed by the contracting parties or may adjust the contract profit rate.

**8.4** Can the SSRO confirm that where it provides a pre-contract opinion – provided there is no change to the material facts – that it would not revise its position if post-contract it was asked to provide a determination?

Provided that there is no change to the material facts the views and reasoning of the SSRO in a determination would be expected to be consistent with the views and reasoning in the prior opinion on the same matter.

If these responses do not answer your specific questions please email the SSRO helpdesk:

**[helpdesk@ssro.gov.uk](mailto:helpdesk@ssro.gov.uk)**

