

# Single Source Contract Regulations 2014 Guidance

## Chapter 4 Pricing a Qualifying Defence Contract: The Profit Element

### Purpose

1. The guidance in this chapter relates to Qualifying Defence Contracts and applies equally to Qualifying Sub-contracts unless stated otherwise. To assess whether you are dealing with a prospective or actual Qualifying Defence Contract (QDC) or Qualifying Sub-contract (QSC) you must read [Chapter 2 Qualifying Defence Contracts](#).
2. The guidance does not apply to other single source contracts (Non-qualifying contracts). You must read the [Pricing of single source Non-qualifying contracts](#) Commercial Policy Statement and [Commercial Cascade 06/2017](#) if you assess your contract is a Non-qualifying contract.
3. If you are dealing with a prospective or actual QDC you must read this chapter to understand how to determine the Contract Profit Rate (CPR). This chapter explains:
  - a. the six steps you must follow to determine the Contract Profit Rate (CPR) in accordance with the Defence Reform Act 2014 (DRA);
  - b. why your contractor must provide the information necessary to calculate certain elements of the CPR in particular the Profit On Cost Once (POCO) calculation (step 3) and the Capital Servicing Adjustment (CSA) calculation (step 6);
  - c. what profit rate should be applied if you amend a QDC; and
  - d. what you can do if you are unable to reach agreement with your contractor on elements of the CPR calculation.
4. You can find more information about the pricing formula and Allowable Costs in [Chapter 3 Pricing a QDC: the Cost Element](#).
5. This chapter has been created as definitive guidance for MOD Commercial Officers so 'you' indicates an action on the Commercial Officer.

### What is the Legal Framework?

6. The primary legislation is the [Defence Reform Act 2014 \(DRA\)](#). Section 17 of the DRA sets out the six steps for calculating the CPR.
7. The secondary legislation is the [Single Source Contract Regulations 2014 \(SSCR\)](#). Regulation 11 of the SSCR sets out further details about the six steps for agreeing the CPR.

## Confidentiality – Criminal Offence of Unauthorised Disclosure

8. The DRA requires contractors with QDCs to keep relevant records, which the MOD may access. Contractors must also provide a range of standardised reports to the MOD and the Single Source Regulations Office (SSRO). Much of the information received will be commercially sensitive and you must handle it accordingly.

9. Schedule 5 of the DRA details a list of 'permitted disclosures' in relation to this information, and information derived from it. You can find detailed guidance on your confidentiality obligations in relation to Schedule 5 protected information at [Chapter 9 Confidentiality](#).

## What are the Six Steps for Calculating the CPR?

10. You must calculate the CPR for a QDC by taking the following six steps as laid down at Regulation 11 of the SSCR.

### Step 1: Baseline Profit Rate (BPR)

11. The BPR is the largest element of the total profit rate calculation.

12. The BPR is determined annually based on a recommendation by the Single Source Regulations Office (SSRO) to the Secretary of State for Defence. The SSRO's recommendation is an independently set, fair and reasonable starting point for the calculation of the CPR for all QDCs. You can find the latest BPR at Annex A.

13. The BPR is published in March each year and will take effect from 1 April of the same year. If you price your QDC before the updated BPR is announced in March, but do not enter into the contract until 1 April or after, you must use the newly published BPR to calculate the CPR. If you price a contract after 31 March and the rates at Annex A have not been updated you must contact the [Commercial Policy Help Desk](#) for assistance.

### Step 2: Cost Risk Adjustment

14. The BPR represents a fair return for an average risk contract. The cost risk adjustment is to account for the contractor's financial risk that actual Allowable Costs incurred during the contract may differ from the estimated Allowable Costs used in pricing.

15. You must agree a risk adjustment with your contractor within the range specified by the SSCR of plus or minus 25% of the BPR. For example, if the BPR is 7.46%, the permitted risk adjustment is any point (including zero) between minus 1.87% and plus 1.87% (i.e. plus or minus 25% of 7.46%).

16. To negotiate the risk adjustment with your contractor you must follow the Single Source Statutory Guidance on Adjustments to the Baseline Profit Rate, published on the [SSRO website](#). The SSRO website also includes consultative and archive documents, so you must take care to use the current Statutory Guidance. If for any reason you wish to agree a 'step 2' risk adjustment that

deviates from the Statutory Guidance, you must consult with the MOD Single Source Advisory Team (SSAT) [DESComrc1-SSAT-1 \(MULTIUSER\)](#)

17. The contractor must record the agreed risk adjustment, including details of any deviation from Statutory Guidance, in the Contract Pricing Statement (CPS). See [Chapter 3 Pricing a QDC, the Cost Element](#) and [Chapter 5 Contract Reporting](#), for more information on the CPS.

18. If the risk adjustment cannot be agreed then either party may refer the matter to the SSRO pre-contract award, for an advisory non-binding opinion of what the SSRO believe the adjustment should be. In addition either party can refer this matter to the SSRO after contract award for a binding determination. Unless circumstances have changed it is likely that a binding determination by the SSRO would follow their previous advisory opinion, if they had been asked to provide one. See paragraphs 69 -76 for further information.

### **Step 3: Profit On Cost Once (POCO) Adjustment**

19. First, it is important to understand that it is the contractor's responsibility, not yours, to produce the POCO calculation. Guidance on the methodology your contractor must use is contained in the SSRO Statutory Guidance published on the [SSRO website](#). It is the MOD's responsibility to verify the calculation submitted by the contractor; this can be complex and if you have not already secured CAAS support you should task them (via a DEFFORM 122) to review the contractor's POCO calculation.

20. A POCO calculation may be required when a QDC includes commercial supply chains in which one or more single source sub-contracts are awarded between different companies or business units within the same group. Additional profits above those agreed by MOD for the prime contract can occur when the prime contractor places single source sub-contracts with companies or business units to which they are related<sup>1</sup>.

21. This is because the group sub-contractor's invoice to the prime may legitimately include an element of profit (groups of companies often operate as separate profit and accounting centres). The invoiced price from the group sub-contractor (i.e. cost plus profit) then becomes a cost to the prime, which is charged to the MOD and attracts the agreed prime contract profit rate. This means that although the MOD has paid the contract profit rate on the prime's costs, the true profit rate paid will actually be higher, because the prime's costs include the undisclosed group profits. When the contract is high value and there are many such transactions, the sums involved can be significant.

22. MOD should not pay these additional, undisclosed group profits within the QDC prices it agrees with prime contractors. The purpose of the 'step 3' POCO adjustment is to eliminate these group profits, to ensure that the prime contractor's group only earns profit on group costs once. Note that the adjustment only applies to sub-contracts over £100k placed with related

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<sup>1</sup> A prime contractor will pay profit to a sub-contractor that is not related to the prime's own group, and the prime will then add their own agreed profit rate to that sub-contract. This is generally acceptable and is not the matter under discussion here. The term 'profit on cost once' only refers to the additional profit that may arise on a contract because of single source pricing between related group companies.

companies using a single source procurement route (i.e. the adjustment does not apply to any transactions where the prime can show that a group sub-contract was awarded under genuinely competitive conditions).

23. If your contract does not include any single source group sub-contracts then there will be no profit on profit to eliminate and the POCO adjustment will be zero.

24. If your contract does include single source group sub-contracts but the contractor can demonstrate that inter-group profits have been eliminated from the cost base (whether priced at the outset on estimated costs or later on the basis of actual costs), and will also be eliminated from subsequent contract cost reporting, the POCO adjustment will be zero.

25. If group sub-contract profits are built into the prime's costs, the contractor and the MOD must agree a 'step 3' POCO adjustment, which will be a percentage rate by which the CPR is reduced. The 'step 3' adjustment can only ever be a zero or negative adjustment, it can never be an addition. The POCO adjustment will adjust the contract price to be the same as it would have been if the inter-group profit had not been included. As a result, although the contractor can choose to take profit wherever they wish within the group supply chain, the MOD will only pay the agreed profit rate on group costs once. If CAAS are unable to assist then your team should carry out the verification exercise. Your contractor should explain how the calculation has been performed, and provide evidence for the key data inputs. For example, the methodology explained in the SSRO Statutory Guidance requires the input of the estimated group-subcontract costs and agreed inter-group profit levels, so your contractor needs to demonstrate the accuracy of these inputs.

26. While it is important you carry out these checks on the reasonableness of the contractor's calculation, you should also consider the materiality of the adjustment in relation to the total contract value. If sub-contracting values are only a minor element of the price, then the impact of the calculation is unlikely to be materially significant on the contract price.

27. The contractor must follow the SSRO Statutory Guidance on the POCO calculation. If you believe a deviation to the Statutory Guidance is appropriate, you must consult with the MOD SSAT. The contractor must record the agreed POCO adjustment in their Contract Pricing Statement (CPS). They must also record the justification if departing from the Statutory Guidance.

28. If the POCO adjustment cannot be agreed by the parties, then either party may refer the matter to the SSRO before contract award for an advisory non-binding opinion. Either party can also refer the matter to the SSRO after contract award for a binding determination. See paragraphs 69 -76 for further information.

## **Step 4: Single Source Regulations Office (SSRO) Funding Adjustment**

29. The role of the SSRO is to oversee and maintain the SSCR and uphold the rights and obligations of both parties to a QDC. See [Chapter 11 The Single Source Regulations Office](#) for more information on the SSRO. The legislation

enables a contribution towards SSRO running costs from industry, through the calculation of a funding adjustment to the CPR. The SSRO funding adjustment is determined annually and will decrease the CPR.

30. The current 'step 4' SSRO Funding Adjustment is at Annex A.

### **Step 5: Incentive Adjustment**

31. This adjustment is solely at the MOD's discretion and contractors should not presume it will be applied. It must only be used in cases where the MOD sees a genuine benefit in incentivising and paying more for an enhanced level of performance over and above the contracted performance requirement.

32. Where MOD has no requirement in the contract for an enhanced level of performance linked to additional payments, the incentive adjustment will be zero.

33. If MOD does wish to incentivise performance the adjustment allows a contractor some additional profit as a reward linked to exceptional performance on a specific contract output i.e. a positive incentive. This adjustment cannot exceed the maximum of 2% of the Allowable Costs.

34. The 2% maximum includes all performance incentives under the contract, for example any payments linked to key performance indicators (KPIs). You should aggregate all potential incentives specified in the contract to ensure they do not exceed 2% of the Allowable Costs. Note that for TCIF contracts, you should base the aggregate on the target cost (i.e. the 2% is about performance incentives and excludes any future cost underrun / overrun shareline adjustments).

35. Key points to consider in agreeing the incentive adjustment rate are as follows.

- a. Determine any incentive payments based on the contractor's wider portfolio or programme performance.
- b. Determine any incentive payments based on specific contract performance, for example stretch schedule milestones, specific service availability targets.
- c. Agree the parameters / outcomes to be linked to any incentive payments. You must define specific and measurable metrics and how they will be measured to determine payment of any incentive.
- d. Ensure you define all incentive payments, metrics and their measurement terms in the contract.
- e. Calculate the absolute value of all potential incentive payments, and confirm the total is within the maximum permitted value of 2% of Allowable Costs.
- f. Gain approval through your usual Commercial Assurance route for the metrics, incentive values and total potential adjustment.

36. Although the incentive adjustment is expressed as an addition to the CPR agreed at the time of contract award, you will need to express the contract and

payment terms so that this element is not paid if the incentivised performance targets are not achieved.

37. You must follow the SSRO Statutory Guidance if you wish to include an incentive adjustment. You must consult with the MOD SSAT, if you believe a deviation to the Statutory Guidance is appropriate. Any deviation from Statutory Guidance must be justified and recorded in the Contract Pricing Statement, see Chapter 3 The Cost Element.

38. This incentive will increase the CPR or, if no incentive is awarded, the adjustment will be zero.

## **Step 6: Capital Servicing Adjustment**

39. It is important to understand that it is the contractor's responsibility, not yours, to produce the CSA calculation. Guidance on the methodology your contractor should adopt is contained in the SSRO Statutory Guidance published on the [SSRO website](#). It is the MOD's responsibility to verify the calculated CSA submitted by the contractor and subject it to due diligence. You may be able to get CAAS support for this task and in some cases a CSA adjustment for your contractor may already have been agreed with MOD.

40. The Capital Servicing Adjustment (CSA) ensures the contractor receives an appropriate return on the investment they have made in fixed capital (e.g. buildings, plant, equipment etc.) and working capital (e.g. inventory, cash flow) required to deliver the contract.

41. The CSA is specific to a contractor's business unit because different business units will use different mixes of fixed and working capital. The CSA methodology is familiar to the MOD and many of its contractors, since it pre-dates the DRA / SSCR. The CSA is calculated using a contractor's Cost of Production to Capital Employed (CP: CE) ratios, usually investigated by CAAS as part of an annual, formalised 'Rates Programme'. Once the investigation is completed, CAAS will make a recommendation to the senior commercial officer allocated as the lead for a named contractor and, if accepted, the CSA adjustment will become the 'MOD agreed CSA adjustment' for use in pricing single source work.

42. You can check whether there is a current MOD agreed CSA adjustment for your contractor by contacting [DES CAAS-Acct-DepHoP4](#), copied to [DES CAAS-Acct-DepHoP-SL](#). Where an agreed CSA adjustment already exists, you should use this unless you are aware that it has become materially inaccurate (in which case you should advise CAAS).

43. If there is no MOD agreed CSA adjustment for your contractor you may still be able to obtain CAAS support in verifying the contractor's claimed CSA 'step 6' adjustment. You should task CAAS to provide this support by completing a DEFFORM 122.

44. If CAAS are unable to provide support to verify the contractor's CSA calculations, this does not alter the contractor's obligation to calculate a 'step 6' adjustment that complies with the DRA / SSCR, in accordance with the Statutory Guidance. At Annex C of the Statutory Guidance on Adjustments to the Baseline Profit Rate, there is a worked example of how to calculate the step 6 CSA

adjustment. Your responsibility is to perform due diligence on the evidence provided by the contractor, to satisfy yourself that the adjustment is justifiable.

45. You can find the **latest CSA rates at Annex A**. The published rates are 'returns on capital' and it is very important that you understand they must not be directly applied to contract costs. **The rates at Annex A must be converted into 'returns on costs'** which are specific to an individual contractor, and which can then be applied as the 'step 6' adjustment when pricing a QDC.

46. The CSA rates are published in March each year and take effect from 1 April of the same year. If you have priced your QDC before new CSA rates are announced in March, but you award the contract on 1 April or after, you must update your Contract Profit Rate to reflect the new CSA rates.

47. If you price a contract after 31 March of the current year and the rates at Annex A have not been updated you must contact the [Commercial Policy Help Desk](#) for assistance.

48. The CSA will in almost all cases increase the CPR although in exceptional cases it may decrease it.

49. If the parties cannot agree the CSA adjustment, then either party may refer the matter to the SSRO pre contract award, for an advisory non-binding opinion. Either party can also refer the matter to the SSRO after contract award for a binding determination. Unless circumstances have changed it is likely that a binding determination by the SSRO would follow their previous advisory opinion, if they had been asked to provide one. See paragraphs 69 - 76 for further information.

## How do you use the Contract Profit Rate?

50. The table below summarises how the CPR is calculated by applying the six steps once all adjustments have been determined. Annex B shows an example of how to calculate the CPR.

Steps	Action Add (+) or Subtract (-)	Adjustment	Method
Step 1	Start	Baseline Profit Rate (BPR)	Take the BPR in force at the time of agreement (see Annex A).
Step 2	+ or -	Cost Risk Adjustment	Adjust step 1 by an agreed amount within +/- 25% of the BPR.
Step 3	-	Profit On Cost Once (POCO) Adjustment	Deduct from step 2 the POCO adjustment. If POCO does not apply the adjustment is zero. It is important to understand the POCO adjustment can never be an increase.
Step 4	-	Single Source Regulations Office (SSRO) Funding Adjustment	Deduct from step 3 the SSRO funding adjustment in force at the time of agreement (see Annex A).
Step 5	+	Incentive Adjustment	At MOD's sole discretion, increase step 4 to give the contractor a financial incentive to deliver a specified, enhanced level of performance. The amount must not exceed 2% of AC.
Step 6	+ or -	Capital Servicing Adjustment (CSA)	Increase or decrease step 5 by the amount of the CSA calculated in accordance with SSRO Statutory Guidance.

51. On completion of all six steps, you can use the CPR percentage to calculate the contract price using the pricing formula:

$$\text{Allowable Costs} + (\text{Allowable Costs} \times \text{Contract Profit Rate}) = \text{Contract Price}$$

52. Once the contract price is calculated, the CPR will not change other than in relation to future contract amendments or elements not priced at the time of contract award (e.g. tasking) see paragraphs 55 - 61 below.

53. Ideally, a contract should have one CPR. However where different pricing methods have been used and a single CPR is inappropriate, you may decide to calculate separate profit rates for the different elements of Allowable Costs.

## Profit Rate on Contract Amendments

54. If you amend a contract that is already a QDC, you must negotiate the amendment price using the Baseline Profit Rate (step 1), the SSRO funding adjustment (step 4) and the CSAs (step 5) that are in force at the time that you make the amendment to establish and agree the Contract Profit Rate for that amendment.

55. When you award a QDC you must not include any contractual clauses or agreements to price future amendments using the original contract profit rate. If you do include such provisions they will be invalid and have no legal force as QDC amendments must be priced using the profit rate and adjustments that prevail at the time of making the amendment. However this would not apply to any Options that are fully priced at contract award – these would use the profit rate at the time they are priced (i.e. at contract award), even though they might not be exercised until some point in the future. The key point is ‘when the work is priced’ – whenever that is, it is the profit rate and adjustments in force at that time which will apply to the pricing.

56. The pricing of QDC contract amendments is governed by Regulation 14 of the SSCR, which presents some difficulties that the MOD, Industry and the SSRO are currently discussing as part of the first statutory review of the SSCR, due to complete in December 2017. Any changes to the SSCR are likely to be actioned in 2018.

57. Regulation 14 classifies contract amendments as ‘severable’ or ‘non-severable’. Where the costs of the original contract price and the amendment cannot be separated out, the amendment is ‘non-severable’ in SSCR terms. This presents difficulties regarding the extent to which the contract price needs to be re-determined and what profit rate is applicable.

58. Where the amendment can be priced separately from the original contract price, Regulation 14 of the SSCR defines this as a ‘severable amendment’, which is more straightforward to price. In this case the amended total contract price will be:

- a. the total of the original contract price; plus
- b. any price increase or price reduction payable under the contract which is attributable to the amendment.

59. MOD policy, following Central Legal Services (CLS) advice on the interpretation of Regulation 14, is that until the SSCR 2017 statutory review is complete, an approach should be adopted which classifies most amendments as ‘severable’.

60. MOD calls this the ‘delta approach’, which means that the profit rate in force at the time of the amendment should only be applied to the £ delta (i.e. the difference) between the total Allowable Costs before the amendment, and the total Allowable Costs after the amendment. This £ delta in the Allowable Costs is

the value of the 'severable' element. It is easier to understand this approach by considering the worked example at Annex A to [Chapter 3 Pricing a QDC: The Cost Element](#).

## Sub-contract Pricing

61. A single source sub-contract may be a qualifying contract under the DRA / SSCR if placed at any level of the supply chain on a non-competitive basis, predominantly for the purposes of delivering a QDC or group of QDCs, or prospective QDCs, and has a value of £25M or more. If a sub-contract meets the criteria as a qualifying contract it is called a Qualifying Sub-contract (QSC). You can find further information on QSCs in [Chapter 2 Qualifying Defence Contracts](#).

62. The CPR for a QSC must be calculated in the same way as a QDC. It is the responsibility of the procuring contractor to agree the CPR for any sub-contracted work with a qualifying sub-contractor, in accordance with the DRA / SSCR. If it is not compliant, the sub-contractor is exposed to the risk of a subsequent referral by the MOD to the SSRO, to determine a CPR that is consistent with the DRA / SSCR.

63. The normal relationship in a supply chain is between the MOD and the prime contractor, and the prime and the sub-contractor. However, where the sub-contractor has good reason not to share sensitive commercial information with the prime contractor, some elements of the pricing, reporting and auditing regime operate directly between the MOD and the sub-contractor.

## Group Profit Rates

64. In some cases, you may decide to agree group profit adjustments across two or more QDCs, for example, a large number of comparatively low value QDCs placed with one contractor within a particular period. In this case, it may be more efficient to determine one CPR which can be used for the group of contracts as a whole rather than assess each one individually.

65. You may only agree group adjustments with a contractor for three steps of the CPR: steps 2 (risk), 3 (POCO) and 6 (capital servicing rate) in accordance with the guidance explained previously in this chapter. You must determine steps 1 (BPR), 4 (SSRO funding adjustment) and 5 (incentive adjustment) using the published rates relevant at the time the contract is entered into in the same way as for a single QDC.

66. You may only use agreed group rates for any QDCs entered into within one year from the date that the group rate is agreed.

67. The application of group profit adjustments does not apply to sub-contract pricing.

## Disputes and Remedies

### SSRO Opinions

68. If there is a matter of dispute with the contractor that is preventing the agreement of the CPR, you must attempt to resolve the matter through local negotiations and escalation as necessary. If you cannot resolve the matter

through negotiation, you may wish to seek an opinion from the SSRO. However, you must not approach the SSRO directly; you must first involve the MOD [SSAT](#).

69. During the pre-contract phase, the SSRO may give an opinion on any pricing matter if both parties agree to make a joint referral. Certain other matters may be unilaterally referred to the SSRO for an opinion, by either the MOD or the contractor. Either party can refer to the SSRO for a non-binding opinion for adjustments under steps 2 (risk), 3 (POCO), or 6 (CSA) of the CPR calculation. This also applies to group adjustments (see paragraphs 65 - 68). Steps 1 (BPR) and 4 (SSRO funding adjustment) are determined by the SSRO. Step 5 (incentive adjustment) is at the discretion of the MOD and is not referable.

70. An SSRO opinion made before contract award is not legally binding but will provide a clear indication of how the SSRO believe the pricing dispute should be resolved. This is important because either party can refer the matter again for an SSRO determination once on contract (see SSRO determinations below). In this scenario, the SSRO must maintain its original position unless there has been a significant change of circumstance.

## SSRO Determinations

71. Once on contract, (including QSCs) the MOD or the contractor (or sub-contractor) may seek a legally binding determination on certain matters relating to the CPR. Either party may ask the SSRO to make a legally binding determination if they consider that, based on information available to either party at the time the QDC was entered into, an adjustment under steps 2 (risk), 3 (POCO), or 6 (CSA) of the CPR calculation was not appropriately agreed. This also applies to group adjustments. If the SSRO establishes that a different adjustment should have been made, it will make a legally binding order for the contract price to be adjusted to what it would have been had the pricing principles been followed.

72. Where you require a determination from the SSRO, you must give at least 20 working days written notice to the contractor asking them to provide evidence of how the principles of the CRP calculation steps 2, 3, or 6 were met. Where at least 20 working days has elapsed and you have not received a response or you have received a response which you consider to be unsatisfactory, you may request a determination. However, you must not approach the SSRO direct, you must first involve the MOD SSAT. You can find more information about how the referrals process to the SSRO operates in [Chapter 12 The Single Source Advisory Team](#).

73. In making a determination about the CPR the SSRO must consider:
- a. the SSCR and Statutory Guidance that was in place at the date the contract was entered into;
  - b. the extent to which each party to the contract has fulfilled its responsibilities under the DRA and SSCR;
  - c. the extent to which relevant Statutory Guidance was followed (and any justification for not following it);
  - d. any relevant previous decisions of the SSRO: and

- e. representations by the parties (and the MOD, where it is not a party i.e. in a QSC).

74. In the event of a referral to the SSRO for a determination, you will be required to provide an audit trail of the pricing assumptions. This must include as a minimum the CPS agreed at the time of agreeing the contract price. Other key pieces of information may include the contract terms and conditions and the pricing model used to agree the price.

75. There are time constraints which both the MOD and the contractor must follow if either decides to refer a matter to the SSRO for a determination. In the case of a determination of the CPR, this referral must occur at the latest within 2 (two) years of contract completion<sup>2</sup>. The SSRO will write to the MOD and the contractor in accordance with agreed timescales for making such a determination, to be set out in [SSRO terms of reference](#). Once made, the SSRO's determination is final and there are no grounds for appeal, except through a judicial review.

## Compliance and Penalty Notices

76. The MOD SSAT has sole responsibility for managing the compliance regime and issuing compliance notices. Responsibility for issuing penalty notices will depend on the value of the penalty, and you must consult with the [SSAT](#) where the contractor has failed in its duties defined within this chapter. You can find further information about the compliance and remedies regime in [Chapter 10 Compliance and Remedies](#).

## Contacts, Training and Further Information

77. The [Web Access Page](#) for the DRA and SSCR contains a summary of the legislation, details of who you can speak to for advice, and what training is available. It also contains links to other chapters in the SSCR guidance and other relevant topics and information.

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<sup>2</sup> Contract completion is defined as the date described in the contract as being the contract completion date. Where no such date exists, the date on which the contractor completes all obligations which entitles it to final payment under the contract, excluding any final price adjustment. If the contract is terminated before either of these events, the date the contract is terminated.

### **What are the key points to remember?**

1. You must calculate the Contract Profit Rate (CPR) in accordance with the process described in this chapter for all prospective Qualifying Defence Contracts (QDC).
2. You must not change or leave out any of the six steps of the CPR calculation (although some steps may result in a nil adjustment) – this would be a breach of the legislation.
3. You should follow the SSRO Statutory Guidance when negotiating the Risk, POCO and Incentive adjustments. You must consult with the MOD SSAT before agreeing to any deviations from the Statutory Guidance.
4. You must ensure you keep a record of all assumptions, agreements and challenges to the calculation of the CPR.
5. Either party may seek an SSRO non-binding opinion (pre-contract) or an SSRO binding determination (once on contract), on the appropriateness of the profit adjustments for Risk, POCO and business unit specific CSAs.
6. Rates for the Baseline Profit Rate, the SSRO funding adjustment and Capital Servicing Allowances are revised and published annually in March and take effect from 1 April. The current rates are produced at Annex A.
7. You must be aware of the serious consequences of unauthorised disclosure of information protected under Schedule 5 of the DRA. Penalties will apply to you personally and may include a fine or imprisonment.

## Annex A

### Rates to be used for QDCs and QSCs from 1 April 2017 to 31 March 2018

Note	Item	Rate
	Baseline Profit Rate (BPR)	7.46%
1	SSRO Funding Adjustment	- 0.025%
2	Capital Servicing Rate – Fixed Capital	4.84%
2	Capital Servicing Rate – Working Capital (positive WC)	1.37%
2	Capital Servicing Rate – Working Capital (negative WC)	0.59%

Published rates apply to pricing of all the following from 1 April 2017:

- New QDCs and QSCs signed on or after 1 April 2017
- Amendments to QDCs and QSCs signed on or after 1 April 2017
- Pricing of additional work where an extant contract converts to a QDC

#### Notes

1. This is the first application of the SSRO funding adjustment (previously 0%).
2. The published Capital Servicing Rates are returns on capital and must not be directly applied to contract costs. **The Capital Servicing Rates must first be converted to returns on cost for the specific contractor pricing unit you are dealing with** and then applied at Step 6 of the SSCR Contract Profit Rate calculation. It is the responsibility of the contractor to calculate their Capital Servicing Allowances - there is an example of how they should do this in the [SSRO Statutory Guidance on Adjustments to the Baseline Profit Rate](#).

## Annex B

# Contract Profit Rate (CPR) Calculation Example

Step 1. Baseline Profit Rate		
Baseline Profit Rate (from Annex A)	=	7.46%
Step 2. Cost Risk Adjustment		
Cost Risk Adjustment (negotiated with the contractor)	=	Nil
Step 3. Profit on Cost Once		
POCO adjustment	=	-0.9%
Step 4. Single Source Regulations Office Funding Adjustment		
SSRO adjustment (obtain from Annex A)	=	-0.025
Step 5. Incentive Adjustment		
When appropriate, as agreed by the MOD (max 2%)	=	+0.4%
Step 6. Capital Servicing Adjustment		
From CAAS or calculate	=	+1.25%

Therefore, in this example the Contract Profit Rate for the QDC is 8.19