

SSRO

Single Source
Regulations Office

Allowable Costs guidance review 2022

Changes for November 2022

Issued: 7 November 2022

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1. Introduction

- 1.1 Section 20 of the Defence Reform Act 2014 (the Act) states that the SSRO must issue guidance about determining whether costs are Allowable Costs under QDCs and QSCs. The SSRO aims to keep its guidance on these matters current and relevant and consult, as required, with stakeholders to provide additional clarity and certainty for those involved in single source defence contracting. The current guidance on Allowable Costs¹ was published in September 2021, following public consultation.
- 1.2 Following engagement with key stakeholders during summer 2022, the SSRO conducted an eight-week public consultation² on proposed changes to its Allowable Costs guidance.
- 1.3 During the consultation period, the SSRO:
 - a. held a workshop on the consultation document;³ and
 - b. received written responses to the working papers from five stakeholders, including the MOD, DSAG, and defence contractors.
- 1.4 The SSRO would like to take this opportunity to thank all those who responded to the consultation for sharing views and evidence with us. All respondents gave permission for their responses to be published and these are available in SSRO (2022) Allowable Costs Guidance Review 2022: Consultation Responses.
- 1.5 A summary of the views and evidence provided by consultation respondents, together with the SSRO's commentary on how these responses have informed the final guidance in the areas on which we consulted, is available in SSRO (2022) Allowable Costs Guidance Review 2022: Summary of Consultation Responses.
- 1.6 Having considered the feedback provided on the proposed guidance, this document presents the changes to the SSRO's guidance that will apply from November 2022. The SSRO will republish its Allowable Costs guidance document in full in November 2022, incorporating the changes set out in this document.
- 1.7 Any queries relating to the revised Allowable Costs guidance for 2022/23 should be addressed to the SSRO's helpdesk (020 3771 4785 or helpdesk@ssro.gov.uk).

¹ [SSRO Allowable Costs Guidance \(Version 5.1\)](#) published 29 September 2021.

² From 24 May to 18 July 2022. See SSRO (2022) [Allowable Costs guidance: overheads and indirect costs consultation on changes](#).

³ 19 July 2022

2. Changes to Allowable Costs guidance following consultation

Key to changes:

No change (moved)
Deleted
Revised
Added

Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation
<p>New 2.2 paragraph:</p> <p>This guidance is intended to assist the parties to determine whether costs are allowable under qualifying contracts. It sets out advice and information on how the parties should assess particular costs under a QDC or QSC against the AAR test. It may also be used to support the formulation of cost recovery rates, which may in due course form part of the price of a qualifying contract. An example is where cost recovery rates are agreed at a business unit level, but not yet applied for the purposes of determining a discrete cost under a contract.</p>	<p>New Paragraph 2.2:</p> <p>This guidance is intended to assist the parties to determine whether costs are allowable under qualifying contracts. It sets out advice and information on how the parties should assess particular costs under a QDC or QSC against the requirements of allowable costs. It may also be used to support the formulation of cost recovery rates, which may in due course form part of the price of a qualifying contract. An example is where cost recovery rates are agreed at a business unit level, but not yet applied for the purposes of determining a discrete cost under a contract.</p>	<p>Change to consistency in referring to the “requirements of allowable costs”.</p>
<p>New Paragraph after new paragraph 2.2:</p> <p>We have provided some illustrative examples to help practitioners interpret and apply the guidance in various situations. The examples should not be rigidly applied. They are intended to assist negotiating parties to use the guidance to determine whether costs are allowable and should not be taken as mandating a particular outcome from application of the AAR test.</p>	<p>Paragraph removed.</p>	<p>Stakeholder feedback suggested that the SSRO's illustrative examples were unhelpful. We have therefore excluded them from this update, but remain open to developing examples in future with stakeholder engagement.</p>

Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation
<p>New Paragraph after para 2.4(now para 2.5):</p> <p>The primary contractor (or sub-contractor) must provide statutory contract reports for any QDC (or QSC), as described in Part 5 of the Regulations. Suppliers may also be required to provide statutory reports on overheads as described in Part 6 of the Regulations. These reports include requirements where contractors and suppliers must report estimated and actual Allowable Costs, including the reporting of cost recovery rates and cost recovery bases used to calculate Allowable Costs. The SSRO has provided separate contract reporting²⁶ and supplier reporting²⁷ guidance which will assist with preparing and submitting the reports required. The reports should be submitted to the MOD and the SSRO using the Defence Contract Analysis and Reporting System (DefCARS).</p>	<p>New Paragraph 2.5:</p> <p>The primary contractor (or sub-contractor) must provide statutory contract reports for any QDC (or QSC), as described in Part 5 of the Regulations. Suppliers may also be required to provide statutory reports on overheads as described in Part 6 of the Regulations. These reports include requirements where contractors and suppliers must report estimated and actual Allowable Costs, including the reporting of cost recovery rates and cost recovery bases used to calculate Allowable Costs. The SSRO has provided separate contract reporting²⁶ and supplier reporting²⁷ guidance which will assist with preparing and submitting the reports required. The reports should be submitted to the MOD and the SSRO using the Defence Contract Analysis and Reporting System (DefCARS).</p>	<p>No Changes</p>

Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation
<p>Former paragraph 2.6 (now para 2.8)</p> <p>The Act and Regulations do not specify what information is required in order to be satisfied that a cost is an Allowable Cost. Information used for this purpose might include relevant records kept by the contractor, information held by the Secretary of State or information available from third party sources. In determining what type and standard of information is required, the relevant parties identified in paragraph 2.2 should take a proportionate approach considering:</p> <ul style="list-style-type: none"> a) the specific requirements and circumstances of the contract; b) materiality and type of particular costs; c) the information that is available and its relevance; and d) what it is reasonable to expect would be available. 	<p>2.8 (formerly para 2.6)</p> <p>The Act and Regulations do not specify what information is required in order to be satisfied that a cost is an Allowable Cost. Information used for this purpose will include relevant records kept by the contractor, information held by the Secretary of State or information available from third party sources. In determining what type and standard of information is required, the relevant parties identified in paragraph 2.2 should take a proportionate approach considering:</p> <ul style="list-style-type: none"> a) the specific requirements and circumstances of the contract; b) materiality and type of particular costs; c) the information that is available and its relevance; and d) what it is reasonable to expect would be available. 	<ul style="list-style-type: none"> • “might” was changed to “will” in response to industry stakeholder feedback. • Similarly “and type” was added to considerations within sub-paragraph b.
<p>3.1 A contractor's costs (which include those already incurred and those which are anticipated) are Allowable Costs in a QDC or QSC to the extent they are appropriate, attributable to the contract and reasonable in the circumstances. The requirements of allowable costs are that they must be appropriate, attributable, and reasonable. Each of these must be met whether the contractor's costs are estimated or actual, and whether they are applied to the contract as a direct cost or as an indirect cost.</p>	<p>3.1 A contractor's costs (which include those already incurred and those which are anticipated) are Allowable Costs in a QDC or QSC to the extent they are appropriate, attributable to the contract and reasonable in the circumstances. The requirements of allowable costs are that they must be appropriate, attributable, and reasonable. Each of these must be met whether the contractor's costs are estimated or actual, and whether they are applied to the contract as a direct cost or as an indirect cost (i.e. one which has been calculated using a cost recovery rate).</p>	<p>Added clarification in response to suggestion from industry.</p>

Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation
3.2 The guidance in this section sets out the typical characteristics of costs that meet the requirements of Allowable Costs. The relevant parties should consider the characteristics when evaluating whether a particular cost incurred by the contractor meets each of the requirements of allowable costs, i.e. the AAR principles.	3.2 Paragraphs 3.12 to 3.15 of this guidance sets out the typical characteristics of costs that meet the requirements of Allowable Costs. The relevant parties should consider the characteristics when evaluating whether a particular cost incurred by the contractor meets each of the requirements of allowable costs.	Paragraph numbers added for clarity. Removed text for consistency in referring to the requirements of allowable costs.
3.4 The relevant parties may agree on differing standards and types of information in evidencing each of the three characteristics of allowable costs.	3.4 The relevant parties may agree on differing standards and types of information in evidencing each of the three characteristics of allowable costs.	No change.
<p>New para after existing paragraph 3.4 (now para 3.5):</p> <p>An assessment against the requirements of allowable cost cannot be fully concluded until a cost is claimed as allowable under a contract. Where this guidance is applied in advance of a cost being applied to a particular qualifying contract (for example when agreeing cost recovery rates for a business unit), the parties should agree which aspects of the requirements of allowable costs can be demonstrated at the time, and those which should be considered once the circumstances of the contract are known. Section 4 of this guidance provides additional guidance on the application of the requirements of allowable costs in the agreement of cost recovery rates.</p>	<p>3.5 (formerly new para after existing para 3.5):</p> <p>Sections 20 of Act sets out the requirements of allowable costs which apply to a particular cost under a qualifying contract. These requirements may be assessed at any time. Where this guidance is applied in advance of a cost being applied to a particular qualifying contract (for example when agreeing cost recovery rates for a business unit), the parties should agree which aspects of the requirements of allowable costs can be demonstrated at the time, and those which should be considered once the circumstances of the contract are known. Section 4 of this guidance provides additional guidance on the application of the requirements of allowable costs in the agreement of cost recovery rates.</p>	<p>Stakeholders expressed confusion regarding this section. It has been amended to clarify that an assessment of allowable costs under section 20 relates to a particular cost under a qualifying contract.</p>

Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation
<p>3.9 (previously paragraph 3.8)</p> <p>References in this guidance to costs that 'enable the performance of the contract' include those suitably and necessarily incurred by the contractor before, at or after the time of agreement to:</p> <ul style="list-style-type: none"> a) deliver the contract in question; or b) deliver multiple contracts including the contract in question, in which case the cost is equitably apportioned to those contracts; or c) ensure the efficient and proper operation of the business of delivering qualifying defence contracts and subcontracts. 	<p>3.9 (previously paragraph 3.8)</p> <p>References in this guidance to costs that 'enable the performance of the contract' include those suitably and necessarily incurred by the contractor before, at or after the time of agreement to:</p> <ul style="list-style-type: none"> a) deliver the contract in question; or b) deliver multiple contracts including the contract in question, in which case the cost is equitably apportioned to those contracts; or c) ensure the efficient and proper operation of the business of delivering defence contracts and subcontracts. 	<p>Removed "qualifying". Industry respondents noted the appropriate scope may extend beyond those of the regime.</p>
<p>3.10 (previously paragraph 3.9)</p> <p>Delivering the contract in question may require sustaining an essential or desirable capability. This may include a capability that is required to deliver the contract in question or similar contracts.</p>	<p>3.10 (previously paragraph 3.9)</p> <p>Delivering the contract in question may require sustaining an essential or desirable capability. This may include a capability that is required to deliver the contract in question or similar contracts in the future. Whether the cost of sustaining an essential or desirable capability is allowable will depend on the circumstances and the contract in question. For example, if there is an explicitly recorded agreement between contracting parties that the MOD requires an essential or desirable capability to be maintained, or other circumstances which would indicate the MOD's ongoing or future need for the capability.</p>	<p>Added text in response to MOD feedback to further assist the parties to understand what may constitute an essential or desirable capability, for the purpose of the allowable costs guidance.</p>

Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation																
<p>4.1 When used in this guidance, the terms direct, indirect and overhead costs have the meanings assigned to them in Table 3. Contractors may use terms which differ from those given. Where those terms are synonymous, or otherwise refer to the same thing, the guidance should be construed and applied accordingly.</p> <p>Table 3: Terms and definitions</p> <table><tr><th colspan="2">Definitions</th></tr><tr><td>Direct cost</td><td>A cost that can be traced to a discrete package of goods, works or services specified under a particular qualifying contract.</td></tr><tr><td>Overhead cost or overhead</td><td>A cost that is used by multiple activities and which cannot be traced, or that the parties agree not to trace, to a discrete package of goods, works or services specified under a particular qualifying contract.</td></tr><tr><td>Indirect cost or indirectly recovered cost</td><td>A cost that is allocated and apportioned to a qualifying contract using a cost recovery rate. Indirect costs may include overheads. Some direct costs, such as labour, may be applied indirectly as a matter of convenience.</td></tr></table>	Definitions		Direct cost	A cost that can be traced to a discrete package of goods, works or services specified under a particular qualifying contract.	Overhead cost or overhead	A cost that is used by multiple activities and which cannot be traced, or that the parties agree not to trace, to a discrete package of goods, works or services specified under a particular qualifying contract.	Indirect cost or indirectly recovered cost	A cost that is allocated and apportioned to a qualifying contract using a cost recovery rate. Indirect costs may include overheads. Some direct costs, such as labour, may be applied indirectly as a matter of convenience.	<p>4.1 When used in this guidance, the terms direct, indirect and overhead costs have the meanings assigned to them in Table 1. Contractors may use terms which differ from those given. Where those terms are synonymous, or otherwise refer to the same thing, the guidance should be construed and applied accordingly.</p> <p>Table 1: Terms and definitions</p> <table><tr><th colspan="2">Definitions</th></tr><tr><td>Direct cost</td><td>A cost that can be traced to a discrete package of goods, works or services specified under a particular qualifying contract.</td></tr><tr><td>Overhead cost or overhead</td><td>A cost that is used by multiple activities and which cannot be traced, or that the parties agree not to trace, to a discrete package of goods, works or services specified under a particular qualifying contract.</td></tr><tr><td>Indirect cost or indirectly recovered cost</td><td>A cost that is allocated and apportioned to a qualifying contract using a cost recovery rate. Indirect costs may include overheads. Some direct costs, such as labour, may be applied indirectly as a matter of convenience.</td></tr></table>	Definitions		Direct cost	A cost that can be traced to a discrete package of goods, works or services specified under a particular qualifying contract.	Overhead cost or overhead	A cost that is used by multiple activities and which cannot be traced, or that the parties agree not to trace, to a discrete package of goods, works or services specified under a particular qualifying contract.	Indirect cost or indirectly recovered cost	A cost that is allocated and apportioned to a qualifying contract using a cost recovery rate. Indirect costs may include overheads. Some direct costs, such as labour, may be applied indirectly as a matter of convenience.	<p>Table number and references corrected.</p>
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Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation
<p>4.2 Contractors with QDCs and QSCs may agree with the Secretary of State a methodology for the allocation and apportionment of costs to be used in the contract. A cost accounting methodology includes:</p> <ul style="list-style-type: none"> choosing whether a cost, or class of cost, is to be applied directly or indirectly to the contract; where a cost is applied indirectly to the contract; identifying the cost recovery base for each pool and measuring it; and calculating the cost recovery rates (for example £ per hour of labour). 	<p>4.2 Contractors with QDCs and QSCs may agree with the Secretary of State a methodology for the allocation and apportionment of costs to be used in the contract. A cost accounting methodology includes:</p> <ul style="list-style-type: none"> choosing whether a cost, or class of cost, is to be applied directly or indirectly to the contract; where a cost is applied indirectly to the contract; identifying the cost recovery base for each pool and measuring it; and calculating the cost recovery rates (for example £ per hour of labour). 	No changes
<p>4.3 The methodology may be described in a Quantified Method of Cost Allocation (QMAC) which is agreed between the relevant parties. The agreement of a QMAC does not demonstrate that costs are allowable, however the parties may find its contents informative in applying this guidance. For example, in identifying the type of costs and corresponding cost recovery bases which the parties may agree to recover through application of rates.</p>	<p>4.4 (formerly para 4.3):</p> <p>The methodology may be described in a Questionnaire on Method of Allocation of Costs (QMAC) which is agreed between the relevant parties. The agreement of a QMAC does not demonstrate that costs are allowable, however the parties may find its contents informative in applying this guidance. For example, in identifying the type of costs and corresponding cost recovery bases which the parties may agree to recover through application of rates.</p> <p>The methodology detailing in what circumstances costs will be applied should be unambiguous.</p>	<p>Correction “Quantified” amended to “Questionnaire” The addition of the final sentence is in response to MOD feedback on Table 1, which the SSRO felt to be better suited to this paragraph.</p>

Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation
<p>4.4 In order to be allowable, the contractor must be able to demonstrate that costs have been allocated in a way that is reasonable and which avoids any over or under recovery. Additional care will be needed where the contractor's costing system for work under contract to the Secretary of State is different from that used for other work, as the costing systems may not be directly comparable.</p>	<p>4.4 In order to be allowable, the contractor must be able to demonstrate that costs have been allocated in a way that is fair in the circumstance and which avoids systematic over or under recovery. Additional care will be needed where the contractor's costing system for work under contract to the Secretary of State is different from that used for other work, as the costing systems may not be directly comparable.</p>	<p>In response to stakeholder feedback "reasonable" has been amended to "fair" to better link back to the SSRO's statutory aims.</p> <p>In response to stakeholder feedback "which avoids any over or under recovery" has been amended to "which avoids systematic over or under recovery", which was our original intent.</p> <p>Stakeholders correctly pointed out that avoiding any over or under recovery was unlikely to be possible. The wording was changed to be more in line with the objective of the guidance.</p>
<p>4.5 The SSRO is not prescriptive about whether costs are categorised as direct or indirect costs, but the MOD will want to be satisfied with the assignment of costs to contracts (or groups of contracts) and the method by which costs are shared amongst contracts. Section 2 of this guidance sets out the contractor's duty to keep relevant records and submit statutory reports in respect of allowable costs.</p>	<p>4.5 The SSRO is not prescriptive about whether costs are categorised as direct or indirect costs, but the MOD will want to be satisfied with the assignment of costs to contracts (or groups of contracts) and the method by which costs are shared amongst contracts. Section 2 of this guidance sets out the contractor's duty to keep relevant records and submit statutory reports in respect of allowable costs.</p>	<p>No change</p>
<p>4.6 Direct costs which are attributable to a single contract should be assessed against section 3 and relevant guidance in section 4 to be claimed as allowable. Direct costs which the contractors seeks to recover following use of cost recovery rates should be assessed against the guidance on indirect costing in paragraphs 6.23 - 6.25.</p>	<p>4.6 Direct costs which are attributable to a single contract should be assessed against section 3 and relevant guidance in section 4 to be claimed as allowable. Direct costs which the contractors seeks to recover following use of cost recovery rates should be assessed against the guidance on indirect costing in paragraphs 6.23 - 6.25.</p>	<p>No change</p>

Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation
4.7 Overhead costs considered allowable and not identified as arising from performing a single qualifying contract should be assessed against the guidance in section 3 and any relevant guidance in section 4. Overhead costs which the contractor seeks to recover following use of cost recovery rates should be assessed against the guidance on indirect costing in paragraphs 4.8– 4.10.	4.7 Overhead costs considered allowable and not identified as arising from performing a single qualifying contract should be assessed against the guidance in section 3 and any relevant guidance in section 4. Overhead costs which the contractor seeks to recover following use of cost recovery rates should be assessed against the guidance on indirect costing in paragraphs 4.8– 4.10.	No change
4.8 Some costs may be determined through the use of recovery rates which are applied to an appropriate recovery base. A contract may contain allowable costs which are both applied directly, and applied indirectly through the use of a rate. A cost recovery rate is a rate of cost per unit of a cost recovery base. For example, a rate of £50 per hour applied to a cost recovery base of 1,000 labour hours would generate a cost of £50,000.	4.8 Some costs may be determined through the use of recovery rates which are applied to an appropriate recovery base. A contract may contain allowable costs which are both applied directly, and applied indirectly through the use of a rate. A cost recovery rate is a rate of cost per unit of a cost recovery base. For example, a rate of £50 per hour applied to a cost recovery base of 1,000 labour hours would generate a cost of £50,000.	No change
4.8 The agreement of estimated and actual rates will be determined between the contractor and the MOD. For cost recovery rates to be consistent with the requirements of allowable costs, a cost recovery rate, when is applied to a suitable cost recovery base, should produce a cost estimate which is allowable. It cannot be fully determined, however, that a particular cost is an allowable cost under a qualifying contract in accordance with the requirement of section 20(2) of the Act until the contract to which the rate is to be applied is being priced.	4.8 The agreement of estimated and actual rates will be determined between the contractor and the MOD. For cost recovery rates to be consistent with the requirements of allowable costs, a cost recovery rate, when is applied to a suitable cost recovery base, should produce a cost estimate which is allowable. It cannot be fully determined, however, that a particular cost is an allowable cost under a qualifying contract in accordance with the requirement of section 20(2) of the Act until the contract to which the rate is to be applied is being priced.	No change

Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation
<p>4.10 Because cost recovery rates may be used as the basis of a costs claimed as allowable under a qualifying contract, there formulation should be guided by the requirements of allowable costs. Rates which are not consistent with the requirements of allowable cost are unlikely to be applicable in a way that would be suitable for determining the allowable costs under a qualifying contract. The following are typical characteristics of a suitable cost recovery rate which is consistent with the requirements of allowable costs. The relevant parties should consider these characteristics during the process of evaluating whether a cost recovery rate to be used to price a qualifying contract is consistent with each requirement:</p> <p>i. Appropriate: cost pools comprise costs arising from activities which enable the performance of contracts of the type to which the rate is anticipated to apply. It is not a requirement that a cost that is included in a cost pool meets the requirements of allowable costs. Examples of costs which may be appropriate include: the HR cost of the relevant business unit delivering the contract(s); research in the domain of the scope of the contract(s); and other business enablers that exist for the benefit of the customer or are required for the contracting company to function lawfully or efficiently.</p>	<p>4.10 Because cost recovery rates may be used as the basis of a costs claimed as allowable under a qualifying contract, their formulation should be guided by the requirements of allowable costs. Rates which are not consistent with the requirements of allowable cost are unlikely to be applicable in a way that would be suitable for determining the allowable costs under a qualifying contract. The following are typical characteristics of a suitable cost recovery rate which is consistent with the requirements of allowable costs. The relevant parties should consider these characteristics during the process of evaluating whether a cost recovery rate to be used to price a qualifying contract is consistent with each requirement:</p> <p>i. Appropriate: cost pools comprise costs arising from activities which relate to the performance of contracts of the type to which the rate is anticipated to apply. It is not a requirement that a cost that is included in a cost pool meets the requirements of allowable costs, only the element which is to be allocated and apportioned to qualifying contracts. Examples of costs which may be appropriate include: the HR cost of the relevant business unit delivering the contract(s); research in the domain of the scope of the contract(s); and other business enablers that exist for the benefit of the customer or are required for the contracting company to function lawfully or efficiently.</p>	<p>Corrected a prior typo.</p> <p>Added explanatory sentences to i) and ii) to more clearly indicate the intent of the guidance.</p> <p>Amended wording of point iii) to better clarify the intent of the guidance and avoid example wording that could be misinterpreted as being prescriptive.</p>

Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation
<p>ii. Attributable to the contract: the recovery base used to apportion the cost pool is applied in a way that reflects the expected utilisation of the resource by the contract(s) to which the rate may apply. For example, using a recovery base of labour hours may be suitable for direct labour costs, but headcount may be more suitable for back-office functions. The scope of the recovery base should match that of the cost pool.</p> <p>iii. Reasonable in the circumstances: the quantum of costs in the pool and of the recovery base are justifiable with respect to what a contractor typically incurs in similar circumstances, and exhibit suitable levels of efficiency and productivity. For example, the quantum of cost in the cost pool should be consistent with historical trends given the outputs, accounting for any changes in circumstance, cost control measures, and planned or assumed productivity improvements.</p>	<p>ii. Attributable to the contract: the recovery base used to apportion the cost pool is applied in a way that fairly reflects the use of resource by the contract(s) to which the rate may apply. In general, a suitable method is one which most closely aligns the driver of a particular cost to the recovery base. For example, using a recovery base of labour hours may be suitable for direct labour costs, but headcount may be more suitable for back-office functions. The scope of the recovery base should match that of the cost pool.</p> <p>iii. Reasonable in the circumstances: the quantum of costs in the pool and of the recovery base are justifiable with respect to agreed levels of efficiency and productivity. For example, they may be consistent with those that a well run company operating under competitive market pressure to maximise efficiency would be expected to incur and allocate to contracts. This may reflect improvements on historical trends given the outputs, accounting for any changes in circumstance, cost control measures, and the expectation of productivity improvements.</p>	

Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation
<p>4.11 The parties will need to apply judgement in agreeing the type and standard of evidence that it is reasonable for the contractor to provide in order to demonstrate that their estimated, actual and claimed rates are consistent with the requirements of allowable costs. In determining what type and standard of information required, the relevant parties should take a proportionate approach (see section 2). When determining a proportionate type and standard of information to support the calculation of cost recovery rates, the parties should:</p> <ul style="list-style-type: none"> Consider the types of contracts to which the rates will be applied to ensure the scope of the cost pool and recovery base are suitable. Maintain consistency between the scope of the cost pool and recovery base when adjusting either. <p>Illustrative example:</p> <p>The below example is intended to assist in the understanding and application of the guidance. It is not intended to be used as evidence as to whether a cost is allowable in a specific QDC or QSC.</p> <p>A contract proposed a cost recovery rate for a range of general and administrative (G&A) expenses.</p> <p>The contractor proposed that the cost pool should comprise all G&A costs of the business unit that the MOD was seeking to contract with, as well as some G&A costs of a centralised group function, as it argued these were necessarily and suitably incurred to facilitate operational delivery of contracts by the business unit and therefore appropriate. It proposed that the labour hours of employees in G&A related roles should be used as a recovery base such that the rate was consistent with a cost that was attributable to the contract.</p>	<p>4.11 The parties will need to apply judgement in agreeing the type and standard of evidence that it is reasonable for the contractor to provide in order to demonstrate that their estimated, actual and claimed costs within recovery rates are consistent with the requirements of allowable costs. In determining what type and standard of information is required, the relevant parties should take a proportionate approach (see section 2). When determining a proportionate type and standard of information to support the calculation of cost recovery rates, the parties should:</p> <ul style="list-style-type: none"> Consider the types of contracts to which the rates will be applied to ensure the scope of the cost pool and recovery base are suitable. Consider consistency between the scope of the cost pool and recovery base when adjusting either. 	<p>Amended wording in line with feedback to offer greater clarity.</p> <p>The Illustrative example removed as stakeholder feedback suggested that the SSRO's proposed illustrative examples were unhelpful. We remain open to developing examples in future with stakeholder engagement.</p>

Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation
<p>The MOD did not agree that all the G&A costs of the centralised group function should be included in the pool. It said some of these costs only supported the operations of business units that delivered non-qualifying contracts and not the type of contracts the MOD would seek to price using the rate. These costs were removed from the cost pool. In order to maintain consistency, the scope of the recovery base was adjusted, to remove some employees to which removed cost related. The parties also agreed that headcount, rather than labour hours, would better reflect the utilisation of G&A functions across operational activities and therefore modified the recovery base accordingly. It was considered that square footage may be the most appropriate recovery base for the utilities element of the cost pool, but that in taking a proportionate approach it was agreed this element would remain in the G&A pool and not be broken out into a separate rate.</p> <p>The supplier provided evidence that the quantum of the costs and headcount were in line with recent trends and achieved by the contractor and therefore reasonable in the circumstances. The MOD agreed to this, having undertaken comparative analysis across contractors using the QBUCAR, seeking evidence to explain differences in G&A costs and a review of recent Rates Comparison Reports for the business unit to ascertain if the approach agreed was likely to be associated with under or over recovery of overheads.</p>		

Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation
<p>4.12 Contracting companies may adopt a variety of accounting policies and practices and make judgements in the preparation of financial statements for statutory reporting purposes (for example, International Financial Reporting Standards and UK Generally Accepted Accounting Practice) and for the preparation of management accounts to inform internal decision-making. Application of these policies and practices to QDCs, will not necessarily result in costs charged satisfying the AAR principles, and contractors must therefore have regard to this guidance.</p>	<p>4.12 Contracting companies may adopt a variety of accounting policies and practices and make judgements in the preparation of financial statements for statutory reporting purposes (for example, International Financial Reporting Standards and UK Generally Accepted Accounting Practice) and for the preparation of management accounts to inform internal decision-making. Application of these policies and practices to QDCs, will not necessarily result in costs charged satisfying the AAR principles, and contractors must therefore have regard to this guidance.</p>	<p>No change</p>
<p>A2.4 Defined Benefit scheme: the relevant annual Allowable expense will be limited to the current or 'normal' service cost charged to the income statement, and not related to the funding of any deficit cost or past expenses, therefore:</p> <ul style="list-style-type: none"> a) the current service cost is Allowable, this represents the increase in the pension scheme liability for an extra year of service for the contractor's employees; and b) the annual administrative expenses and running costs are Allowable as these are reported as an operating cost relating to the scheme (including Pension Protection Fund levies); however c) all other expenses recognised in the income statement which relate to past service costs, settlement gains and losses, net interest on the pension liability and all re-measurements recognised through the statement of other comprehensive income are not Allowable 	<p>A.2.4 Defined Benefit scheme: the relevant annual allowable cost will be limited to the current or 'normal' service cost charged to the income statement, and not related to the funding of any deficit cost or past expenses, therefore:</p> <ul style="list-style-type: none"> a) the current service cost is Allowable, this represents the increase in the pension scheme liability for an extra year of service for the contractor's employees; and b) the annual administrative expenses and running costs are Allowable as these are reported as an operating cost relating to the scheme (including Pension Protection Fund levies); however c) all other expenses recognised in the income statement which relate to past service costs, settlement gains and losses, net interest on the pension liability and all re-measurements recognised through the statement of other comprehensive income are not Allowable. 	<p>Minor change from "Allowable expense"</p>

Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation
<p>D 2.2 In determining whether money spent on research enables the performance of the contract, the parties should consider the requirements of the contract and whether these necessitate the research, either expressly or by implication. Some research costs may be necessary if:</p> <ul style="list-style-type: none"> the goods or services could not have been provided but for the research having been undertaken. the research costs were necessarily incurred to sustain the contractor's skills, expertise and capability to deliver the contract and others like it, and other defence contracts in the future. 	<p>D.2.2 In determining whether research expenditure is an allowable cost, the parties should consider the requirements of the contract and whether these necessitate the research, either expressly or by implication. Some research costs may be necessary if:</p> <ul style="list-style-type: none"> the goods or services could not have been provided but for the research or research of a similar nature, having been undertaken. the research costs were necessarily incurred to sustain the contractor's skills, expertise and capability to deliver the contract and other defence contracts in the future. there is an explicit agreement between the contractor and the MOD in respect of research to meet the MOD's long-term need. 	<p>Changed "money spent on research" to "research expenditure" following feedback and further simplified wording.</p> <p>Amended bullet one in line with feedback to make explicit the broader nature and intent of the guidance.</p> <p>Amended bullet two in line with feedback from industry.</p> <p>Added bullet three to provide further example circumstances.</p>
<p>E1.1 Stock losses and obsolescence costs should be charged directly to the contracts to which they relate as Allowable Costs. In circumstances where it is not possible to identify stock losses or obsolescence costs that specifically apply to contracts then they may still be Allowable. This will only apply when the contractor's costing system is able to isolate these stock losses as an indirect overhead. Contractors will be requested to provide evidence to support any claimed obsolescent stock write-offs and be able to demonstrate that these were not as a result of poor storage, handling or control.</p>	<p>E.1.1 Reasonable stock losses and obsolescence costs should be charged directly to the contracts to which they relate as Allowable Costs. In circumstances where it is not possible to identify stock losses or obsolescence costs that specifically apply to contracts then they may still be Allowable. This will only apply when the contractor's costing system is able to isolate these stock losses as an indirect overhead. Contractors will be requested to provide evidence to support any claimed obsolescent stock write-offs and be able to demonstrate that these were not as a result of poor storage, handling or control.</p>	<p>Amended in line with feedback on consultation.</p>

Guidance proposed in consultation	New guidance from 7 November 2022	Changes arising from consultation
E4.4 Notional values of transactions, those that are not real or hypothetical, are generally not Allowable Costs.	E4.4 Notional values of transactions are generally not allowable costs.	<p>Stakeholder questioned if the proposed changes reflected a widely accepted definition of a 'notional transaction'.</p> <p>We have changed the wording to better clarify the intent as, in some cases, such as futures contracts, notional values may be reacted to by outside parties (such as the market) as if the values were "real" but these would not be allowable costs.</p>
F.2.2 Where a site is closed resulting in other sites operated by the contractor or within a joint venture benefiting from gaining more work as a result of the site closure, the net cost of closure, rationalisation or restructuring must be tested and recovered against the benefits associated with the other sites or joint venture.	F.2.2 Where a site is closed resulting in other sites operated by the contractor or within a joint venture benefiting from gaining more work as a result of the site closure, the net cost of closure, rationalisation or restructuring must be tested and recovered against the benefits associated with the other sites or joint venture.	Minor change - amended "benefits" to "benefiting" in consultation. No change since consultation.
H4.1 -Cost risk is the possibility that the actual amount of costs which are determined to be Allowable Costs will differ from the estimated amount of those costs. The presence of cost risk may be reflected through the agreement of a cost risk adjustment in determining the contract profit rate for a QDC or QSC. The cost risk adjustment should not be used to include within the contract price any element of the estimated costs that have been identified, as these should be considered in the determination of the estimated Allowable Costs. The SSRO provides separate specific guidance on the cost risk adjustment.	H4.1 Cost risk is the possibility that the actual amount of costs which are determined to be Allowable Costs will differ from the estimated amount of those costs. The presence of cost risk may be reflected through the agreement of a cost risk adjustment in determining the contract profit rate for a QDC or QSC. The cost risk adjustment should not be used to include within the contract price any element of the estimated costs that have been identified, as these should be considered in the determination of the estimated Allowable Costs. The SSRO provides separate specific guidance on the cost risk adjustment.	No change since consultation.

