



SSRO

Single Source
Regulations Office

Assuring value, building confidence

Compliance and review methodology

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Introduction

1. Compliance with reporting requirements (Section 36(2))

- 1.1. The SSRO will monitor whether contractors are meeting their reporting obligations under section 36(2) of the Act by considering if the required submissions:
 - are delivered on time; and
 - contain the information prescribed in the Regulations and any relevant statutory guidance issued by the SSRO.
- 1.2. The SSRO's compliance approach will include querying obvious errors (for example internal reporting inconsistencies or arithmetical errors) as well as raising any matter if completed reports seem to be erroneous (for example containing incomplete or limited information on output metrics).
- 1.3. To establish whether the information is accurately reported and can be relied upon, the SSRO will:
 - ask the MOD to notify it, within an agreed period, of all Qualifying Defence Contracts (QDC) that have been entered into;
 - raise queries with contractors if there are errors or omissions apparent in a report; and
 - agree with the MOD that they will verify and confirm either: that the information from contractor submissions concerning the Allowable Costs and the contract profit rate is in accordance with the contract; or any variances identified.
- 1.4. The information contained in the statutory reports helps the SSRO understand how the regulatory framework with respect to the pricing of contracts is operating. To this end, the reports should include:
 - the facts, assumptions and calculations relevant to each element of the Allowable Costs used to determine the contract price;
 - the calculation that was made under Regulation 11 of the Regulations, including all adjustments under the six steps, to determine the contract price;
 - any known deviation from statutory guidance; and
 - any other information material to the pricing of the contract.

Keeping the regulatory framework under review (Section 39(1))

- 1.5. The duty under Section 39(1) of the Act requires the SSRO to keep the provision of the regulatory framework under review. The pricing of contracts is a key aspect of the regulatory framework. The Act requires that:
- contract prices are determined according to the formula “Contract Price = Allowable Costs + (Contract Profit Rate x Allowable Costs)” and in accordance with one of the six regulated pricing methods;
 - costs are only determined to be Allowable Costs where they satisfy the test of being Appropriate, Attributable to the contract and Reasonable in the circumstances (the AAR test); and
 - the contract profit rate for each contract is determined by a six step process that starts with the baseline profit rate set annually by the Secretary of State (the six steps).
- 1.6. If reports are submitted that comply fully with the requirements of the Regulations and the SSRO’s statutory guidance, then these will provide the SSRO with a range of information needed to carry out its review function. Accordingly, a high degree of compliance with reporting requirements should reduce the need for the SSRO to raise queries in order to understand the operation of the pricing of the contract.
- 1.7. The SSRO may raise points of clarification with either the MOD or the contractor on issues of language or internal inconsistencies within reports. The SSRO may also ask questions of the MOD arising from submitted reports if that facilitates the discharge of its duty to review the provision of the Act and the Regulations and to develop a proper understanding of how the system of pricing of contracts is being applied. Further enquiry of the MOD may well be prompted in cases where there are items that prima facie appear out of line with statutory guidance, with no clear explanation provided by the contractor.

Contractor reporting requirements

- 1.8. The SSRO will monitor compliance by contractors against statutory reporting requirements by using two specific indicators:
- 1a) “all required reports have been submitted within the relevant deadlines”;** and
- 1b) “reporting obligations have been met for all reports submitted in accordance with the Regulations and relevant statutory guidance”.**
- 1.9. The SSRO will detail, by contractor, in its annual Compliance Report the number of reports that were not submitted within the relevant deadline and the number of reports where reporting obligations, in accordance with the Regulations and relevant statutory guidance had not been met.
- 1.10. Where specific issues are raised by the SSRO with a contractor and are then resolved within the reporting period, either through resubmission of the report being queried or through submission of further information in the next relevant report (e.g. the next quarterly contract report), the SSRO will also note the resolution of the issue in the Compliance Report. Where specific issues are raised by the SSRO with a contractor and are then not resolved within the reporting period, the SSRO may inform the MOD and ask that a Compliance Notice is issued in accordance with Section 31 of the Act. The SSRO will detail in the Compliance Report:
- the issue, by contractor, reported to the MOD;
 - whether a Compliance Notice was issued by the MOD; and
 - whether a Penalty Notice was issued by the MOD under Section 32 of the Act.

2. The pricing of contracts

- 2.1. The SSRO will review the reports submitted by contractors to understand the operation of the provision of the Act and Regulations with respect to the pricing of contracts. The SSRO's reviews will be based on the information that is required to be submitted by contractors in line with the Regulations.
- 2.2. Under the Act, the parties to qualifying contracts may only agree a contract price based on Allowable Costs and a contract profit rate calculated in accordance with the prescribed steps and after having regard to the SSRO's statutory guidance. Both parties must be satisfied that the contract costs are Allowable. The contractor must report the facts, assumptions and calculations relevant to each element of the Allowable Costs in its statutory reports.
- 2.3. While the SSRO may seek to understand the operation of the pricing provisions of the regulatory framework by reference to information reported on individual contracts, it is not the SSRO's role to audit reported costs or profit rates on a contract by contract basis. The SSRO does not provide assurance that individual contracts have been priced in accordance with statutory requirements and it remains for the MOD to ensure that the contracts it enters into comply with the legal framework. The SSRO may positively determine a matter of price (such as whether a cost is Allowable), but only if such a question is referred to it under the framework.
- 2.4. The SSRO may raise concerns with the MOD as the responsible party to validate the pricing controls, by asking for a response within an agreed time period, as to how the price control provision of the Act and the Regulations are being applied. Information reported about a particular contract may give rise to concerns in the following circumstances:
 - the facts, assumptions and calculations relevant to an element of the Allowable Costs suggest a breach of the Act and the Regulations or deviation from the statutory guidance which has neither been reported nor explained;
 - the calculation made under Regulation 11 of the Regulations, including any adjustment under the six steps, to determine the contract price of a QDC appears to be a breach of the Act, and the Regulations or a deviation from the statutory guidance but has neither been reported nor explained;
 - an unsatisfactory explanation has been provided for a contravention of the Act or the Regulations;
 - a deviation from the statutory guidance has been reported by a contractor; and
 - other information material to the pricing of the contract has been reported and this appears to suggest a failure to comply with the Act, the Regulations or deviation from the statutory guidance.
- 2.5. The SSRO considers that it is preferable to promptly raise with the MOD any concerns or queries that it has identified after reviewing the information reported on a contract. This provides an early opportunity for an explanation to be provided that informs the SSRO's understanding of how the pricing provisions have been applied, or for appropriate action to be taken to act on well-founded concerns.

- 2.6. Subject to the MOD's response, the SSRO will categorise these issues into two groups where either the issue has already been notified by the contractor as a known deviation, or where it has been identified by the SSRO separately. These will then be categorised into those in which the MOD:
- advises that the contract will be amended to address a failure to comply with the Act or the Regulations or a deviation from the statutory guidance [category 1];
 - refers the matter to the SSRO for determination [category 2];
 - confirms that any contravention of the Act or the Regulations has taken place and indicates that no action is to be taken [category 3];
 - confirms that any deviation from the Statutory Guidance has taken place but provides an explanation, justifying the departure, and indicates that no action is to be taken [category 4];
 - has not yet responded to the SSRO [category 5]; or
 - advises that no failure to comply with the Regulations or deviation from the statutory guidance has taken place and provides an explanation [category 6].
- 2.7. In its Compliance Report the SSRO will summarise the issues, by category, which it has raised with the MOD during the reporting period. If the pricing of individual contracts gives rise to broader concerns, the SSRO will address these in its annual compliance report. This will inform consideration by the SSRO of whether to amend its statutory guidance or to recommend changes to the Act or Regulations to the Secretary of State.
- 2.8. Where the MOD confirms that no deviation from the Regulations and statutory guidance has taken place, the SSRO will note the resolution of the issue and not include the matter in its compliance report. The SSRO will also consider naming contractors under specific categories and commenting on the range and extent of deviation from the statutory guidance.

