

## Opening Letter from new Chairman, George Jenkins OBE



Dear Stakeholders

Welcome to the first edition of the SSRO's newsletter this year. As you may have read, I took up my role as Chairman of the SSRO on 1 January 2017. It is a role that I am already greatly enjoying. I understand there will be challenges, but I believe the organisation has the expertise and the will to make a difference to non-competitive defence procurement in a positive manner.

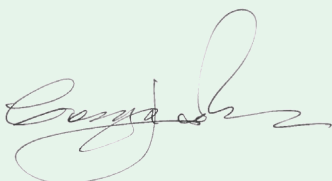
As the new Chairman of the SSRO, my immediate priorities are to: build a comprehensive understanding of current issues relating to single source defence procurement; learn about the impact of the Act and the Regulations; and consider how the SSRO's statutory functions can best deliver the aims of the regime.

I have a busy programme of engagement over the next few months, and I am very much looking forward to meeting with as many stakeholders as possible. I will endeavour to answer your questions and take on-board any concerns you may have to ensure that the SSRO remains both fair and impartial.

In the longer term I plan to raise greater awareness of the SSRO and the regime more widely, demonstrating the benefits and opportunities to improve single source defence procurement that have been brought about by the regime. I want to build mutual respect between all parties, and to establish the SSRO as the trusted expert and authoritative voice on issues of single source procurement. As you might sense from my tone, I am eager to make a difference.

The SSRO has a busy year ahead, having just made our recommendation to the Secretary of State on the profit rate, launching a consultation that will inform our recommendations to the Secretary of State in June following our review of the legislation, and publishing the outcome of discussions with stakeholders on the SSRO's approach to calibrating profit rates in single source contracts in the spring.

I hope you find this edition of interest, and I look forward to engaging with you in the coming months.

A handwritten signature in black ink, appearing to read 'George Jenkins'.

## Review of the Legislation



At the end of January we [launched a consultation](#) on our proposed recommendations for the first review of the regulatory framework for single source defence contracts. Previous newsletters have highlighted that the first review of the regulatory framework by the Secretary of State for Defence is due by the end of this year. The SSRO is required to submit any comments or recommendations six months in advance, for the Secretary of State's consideration.

Our consultation follows the two 'call for input' documents we published in 2016, publicised in previous newsletters. We are consulting on proposed recommendations that aim to improve the regulation of single source defence contracts by:

- enhancing the transparency on public money;
- ensuring a level playing field for all of industry;
- achieving the appropriate coverage of defence contracts; and
- making the regime stick.

The proposals are of a technical and developmental nature that build on the SSRO's experience with operating under the Defence Reform Act since 2014.

Among the proposed recommendations, the SSRO is seeking to clarify the working of the regime and wants to access and use the information needed to carry out its functions in a way that would bring it in line with other regulators.

We are also interested in receiving views and further evidence in areas where other organisations have suggested changes and where there are issues that may justify making further recommendations.

This is a public consultation, and we strongly encourage all those with an interest in the SSRO's two statutory aims of obtaining good value for taxpayers' money and a fair and reasonable return for industry to submit a response. We welcome comments from people or organisations with a particular interest in defence procurement. This is an important opportunity to contribute to the formation of the SSRO's recommendations and to influence the future of regulation in this sector.

## Compliance and review methodology

Under the Defence Reform Act 2014, the SSRO is obliged to keep the regulatory framework and the extent to which organisations subject to reporting requirements are complying with them under review. The SSRO published its [compliance and review methodology](#) in January.

The compliance and review methodology has been updated to reflect our experience to date and the latest regulatory best practice, and took into account feedback from responses received from industry, government and defence industry consultants during the six-week consultation that ran from 27 September to 8 November 2016. The input from stakeholders provided us with constructive feedback on the principles behind the methodology.



The final compliance methodology sets out an approach that:

- makes the compliance methodology more closely aligned with best practice models of regulation;
- clarifies the distinction between the work / roles of the SSRO and the Cost Assurance and Analysis Service (CAAS);
- clarifies the legislative roles and responsibilities of the SSRO, the MOD and industry;
- improves collaboration and understanding between the SSRO, the MOD and industry, whilst still maintaining the SSRO's independence;
- reduces the overall 'compliance burden' on industry and the MOD; and
- focuses on the actions taken by industry and the MOD, as the intermediary assurance authority, as a result of issues that are identified by the SSRO.

You can read the [final compliance and review methodology](#) on our website, as well as a [summary of key issues raised by stakeholders during the consultation and the SSRO's response to them](#).

## SSRO research and analysis - capital servicing adjustments in qualifying defence contracts

Capital servicing adjustments in qualifying defence contracts

**SSRO**  
Single Source  
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Capital servicing adjustments in  
qualifying defence contracts  
25 October 2016

The Defence Reform Act 2014 (the Act) requires that the price payable under a qualifying defence contract (QDC) or qualifying sub-contract (QSC) must be determined in accordance with the formula:  $\text{price} = (\text{CPR} \times \text{AC}) + \text{AC}$ . CPR is the contract profit rate for the contract and AC is the Allowable Costs under the contract. When agreeing the contract profit rate, contractors and the MOD must follow a six-step process set out in section 17(2) of the Act and Regulation 11 of the Single Source Contract Regulations 2014 (the Regulations).<sup>1</sup> The sixth step in the process is the capital servicing adjustment (CSA). The CSA aims to ensure that the primary contractor receives 'an appropriate and reasonable return' on the fixed and working capital they employ in contract delivery. This bulletin presents analysis of the CSA applied to QDCs and QSCs agreed between 1 April 2016 and 30 September 2016. It uses data reported to the Single Source Regulations Office by defence contractors, as required by Regulation 22 of the Regulations.<sup>2</sup>

**Key points**

- In 2015/16 the average contract profit rate reported by contractors was 11.52 per cent (compared to the prevailing baseline profit rate (BPR) of 10.60 per cent). The average contract profit rate reported in the first half of 2016/17 was 10.97 per cent (compared to the prevailing BPR of 8.95 per cent).
- On average, the CSA is the largest adjustment made to the BPR when calculating the contract profit rate. It accounted for 1.10 percentage points of the average contract profit rate in 2015/16 and 1.55 percentage points of the average for contracts agreed in the first half of 2016/17.
- Of the 46 QDCs/QSCs examined, 11 (24 per cent) had a CSA of zero. The other 35 had CSAs ranging from 0.30 percentage points to 3.67 percentage points.
- As expected, where data was available, we found that contractors with more capital-intensive operations tended to agree higher CSAs on their QDCs/QSCs.

**Contract profit rates in QDCs/QSCs**

Figure 1: Contract profit rates reported in individual QDCs/QSCs

1 Full details of the six-step process can be found in SSRO (2016) *Contract Profit Rate: Guidance on Adjustments to the Baseline Profit Rate*.  
2 Data remain subject to verification by the SSRO. The types of contract reports and the data to be provided in each are prescribed in Part 5 of the Regulations.

In October we published a [statistical bulletin on capital servicing adjustments in qualifying defence contracts](#). Our analysis shows that in 2015/16 the average reported contract profit rate was 11.52 per cent. In the first half of 2016/17 the average reported contract profit rate was 10.97 per cent some 2 percentage points above the baseline rate of 8.95.

On average, the CSA is the largest adjustment made to the baseline profit rate when calculating the contract profit rate. It increased the average contract profit rate by 1.10 percentage points in 2015/16 and 1.55 percentage points in the first half of 2016/17. Of the 46 contracts examined, 11 had a CSA of zero. The other 35 had CSAs ranging from 0.30 percentage points to 3.67 percentage points.

The SSRO's first Quarterly Statistics bulletin will be published on 10 February. The bulletin will highlight key statistics from the QDCs we have reviewed so far.

The SSRO is moving towards being an Official Statistics body and will accordingly seek to issue official statistics under the Statistics and Registration Service Act 2007, which we will aim to make available for re-use by third parties under the Open Government Licence. All statistics will be appropriately anonymised.

## Formal Opinion, October 2016

In October we provided our formal opinion on whether work undertaken at risk on a proposed Qualifying Defence Contract (QDC), ahead of the agreement of a contract through negotiation, may in principle represent Allowable Costs under the contract once it is in place. The referral to the SSRO was made jointly by the MOD and a contractor for an opinion in respect of the proposed QDC.

In brief we found that costs incurred at risk prior to entering into the contract may be Allowable once the contract is in place.

Our opinion outlined that the conclusion reached was subject to the pre-contract at risk costs meeting the requirements of the regulatory framework before they are included in the price of the proposed QDC. The SSRO's opinion that pre-contract costs at risk may be Allowable is therefore subject to whether such costs are considered by the MOD and the contractor (or by the SSRO by way of determination) on or after entering into the contract, as meeting the AAR test, having regard to the [SSRO's Single Source Cost Standards](#).

Both parties welcomed the findings of the SSRO's Opinion. We are confident that referrals to the SSRO continue to be an excellent means to seek an independent view on costs, or a clarification of the legislation for contractors and the MOD.

The SSRO has now published anonymised summaries of two opinions and one determination redacted for commercial sensitivity reasons, all of which can be found on [our website](#).

# SSRO

Single Source  
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*Assuring value, building confidence*

## SSRO Opinion

Opinion on Allowable Costs arising from  
work undertaken at risk

## RUSI event

To promote discussion around single source procurement and its use, we published our paper, [Perspectives on Single Source Procurement](#), in September 2016. In November we hosted an event jointly with RUSI, at their offices in London. Speakers included Lord Currie, Professor Andrew Dorman, Cate Pye and the SSRO Chief Executive Marcine Waterman, and the event was expertly chaired by Professor John Louth. The paper itself and the event inspired some interesting debates around single source procurement and its use – both in the UK and in other countries. We would once again like to thank all of our contributors to the paper and all those who attended the SSRO-RUSI event in November. We are planning to hold another discussion event later in 2017.



## Defence Committee oral hearing

“The Defence Reform Act established our two statutory aims. You are correct that the first one is to ensure value for money for the taxpayer in what the MOD buys, both in equipment and services, and equally, and just as importantly, that industry is paid a fair and reasonable return for those contracts.”

Marcine Waterman, Defence Committee hearing 6 December 2016



In December the SSRO's Chief Executive and Director of Analysis and Reporting were asked to give evidence to the House of Commons Defence Committee for its [inquiry into the defence and acquisition policy of the Ministry of Defence](#).



One of the focuses of the inquiry is the SSRO, and how it and the single-source procurement regime, are contributing to UK defence. We were pleased to be able to contribute to the inquiry and look forward to reading the Defence Committee's report when it is published.

## Visits to defence companies



Continuing the SSRO's programme of stakeholder engagement, senior staff visited Glenrothes and Rosyth in December to meet with teams from Raytheon and Babcock respectively.

November saw a visit to QinetiQ's offices and facilities in Farnborough, and in October we were hosted by BAE Systems in Telford.

At the meetings we discussed the regime and how it related to the contractors' businesses and took the opportunity to learn more about their operations at these sites.

These visits are engaging and informative for the SSRO. We thank all those involved in welcoming us and providing insights into their work.

## Defence Contracts Analysis and Reporting System 2 (DefCARS 2)

One of the SSRO's top priorities over the last quarter has been the development and implementation of the successor system to the pilot Defence Contracts Analysis and Reporting System (DefCARS). The project is on-track, and the system is due to launch, ahead of schedule, in the week commencing 13 March 2017.

DefCARS is the central system for the capture, storage and analysis of all data submitted in accordance with statutory reporting requirements for QDCs/QSCs and Qualifying Business Units. The SSRO signed a contract in August 2016 with Synectics Solutions Ltd to develop the successor to the pilot system, which has been in use since April 2015.

Key features of the new system include replacing excel report templates with web-based forms, a reduction in repeated fields, and greater use of auto-populated cells.

### Development and testing

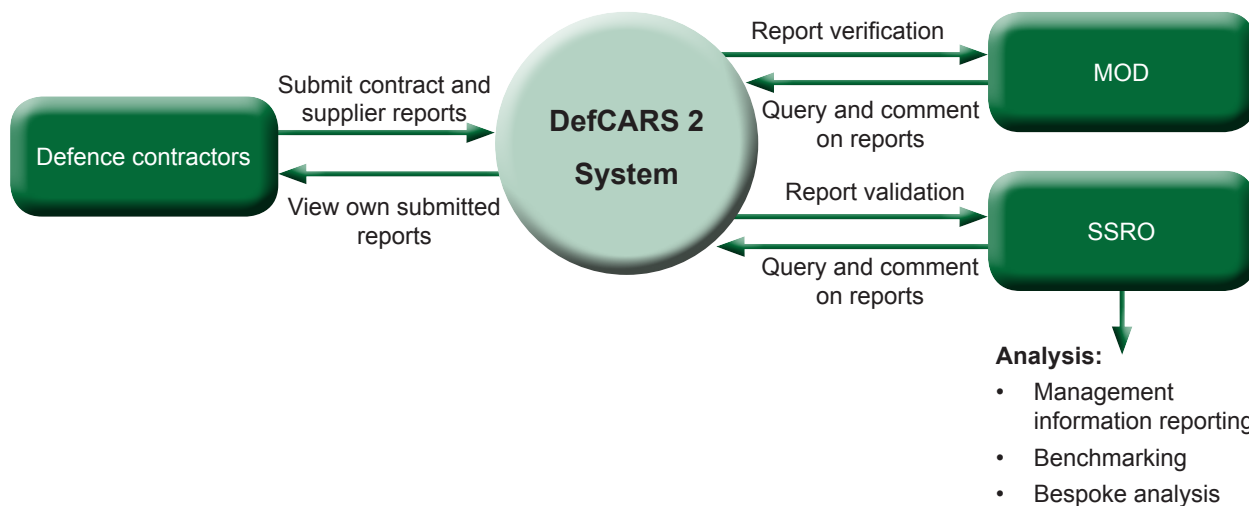
The SSRO has achieved significant project progress since the September 2016 Newsletter. This includes successful SSRO and MOD connectivity to the database, initial data migration from DefCARS 1, and construction of the site architecture.

Phase 1 of system testing, which focused on user access and administration testing, was completed in early December. Subsequent testing phases are underway, which are focussing on the completion of the contract and supplier report web forms. Contractors will be given the opportunity to test the completion of some reports within the system in mid-February, with the intention of increasing system familiarity prior to system launch in March.

### Data security and accreditations

The security of data within DefCARS 2 is the project's top priority. The SSRO is being advised by National Cyber Security Centre certified supplier, Hex Security, during development. DefCARS 2 will be hosted on a platform annually accredited for OFFICIAL-SENSITIVE data by the Cabinet Office. The system is under a routine formal risk review and security accreditation from the MOD and was subject to an IT Security Health Check and thorough penetration testing in January, and met the requirements for both. In addition, the segregation of contractor data will be robustly tested by both Synectics and the SSRO. The Shared Service Security Policy and Operating Procedures, which sets out conditions for use of DefCARS, will be issued to all users upon use of the system.

## Data migration and reporting continuity



All data submitted in DefCARS 1 will be securely migrated to DefCARS 2 in early March before the new system is launched. The migrated data will be viewable to DefCARS 2 users in the new web-based templates as well as in previously submitted Excel reports.

The SSRO has contacted contractors to request nominees to serve as their organisation’s point of contact for information on data migration arrangements.

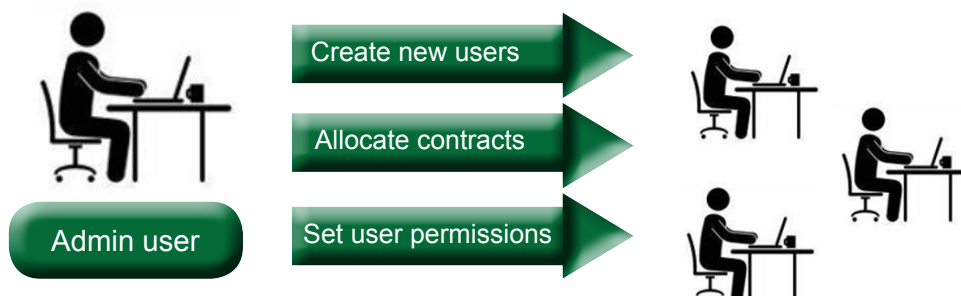
DefCARS 1 will operate until the successor system goes live in March. Any reports due after DefCARS 2 is launched will need to be submitted into the new system. The SSRO is aware of reports from current QDCs and supplier reports due in March, and will contact those contractors regarding arrangements for submission. We also ask that contractors kindly notify the SSRO if they expect to enter into a QDC or QSC between February and April.

## Stakeholder input and engagement

The SSRO has reflected suggestions made by stakeholders at the Reporting and IT Sub-Group in September 2016 into the design of DefCARS 2. These include a reporting calendar and the ability to copy and paste data from an Excel report template into specific pages within the Qualifying Business Unit Cost Analysis Report web-forms.

Stakeholders also suggested that each organisation should have ‘super’ administration users with access to the system, who have the ability to create new accounts, allocate visibility rights for access to specific QDCs and QSCs, and set user editing permissions within their own organisation.

The SSRO has adopted this suggestion as a key feature of user administration. One admin user per organisation will be set up in the new system in March, who will then create new accounts for their organisation. The SSRO has contacted contractors to request nominees to serve as their organisation’s initial admin user. All DefCARS 1 users will be contacted in February to notify them of arrangements.



The SSRO provided contractor reporting officers and MOD DefCARS representatives with an update on DefCARS 2 progress on 18 January 2017, which included a live demonstration of new system features in the DefCARS 2 test environment. The SSRO is reviewing further suggestions made by contractors at the meeting, including email notifications when reports are due and listing any technical issues with the DefCARS site on the SSRO website, once the site is live.

Stakeholders were provided with a further update on DefCARS 2 at a meeting of the Operational Working Group on 31 January 2017. A further meeting of the Reporting and IT Sub-Group will be held at the end of February.

## Contractor support

The SSRO has made arrangements and allocated resources to ensuring contractors and the MOD receive all necessary support during the transition to DefCARS 2. These include:

- an initial IT user guide available to users prior to system launch;
- a consolidated user guide of all the reports available at the go-live date in March;
- email updates on project progress to the Reporting and IT Sub-Group, which will be sent approximately every two weeks;
- the offer of group training sessions; and
- the availability of the SSRO helpdesk: [helpdesk@SSRO.gov.uk](mailto:helpdesk@SSRO.gov.uk)

## Our people

Following a staff initiative, individuals from the SSRO set up a voluntary charity committee in November 2016. The aim was to provide some fun activities for SSRO staff outside of working hours and not in relation to their work, while contributing to a charitable fund. Several charities were proposed by members of staff and in the end staff voted to donate to Blind Veterans UK.

The first staff charity event was held in December on the SSRO Christmas jumper day, and raised £264 for Blind Veterans UK. The staff charity committee is planning to organise more charitable events for the near future.



## Dates for the diary



<b>February</b>	Friday 10 – Quarterly statistics bulletin published
	Thursday 23 – Regulatory Review Committee
	Tuesday 28 – SSRO answers published
<b>March</b>	Wednesday 8 – SSRO Senior Stakeholder Forum
	Monday 13 – Audit Committee
	Wednesday 15 - Profit rate guidance published, following the Secretary of State's announcement of the rates for 2017/18
	Tuesday 21 – Board meeting
	Friday 24 - Review of Legislation consultation ends
	Thursday 30 – Corporate Plan 2017-2020 published
	Friday 31 – SSRO answers published
	Friday 31 – report on calibrating profit rates in single source contracts published
<b>April</b>	Friday 30 – SSRO answers published