



Ministry of Defence (49%)
Red



Industry (43%)
Red

SSRO

Single Source
Regulations Office

Assuring value, building confidence

Single Source Regulations Office
Interim Compliance Statement
July 2016

Introduction

1. The SSRO is charged by Section 36(2) and 39(1) of the Defence Reform Act 2014 (the Act) with keeping under review:
 - the extent to which requirements relating to the provision of contract and supplier reports are being complied with; and
 - Part 2 of the Act and the Single Source Contract Regulations 2014 (the Regulations).
2. In January 2016, the SSRO produced its first **Annual Compliance Report**¹. This was based on a small number of qualifying defence contract (QDC) reports and did not name individual QDCs or contractors.
3. This statement provides an update on the Ministry of Defence (the MOD), and in particular its procurement agency (DE&S), and the defence industry's compliance with the Act and the Single Source Contract Regulations (the Regulations) for the period 1 April 2015 to 31 March 2016. This covers the 12 months since the SSRO received notification of its first QDC. The SSRO has received notification of 34 QDCs during the period, three of which have been qualifying sub-contracts (QSCs).
4. The SSRO assesses compliance based on the methodology published in October 2015. The methodology focuses on reporting requirements and the SSRO examines compliance with pricing controls based on reported information. The SSRO challenges the contracting parties if it appears that profit rates have not been calculated in accordance with the prescribed steps or costs that are not Allowable Costs. The SSRO is not aware whether its findings are shared more widely within the MOD for example with the front line commands who engage DE&S to procure equipment and services on their behalf.
5. This interim statement does not include Red-Amber-Green (RAG) ratings for individual contractors in accordance with the methodology. However, it does communicate the key messages and includes RAG ratings for overall compliance with the regime by industry and the MOD as well as for the individual compliance indicators.

Key messages

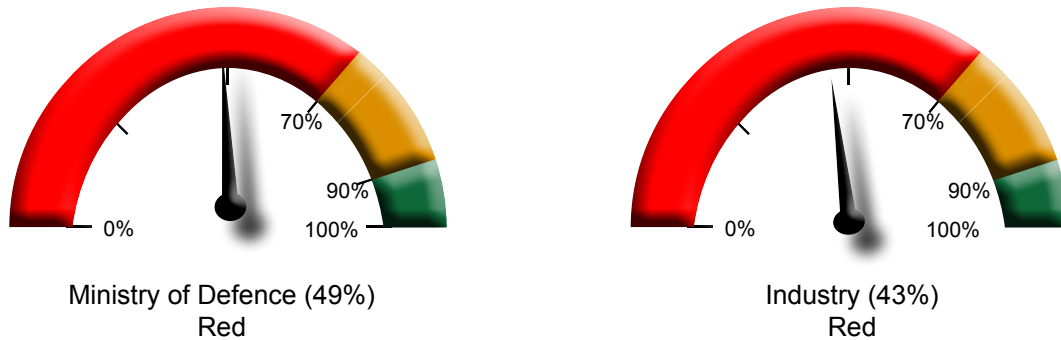
6. For too long single source defence procurement went without effective scrutiny. Through the new single source regime we want to encourage, and drive, improvements in procurement and contracting from both industry and the MOD. This will result in better value for money for the taxpayer.
7. Through the 2015 Strategic Defence and Security Review (SDSR) the Government has provided more money to be spent on greater capability for the United Kingdom's armed forces. In order to deliver what is envisaged by the SDSR, efficiencies and savings must be found. Parliament had the foresight to introduce the new single source regime which can deliver these efficiencies and savings. It is in everyone's interest to make it work. Ultimately it will deliver more capability for front line commands, and a more efficient industry fit to successfully compete and export overseas making a greater contribution to prosperity in the United Kingdom.
8. Success of the single source procurement regime is tested by whether the aims of the Defence Reform Act and the Single Source Contract Regulations are being achieved. We have put in place a number of indicators that will allow us to establish levels of compliance. Over time contractors should become more familiar with the regime requirements and processes for reporting should become embedded within their organisations.

1 <https://www.gov.uk/government/publications/ssro-annual-compliance-report-2015>

9. The following key messages have been identified from our review:

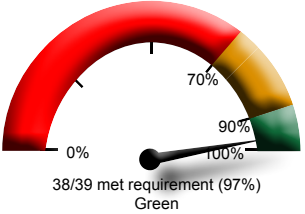
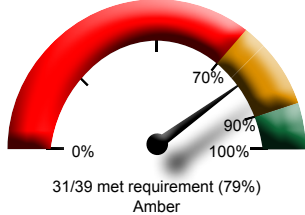
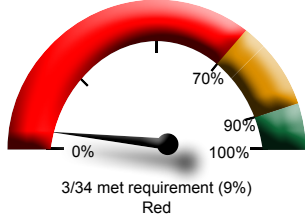
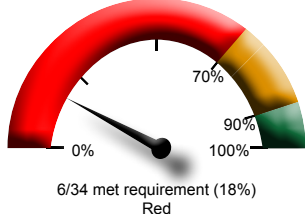
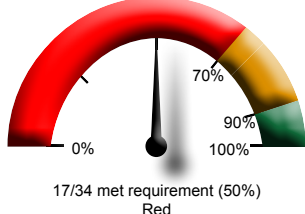
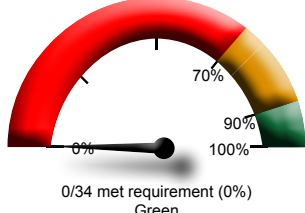
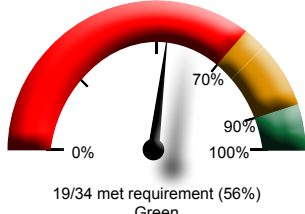

- Overall compliance is currently poor. Six of the eight compliance indicators have red status, one amber, and one green, reflecting significant issues which continue to be reported.

Aggregation of the eight compliance indicators results in the percentages below:



- Not all single source contracts let by DE&S, and which meet the criteria for being a QDC and therefore subject to the requirements of the Regulations, have entered within the regime. A further 20 single contracts were awarded which met the criteria but were not declared by contracting parties as such. The SSRO expected to receive more than 34 QDCs in 2015/16. The SSRO is not informed by the MOD when the Secretary of State exempts a single source contract from the Regulations.
- Twenty-one per cent of report submissions were not made within the statutory deadlines set by the Regulations. All but one of the contractors had submitted all of the required reports as at the date of publication.
- The quality of submissions is still a significant concern. Data quality issues have arisen in 90 per cent of QDC submissions. The remaining 10 per cent without data quality issues equates to only 2 per cent by value of the total QDC submissions or £210 million of the £11.1 billion of contracts awarded.
- The SSRO is unable to confirm what, if any, verification of contract reports is being undertaken by DE&S and/or the MOD. The SSRO does not receive copies of the contracts agreed between DE&S and the contractor so it is not in a position to assess whether information provided in the contract reports accords with what was agreed in the contract.
- Defence contractors' reports do not always comply with the requirement to describe the facts, calculations, information or assumptions that support the inclusion of Allowable Costs or the calculation of the contract profit rate. This means it is not always possible to establish if the contract includes costs that are not appropriate, attributable and reasonable (AAR) and therefore not Allowable.
- The single source procurement regime continues to identify savings. The SSRO has £61 million of potential non Allowable Costs under investigation across 18 QDCs where we now have sufficient information to undertake that review. These 18 QDCs have total value of £2.8 billion. £11.8 million of savings have been identified and confirmed. Furthermore, already in 2016/17, we have confirmed savings of £3.5 million on the first four QDCs.
- We have written to the MOD and contractors on eight occasions notifying them that the contractor's QDC report submissions are non-compliant. To date, we are not aware of any compliance notices or penalty notices having been issued by the MOD.

Below is a summary of the eight compliance indicators which are each explained in Section 5.

	Industry	MOD	% met requirement	Rating
Indicator 1a All reports are submitted	Indicator applies		97%	 <p>38/39 met requirement (97%) Green</p>
Indicator 1b All required reports submitted within the required deadline	Indicator applies		79%	 <p>31/39 met requirement (79%) Amber</p>
Indicator 1c Report data quality was satisfactory	Indicator applies		9%	 <p>3/34 met requirement (9%) Red</p>
Indicator 1d The MOD has informed the SSRO of the QDC		Indicator applies	18%	 <p>6/34 met requirement (18%) Red</p>
Indicator 1e The MOD's notification of the QDC is accurate		Indicator applies	50%	 <p>17/34 met requirement (50%) Red</p>
Indicator 1f The MOD has verified the contractor reports		Indicator applies	0%	 <p>0/34 met requirement (0%) Green</p>
Indicator 2 Contract includes the correct profit rate	Indicator applies		56%	 <p>19/34 met requirement (56%) Green</p>
Indicator 3 All costs are Allowable Costs	Indicator applies		35%	 <p>12/34 met requirement (35%) Green</p>

The regime

10. During the 2015/16 financial year, the SSRO has received notification of 34 qualifying defence contracts (QDCs). This includes three qualifying sub-contracts (QSCs). The SSRO has received 179 report submissions which we have reviewed, are in the process of reviewing, or have just received and not yet reviewed, for compliance with the Act and the Regulations. This includes the initial report submissions, re-submissions and a small number of further reporting requirements as specified in the Regulations.
11. Not all single source contracts let by DE&S, which meet the criteria for being a QDC and therefore should be subject to the requirements of the regime, have become qualifying defence contracts or qualifying sub-contracts. The SSRO still relies on the Defence Contracts Bulletin to identify all single source defence contracts as there is no requirement for the MOD to inform the SSRO as the regulator. There were 20 non-QDC single source contracts, totalling £845 million, published in Defence Contracts Bulletin in this period which were not QDCs but met the criteria to allow them to be QDCs. While 34 QDCs is significantly higher than the 12 QDCs reported in January 2016, we have still not received the volume we expected. The total value of QDC/QSCs reported is £11.1 billion and includes the three qualifying sub-contracts (£207 million).
12. The SSRO expects that the value of all new single source contracts (and not just QDCs) let by the MOD in 2015/16 will be higher than £11.1 billion. It is not possible for the SSRO to identify the total value of all new single source contracts let in 2015/16 until the MOD statistics on single source and competitive contract spend are published in August.
13. The qualifying defence contracts and sub-contracts currently on our Register are with 17 different suppliers but BAE Systems holds just over a quarter (26 per cent) of all contracts. Only three QDCs are with a foreign contractor², and the remainder are with UK registered defence suppliers. The SSRO continues to assist contractors work to ensure that contractors entering into a QDC or QSC for the first time understand the requirements of the regime and are able to report to the SSRO in a timely manner. This interim compliance statement gives an overview of the extent to which contractors and the MOD are complying with the Defence Reform Act, the Regulations and the SSRO's statutory guidance.

Key figures

£11.1 billion

Value of QDCs notified to the SSRO in 2015/16

£11.9 million

Confirmed savings relating to 2015/16 QDCs

£60.9 million

Costs under investigation with 18 of 34 QDCs

£3.5 million

Savings on the profit of 4 QDCs in Q1 2016/17

£5.6 million

Annual running costs of the SSRO

² Industria de Turbo Propulsores, S.A., Saab AB and Van Kappel BV are non-UK registered companies.

Contract details

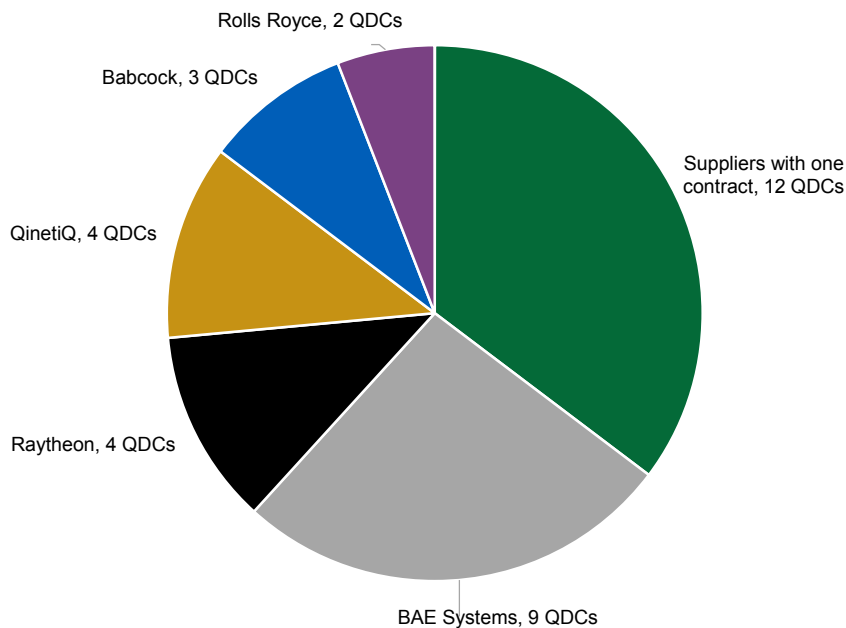
14. About half of the 34 QDCs notified to the SSRO have a total contract value of between £10 million and £50 million. There are twelve contractors with one QDC³ and five with more than one contract.

Figure 1: Total contract value for QDCs entered into in 2015/16



Source: Reports submitted by suppliers to the SSRO. Based on 34 QDCs.

Figure 2: Number of QDCs by supplier in 2015/16 (Total 34 QDCs)

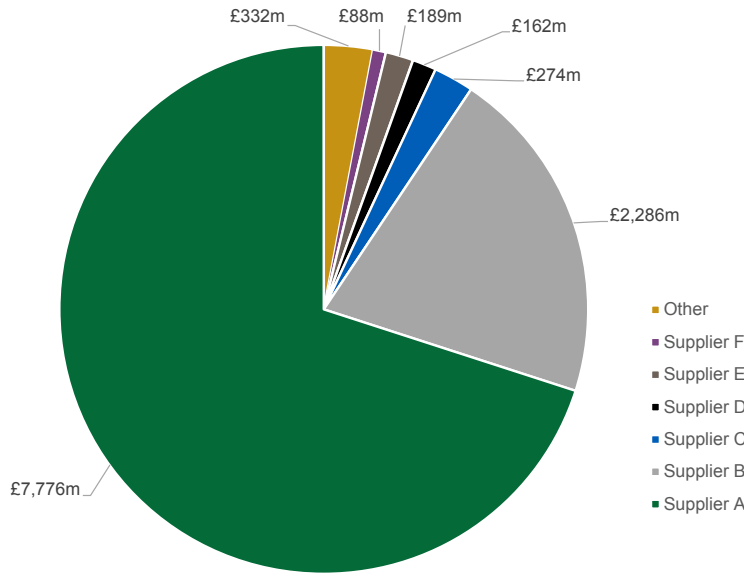


Source: Reports submitted by suppliers to the SSRO. Based on 34 QDCs.

³ Smiths Detection - Watford Limited, CGI IT UK Limited, Saab AB, Turbomeca UK Limited, Thales UK Limited, UAV Tactical Systems Limited, Airbus Defence and Space Limited, Airborne Systems Limited, Lockheed Martin UK Holdings Limited, Industria de Turbo Propulsores, S.A., Van Kappel BV and AWE Management Limited.

- One single contract for £7.8 billion represents 70 per cent of the total value of the 34 QDCs notified to the SSRO in the current reporting year. The reports for this contract have only recently been received and as such have not yet been analysed.

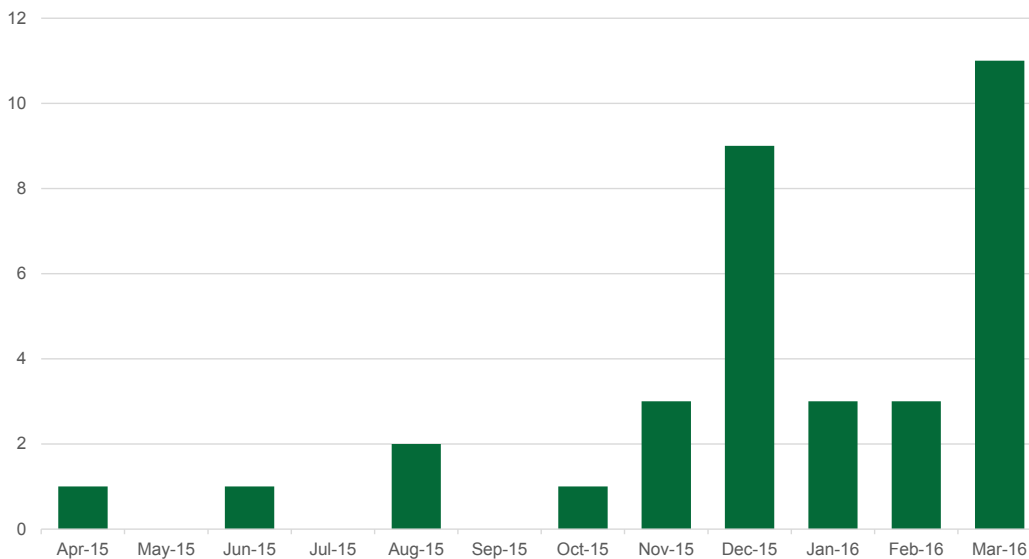
Figure 3: Value of QDCs held by suppliers in 2015/16 (Total £11.1 billion)



Source: Reports submitted by suppliers to the SSRO. Based on 34 QDCs.

- The majority (88 per cent) of contracts were entered into in the second half of 2015/16 around contractor and/or MOD financial year end dates.

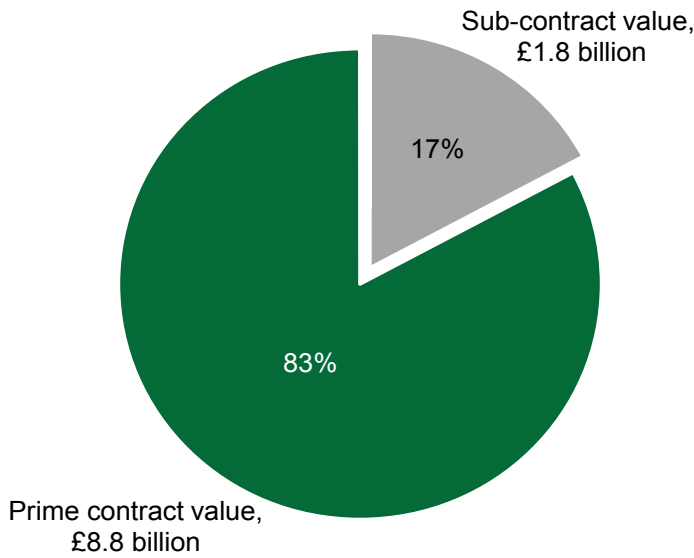
Figure 4: Number of new QDCs/QSCs entered into each month (2015/16)



Source: Reports submitted by suppliers to the SSRO. Based on 34 QDCs.

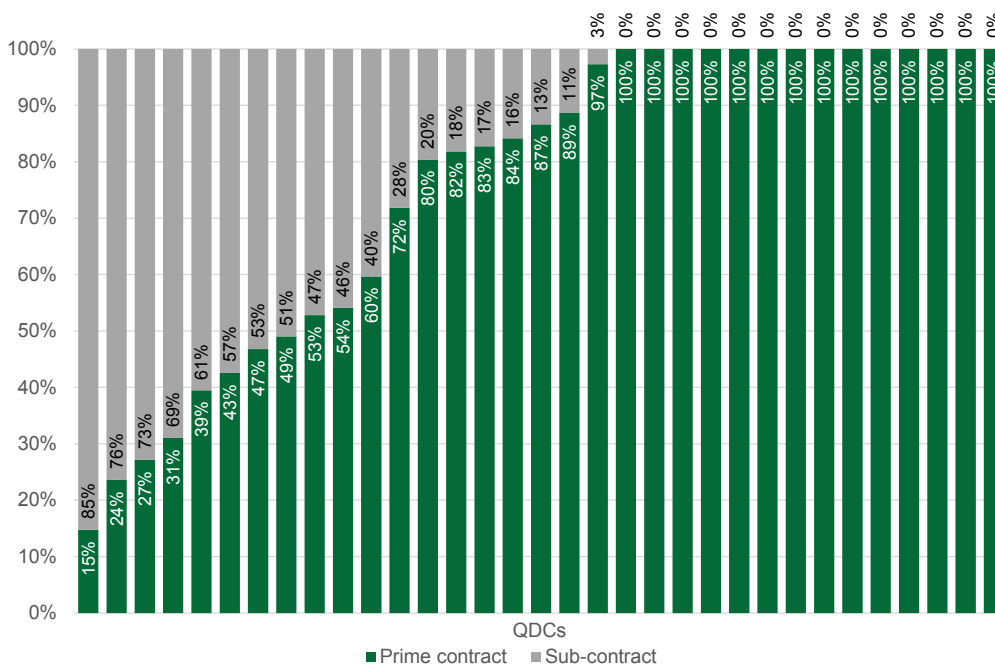
17. Within the group of 33 QDCs (one QDC was excluded due to data quality issues) in 2015/16 where analysis of sub-contracts was possible:
 - There were 112 sub-contracts reported and the value of these sub-contracts was £1.8 billion. This a minimum figure as suppliers are only required to report contracts of over £1 million, and only their top 20 sub-contracts by value. The actual number and value of all sub-contracts is likely to be higher.
 - The sub-contracts reported comprise 17 per cent of the total value of 33 QDCs in 2015/16. The total contract value of the 33 QDCs is £10.6 billion.

Figure 5: Total value of sub-contracts as a proportion of total QDC contract value (based on 33 QDCs in 2015/16 with a total value of £10.6 billion)



18. Sub-contracts ranged from 3 per cent to 85 per cent of the contract value for individual QDCs in 2015/16. 14 QDCs reported no sub-contracts of over £1 million in value.

Figure 6: Sub-contracts as a percentage of contract value in individual QDCs 2015/16



Note: Based on 33 QDCs as one QDC was excluded due to data quality issues. 112 sub-contracts were reported in 2015/16. This is a minimum figure as suppliers are only required to report contracts of over £1 million, and their top 20 sub-contracts by value. The actual number and value of all sub-contracts is likely to be higher.

Compliance indicators

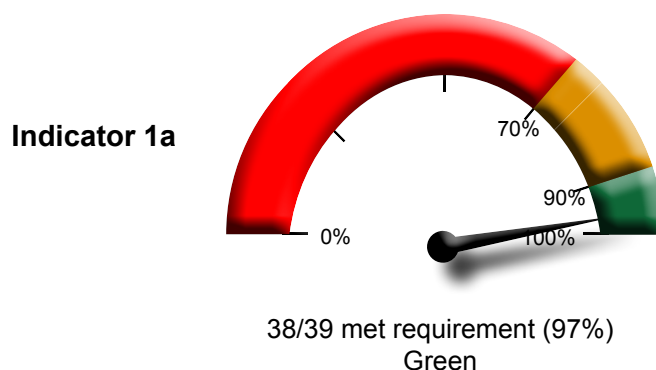
19. This section sets out the SSRO's published indicators which we use to assess compliance of the Ministry of Defence and contractors to the DRA and the Regulations. Our RAG status indicators are:

RAG Status	Percentages
Green	>90 – 100 per cent
Amber	>70 – 90 per cent
Red	0 – 70 per cent

20. The SSRO's review of the extent to which the requirements relating to contract and supplier reports are being complied with begins with its assessment of the Contract Notification Report, Contract Reporting Plan and the Contract Pricing Statement. These three reports must be submitted to the SSRO within one month of the contract being entered into.
21. Where requirements in the reports are missing or incomplete, the SSRO first raises these informally with the contractor. If there is no response or if the response is deemed to be unsatisfactory then the SSRO escalates the issue and ultimately reports on the area(s) of non-compliance to both parties to the contract.

All reports are submitted (Indicator 1a)

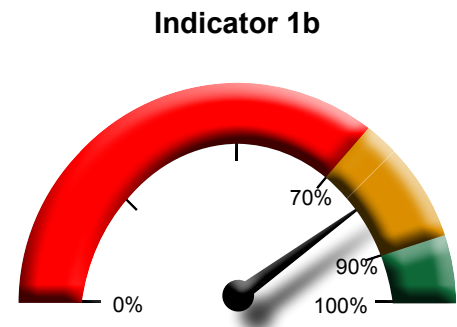
22. Section 24(2)(b) of the Act requires every report under Part 5 of the Regulations to be provided to the Secretary of State and the SSRO within timescales prescribed for each type of report. All but one of the contractors have met the requirement to provide these reports⁴ though not all within the prescribed timescales as shown in the timescale indicator below. This demonstrates that contractors understand the reports they are required to submit. The SSRO published all reporting templates and user guides on its website in May 2015 and these were refreshed in April 2016. The user guides aid the contractors with completing the required reports. In addition to operating a Helpdesk, publishing SSRO Answers and an FAQ document, we have contacted every contractor as soon as we are notified of a QDC to assist them with the reporting requirements for their first QDC or QSC. Industry has welcomed this assistance but this has not always been reflected in the quality of the reports as shown in the data quality indicator below.



⁴ 39 sets of reports were considered for Indicators 1a and 1b. This is made up of 34 initial reports plus five supplier reports as required by the Regulations.

All required reports submitted within the required deadline (Indicator 1b)

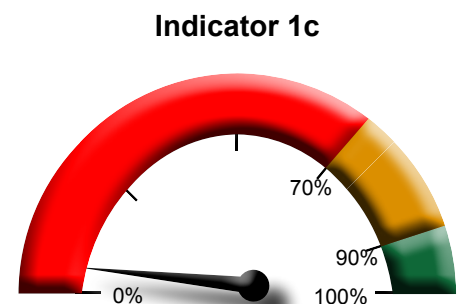
23. Regulation 23, 24 and 25 requires the first three reports (Contract Notification Report, Contract Pricing Statement and Contract Reporting Plan) to be submitted within one month of the initial reporting date. Generally, contractors have achieved the statutory reporting deadlines. Eight suppliers' reports were not submitted within one month.



31/39 met requirement (79%)
Amber

Report data quality was satisfactory (Indicator 1c)

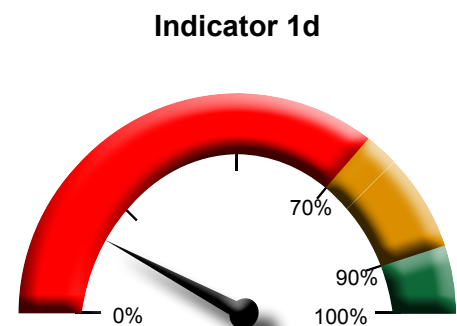
24. The quality of submissions remains a serious concern. In most cases the submissions are incomplete and having reviewed the descriptions of the calculations, facts, information and assumptions the SSRO is provided with, this does not always reconcile to other supporting information received. This means the SSRO is unable to conclude whether the statutory guidance has been followed. This indicator measures the extent to which submissions are incomplete. In addition, in many cases, contractors fail to provide the required information on metrics, outputs and the required lines of the defined pricing structure. We continue to work with contractors and the MOD to help both parties to address data quality issues and in only eight instances have we reached the point in our compliance process where we would recommend to the MOD that a compliance notice should be issued.



3/34 met requirement (9%)
Red

The MOD has informed the SSRO of the QDC (Indicator 1d)

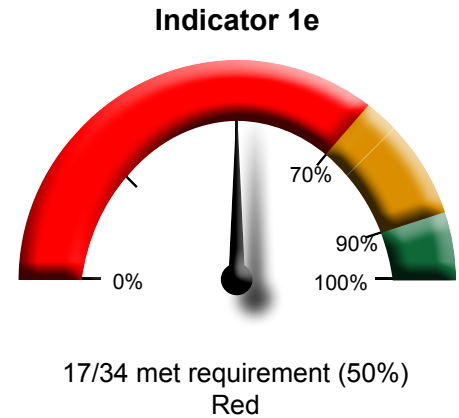
25. The SSRO has, as part of its published compliance methodology, asked the MOD to inform the SSRO within five working days of when a new QDC has been awarded or entered into, provide basic information (indicator 1e) on the QDC. These notifications, whilst not a statutory requirement, enable the SSRO to contact contractors in advance of them submitting reports to offer assistance and ensure the integrity of the database. Once reports are received they are logged in the SSRO's statutory QDC register and checked against the contractor submissions. In six cases, the MOD's notification has been more than one month after the date the contract was entered into. This means the SSRO cannot make contact with a contractor before the statutory deadline for the submission of the first QDC reports. The SSRO is also unable to offer assistance with understanding the reporting requirements, answer any queries or provide access to the secure online portal for submitting reports.



6/34 met requirement (18%)
Red

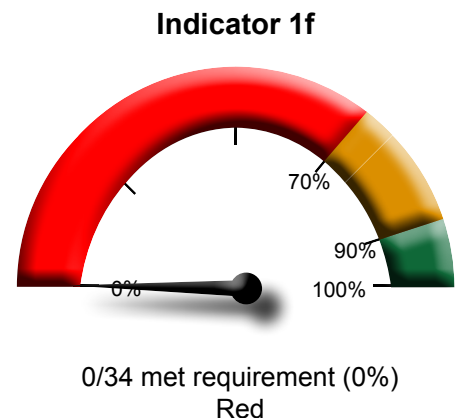
The MOD's notification of the QDC is accurate (Indicator 1e)

26. Linked to indicator 1d above the SSRO also requests the MOD provide basic information on the QDC when it notifies the SSRO of a new QDC. The information that has been supplied by the MOD does not always match that which is included in the statutory reports from the contractor. In 13 cases there has been a disparity between the contract price notified by the contractors and the information provided by the MOD. The budget implications for the difference in contract values equates to £379 million. In addition, there are often significant differences between the contractor's initial three reports themselves.



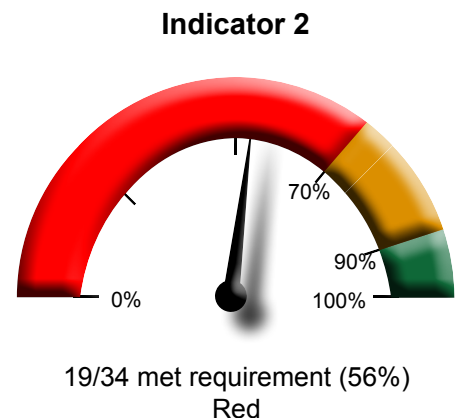
The MOD has verified the contractor reports (Indicator 1f)

27. The SSRO asks the MOD to verify information reported by contractors on Allowable Costs and contract profit rates. This is a key indicator as the SSRO needs to understand whether information is accurate in order to determine the extent to which contractors are complying with reporting requirements. The MOD agreed to notify the SSRO of verification within 30 days of receiving the reports, but has not confirmed verification of any reports. The SSRO has no visibility of contracts to check that reported information accords with what has been agreed, so the absence of verification limits the SSRO's ability to discharge its duty under Section 36(2) of the Act.



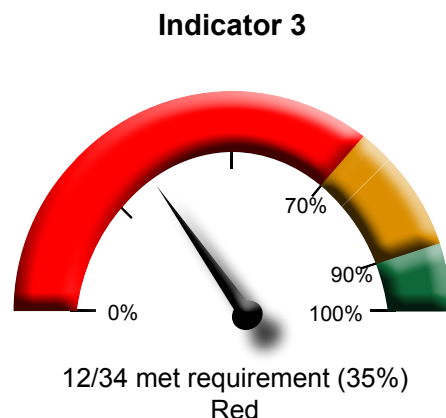
Contract includes the correct profit rate (Indicator 2)

28. The price controls established by the Act and the Regulations require that the contract profit rate be calculated by a six-step process that starts with a baseline profit rate. The SSRO issues statutory guidance on how the contract profit rate must be calculated using the Act's six steps. No deviations from the SSRO's guidance have been reported, which would be required by Regulation 23(2)(c) if the guidance has not been followed. However, the SSRO has identified 15 QDCs where the profit rates appear to have been incorrectly calculated or there is insufficient information to establish that they are correct. The key issues identified include insufficient description of the facts, calculations, information or assumptions for contract risk adjustment and incorrect application of profit on cost once (POCO) adjustments.



Allowable Costs (Indicator 3)

29. The other key element of the price controls established by the Act and the Regulations is that costs must be Allowable. The SSRO issues statutory guidance that the MOD and contractors must have regard to when determining whether costs meet the test of being appropriate, attributable to the contract and reasonable in the circumstances. No deviations from the SSRO’s guidance have been reported, which would be required by Regulation 23(2)(c) if the guidance has not been followed. As part of analysing reports and supporting information the SSRO has identified many instances of costs which appear to be non-Allowable and not in accordance with its statutory guidance. The SSRO investigates such cases and challenges the contracting parties to explain their approach. This indicator measures the extent to which the SSRO has challenged the inclusion of reported Allowable Costs.



Costs under investigation

30. As part of our review of the reporting requirements, we have identified many instances of costs which have been declared as Allowable but which appear not to be Allowable or where the SSRO has seen insufficient description of the facts, calculations, information or assumptions to support them. We are reviewing £61 million of such costs across 18 QDCs where we now have sufficient information to undertake that review. These 18 QDCS have a total value of £2.8 billion. Examples of costs include:

Price risk	Rates and inflation
Sales and marketing costs	Warranty costs
Accommodation costs	Learning curve
Bid costs	Faulty workmanship
Depreciation costs	Hospitality and entertaining costs, Christmas parties
Pre-contract costs	Capital costs
MOD information and regime costs	Profit rate adjustments
Charitable donations	Share options

31. The SSRO can confirm £11.9 million savings in its first year of operating to the new single source procurement regime. These savings have emerged from the SSRO's first opinion and determination and the change to the baseline profit rate as follows:

Source of savings	Total
Sales and Marketing	£0.5 million
Cost Risk Adjustment	£0.8 million
Total SSRO Determination	£1.3 million
SSRO Opinion	£0.6 million
Other Confirmed Cost Reductions	£0.1 million
Reduction in baseline profit rate	£9.9 million
TOTAL	£11.9 million

Conclusion

32. Clearly significant progress is still required by contractors and the MOD to increase compliance with the Act and the Regulations. This interim compliance statement includes key messages intended to facilitate and promote this. The SSRO will continue to raise compliance issues with individual contractors and the MOD as contracts are assessed, providing the opportunity for matters to be resolved in a timely manner.
33. The SSRO will continue to enhance and add to guidance around contract and supplier reports to assist compliance with the Act, Regulations and the Statutory Guidance.
34. The SSRO has received notification of four further contracts during the 2016/17 year to June 2016, which are not included in this interim statement.
35. The SSRO will publish its full annual Compliance Report for the period 1 April 2015 to 31 October 2016 in January 2017.

...the first of these is the fact that the ...

...the second of these is the fact that the ...

...the third of these is the fact that the ...

...the fourth of these is the fact that the ...

...the fifth of these is the fact that the ...

...the sixth of these is the fact that the ...

...the seventh of these is the fact that the ...

...the eighth of these is the fact that the ...

...the ninth of these is the fact that the ...

...the tenth of these is the fact that the ...

...the eleventh of these is the fact that the ...

...the twelfth of these is the fact that the ...

...the thirteenth of these is the fact that the ...

...the fourteenth of these is the fact that the ...

...the fifteenth of these is the fact that the ...

...the sixteenth of these is the fact that the ...

...the seventeenth of these is the fact that the ...

...the eighteenth of these is the fact that the ...

...the nineteenth of these is the fact that the ...

...the twentieth of these is the fact that the ...

...the twenty-first of these is the fact that the ...

...the twenty-second of these is the fact that the ...