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Single Source  
Regulations Office

*Assuring value, building confidence*

# 2017/18 Profit rate consultation

## Summary of responses

# Contents

1. Introduction	1
2. The comparability principle	3
3. Multiple rates	15
4. Deriving a profit-level indicator	17
5. Replicating our approach to data gathering	22
6. The SSRO funding adjustment	24
7. Other issues	26
8. Next steps	28
Appendix 1: Glossary of terms	29

# 1. Introduction

## Background

- 1.1 Section 19 of the Defence Reform Act 2014 (the Act) states that, for each financial year, the SSRO must provide the Secretary of State for Defence with its assessment of the appropriate baseline profit rate (BPR) for single source defence contracts, SSRO funding adjustment and capital servicing rates (CSRs). This is to assist the Secretary of State in determining those amounts for each financial year.
- 1.2 In announcing the BPR and CSRs for 2016/17, the Secretary of State asked the SSRO 'further to develop the methodology used to calculate the baseline profit rate over the next year'.<sup>1</sup> We have carried out a review of the methodology and in July 2016 we published a consultation<sup>2</sup> on how we plan to update the approach we take to setting the BPR for 2017/18. The consultation covered our proposals for moving from one BPR to six, which we believe will better reflect the diversity of the activities undertaken in qualifying defence contracts (QDCs) and qualifying sub-contracts (QSCs). We also outlined how the SSRO would implement the SSRO funding adjustment in 2017/18, through which single source contractors with QDCs would contribute to half of the running costs of the SSRO.
- 1.3 The SSRO's consultation proposals were published on our website on 8 July 2016. Alongside the consultation we published examples of the methodology we would use to calculate multiple BPRs and the CSRs<sup>3</sup> and how contractors and the Ministry of Defence (MOD) would apply these in practice in agreeing contract profit rates.<sup>4</sup>
- 1.4 We wrote to the MOD, single source defence contractors and other interested organisations to make them aware of the consultation. We invited comments on the intended approach to the calculation and application of the multiple BPRs and the SSRO funding adjustment for 2017/18. The closing date for consultation responses was 18 August 2016.
- 1.5 We received consultation responses from 11 organisations, including eight contractors to the MOD, and we would like to take this opportunity to thank respondents for sharing their views with us.

	Govt	Industry	Regulators/ other government bodies	Trade and professional associations and think tanks	Research/ academics	Consultants	Total
Number of stakeholders invited to comment	1	30	19	11	5	5	71
Number of responses received	1	8	0	1	0	1	11
Response rate (%)	100	27	0	9	0	20	15

<sup>1</sup> Michael Fallon MP, Secretary of State for Defence (2016) *Single Source Contracts: Written Statement* – HCWS618.

<sup>2</sup> SSRO (2016) *2017/18 Profit Rate Consultation*.

<sup>3</sup> SSRO (2016) *Baseline Profit and Capital Servicing Rates Methodology 2017/18: Illustrative Example*.

<sup>4</sup> SSRO (2016) *Guidance on Adjustments to the Baseline Profit Rate 2017/18: Illustrative Example*.

- 1.6 We have published separately a compendium of the responses where permission was given to do so.<sup>5</sup>

#### Issues raised

- 1.7 There was much commonality in the issues raised by industry respondents. Many explicitly supported or repeated the points raised by ADS, an aerospace and defence industry trade association. This publication summarises the main issues and indicates our response to them. We have categorised the issues under six headings:
- The comparability principle (Section 2);
  - Multiple rates (Section 3);
  - Deriving a profit-level indicator (Section 4);
  - Replicating our approach to data gathering (Section 5);
  - The SSRO funding adjustment (Section 6); and
  - Other issues (Section 7).

#### Next steps

- 1.8 The final section of this document outlines the forward timetable by which the SSRO will finalise and publish the BPR methodology and make its recommendation on the BPR for 2017/18 to the Secretary of State.

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5 The compendium of responses is available on the SSRO website at: <https://www.gov.uk/government/consultations/review-of-single-source-baseline-profit-and-capital-servicing-rates-methodology-and-adjustment-guidance-2016>.

## 2. The comparability principle

### Background

- 2.1 Prior to 2016/17, the Review Board for Government Contracts calculated the BPR based on the principle that defence contractors should receive a return equal on average to the overall return earned by British industry having regard to both capital employed and cost of production (the comparability principle). The Review Board's calculation was based on a reference group of more than 600 UK companies listed on the UK Stock Exchange. The reference group excluded companies from financial, regulated and primary industrial sectors (such as mining) but included a wide range of companies from other sectors, for example the retail, manufacturing, pharmaceuticals and food and drink industries.
- 2.2 In 2015, the SSRO reviewed the principles and approach used to set the BPR.<sup>6</sup> We concluded that comparability was important in setting the profit rate as this would ensure fairness for contractors. However, we believed the Review Board's approach to identifying comparable companies resulted in a reference group that was too functionally diverse, and that the comparability principle needed to be updated. We consulted on a proposal to introduce separate profit rates for different types of activity undertaken in QDCs and QSCs, based on our review of contract activities. This would enhance comparability in setting the BPR, as contractors would earn returns that were set with reference to more appropriate groups of companies undertaking similar activities. Such a change would result in returns for contractors that were both fair and reasonable and that represented value for money for taxpayers.
- 2.3 Respondents to the 2015 consultation generally supported the principle of separate rates for different activities although there was mixed support for the activity types we proposed at that time. Respondents also highlighted that multiple rates might be difficult to apply in practice, particularly where contracts covered multiple activities.
- 2.4 The nature of the equipment and services that the MOD will procure over the next decade has been clearly signalled in its October 2015 update to the Defence Equipment Plan.<sup>7</sup> The MOD plans to spend £166 billion on the support and equipment needed by the armed forces up to 2024/25. This is a mixture of equipment and services in roughly equal proportions. The MOD also has a well-established acquisition model that recognises six phases in the product life-cycle: Concept, Assessment, Demonstration, Manufacture, In-service and Disposal (CADMID).

6 SSRO (2015) *Review of Single Source Contract Profit Rate Methodology 2015*.

7 MOD (2015) *The Defence Equipment Plan 2015*.

- 2.5 We developed our proposals further following the consultation and concluded that a simpler grouping of activities would make it easier to apply multiple rates to contracts and increase the number of companies within the activity type comparator groups, providing for more stable comparisons over time.<sup>8</sup> The activity types for which we decided profit rates should be developed were:
- Develop and Make (D&M) – for activities within concept, assessment, demonstration, manufacture and disposal phase contracts;
  - Provide and Maintain (P&M) – for activities within ‘in-service’ phase contracts and contracts for the provision or availability of equipment;
  - Ancillary Services – including back office and routine support services, for example, clerical work or upkeep of grounds and facilities; and
  - Construction – applicable to contracts for construction or related activities, which include architectural, engineering and/or building services.<sup>9</sup>
- 2.6 Where contracts covered a combination of activities from the D&M and P&M activity types, a ‘composite rate’ could be applied based on the average of the applicable rates.
- 2.7 Before we made our recommendation to the Secretary of State in January 2016 he issued statutory guidance to the SSRO that for 2016/17 the methodology should result in the setting of a single BPR. He noted, however, that the MOD supported the principle that multiple rates would better reflect the risk and reward balance in single source defence contracts.<sup>10</sup> Following consideration of the maturity of the new regime, the SSRO recommended a single BPR for 2016/17 to the Secretary of State in January 2016<sup>11</sup> and made clear that we would continue to work towards having multiple profit rates from 2017/18.
- 2.8 For the purpose of setting the BPR in 2017/18 we again consulted on a proposal to introduce multiple profit rates for different activities. We consulted on six rates. They included the five rates signalled in our response to the 2015 consultation, together with a ‘zero rate’ category for contracts with organisations that are not permitted or do not wish to make a profit and/or where the MOD and contractor agree a zero rate is appropriate.
- 2.9 Our consultation this year provided further detail on the activities included in the Ancillary Services and Construction activity types and on how the MOD and contractors would select the most appropriate BPR for the purpose of calculating a contract profit rate. We comment below on specific points raised by respondents in relation to the way that we have updated the comparability principle and how we operationalise this through the BPR calculation process.

### The basis of comparability

- 2.10 Four respondents made general comments that the approach we adopted for 2016/17 was no longer sufficiently comparable to UK defence contractors.
- 2.11 The approach that the SSRO introduced for 2016/17 provides a sound basis for determining the BPR that is preferable to the previous approach, which had been in place since 1968. Its principal benefit is that it is more focused on companies whose activities resemble those that contribute to the delivery of QDCs and QSCs, which results in a more appropriate set of comparable companies for determining the BPR. While we have narrowed the basis of comparability, by excluding companies that we do not consider to undertake comparable activities, it has not been our intention to confine comparison to defence companies. We explain the reasons for this below.

<sup>8</sup> SSRO (2016) *Review of Single Source Contract Profit Rate Methodology 2015: Response to Consultation*.

<sup>9</sup> We noted that it would be usual for both Ancillary Services and Construction contracts to be competed.

<sup>10</sup> Letter from Michael Fallon, Secretary of State for Defence, to Jeremy Newman, Chair of Single Source Regulations Office, 20 January 2016.

<sup>11</sup> We recommended a ‘composite’ rate that was the average of the rates we calculated for the D&M and P&M activity types.

- 2.12 The approach we take has been informed by transfer pricing principles.<sup>12</sup> In determining the appropriateness of transfer prices for goods or services exchanged between associated enterprises<sup>13</sup> ('controlled' transactions), tax authorities will look at the prices charged or profit made on 'uncontrolled' transactions undertaken by the same or similar companies operating at arm's length from their customers in comparable economic circumstances. This is a similar undertaking to determining what level of profit should be made on a non-competitive contract by reference to the profits earned by companies operating in competitive environments.
- 2.13 In developing our approach we have considered the best practice for transfer pricing comparability analysis recommended by the OECD.<sup>14</sup> The OECD's guidelines suggest that the closest comparator for determining the appropriate return on non-competitive contracts between defence companies and the MOD would be the returns made on contracts between those contractors and the MOD (or other customers) which are subject to competitive pressure. However, we do not have access to such contract-level data. An alternative approach is to consider the profits made by companies. However, looking just at UK defence contractors would be too limited a comparator base on which to determine the BPR in a way that would give both fair returns and achieve value for money for taxpayers. Returns would be based on companies with a significant proportion of business in non-competitive markets and there would be a risk of circularity in determining the BPR.
- 2.14 Our application of the OECD's guidance is, therefore, to identify an overall measure of the returns<sup>15</sup> of comparable companies whose economic activities are included, in whole or in part, in the activity types that contribute to the delivery of QDCs and QSCs.<sup>16</sup>
- 2.15 To make such a comparison in practice, in a way that is both objective and replicable, we have developed the methodology and criteria we apply when searching for comparable companies.<sup>17</sup> This has involved:
- (1) reviewing the activities undertaken by contractors in single source defence contracts;
  - (2) identifying a set of internationally recognised activity codes<sup>18</sup> and textual search terms that can be used to identify companies undertaking those activities;
  - (3) establishing other search criteria such as legal form, degree of shareholder control, country of incorporation and size (based on turnover) where these are needed to restrict the search to comparable companies that operate independently in economically similar markets;
  - (4) selecting an appropriate database of company financial information and using it to conduct a search for data on companies that meet the search criteria; and
  - (5) undertaking a manual review of the companies identified by the database search to provide assurance that the search has returned comparable companies.

12 The principles that underpin tax authorities' assessments of the tax liabilities of multinational enterprises that transfer goods or services between their component entities across territorial boundaries.

13 Enterprises where one has a controlling interest in the other, or where both are controlled by another enterprise.

14 Organisation for Economic Cooperation and Development (OECD) (2010) *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.

15 The SSRO uses net cost plus as the profit-level indicator. We discuss issues related to how we derive a profit-level indicator in Section 4.

16 Appendix 1 provides a glossary of key terms used in this publication.

17 SSRO (2016) *Single Source Baseline Profit and Capital Servicing Rates Methodology*.

18 We use NACE (Nomenclature des Activités Économiques dans la Communauté Européenne) codes; the European statistical classification of economic activities. NACE groups organisations according to their business activities. Financial databases can also map these to North American industry codes.



- 2.16 Having defined our search with reference to the activities undertaken by defence companies in single source contracts, we would expect defence companies to appear in the activity type comparator groups. Five of the nine parent companies paid over £500 million<sup>19</sup> by the MOD in 2014/15 were present in one of the 2016/17 comparator groups. Five others paid more than £50 million were also present (Figure 1). Where companies were absent, there are clear and logical reasons for this (see paragraph 2.29). We are satisfied that the MOD's suppliers are present in the comparator groups to the extent that they meet the criteria for inclusion applied to every other company.

**Figure 1: Representation of the MOD's main suppliers in the 2016/17 BPR comparator groups**

Amount of MOD spend with supplier in 2014/15 *	Number of suppliers	Number in comparator groups
Over £500m	9	5
£250m - £500m	7	1
£100m - £250m	16	2
£50m - £100m	20	2
Total	52	10

\* For details of holding companies paid more than £50 million in 2014/15 see MOD (2015) *Finance & Economics Annual Bulletin Trade, Industry & Contracts Statistics 2015* (p6) available at [www.gov.uk/government/collections/defence-trade-and-industry-index](http://www.gov.uk/government/collections/defence-trade-and-industry-index).

Source: SSRO

- 2.17 In summary, we are satisfied that our approach achieves a reasonable level of comparability.

**SSRO response:** We do not intend to make any further changes at this time to the basis of comparability.

## Activity codes

- 2.18 The OECD's transfer pricing guidance<sup>20</sup> supports the use of economic activities undertaken in similar economic circumstances as the basis for comparison, as the level of compensation an enterprise receives from a transaction usually reflects the economic activities it performs, the assets used and the risks assumed.<sup>21</sup>
- 2.19 We published the activity codes (NACE codes) that we used to identify comparable companies for the D&M and P&M activity types in January 2016.<sup>22</sup> Our July 2016 consultation included details of the NACE codes we proposed to use for the Ancillary Services and Construction activity types. Our selection of NACE codes is based on our 2015 review of the activities undertaken within QDCs and QSCs.

<sup>19</sup> From either competitive or non-competitive contracts.

<sup>20</sup> OECD (2010) *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.

<sup>21</sup> Other elements of the methodology for establishing a contract profit rate take account of variances in the use of assets (the capital servicing adjustments) and risks assumed (the cost-risk adjustment) by contractors.

<sup>22</sup> SSRO (2016) *Single source baseline profit and capital servicing rates methodology*.

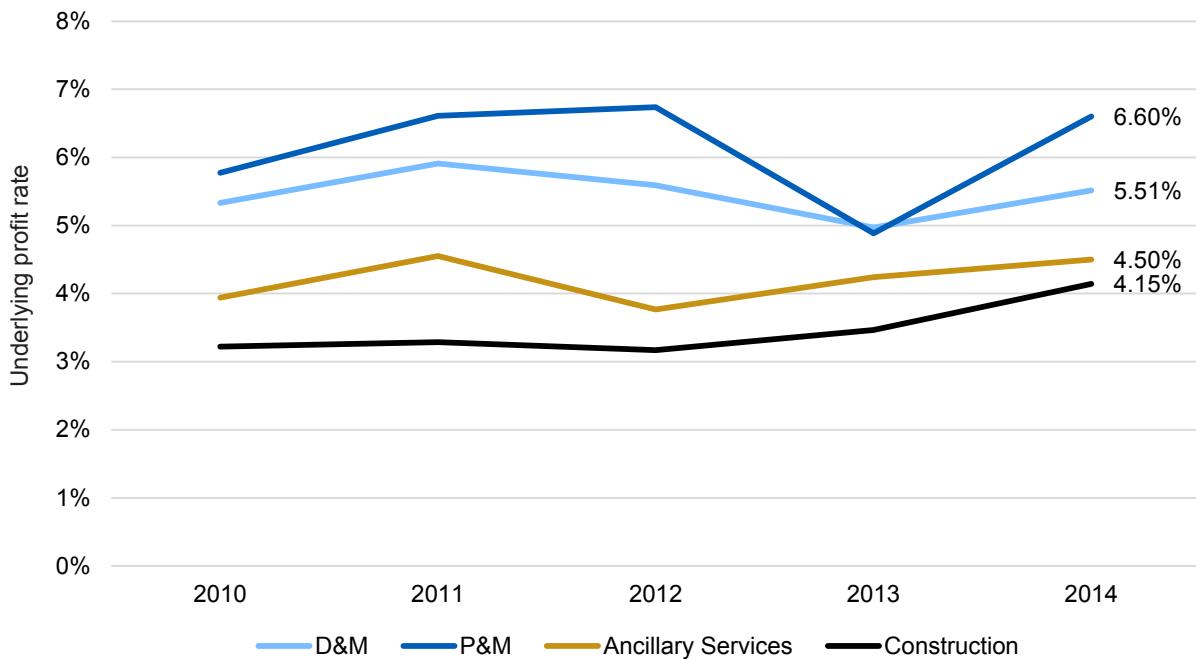


- 2.20 Respondents commented that the selection of codes used last year had resulted in the inclusion of non-comparable companies. We have reviewed the NACE codes used to conduct the company search and are satisfied that they reflect the comparability principle set out in paragraph 2.14.
- 2.21 Respondents identified two other codes that they felt should be included going forward:
- 8020: Security systems service activities – This code includes monitoring or remote monitoring of electronic security alarm systems, along with related support and sales activities. This appears to warrant inclusion under the security aspect of facilities support under the Ancillary Services activity type.
  - 84: Public administration and defence; compulsory social security – This code includes activities of a governmental nature, normally carried out by the public administration. This includes the enactment and judicial interpretation of laws and their pursuant regulation, as well as the administration of programmes based on them, legislative activities, taxation, national defence, public order and safety, immigration services, foreign affairs and the administration of government programmes. We think the code is too broad for inclusion.
- 2.22 In addition to considering the codes suggested above, we have reviewed the list of available NACE codes in the light of activities undertaken in QDCs and QSCs and identified a small number of additional codes that we will include in the company search going forward.

**SSRO response:** We do not propose removing any of the codes used in the company search for the 2016/17 BPR calculation. We do, however, propose to include a small number of additional codes going forward. We will publish the full list of codes used for each activity type in our BPR methodology in January 2017.

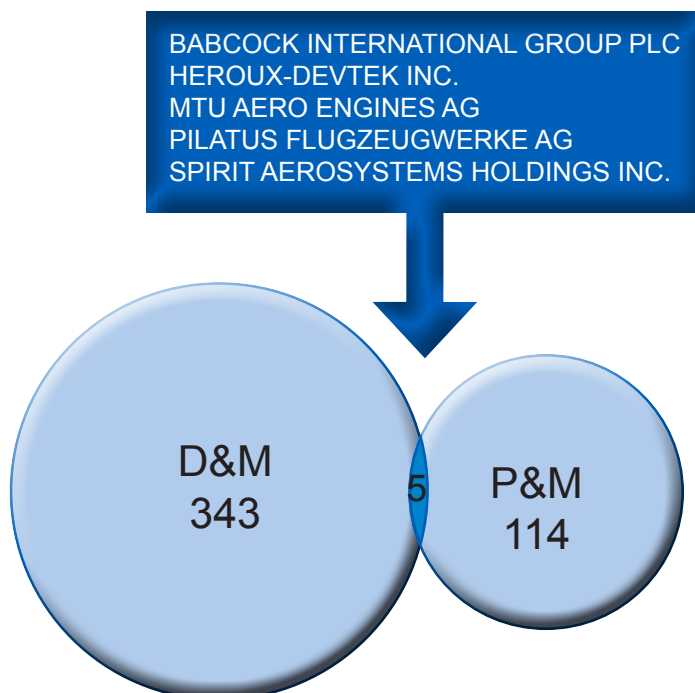
### Activity types

- 2.23 Respondents expressed differing views about the merits of having more-generic or more-specific comparator groups.
- 2.24 Some commented that the activity types proposed were not sufficiently distinctive as to merit separation or that the introduction of separate activity types would lead to smaller groups and, consequently, anomalies in the calculation of the BPR. Using the data collected for the 2016/17 BPR calculation we observe that the underlying profit rates for the different activity type comparator groups were broadly stable with a consistently different hierarchy in most years from 2010 to 2014 (Figure 2). This indicates to us that the groups of companies associated with different activity types are sufficiently large and distinct to provide stability over time in the calculation of multiple profit rates.

**Figure 2: Underlying profit rate for activity type comparator groups 2010 to 2014**

Source: SSRO

2.25 The activity types contain distinct sets of NACE codes so overlap between them is rare. For the 2016/17 BPR calculation only 5 out of 462 companies appeared in both the D&M and P&M comparator groups (Figure 3).

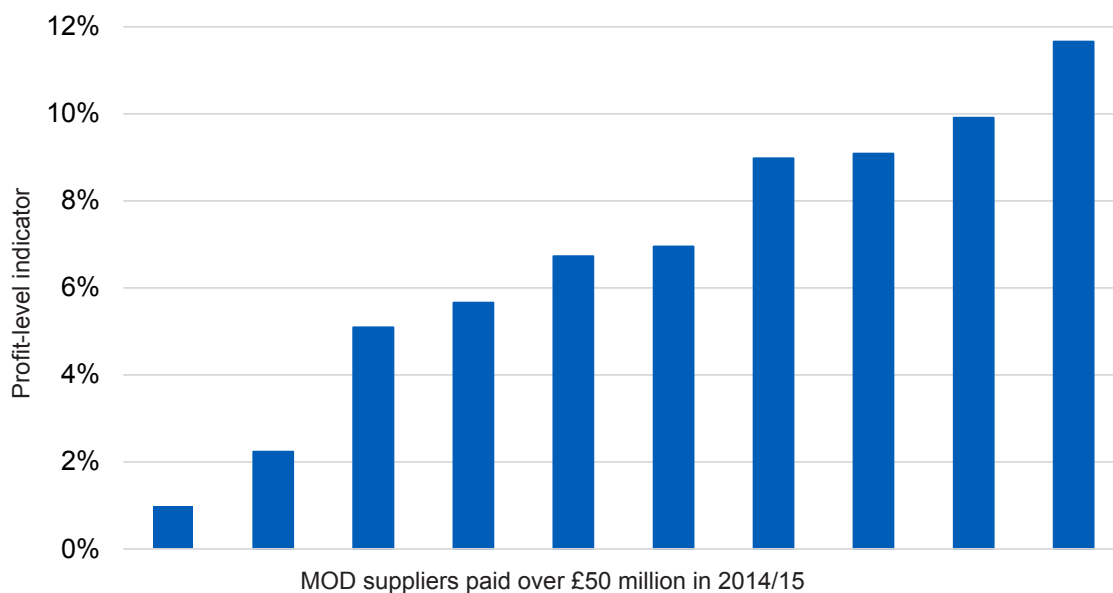
**Figure 3: Membership of the D&M and P&M comparator groups**

Note: Numbers represent group size before the exclusion of loss-makers. Shapes are not drawn to scale.

Source: SSRO

- 2.26 One respondent highlighted the range of profits on cost demonstrated by the companies in the D&M and P&M activity types as evidence that the companies within them could not be considered comparable. Although some outliers in the data set exist, these are few in number and the majority of firms exhibit profits that are clustered around the median. We also observe that 68 per cent of companies in the D&M comparator group and 58 per cent of companies in the P&M comparator group have a profit-level indicator within the range displayed by the MOD's main suppliers present in those groups (Figure 4). We do not, therefore, agree that the data demonstrate a lack of comparability.

**Figure 4: Adjusted profit-level indicator for the main MOD suppliers in the 2016/17 BPR comparator groups**



Source: SSRO

- 2.27 One respondent commented that the Ancillary Services and Construction activity types were unnecessary as contracts for these activities were unlikely to be non-competitive given the supplier market. We published our analysis of how the activity types could be applied to QDCs and QSCs in our consultation document. The majority, 95 per cent, related to the D&M and P&M activity types. We maintain, however, that it is helpful for the MOD to have the option to apply different, more appropriate, profit rates for the routine work carried out under Ancillary Services and Construction contracts.
- 2.28 In the light of the above, we are satisfied that the four activity types reflect the fundamentally different activities that take place in QDCs and QSCs while being broad enough to ensure that there are sufficient companies in each comparator group to provide stability over time in the calculation of rates.

**SSRO response:** We will proceed on the basis of the proposed activity types.

## Representation of UK defence companies

- 2.29 Respondents queried why some of the MOD's main contractors were absent from the comparator groups for the 2016/17 BPR calculation.
- 2.30 All companies were treated equally in the company search and were present in the comparator groups if they met the search criteria. In practice, this meant that some of the MOD's contractors did not appear in the comparator groups as they did not meet the criteria. We examined the reasons why these companies were absent. The main reasons were having NACE codes that did not fall within the activity codes used to conduct the company search, not meeting the 'legal form' criterion, or there being insufficient financial data on these companies in the database we used to calculate a profit-level indicator (see paragraph 2.45). We maintain that it would be inappropriate for us to apply different criteria to the MOD's contractors.

**SSRO response:** We will review the representation of the MOD's main suppliers in the comparator groups for future BPR calculations to ensure that any which meet the company search criteria are present. We will publish details of why any of the MOD's main contractors are absent from the comparator groups when we publish the names of the companies that are present in the groups.

## Complexity and risk

- 2.31 Two respondents commented that there was a higher degree of complexity and risk in the work undertaken by some defence contractors than was evident in the activities of the comparable companies. Systems integration and nuclear-related work were specific activities that these respondents felt merited special treatment. These activities, the respondents felt, should earn a higher level of return on cost than was suggested by the median of the existing comparison groups.
- 2.32 The OECD's transfer pricing guidance<sup>23</sup> notes that the risks assumed by each party in a transaction should be considered when determining comparability, as this would influence the transaction. Adjustments should, however, only occur where these are likely to increase the reliability of the results. While we recognise the complexity inherent in systems integration and nuclear-related activities, respondents provided insufficient evidence to support their view that the level of risk is greater than that experienced by the comparator group of companies.
- 2.33 We believe the range of activities undertaken by systems integrators and nuclear contractors are adequately represented within the D&M and P&M activity types. We therefore do not agree that there should be specific activity types related to systems integration and nuclear-related activity. The Defence Reform Act provides opportunities for risk to be addressed when determining the contract price – the pricing method may reflect the contract risk; the baseline profit rate may be adjusted for cost risk; and risk may be priced in the Allowable Costs.

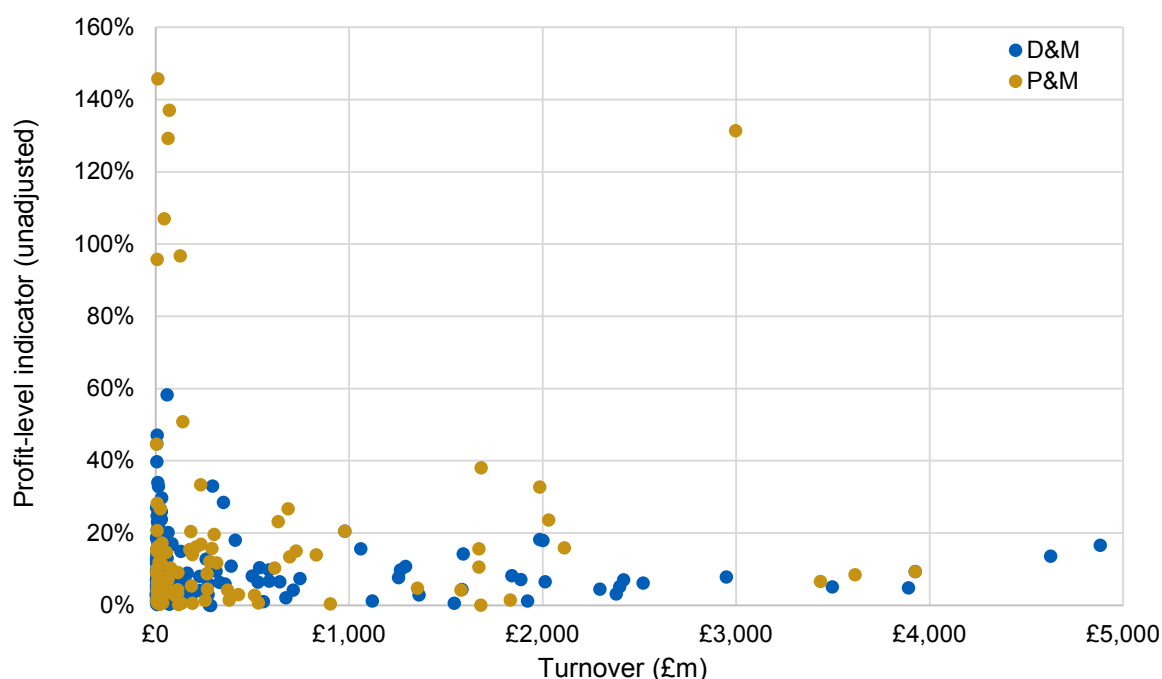
**SSRO response:** We will proceed on the basis of the proposed activity types. We will be undertaking further work during the autumn to assess the impact of the single source regulatory framework on UK defence contractors.

<sup>23</sup> OECD (2010) *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.

### Size of comparable companies

- 2.34 In revising the approach to identifying comparable companies in 2015, the SSRO introduced a minimum threshold for the level of annual turnover that a company would need to earn before it could be included in the analysis of the BPR. We set this threshold at £5 million; the value above which a single source defence contract becomes subject to regulation under the Act. This was a reasonable decision. It ensures that the comparator groups contain a sufficient number of companies to provide a reliable and stable comparison over time without making it impossible for us to undertake the quality assurance necessary to check that inappropriate comparators had not been identified in the company search.
- 2.35 Two respondents commented that the £5 million threshold was too low, and identified two reasons. First, that companies with such low levels of turnover could not be considered comparable to companies undertaking QDCs and QSCs. Second, that including smaller companies distorted the profit rate.
- 2.36 We have noted the OECD's transfer pricing guidance<sup>24</sup> highlights that the size of transactions should be considered when assessing comparability. Transactions of differing scale might suggest non-comparability in the competitive positions of the buyers and sellers. As our comparison is based on companies, not transactions, we have considered the size of the companies, represented by turnover, when assessing comparability. Our analysis finds no correlation between turnover and profit on cost in the 2016/17 comparator groups (Figure 5). There is therefore no evidence to suggest any systematic bias towards lower profits due to the inclusion of smaller companies.

**Figure 5: Comparing company turnover with profit (return on cost) for companies included in the D&M and P&M comparator groups for the 2016/17 BPR calculation**



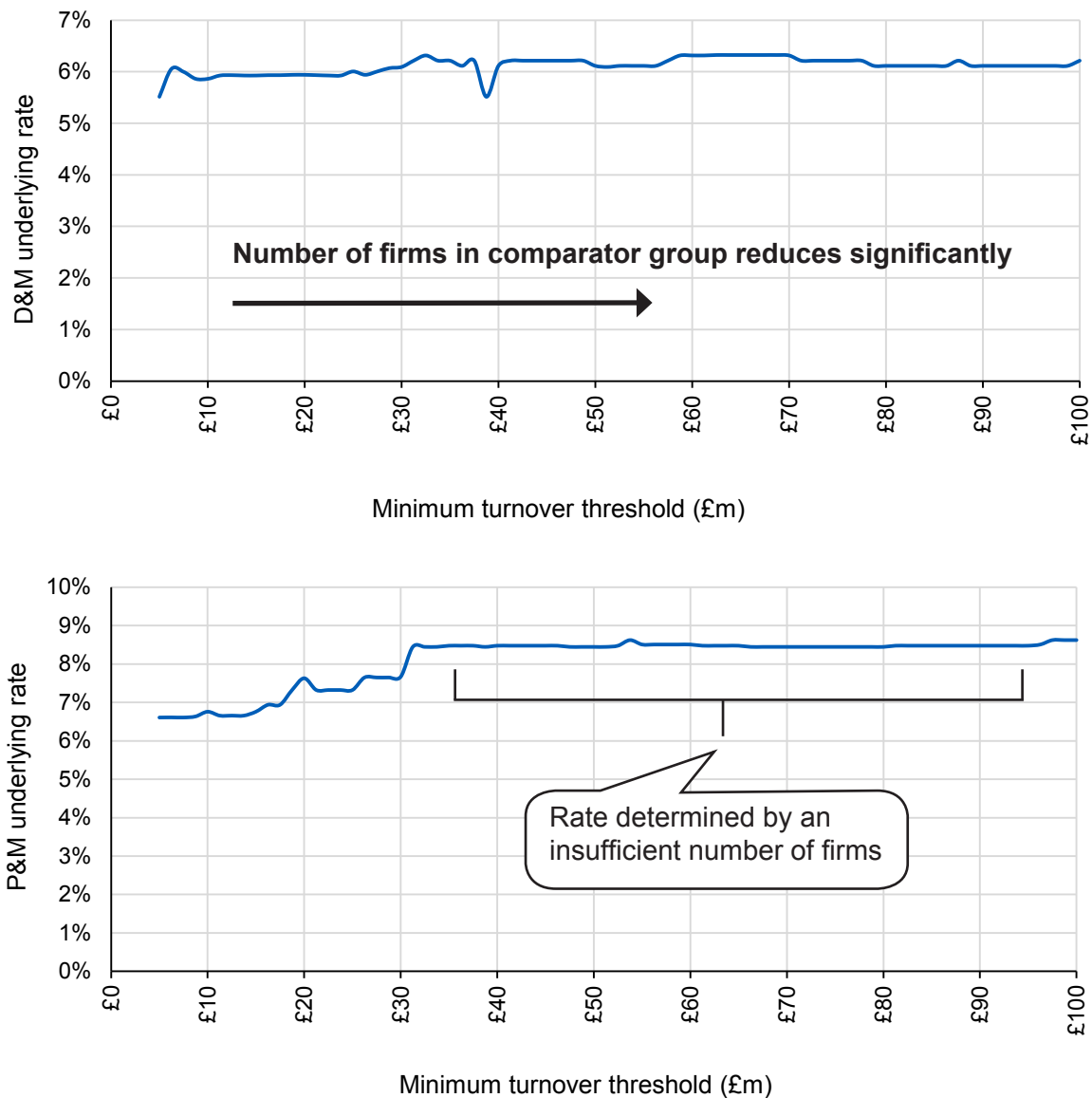
Notes: Some outliers are excluded from chart to enhance presentation.

Source: SSRO

24 OECD (2010) *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.

- 2.37 We have considered the consequences of increasing the turnover threshold. This has the effect of making the comparator groups smaller. Smaller groups are more prone to the influence of individual companies. Using the data we gathered for the 2016/17 BPR calculation, we found that incremental increases in the turnover threshold resulted in unpredictable fluctuation in the underlying profit-level indicators (Figure 6).

**Figure 6: The effect of increasing the turnover threshold on the underlying profit rates in 2016/17 for the P&M and D&M comparator groups**



Source: SSRO

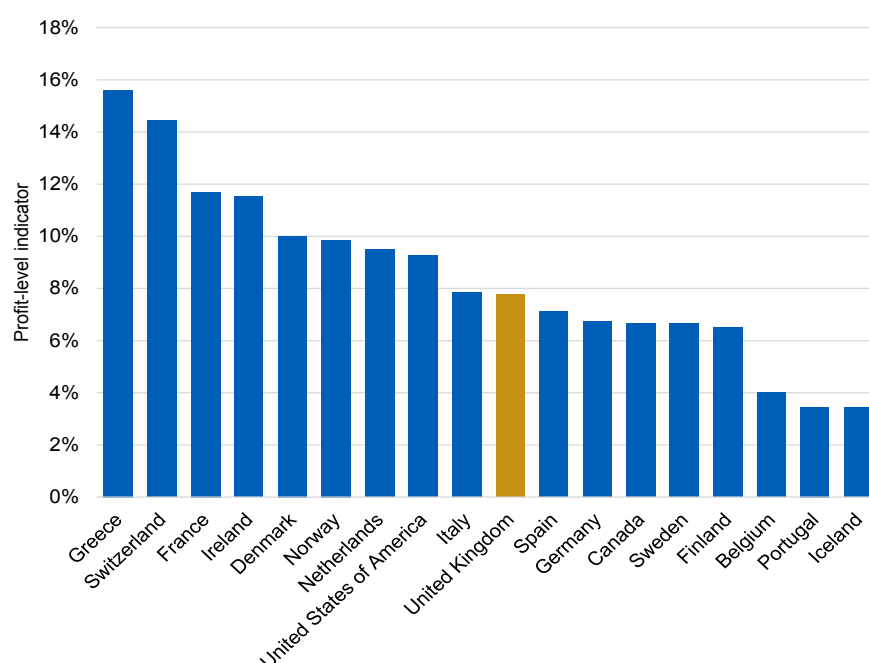
- 2.38 It is our view that raising the turnover threshold would lead to an unacceptable reduction in the size of the comparator groups. Smaller groups would lead to greater volatility in the calculation of the BPR from one year to another. Respondents to our 2015 consultation agreed that stability in the BPR was essential for long-term planning.

**SSRO response:** We will continue to use the £5 million turnover threshold in the company search.

### Geographic comparability

- 2.39 In 2015, recognising that UK-headquartered companies may earn profits from activity in non-UK markets, we extended the geographic area from which comparable companies might be identified to include Western Europe and North America.
- 2.40 Four respondents expressed concern about the inclusion of non-UK-headquartered companies in the comparator groups on the basis that companies headquartered in other countries face different economic conditions or incentives that impact on their profit levels.
- 2.41 The OECD's transfer pricing guidance<sup>25</sup> indicates the need for there to be comparability between the markets in which compared enterprises operate. This means there should be no differences that have a material impact on the prices charged in the compared transactions, or that adjustments can be made to accommodate these. We consider Western Europe and North America comparable on the basis of their operation of mixed economic systems of private and state enterprise in their domestic markets as well as cross-border economic integration within each territory. On this basis, we are satisfied that the economic circumstances of the countries where comparable companies are headquartered are sufficiently similar to achieve comparability.
- 2.42 Several respondents were concerned that the level of representation of companies from Italy ('over-represented') and the USA ('under-represented') had had a distorting effect on the range of returns on cost used to calculate the BPR in 2016/17.
- 2.43 We have examined the representation of companies from Italy and the USA in the comparator groups last year, and the impact of this on the calculation of the BPR.
- 2.44 Italian companies accounted for 44 per cent (118 in number) of the D&M comparator group. UK companies were the next largest group, accounting for 15 per cent (41 in number) of the total. Despite their higher representation, our analysis of the range of profit-level indicators exhibited by Italian companies indicates that they had no greater bias on the calculation of the BPR than companies from any other country (Figure 7). We are satisfied that the economic circumstances facing Italian companies are sufficiently comparable to warrant their inclusion in the comparator groups.

**Figure 7: Average profit-level indicator for companies in the D&M comparator group by country of incorporation**



Source: SSRO

<sup>25</sup> OECD (2010) *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.



- 2.45 Companies identified as being from the USA accounted for 18 per cent of the P&M activity type comparator group (UK 36 per cent) and 6 per cent of the D&M comparator group. We are aware that public financial reporting requirements are different in the USA from those in the UK. This is a matter beyond our control. We are also aware that some companies in the USA were not included in our 2016/17 calculation due to limitations in the data available. We are working to improve the availability of data on companies from the USA for the calculation of the 2017/18 BPR.

**SSRO response:** We do not propose to make any changes to the geographic coverage of the company search. We will, however, review the proportional representation of comparable companies from different countries, and the impact of this, as we calculate the BPR for 2017/18. Having done so, we will consider whether any changes are required to the methodology to enhance comparability.

## 3. Multiple rates

- 3.1 The SSRO believes that a single baseline profit rate does not allow for the diversity of products and services covered in single source contracts. An approach involving multiple rates would contribute to enhancing the credibility of the single source regime while providing more appropriate returns for contractors that are fair and reasonable and represent value for money for taxpayers. The preceding section set out the background to our consultation proposal to introduce multiple rates in 2017/18.
- 3.2 Responses to the 2016 consultation confirm that the principle of multiple rates is still supported by industry, with seven respondents expressing this view. However, respondents had concerns about some aspects of the proposal to move to multiple rates at this time. We describe and address these below.
- 3.3 The MOD requested further time to fully consider the question of multiple rates. At the time of publication we are still awaiting its comments on this point.

### Intent of the Act

- 3.4 Two respondents challenged whether the Act supported the proposal to move to multiple profit rates.
- 3.5 Having sought legal advice, we are satisfied that Section 19 of the Act would permit more than one BPR to be set each year, such that different BPRs might then be applied to different categories of QDCs and QSCs. This is on the basis that:
- Section 19(1) of the 2014 Act requires the Secretary of State to set “*the baseline profit rate*” but, unless the contrary intention appears, the singular (baseline profit rate) includes the plural (baseline profit rates) (Interpretation Act 1978, section 6);
  - applying different baseline profit rates to different types of contract would be consistent with the process in Section 17 of the Act for determining the contract profit rate for a contract (it is not an approach that would render any part of that process either redundant or unworkable, nor would it radically change any of steps 2 to 6);
  - the setting of multiple baseline profit rates sits well with the SSRO’s aims at Section 13(2) of the Act to ensure good value for money for government and fair and reasonable prices for contractors; and
  - it is possible to categorise qualifying defence contracts by reference to different subject matters so as to be able to apply a different baseline profit rate to each category.

### Maturity of the current methodology

- 3.6 Industry respondents commented that the BPR methodology was not yet sufficiently mature or robust to be applied to the determination of multiple profit rates.
- 3.7 Our analysis of the underlying profit-level indicators for the activity type comparator groups demonstrates both differentiation between the groups and stability over time. The SSRO is satisfied that the methodology is robust.

- 3.8 We also think there is sufficient information in the public domain for stakeholders to have confidence in the approach. We have consulted on the methodology in 2015 and 2016 and engaged directly with stakeholders on multiple occasions during the last year regarding questions or concerns. For the 2016/17 BPR calculation we published our methodology and the names of the companies included in the comparator groups. This level of transparency exceeds that which occurred under the preceding 'Yellow Book' regime. To increase confidence further, we will be publishing a more comprehensive methodology in January 2017 alongside our recommendation to the Secretary of State.

#### Application of multiple rates

- 3.9 One respondent commented that, where there were multiple profit rates to choose from, it may be difficult to determine which profit rate should be chosen as Step 1 in determining the contract profit rate. This could result in delays in contracts being signed.
- 3.10 Section 5 of our consultation document described how the MOD and contractors would choose an appropriate baseline profit rate, based on the proportion of Allowable Costs that fall under each activity type. Our consultation document also contained details of our assessment of how multiple profit rates might have been applied to the QDCs and QSCs signed by June 2016. Therefore, we do not agree that selecting the most appropriate profit rate need be complex.

#### Calculating the contract profit rate

- 3.11 Two respondents highlighted concerns about how multiple profit rates would affect the calculation of the contract profit rate. This was thought to be problematic where the intention was to achieve a zero per cent contract profit rate in cases where the supplier was not permitted or did not wish to make a profit.
- 3.12 Steps 1 to 6 in the adjustment process to reach the contract profit rate should be applied in the same way as at present with a single baseline profit rate. In order for the contract profit rate to equal zero, the 'zero rate' baseline profit rate will need to be set at the level of the SSRO funding adjustment. The achievement of a zero profit rate is dependent on the MOD and contractor agreeing to make no further adjustments at Steps 2, 3, 5 and 6. This approach is implicit in the stated basis for using the rate.

**SSRO response:** We will publish further information on multiple rates in due course. We will proceed, in the meantime, with the work necessary to calculate multiple rates so that these are ready for our 2017/18 BPR recommendation.

## 4. Deriving a profit-level indicator

- 4.1 The BPR is calculated as the three-year rolling average of the median of the range of profit-level indicators displayed by the companies in the comparator group. For 2016/17 separate profit rates were calculated for the D&M and P&M comparator groups and a straight average of these rates was recommended to the Secretary of State as the BPR for that year.
- 4.2 We make two adjustments in calculating the BPR. We exclude from the calculation any comparable company that made a loss in the year for which data is drawn to calculate the BPR. The comparable company profit-level indicators are adjusted to take account of the costs of servicing capital (the capital servicing adjustment).<sup>26</sup> The data to support the calculations is taken from the Orbis database.
- 4.3 The BPR is the starting point for the calculation of a contract profit rate. Adjustments are made by agreement between the MOD and contractors using the six-step process set out in the Single Source Contract Regulations and described in our guidance on adjustments to the BPR.<sup>27</sup> Our analysis of profit rates agreed for QDCs in 2015/16 found that, on average, contract profit rates were 1.1 percentage points higher than the prevailing BPR as a result of adjustments.<sup>28</sup>
- 4.4 Respondents commented on some aspects of our approach to deriving the BPR and company-level profit indicators.

### Choice of average

- 4.5 Industry respondents did not agree with the SSRO's use of the median as the appropriate measure of central tendency for the comparator groups' profitability. Most recommended the use of the mean rather than the median, on the grounds that this was a measure that would be used by investors considering the level of return they might expect from investing in an industry. Respondents stated that the mean takes account of all cases present in a range of values.
- 4.6 The OECD's transfer pricing guidance<sup>29</sup> sanctions the use of a measure of central tendency where the comparator group displays a range of results, to adjust for comparability defects. The choice of measure employed should be appropriate for the characteristics of the data in question. Our examination of the profit-level indicators for the comparable companies finds that the range of values is skewed towards some companies with very large profits (even after the capital servicing adjustment has been applied). These tend to be companies with low operating costs that generate profit as a result of their investment in capital assets. The median is an appropriate measure of central tendency to take account of these companies which are uncharacteristic of the majority in the comparator group.
- 4.7 One respondent advocated the use of a weighted mean which would give companies with higher turnover or higher profits greater influence on the calculation of the BPR.

<sup>26</sup> Details of the capital servicing adjustment can be found in SSRO (2016) *Single Source Baseline Profit and Capital Servicing Rates Methodology*.

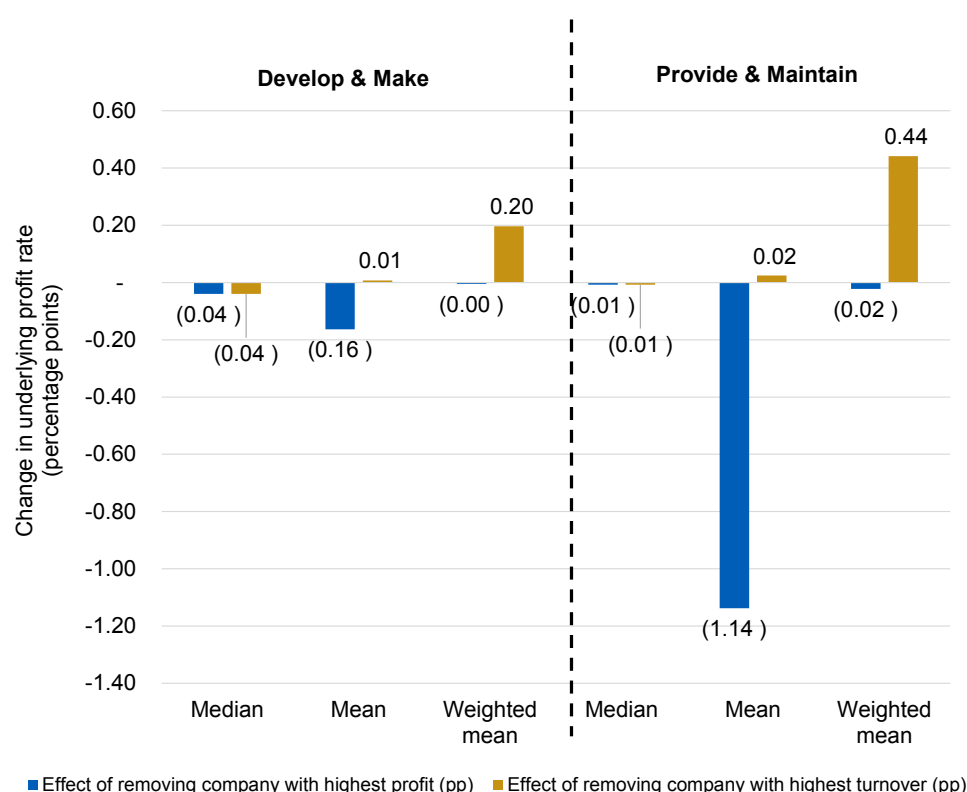
<sup>27</sup> SSRO (2016) *Contract Profit Rate: Guidance on Adjustments to the Baseline Profit Rate*.

<sup>28</sup> SSRO (2016) *Profit Rates Reported in Qualifying Defence Contracts 2015/16*.

<sup>29</sup> OECD (2010) *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.

- 4.8 A small number of very large companies account for a large proportion of the turnover in the comparator groups. In the 2016/17 calculation, the five largest companies in the D&M comparator group accounted for 53 per cent of the turnover generated by that group. The five largest companies in the P&M comparator group accounted for 49 per cent of the group's turnover. Setting the baseline profits rate with reference to a small number of companies by virtue of their size, as would be the case if the weighted mean was used, would not be consistent with the SSRO's aim of identifying a return on cost that is representative of a range of companies undertaking similar activities. An approach that was weighted towards companies with the highest profit-level indicators would be similarly unrepresentative of the comparator group.
- 4.9 We have also considered the sensitivity of different measures of central tendency (median, mean and weighted mean) to the presence or absence of untypical cases in the comparator groups. We examined the effect in the 2016/17 BPR comparator groups of removing the companies with, respectively, the highest profit-level indicator and the highest turnover. Our analysis shows that the median is the most robust measure of central tendency, least influenced by the presence or absence of these cases (Figure 8). As such the median is the measure of central tendency that most enhances comparability. It is also the least likely to be influenced by changes in the composition of the comparator group and changes in the profit-levels of individual comparable companies over time.

**Figure 8: The influence of untypical cases on measures of central tendency in the 2016/17 comparator groups**



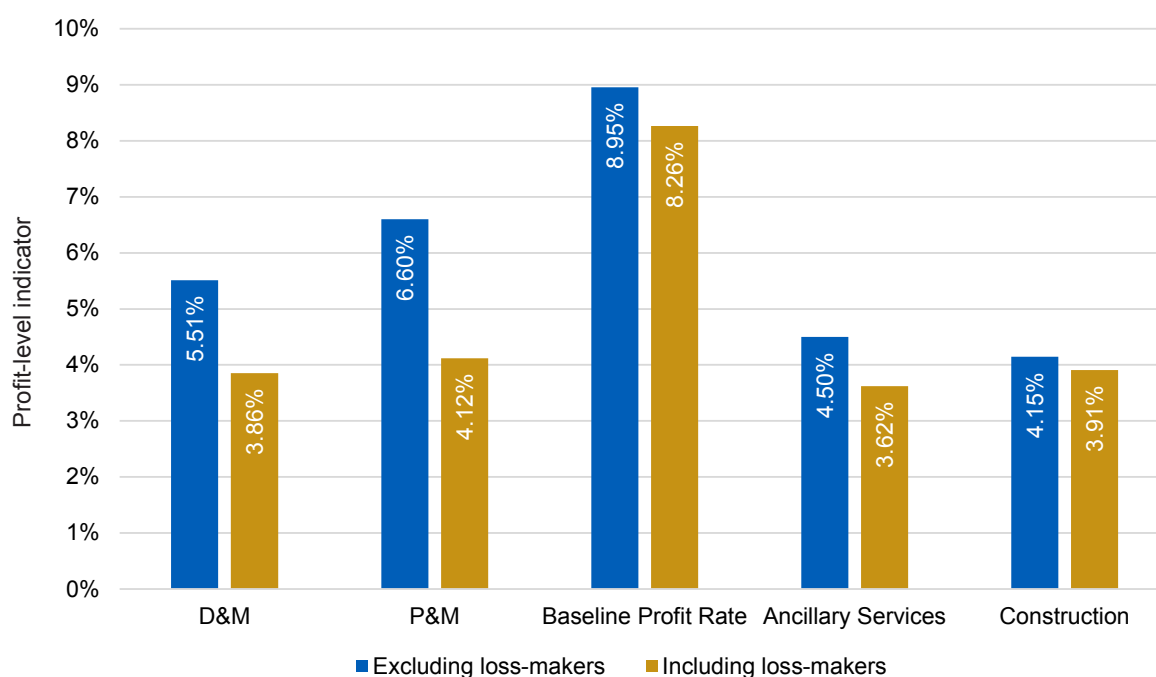
Source: SSRO

**SSRO response:** We will continue to use the median in the BPR calculations.

## Exclusion of loss-makers

- 4.10 Almost all Industry respondents requested the inclusion of loss-making companies in the calculation of the BPR on the grounds that this would make the groups more representative of the diverse levels of companies' profitability. Industry respondents' call for the inclusion of loss-making companies is linked to their preference for use of the mean as a measure of central tendency. Respondents pointed to Ofgem's use of benchmarking in its retail energy market investigation as an example of an approach that included loss-makers.
- 4.11 The OECD's guidance<sup>30</sup> encourages consideration of whether loss-making companies should be included in the comparability analysis. The circumstances in which loss-making enterprises should be excluded include cases where the losses do not reflect normal business conditions. QDCs are priced in a way that should lead to a profit under normal business conditions. With this in mind, we believe loss-making companies would provide a poor comparator for the purposes of calculating the BPR. The removal of loss-makers helps to address going concern issues in the comparator groups.
- 4.12 We have quantified the effect of excluding loss-makers from the calculation of the BPR in 2016/17. As expected, this increased the BPR that year; by 0.69 percentage points. The effect was most prominent within the P&M comparator group, increasing the underlying profit rate for that activity type by 2.49 percentage points (Figure 9).

**Figure 9: Effect of loss-makers on underlying profit rates**



Source: SSRO

- 4.13 For the 12 QDCs signed to date in 2016/17 (with a total value of £298 million) the exclusion of loss-makers from the calculation of the BPR increased the profit payable to contractors by £1.9 million (7 per cent) – from £25.8 million to £27.6 million.

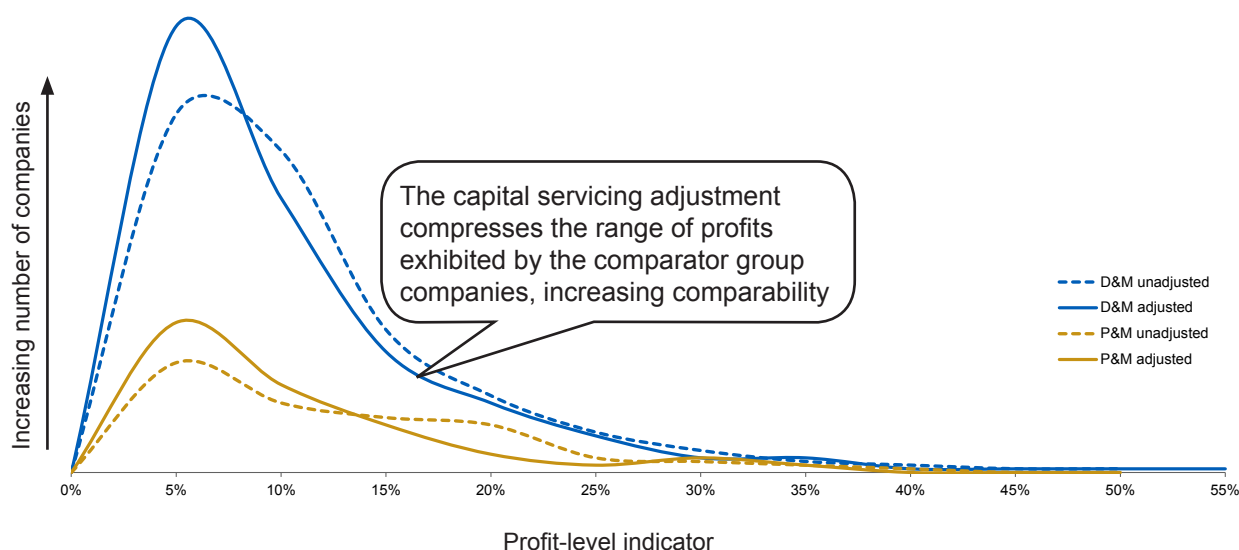
**SSRO response:** We will continue to exclude loss-makers from the calculation of the BPR.

<sup>30</sup> OECD (2010) *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.

## Data issues

- 4.14 The BPR is calculated with reference to the profits earned by comparable companies. Industry respondents noted that company-level profits were not directly comparable to the profits earned on specific contracts. To adjust for this, given that the BPR is used to derive a contract profit rate, respondents suggested a number of adjustments that might be made to company-level data. These were:
- using divisional results rather than company-level results;
  - taking account of exceptional income or expenditure;
  - adjustments for amortisation; and
  - removing costs that would not be considered Allowable Costs for the purpose of pricing single source contracts with the MOD.
- 4.15 The OECD's guidance<sup>31</sup> supports the comparison of company-level results to transactions where there is limited data on transactions. Adjustments to company-level data should only be made where there is a reasonable expectation that these will enhance comparability. The SSRO's calculation of the BPR is based on publicly reported financial data that is prepared in accordance with accounting standards and is audited. The SSRO's view is that this approach, where the only adjustment made relates to capital servicing (as required by the Act), reduces subjectivity in the calculation of the BPR. Differences in the approaches taken by companies to amortisation or the reporting of exceptional items would introduce inconsistency into the data used to calculate the BPR. A lack of consistently reported data would limit our ability to use divisional results or remove non-Allowable Costs. Where data was available, judgement would be needed as to how any adjustments should be made. Overall, we think that this would introduce more subjectivity and less replicability into the process.
- 4.16 The capital servicing adjustment enhances comparability by reducing the effect of different capital structures on companies' profit-level indicators. This can be seen in the way that there is greater commonality among companies' capital-adjusted profit-level indicators than in the unadjusted profit-level indicators (Figure 10).

**Figure 10: Distribution of comparable company profit-level indicators with and without the capital servicing adjustment**



Source: SSRO

31 OECD (2010) *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.



- 4.17 One respondent commented that an approach that applies a BPR to future contracts based on the financial performance of comparable companies in the preceding three years will result in a time lag between the economic cycle experienced by comparable companies and the profits earned by defence contractors.
- 4.18 We note this point, which was part of a broader critique of the approach to determining the returns that should be earned by single source contractors. In the absence of reliable forecasts of company profitability we maintain that the current approach based on a three-year rolling average of the profits earned by comparable companies is reasonable and meets the requirements of the Act.

**SSRO response:** We do not propose to make any additional adjustments to the financial data used to calculate the BPR. We will continue to apply the capital servicing adjustment.

## 5. Replicating our approach to data gathering

- 5.1 The OECD's guidance<sup>32</sup> highlights the need for transparency in the approach to comparability analysis as a way of ensuring there is a sufficient degree of objectivity. The SSRO is committed to increasing the level of transparency for stakeholders in the approach taken to setting the BPR. We respond below to comments made by respondents about their ability to replicate the approach we take to identifying comparator groups and calculating the BPR.

### Transparency in selecting comparators

- 5.2 Respondents commented that they were unable to replicate the approach taken by the SSRO to the selection of comparable companies from the information currently published about the method.
- 5.3 The OECD<sup>33</sup> identifies two approaches to the selection of comparable companies for analysis. An 'additive' approach involves making detailed analysis for a limited number of companies that are thought to be potentially comparable. A 'deductive' approach takes a wide set of companies that perform similar activities in circumstances that are not obviously different and refines this using selection criteria and publicly available information (for example, from databases). The latter approach is more easily reproducible and transparent. We use a deductive approach in identifying comparable companies for the BPR calculation.
- 5.4 As noted above, we have published and consulted on details of our methodology and will continue to do so. We believe there is sufficient information in the public domain to allow replicability of the approach to an extent that generates confidence in our methods. We have appointed an external advisor to quality assure the approach, including testing the replicability of our methodology. Where we identify that further information is desirable to enhance stakeholders' ability to verify our approach we will update our published methodology.

**SSRO response:** The SSRO will publish an updated BPR methodology in January 2017 when making its recommendation on the BPR to the Secretary of State.

### The quality of financial data we use

- 5.5 Industry respondents raised concerns about their ability to reconcile their published financial accounts with the Orbis database which provides the source data for our calculation of the BPR.
- 5.6 The OECD's transfer pricing guidance<sup>34</sup> supports the use of databases as a source of information to undertake comparability analysis, while noting that database searches may need to be refined with other publicly available information. The Orbis database, compiled by Bureau van Dijk, is a comprehensive global database commonly used for transfer pricing. It contains current and historical data and information for around 200 million public and private companies, including ownership, country of incorporation, economic activity classification, and financial data.

<sup>32</sup> OECD (2010) *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.

<sup>33</sup> OECD (2010) *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.

<sup>34</sup> OECD (2010) *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.

- 5.7 For the 2017/18 BPR calculation we will review, for a sample of the MOD's contractors, the data collected from Orbis to satisfy ourselves that this can be reconciled with published accounts.

**SSRO response:** The SSRO will review for a sample of the MOD's contractors the data collected from Orbis as part of the 2017/18 BPR calculation process.

#### Updating the comparable companies

- 5.8 We have previously indicated that the set of companies used to calculate the BPR would be reviewed annually to check that the companies continued to meet the criteria for inclusion. A full review of companies to include in the comparator groups would only be undertaken every three years to determine if any additional companies should be incorporated.
- 5.9 This aspect of the BPR methodology was not the subject of specific consultation this year, nor commented on by respondents. However, our annual review of the most recent data on companies used to set the BPR in 2016/17 has revealed that around 20 per cent now fail to meet the criteria for inclusion in 2017/18. Around half of this reduction is the result of companies no longer meeting the 'independence' criterion. As a result of the review, we now propose to change the approach. We will now repeat the company search each year. This will ensure there is a discrete and replicable end-to-end process for each BPR calculation.

## 6. The SSRO funding adjustment

- 6.1 The Regulations provide that from 2017/18 the SSRO's funding will be provided by deductions from the price payable under QDCs and QSCs. The extent of the funding recovered by this means is not set out in the Act. The explanatory notes to the Act further set out an expectation that up to half of the SSRO's funding requirements are to be met by deductions from the price payable by the MOD to contractors in QDCs and QSCs. The deduction is implemented as an adjustment (Step 4) in the calculation of the contract profit rate for QDCs and QSCs.
- 6.2 Section 19(2) of the Act requires the SSRO to provide the Secretary of State with its assessment of the appropriate funding adjustment rate for that year. The Regulations required a zero rate until the end of 2016/17. After that, the funding adjustment rate would need to be published in the London Gazette in accordance with section 19(4) of the Act.

- 6.3 The SSRO's consultation reiterated our view that a levy or licence would be a superior funding mechanism, but one that is not possible without legislative change. In order to meet our obligations under the Act as it stands, our consultation set out how the SSRO funding adjustment would be calculated and proposed that the MOD undertake a periodic reconciliation to assist the SSRO in setting future rates to avoid under- or over-recovery. Respondents raised a number of points about the proposals.

### Calculating the adjustment

- 6.4 Respondents confirmed their support for the use of a funding adjustment, although commented that the calculation of the adjustment was disproportionately complex for the level of costs being recovered.
- 6.5 The adjustment is a requirement of the Act. The SSRO will consider the feedback received on alternatives to a funding adjustment as part of its forthcoming review of the Act and Regulations.

### Reconciling funding recovery

- 6.6 Respondents felt that the proposal to undertake periodic reconciliation of the level of cost recovery through the funding adjustment was unlikely to be feasible in practice. The MOD commented that the Act had not intended for there to be any reconciliation and that this might be administratively burdensome.
- 6.7 We maintain that periodic reconciliation of the actual level of recovery at contract closure may be helpful to avoid under- or over-recovery and give assurance to contractors on this. We accept that this is not a requirement. We will reconsider in due course whether this matter should be revisited in the light of rates set and actual contract values awarded, as this will provide an indication of over- or under- recovery.

### Data used to calculate the adjustment

- 6.8 Respondents sought clarification on how we would derive the amounts to be used in the calculation of the adjustment.
- 6.9 To clarify, the denominator used in deriving the funding adjustment is the annual average of the total Allowable Costs (including any Risk Contingency Allowance) reported in Contract Notification Reports for all QDCs and QSCs over the three preceding financial years.

### Level of costs to be recovered

- 6.10 Respondents pointed out that the formula in the consultation suggested that all the costs would be recovered through the adjustment, not 50 per cent.
- 6.11 To clarify, only 50 per cent of the average costs of the SSRO will be recovered through the adjustment. The formula for calculating the funding adjustment is:

$$\text{SSRO funding adjustment} = \frac{\frac{1}{2} \times (\text{Average SSRO costs} - \text{costs of additional tasks requested by Secretary of State})}{\text{Average Total Allowable Costs (including any Risk Contingency Allowance)}}$$

(Note: The numerator and denominator use averages of the three preceding financial years.)

**SSRO response:** We will include an updated methodology for calculating the SSRO funding adjustment as part of the BPR methodology to be published in January 2017.

## 7. Other issues

- 7.1 There were a small number of other issues raised by consultation respondents that were very general in nature or mentioned rarely.

### Fair and reasonable returns

- 7.2 Some industry respondents challenged whether the approach taken to calculating the BPR resulted in a level of return that was sufficiently high as to be considered fair and reasonable to industry. One aspect of this was the ability of contractors to generate returns that would meet the cost of expenditure that did not meet the criteria to be Allowable under the Single Source Cost Standards.<sup>35</sup>
- 7.3 We recognise that there are a number of ways to measure the profitability of companies. Other economic regulators in the UK use different approaches to determining the price controls that apply in the markets they regulate. The approach we take is guided by the Act and the Single Source Contract Regulations. We indicated earlier this year<sup>36</sup> that during the autumn of 2016 we would analyse the financial health of the UK defence industry. As part of this work we will use some of the approaches used by other regulators to assess the profitability of UK defence contractors. This will help us test whether the BPR is delivering fair and reasonable returns for industry and value for money for taxpayers.

**SSRO response:** We will examine whether returns to industry are fair and reasonable as part of our work on the financial health of UK defence contractors. Our findings will help to inform our ongoing review of the Regulations.

### The Act and Regulations

- 7.4 Some respondents drew attention to aspects of the overall approach to regulating UK single source defence contracts which they felt required attention. Some saw merits in the regimes operating in the USA and France which the UK government should consider in its approach. A lack of clarity for contracts below the threshold for regulation was raised as a cause for concern. One respondent associated the pursuit of multiple rates with the ability to blend those rates.
- 7.5 The issues raised require consideration in the context of updates to the regulatory framework. The Secretary of State for Defence is required to conduct periodic reviews of the regulatory framework for single source defence contracts. The SSRO will provide its recommendations for the first of these periodic reviews by June 2017 and has already been engaging with stakeholders on issues for consideration in that review.<sup>37</sup>

**SSRO response:** The SSRO will consider these points in its ongoing review of the Regulations.

<sup>35</sup> SSRO (2016) *Single Source Cost Standards: Statutory Guidance on Allowable Costs*.

<sup>36</sup> SSRO (2016) *Monitoring the Impact and Performance of the Single Source Regulatory Framework*.

<sup>37</sup> See SSRO (2016) *Review of the Single Source Regulatory Framework: Call for Input* and SSRO (2016) *Review of the Single Source Regulatory Framework: Call for Input – Transparency*.

### Step 2 cost-risk adjustment

- 7.6 One respondent stated that the principles of the cost-risk adjustment were unclear and noted concerns over their formulation.
- 7.7 The SSRO is satisfied that the principles stated to guide the cost-risk adjustment are sound and sufficiently clear.

**SSRO response:** No action required.



## 8. Next steps

- 8.1 In light of the responses to the consultation we are reviewing the content of the methodology and guidance we publish. The forward timetable of publications related to the BPR is set out below.

By	Action
30 January 2017	<ul style="list-style-type: none"><li>• The SSRO makes and publishes its recommendation to the Secretary of State on the BPR, SSRO funding adjustment and CSRs.</li><li>• The SSRO publishes its methodology and guidance on how the recommended rates are to be applied in setting contract prices.</li></ul>
15 March 2017	<ul style="list-style-type: none"><li>• The Secretary of State publishes details of the BPR, the SSRO funding adjustment and CSRs in The London Gazette.</li></ul>

# Appendix 1: Glossary of terms

<b>Activity type</b>	A group of economic activities, defined by the SSRO, which correspond to types of activity that contribute to the delivery of QDCs and QSCs. For example 'Develop and Make' or 'Provide and Maintain'. In practice, activity types are defined as distinct groups of NACE codes and text search terms.
<b>Comparability principle</b>	The aim of the baseline profit rate is to provide the starting point in the determination of the contract profit rate. It is set with reference to the returns of comparable companies whose economic activities are included in whole or in part in the activity types that contribute to the delivery of QDCs and QSCs.
<b>Comparable company</b>	A company whose economic activities are included, in whole or in part, within an activity type.
<b>Comparator group</b>	A group of comparable companies undertaking one or more of the economic activities which make up an activity type.
<b>Economic activity</b>	An activity that involves the production, distribution and consumption of goods and services.
<b>NACE code</b>	The European Union system of classifying economic activities for the purpose of statistical and other analysis. The SSRO uses NACE codes in conjunction with text search terms to identify comparable companies within the Orbis database.
<b>Orbis</b>	The database of company-specific information and data supplied by Bureau van Dijk. The SSRO uses this to identify comparable companies and as a source of financial data on those comparable companies for use in the calculation of the baseline profit rate.
<b>Text search term</b>	A word or group of words relating to economic activities used to identify comparable companies. For example 'manufacture' or 'production'. The SSRO uses text search terms in conjunction with NACE codes to identify comparable companies within the Orbis database.

the 1990s, the incidence of *S. flexneri* has increased in the United Kingdom [10]. In the United States, *S. flexneri* has been reported as the most common serotype in children with acute bacterial dysentery [11].

There is a paucity of data on the epidemiology of *S. flexneri* in the United Kingdom. In the 1980s, *S. flexneri* was the most commonly isolated serotype from patients with acute bacterial dysentery in the United Kingdom [12]. In the 1990s, *S. flexneri* was the most commonly isolated serotype from patients with acute bacterial dysentery in the United Kingdom [13].

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