aerospace
defence
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space

Marcine Waterman
Chief Executive
Single Source Regulations Office
Finlaison House
15-17 Furnival Street
London
EC4A 1AB

26 May 2016

Dear Marcine,

ADS welcomes the Single Source Regulations Office's (SSRO) efforts to seek clarity on a number of aspects of the Single Source Costs Standards (SSCS) - Allowable Costs, which both contractors and the Ministry of Defence (MOD) must have regard to when determining whether costs are Allowable in single source qualifying defence contracts and sub-contracts. ADS remains committed to working with the SSRO to ensure single source contracts not only deliver good value for money for the taxpayer, but also fair and reasonable prices for companies undertaking qualifying contracts.

Over the past few weeks, representatives of the ADS Defence SSCR Advisory Group (DSAG) - comprised of a range of member companies - has met on a number of occasions to discuss the proposed updates to the SSCS. These meetings were also attended by representatives from the Single Source Advisory Team at the MOD, together with Akhlaq Shah and Monika Kochanowska-Tym from the SSRO. Discussions between all parties proved to be very fruitful and, encouragingly, a degree of consensus on the proposed changes has been achieved between industry and the MOD. To that end, I enclose a copy of ADS' response to the SSRO's consultation on the statutory guidance. The table inserted into the response form provides detailed feedback on each section of the guidance, together with suggested textual amendments that industry feel would serve to provide further clarity to both the MOD and contractors.

A significant number of members have noted that the SSCS contain a mix of general and statutory guidance. This poses a challenge in that it is often difficult to decipher whether a specific aspect is general guidance or statutory guidance. Industry believes that it would be preferable and more appropriate for the SSCS to contain statutory guidance only. Additional information and general guidance could be provided in a separate section or document. Furthermore, it would be beneficial for industry to better understand the status of the answers provided in the in the regularly updated 'SSRO Answers' document in relation to the statutory guidance - especially when the latter refers to issues not currently addressed in the guidance. Finally, industry would urge caution in restating specific aspects of the Defence Reform Act 2014 and the Single Source Contract Regulations in the guidance as this may lead to ambiguity or misinterpretation. However, cross-references to the Act and Regulations would be welcome where they improve understanding and provide clarity.

I hope this feedback is useful and please do not hesitate to contact me should you require any further information on any aspect of industry's submission. ADS looks forward to the publication of the final guidance document in the summer.

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Consultation Response Form

Your details

Name:

Organisation:

ADS Group

Position:

Consultation questions

When answering the consultation questions, it would be very helpful if you could support your responses with additional explanation and detail, particularly on areas where you disagree. This will help us to understand the basis for your answer and inform our finalisation of the guidance. As a minimum, please include the paragraph number your comment refers to.

Please do not feel that you need to respond to all of the consultation questions set out in the document: we welcome brief or partial responses addressing only those issues where you wish to put forward a view.

Comments on style and formatting are not required.

In the interests of transparency, it is our intention to publish responses to this consultation on the SSRO website upon completion of the consultation. Please indicate whether or not you consent to publication of your response by ticking one of the boxes below.

Please note, if you do not consent to publication, we will treat your response as confidential to the extent of any disclosure that is required by law. In the event we are required by law to make a disclosure of your consultation response, to the extent we are legally permitted to do so, we will give you as much notice as possible prior to such a disclosure and will take into account all reasonable requests made by you in relation to the content of such a disclosure.

Yes ☑ No ☐

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Introduction

QUESTION 1 - Do you have any comments on the updated Single Source Cost Standards?

Yes ☑ No ☐

Please add comments:

Please see table, overleaf.

QUESTION 2 - Do you think there are any other sections of the guidance that would benefit from further clarity?

Yes ☑ No ☐

Please add comments:

Please see table, overleaf.

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Item	SSCS guidance/reference	Issue/Consequence	Proposed change to SSCS guidance
1.	1.2 'This guidance must be followed unless there are good reasons not to'	Circumstances are complex between the MoD and industry. The SSCSs cannot envisage many of the circumstances or prior agreements/contracts/sales terms.	If both the MoD and industry expressly agree that a cost is to either be allowable or not allowable, that agreement must be adequate and not subject to later challenge/SSRO review. This ability to depart by agreement is common in many countries' allowable cost arrangements. It is particularly relevant when the SSCSs are principles based and not rules. Either the SSCSs should be followed or an explanation for the divergence should be fully documented.
2.	2.1-2.4 Background 4.1-4.4 Previous Guidance	This is not statutory guidance, nor is it required (except for 4.4 sunk costs to be moved to appropriate statutory guidance section).	Delete. The document should clearly set out what is and what is not statutory guidance.
3.	4.3-4.5, sunk costs. 'The parties would make appropriate arrangements such that is should be unnecessary for any question to	Can parties agree that sunk costs are Allowable Costs (remedy above in 1 would make this possible), or is this out with the law. What are sunk costs must be defined (costs in	Where contacts are converted to QDCs by agreement on amendment then all costs, pricing, commitments, and liabilities arising from the contract before

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	arise…'	inventory not applied to contract, rates for part of a year, sub-assemblies, items on order but not yet delivered). All committed work should be outside of the SSCS definition.	amendment shall be exempt from the DRA. Each party agrees that it will not make any reference to the SSRO with regard to any matter arising from or related to the contract prior to that amendment. Contract reporting under the DRA shall be limited to the amendment alone. No sub-contract under the un-amended contract requirements shall become a QSC.
4.	5.4-5.5 Seeks to define the calculation of value for the purposes of the thresholds for QDC/QSC 5.2-5.7 Is not statutory guidance.	The definition goes beyond the Act/Regulations, and is a poor interpretation. The definition is outside of the scope of Statutory Guidance on Allowable Costs	Delete section. The footnote on 'primary equipment' is an artificial construct and has no application under the Regulations.
5.	5.6 More information on international collaborative contracts	As per item 3, not suitable for Allowable Cost statutory guidance	Delete section. Industry has repeatedly asked for this definition to be clarified. The

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			SSRO should clarify / explain what this means BUT not in the SSCS guidance. Use of the word 'and' rather than 'or' is not in accordance with the Regulations.
6.	5.8-5.10 SSRO advice/opinion/determination	Section is not wholly application of guidance, particularly when using the SSRO Help desk	Rewrite section to ensure only refers to application of guidance.
7.	6 Section should clearly state this is now statutory guidance	Currently unclear what is and what is not statutory guidance.	Clearly designate as statutory guidance.
8.	7.1 Cost must meet AAR 'supported by adequate and sufficient evidence'	All costs must be AAR, but the guidance should state that the standard of adequate (remove sufficient from statement as this is a tautology) evidence should differ depending if the cost is actual, or estimated Revisit section wording including: Bullet 3 'not reflected again' Bullet 4 'and reflected'	In this context adequate evidence refers to credible information that materially substantiates the matter contended. The extent of that information should be limited to what is realistically available without disproportionate expense. Expand principles to set out different standards of evidence that may apply between actual costs and estimated costs.

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			Levels of evidence must be reasonable, that contractors will be expected to have the data, otherwise parametric data for estimates is appropriate. A shortage of evidence should not lead to failure of allowability when no more/better information is realistically available. The determination of what is reasonable should be seen not only as part of attributes of cost but also the overall deal. The projects are invariably complex and require the ability to look at what is reasonable in the context of the entire project and not just single elements of costs that distort the negotiation between the parties. Reword section carefully.
9.	7.3 'essential…at pricing and contract delivery….costs are…**demonstrably linked** to the **output delivered**….'	This hurdle is inappropriate for many overhead costs, total business costs, or costs that are for another purpose, however benefit the QDC/QSC through a subsequent potential lowering of cost.	Direct costs can be demonstrably linked to the contract. For indirect costs, they benefit the business as a whole at a realistic

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			scale. They may benefit the contract in question or the pricing of future work. Allowance of costs that benefit future work is consistent with the comparability principle. Remove this requirement for indirect costs and redefine in terms of 'benefit to the contract or the appropriate business overhead'. Also after 'are evidenced' insert 'if requested by the Secretary of State'.
10.	7.4 'It is expected that any costing system….allow the identification of costs as they are allocated' Wording is loose, '**any** costing system' Identification of costs under ERP/MRP systems, necessarily requires algorithms when applying own manufactured material and sub-assemblies.	This is not consistent with many company accounting/ERP/MRP systems. Allocation of cost and incurring cost may be at very different times across multiple projects. Reword Actual costs are often derived using algorithms (usually agreed with MOD and documented in the QMAC).	Section requires re-write to incorporate modern accounting systems. What is meant by the "costing system"? Is costing methodology the correct term? Reword to reflect manufacture under ERP/MRP systems using anonymous/fungible stock, possibly incorporating standard product costing with variances.

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			Distinction needs to be made between the core accounting system and the MoD costing system that draws upon the accounting system data. Contractors and the MoD by agreement, from time to time, spread costs across several years to ease MoD cash positions. The guidance should recognise this pragmatic assistance. The MoD costing system is often separate from, but derived and based upon, the accounting system, again this should be reflected in the guidance.
11.	8.1 Cost identification and measurement • Inclusion of 'demonstrably	• As before, demonstrably linked is an	• Remove demonstrably linked, for indirect costs as

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	linked' again • Definition of 'total cost' here including all options/variations in inappropriate. This requires wider consideration for reporting (separate from threshold testing) • 'In line with International Financial Reporting Standards'	inappropriate test. • Remove definition of total cost, the SSCRs should define at least two levels of contract value/cost – for thresholds and reporting, as the requirements are separate • Many contractors do not report under IFRS	per item 9 above. • Address valuation in SSCRs • 'is derived from' the normal accounting system (subject to agreed recovery methodologies). Remove 'policies' from last sentence in 8.1. • Change IFRS with reported GAAP. The SSRO needs to define treatment of hedging, and foreign exchange. • Reword to read 'direct and overhead and indirect costs'.
12.	8.6 'Overhead and indirect costs which cannot be directly attributed….**though necessarily having been incurred during the performance** of the QDC'	This is too strong a test for many indirect costs. It also ignores the wider business benefit that may exist: Selling and Marketing in reducing cost to MoD/Developing product This may perpetuate many rates (security for MoD e.g.) rather than take a wider view, in	Relax/remove this requirement, see item 9 above. Attributable definition will also require relaxation. Remove words 'during the performance'

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		extremis, contractors will place QDCs in SPVs. Some costs will be incurred before/after the performance of the QSC (accruals/prepayments/depreciation/PVR&D)	
13.	9.2 No section exists		Renumber section of document
14.	9.4 'A cost is Attributable if incurred directly or indirectly **in the fulfilment of the QDC** in question and **necessary to fulfil the requirements of that contract**.' Bullet 4 in blue box. 'Does the cost have a causal relationship with the contract, in the sense of being required for its delivery?' Bullet 6 in blue box 'incurred in fulfilling the specification of the QDC' Bullet 7 impossible to prove a negative.	These tests are too harsh for indirect costs. They do not permit a wider business benefit, nor the recovery across wide general overhead pools. (See above)	The test should be re-written: Costs should be recovered in a consistent manner (subject to agreed recovery methodologies), the basis of indirect cost apportionment is reasonable, equitable and consistently applied. Remove fulfilment and fulfil the requirements of that contract. Remove bullet 4 & 6 or change to 'a beneficial relationship', 'maintaining capacity'. Bullet 7 reword, 'there is no evidence that the cost has been recovered elsewhere'.
15.	9.5 Reasonable 'incurred in the	This addresses direct costs, not indirect costs,	Widen the definition to allow

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	normal delivery of a contract' and first bullet 'congruent with meeting the contract performance requirements'	overhead costs that may reduce QDC costs through spend on something entirely not in the performance requirements. The definition is long and not well stated. US FAR/Australian cost standards do better.	indirect allocation, and allow costs that benefit the contract, or future pricing, through lower costs/overhead spreading (per item 9 above). 'a cost is reasonable if it would have been incurred by a prudent business person undertaking commercial work'.
16.	10.2 'Costs that are assessed as being allowable….expected to be reconcilable to actual costs incurred.'	This criteria is invalid for estimated allowable costs. Not required by the Act.	Specify for actual costs, or estimated costs where the pricing relies on a previous actual.
17.	10.4 Reference to fixed assets Changes in valuation of assets 'No recovery of depreciation charges	Language is inconsistent with modern GAAP Needs to define what changes, fair-value adjustments, impairment, revaluation, depreciation	Change to 'non-current assets'. Should be limited to contractor discretionary revaluation.

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	where the costs have been recovered through other means'	This could be seen to include CSAs	State other than CSAs. Should be limited to no recovery where recovered **from the MoD** through other means.
18.	10.5 Goodwill may be allowable 'and should be approved by the Secretary of State'	Contractors are entirely at the discretion of the Secretary of State. What guidelines for circumstances when recovery is appropriate? Does not address the logical problem with the BPR being stated net of impairment of goodwill/intangibles. This should address 3 types of intangible 1. 'operating assets', such as software, fair value assets on business combination, and goodwill	Further definition required. Remove the discretion of the Secretary of State. Amortisation of software must be simply allowable and removed from this section. Goodwill impairment should be an adjustment to the reference group for comparability. It should not be an allowable cost (and relates to group accounts only). IFRS replace with GAAP.
19.	10.6-10.8 New section on risk. Defines: • Estimated Risk (some degree of contractor control)	Fundamental misunderstanding of risk, and the BPR does not address estimated/programme	Rewrite section: Contractors should price all risks

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	• Programme Risk (may be covered under the risk adjustment to the BPR)	risk. Contractors must price, so that on average the outturn is at the priced profit rate (or the contractor/MoD will be advantaged). The variability around that outturn is risk. Contractors cannot influence the price of steel per se; however they must assess the likely actual costs and price it in. Indeed they can buy forward to manage the risk.	into the contract at the average expected outturn. The BPR should assess the variability of that outcome (the shape of the distribution curve). Contracts with long and flat distributions are risky, and vice versa. Consolidate bullets from 11.1. An agreed lexicon of terminology on risk is required. This requires further discussion, however the above methodology would lead to fair and reasonable prices with average expected outturns at the reference group profitability with reward for (variable) risky contracts.
20.	10.9 'where it is not possible to identify stock losses or obsolescence costs that specifically apply to contracts then they may be accepted for inclusion as Allowable Costs. This	This should state 'accepted for inclusion as **indirect** Allowable Costs **through the overhead process**'	Add indirect … through the overhead process. Delete last sentence, or change, 'if

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	will only apply when the contractor's costing system is able to isolate these stock losses as an indirect overhead'	The last sentence is not understood.	there is evidence of poor storage, handling or control'. It is impossible to provide affirmative evidence, negative evidence is possible.
21.	10.10 Redundancy payments 'and notified to the SSRO as part of the reporting process.	Redundancy happens as a process not always in large initiatives. Much of the requirement to pay levels of redundancy is contractual and often dates from MoD TUPE requirements. Reporting is therefore onerous, with no added value and the 'process' is unclear	Remove requirement to report. Otherwise there should be a *de minimis* threshold for redundancy (HR1 threshold?). Remove requirement to gain approval for the MoD. If payments are contractual, and the contract of employment is reasonable this should satisfy AAR, no other test is required. Possibly add a total redundancy paid in year to a supplier report.
22.	10.11Employee benefits 'arrived at in the manner prescribed by the relevant International Financial Reporting Standards	Many contractors do not use IFRS	Add 'or contractor local GAAP'.
23.	10.12 PVR&D 'development expenditure in accordance with the relevant International Financial	Many contractors do not use IFRS	Add 'or contractor local GAAP'.

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	Reporting Standards'		
24.	10.13 Research and Development final bullet. 'Research and development costs will not be allowed where there has been no discernible benefit provided to the MOD or the public sector as a whole or where sufficient evidence is not available to support the research and development costs'	First sentence is not required: Development, MoD then does not procure - no proportional allocation. Is this to restrict research – is it required? 'Sufficient evidence' this is not required, without evidence it would not be allowable	Remove this bullet point. Research should be allowable, relevant to business development.
25.	10.14 Abortive research and technology expenditure	What is abortive technology expenditure – not understood How is abortive research achieved?	Reword 'Abortive **development** expenditure should be treated in the same was as any other **development** expenditure'.
26.	10.15 'MoD had agreed to it in advance of the research being undertaken	Much research is small and a continuous process	Research should be replaced by development. Material development programmes only should be agreed in advance.
27.	10.16 'Due to the timeframes that research and development programmes can span, it may be difficult to reach final decisions on the treatment for pricing….'	Research and Development are separate issues, this is not relevant for research	Delete research.

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28.	10.17 Pension Costs. 'Whether pension costs are Allowable……dependent upon whether it is a defined benefit or defined contribution scheme'	Both types of scheme are Allowable, only the quantum/what elements are allowable are in question	Remove this sentence.
29.	10.17 'Any pension costs claimed must reconcile with those shown in the contractor's income statement, otherwise these will be disallowed.' Defined contribution plan **contributions** are to be included as an Allowable Cost; First sentence is incorrect.	This is unclear; it should state that the rates for a BU should be reconciled to the accounts pension disclosures. Costs as accounted for on an accruals basis, not simply the cash contributions. Remove first sentence.	Clarify. And permit FRS 102 dispensation to separate inclusion of pensions information relating to that entity if full disclosure is made (and referenced) at a holding company or group level. In such circumstances an equitable apportionment of the costs should accrue to the reporting entity or BU. Clarify, the charge is allowable. Remove first sentence. Proposed para 10.17 below:
	All current pension costs, whether a defined benefit scheme or a defined contribution scheme, as provided in the Income statement as an operating cost are allowable. These costs should be reconcilable by scheme to the disclosure notes in the		

<table>
<tr><th>Item</th><th>SSCS guidance/reference</th><th>Issue/Consequence</th><th>Proposed change to SSCS guidance</th></tr>
<tr><td></td><td colspan="3">statutory accounts for the entity in accordance with the relevant GAAP, i.e.

• Defined Contribution scheme: All employer contributions paid or accrued in the year.
• Defined Benefit scheme: The relevant annual allowable expense is that which is considered the normal pension costs that is attributed to the relevant employees for service in the current period, and not related to the funding of any deficit cost or past expenses, therefore:
o The current service cost is allowable, this represents the increase in the pension scheme liability for an extra year of service for that employee;
o Annual administrative expenses, running costs and advisory fees are allowable as these are reported as an operating cost relating to the scheme (including PPF levies); however,
o All other expenses recognised in the profit and loss account which relate to past service costs, settlement gains and losses, net interest on the pension liability and all re-measurements recognised through the statement of other comprehensive income should be ignored and not allowed.

It is recognised that retirement benefits are often significant in the context of employer financial statements and some companies operate as part of a group where disclosure is permitted at group level so will not be readily identifiable at a unit level. In these cases an equitable proportion (suggest based on pensionable salaries) of the relevant costs should be included in the claim of the unit.</td></tr>
<tr><td>30.</td><td>10.18 Marketing & Sales

Marketing and sales costs can only</td><td>Sales campaigns that if successful would spread overhead costs away from regulated contract</td><td>M&S costs should benefit the business as a whole and its future scope and development, as per</td></tr>
</table>

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	be considered *allowable*, if they are **demonstrably linked** to a QDC/QSC 'and retrospective in nature'	costs are not encouraged. Product development for others, which the MoD may benefit from, is not encouraged. Contractors may be incentivised to split their legal entities into regulated contract work and other work so as to ensure recovery of MoD costs/no dilution of overheads.	item 9 above. Not allowing M&S costs is inconsistent with the comparability principle (unless the BRP is adjusted). M&S must pass the Reasonable test. With contractors justifying costs, likely outturns and linking campaigns to future volumes. Allowing costs in year, is predictable (not volatile), and relates to normal overhead levels. Linking M&S to specific contracts lacks relevance. The proposed retrospective M&S solution may allow for little or no costs to be allowed. If no/small QDC/QSCs are placed at the time of winning other work.

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31.	10.19 Definition of 'demonstrable link' is helpful but not complete. 'Where it can be **proven** that any such benefit was enabled by **successful** sales and marketing effort'	Cost allowance is at the time of M&S spend. At this point, business plans will set out the potential cost reductions (but they are potential and cannot be 'proved' at this point). Additionally, they are always of a speculative nature therefore 'success' is unknown.	Remove these tests. The M&S activity should be an appropriate level of cost, for an opportunity that is realistic, and would have demonstrable prospective benefits if successful to the MoD either through lower overhead costs or product development. These campaigns and benefits should be discussed with the MoD.
32.	10.20 Reworks. Requires expansion to include scrap. Rework 'that is **agreed** and part of a **complex process** which is evidenced in the circumstance'	Some items are scrapped not reworked, these should be allowable, for normal levels of scrap/yield, where the contractor is not negligent. Rework as above at normal levels should be allowable. Why and with who must it be agreed? Why must the process be complex – some simple processed yield failure rates? Second bullet, what 'is evidence'	Reword 'Rework' singular in the title. Section should consider scrap and rework. Include scrap and rework at normal/non-negligent levels as allowable. Consolidate bullet in 11.1 final bullet. Remove the agreement (contactor and MoD) of scrap/rework unless

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			abnormal. Costs not 'agreed' but MoD satisfied. Remove the complex process Requirement. Substantiation may require the provision of learning curves, historical non-conformance rates, QC systems, etc.
33.	10.21 Refunds. 'reimbursements, credits, grants or refunds are received by contractors and cannot be identified to a particular contract then these should be apportioned to individual contracts to reduce Allowable Costs'.	They should only reduce costs that were allowable originally. Why is there an example for this one type? The first sentence 'apportioned' is confusing and poorly stated.	Amend to read 'reimbursements, credits, grants or refunds **relevant to allowable costs** are received by contractors …' Delete example. Change to 'credits … that are indirect' rather than 'cannot be identified to a particular contract'.
34.	10.22 Insurance. Not allowable 'such as faulty workmanship, defective parts not for loss of profit'	Requires tighter specification: • Should not disallow insurance for others faulty workmanship or own manufactured parts.	• '**contractor abnormal** levels of faulty workmanship, and own

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		• Consider insurance for post-delivery risks e.g. warranties	manufactured defective parts' • Include insurance and/or warranties for post-delivery risks. • Consolidate points from section 11.1
35.	11.1 Contingencies (bullet 9&10). This section is confused, and coupled with the previous inappropriate definitions of risk are problematic.	Simplify by stating that actual allowable costs cannot include contingency, contingency is only relevant for estimated allowable costs.	Delete and rewrite with risk section and BPR section, this needs to be consistent with item 19. The MoD has suggested a full review of risk and contingencies, with time and engagement of all parties. This would be helpful.
36.	11.1 Labour rates (bullet 11) which cannot be evidenced as meeting the AAR principles.	All costs must be evidenced, why is this required.	Delete. Labour rates are discussed, agreed and settled as a whole.
37.	11.1 Inflation (bullet 12) with regard to labour or costs of material, which is not evidenced against **the** appropriate benchmark data.	What is **the** benchmark data?	Pricing is an art, there will be many opinions and different data sets to assess the appropriate level of inflation. This must be discussed and agreed. This statement is not

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			required, simply part of AAR evidence, delete.
38.	11.1 Sponsorships (bullet 14)	Some sponsorships should be allowable, such as graduate/apprentice sponsorship. The SSRO does not want to be seen to discourage workforce development and be out of line with stated government policy.	Definition is too wide, specify what sponsorships are to be disallowed (marketing/lobbying). Is Appropriate.
39.	11.1 Insurance (bullet 16&17). A distinction needs to be made between the cost incurred in rectifying "faulty workmanship" before acceptance of goods and the risk of rectifying defects in goods after acceptance.	It is well established that pre-acceptance, there is a difference between costs incurred in scrap and rework as a normal consequence of the manufacturing process and the cost of repair and replacement of faulty goods pre-delivery and acceptance. The former, subject to AAR, is an allowable cost; the latter is not unless part of normal scrap, rework and learner. Therefore, any insurance premium paid to cover the risk of that latter cost should not be allowable. However, post acceptance, the cost of repairing or replacing faulty goods for which the contractor is legally liable (eg an express or implied warranty as to the quality of the goods) is a risk that has been recognised by the Review Board as a cost that should be taken into account in the	Amend para 11.1: 'Cost or premiums and payments for insurance which cover the contractor's own pre-acceptance defects in materials or workmanship incidental to the normal course of construction or manufacturing. This includes the insurance to repair defects in materials or workmanship or consequential loss that relates to profit and therefore will not meet Appropriate, Attributable and Reasonable criteria. Costs for the remedy of faulty workmanship or the consequences that result pre-acceptance. This

Item	SSCS guidance/reference	Issue/Consequence	Proposed change to SSCS guidance
		contract price [para 319, 7GR, March 1993], and is reflected in comparability [para 309, 1996GR, March 1996]. If that risk is an allowable cost, subject to AAR, then the cost of premiums to insure against that risk should also be allowable. This requires discussion with the MoD (progress was made under a change to the GACs late in the GPFAA's life). We have a separate paper on this.	does not include costs or premiums for experimental industrial processes that have been agreed as part of a contract, nor wastage as a natural consequence of manufacturing (including learner) nor for post-acceptance liabilities.'
40.	11.1 Faulty Workmanship (bullet 18)	Further clarification over what 'rework' is and isn't allowable has been provided within SSRO Opinion 1. Further guidance should be provided to assist in categorising rework into first in class, re-specification and faulty workmanship in order to avoid this being a continued area of excessive negotiation.	Rework, rectification, and concessions are an intrinsic part of any process and therefore should be allowable. Contractors should be encouraged to minimise rework and potentially high levels of rework should be not allowable, but no process will ever give a 100% pass rate. This could be judged under industry norms or historical norms. See items 34 & 39 for warranty.
41.	12.3 'Exceptional or abnormal costs will not generally be allowed where they relate to normal commercial business risk and any discussions	This has no context. No costs are normal in closure/rationalisation. There is no relationship with normal business risk.	This section needs a complete reconsideration and rewrite. Act as a prudent commercial

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Item	SSCS guidance/reference	Issue/Consequence	Proposed change to SSCS guidance
	around closure or rationalisation of plants must ensure that value for money remains the primary consideration. Contractors must demonstrate innovation and efficiency in the proposals they submit for reducing the costs associated with the closure or rationalisation of a plant.'	What are normal commercial business risks? 'must demonstrate innovation and efficiency'	businessman. Cost needs to be reasonable only. Such costs usually fall outside of the scope of the DRA 'goods, works or services', and the MoD seeks to pay without adding profit (a contractual vehicle may be required).
42.	12.4 'net cost of rationalisation/closure must be tested and recovered against the benefits associated with the other sites or joint venture'	This is not understood, the profit stream moves from site to site, this is no change. What benefit does the SSRO see? What does 'tested' and 'recovered' mean. What is the net cost of closure?	Delete section. Allowable costs are not in question. Any windfall to the contractor from say increased volumes and overhead reductions on fixed/firm contracts elsewhere should be addressed in the commercial terms.
43.	Idle Facilities: 12.6 'designed for that purpose'	Unlikely QDCs/QSCs existing when designed	Remove requirement, or relate to MoD needs. Make business case

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Item	SSCS guidance/reference	Issue/Consequence	Proposed change to SSCS guidance
	12.8 'unused due to a change in government or defence policy which could not have been predicted by the contractor'	All facilities will become idle eventually and this can be foreseen, but this should not be a criteria of allowability	optimal to maintain rather than close/reinstate. Remove 'urgent deployments', criteria not required. As ever contractors must seek to be efficient in their management of idle facilities (reasonable). MoD may seek to contract directly for maintenance of facilities.
44.	12.9 'payment'	This is not an AAR matter.	Delete.
45.	12.10 'separately reported to the SSRO'	Whom should make the report to the SSRO? Reported to the SSRO only if the payment is within a QDC/QSC	Clarify, MoD in the first instance? This may be added to the reporting suite.
46.	12.12 Pensions 'Any costs that do not relate to current year service costs, and are factors relating to financing costs, investment performance, insufficient contribution levels in previous years and other activities not directly connected with the current year, are generally not Allowable.'	This is inconsistent with 12.11	Remove Consolidate with 12.11 and 12.12 with 10.17

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Consultation Response Form

Item	SSCS guidance/reference	Issue/Consequence	Proposed change to SSCS guidance
47.	12.14 'Development expenditure that gives rise to an intangible asset should be attributed to the relevant product or products of the contractor'	This conflicts with guidance in section 10. The accounting treatment is not a criterion of allowability	Delete
48.	12.14 'The intangible asset generated should fulfil the criteria set out in the relevant accounting standard.' 'The costs of this **research** expenditure would be recovered through the costs of the relevant products when they are sold'	Yes it would – contractors must follow GAAP, does this mean research is not allowable as it is never capitalised? Wrong word – should be development.	Delete section, not required. Accounting does not define allowability. This is contradictory to earlier sections on research and development.
49.	12.15 'Expenditure made in respect of the research phase of a project that will not generate an intangible asset, and which will not generate probable future economic benefits for the MOD, should not be treated as an Allowable Cost.'	This is at variance with the rest of the guidance. This means research is never allowable (IAS 38), as research is not capitalised.	Delete
50.	12.16 (and 10.13 Research and Development)	The requirement to offset tax credits for R&D against any cost charged to a MoD contract, disadvantages the defence contractors in	If R&D tax credits are offset against allowable costs then, a pragmatic system has been agreed between

Single Source Cost Standards
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Consultation Response Form

Item	SSCS guidance/reference	Issue/Consequence	Proposed change to SSCS guidance
		comparison to other industries. In normal circumstances investments in R&D would be expected to generate profits from sales to customers and receipts from tax credits. If allowed to remain: Should be offset to the extent that costs have been treated as allowable Needs to expand and explain this is limited to ATL	the MoD and contractors, as it is impossible to estimate the benefits (subject to government policy, change and interpretation). 1. No benefits of R&D tax credits are estimated in the allowable costs 2. When direct benefits are realised, on regulated contracts the MoD is directly reimbursed, when realised. 3. When indirect benefits are realised, the actual indirect costs are reduced accordingly.
51.	Section 13 Cost allocation and authority and 14. Authority and responsibilities	This is not statutory guidance.	Delete sections.
52.	13.1 Cost allocation 'required annually to declare, through the questionnaire on the method of allocation of costs, their normal accounting and cost allocation	The QMAC does not determine that costs are allowable, but it is a key way to determine attributable, equitable allocation and single recovery.	Cost types should be sentenced as direct or indirect and that sentencing should be declared and periodically agreed with the MoD. The methodology of recovery of

Single Source Cost Standards
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Consultation Response Form

Item	SSCS guidance/reference	Issue/Consequence	Proposed change to SSCS guidance
	approach. This declaration does not pre-determine whether costs are Allowable.		indirect costs should be documented (numerator composition and denominator calculation) and periodically agreed with MoD.
53.	13.2 'A contractor will follow its own normal accounting systems, and in advance must declare when it plans or decides otherwise to the SSRO and the MOD, together with a clear statement explaining why it is doing so	There may be many small deviations and necessary system changes in a period. Some changes are GAAP or system driven. Cost accounting for MoD will normally be separate from the core accounting system,	The contractor should declare all material deviations, with only major changes requiring prior authorisation. Costs are recorded in the normal accounting system, these are then used as a basis for compiling the MoD costs through a methodology as in item 52.
54.	13.3 'The contractor's costing system must be the same for MOD work as it is for other work in which it is engaged thus ensuring that the allocation of costs can be relied upon as being both fair and transparent.	The accounting system is the system to produce management and statutory accounts. It will be the source of data to produce MoD reports, contract costs, estimates and rates. The contractor is free to report and estimate for non-MoD customers in any way it wishes.	Clarify the requirement. A consistent system is required for MoD costs (often a QMAC), see item 52.
55.	14.1 Scope of SSRO authority	Pricing of COTS/MOTS, commercial items and non-developmental items continue not to have been addressed.	As per item 1, these should be able to be agreed by both parties as sitting outside of the pricing

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Consultation Response Form

Item	SSCS guidance/reference	Issue/Consequence	Proposed change to SSCS guidance
		These are items which have a verifiable market price, and when included in a regulated contract, should be priced at those prices and not using the pricing formula.	formula, and excluded from reporting. If both the MoD and industry expressly agree to price at the market price, that agreement must be adequate and not subject to later challenge/SSRO review.

Your details

Name:

Organisation:

Babcock International Group Plc

Position:

Consultation questions

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Comments on style and formatting are not required.

In the interests of transparency, it is our intention to publish responses to this consultation on the SSRO website upon completion of the consultation. Please indicate whether or not you consent to publication of your response by ticking one of the boxes below.

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Yes √ No

Introduction

QUESTION 1 - Do you have any comments on the updated Single Source Cost Standards?

Yes [√] No [ ]

Please add comments:

The guidance for allowable costs is very useful in enabling contractors to develop their understanding of, and assurance frameworks related to, the Single Source Contract regulations. We are appreciative of the work the SSRO have done to try to improve the guidance.

In line with this we would suggest that a process is established to update this guidance on a regular basis, to particularly include further information which may arise through the opinions and/or determinations which the SSRO will make from time to time. This would be helpful to ensure that a 'case law' type system does not develop, with guidance being held in different documents.

QUESTION 2 - Do you think there are any other sections of the guidance that would benefit from further clarity?

Yes [√] No [ ]

Please note that the comments below are in addition to those discussed during the meeting between Babcock and the SSRO on 5 April 2016 and within the information supplied at that time.

As mentioned above we appreciate the work the SSRO has done to provide further clarity within the allowable costs guidance and believe it is an improvement. There are some areas where we believe all parties would benefit from further guidance.

Rework – we support the inclusion of the section on 'rework as part of a complex process' as being allowable. Further to this and in order to be explicit over the point that a level of rework is involved in most engineering tasks, it would be useful to include terms such as 'non-zero level of rework' as being allowable. The section on insurances should also be updated to make reference to the changes in language made here.

Reasonableness – as agreed by all parties at the SSRO workshop on 4 May 2016, costs need to be viewed in the light of the overall contract, for example if savings have been agreed through productivity improvements or efficiency gains. We believe the guidance should reference this as it would be useful to ensure that these factors in a contract are considered alongside specific costs when determining if they should be allowable.

Applicable rates – contractual costs are often calculated on the basis of historic rates. It would be useful to have guidance as to which rates should be used as a reference or 'baseline', in particular with reference to the timing of publication of any rates.

Inflation – we believe there is some confusion as to how to apply the 'reasonableness' criteria to inflation calculations. In light of the SSRO recognition that in certain circumstances benchmarks are not available to adequately represent the supply and demand dynamics of a market, it would be very helpful to include reference to other sources of evidence for inflation, e.g. historic trends, as being acceptable.

Warranties – we are of the understanding that general warranties, requested by the customer, to cover ongoing support for periods after contract completion may be allowable costs. It would be useful to have a reference to this in the guidance to avoid confusion with the guidance on insurances.

Project specific assets – whilst noting that capital expenditure should be recovered through depreciation, amortisation or impairment, in certain circumstance assets are purchased for the exclusive use of a single contract. It is our understanding that in these special circumstances, provided the assets fulfil the AAR criteria, they could be included as an allowable cost. It would be very helpful to highlight that there are cases where capital expenditure may be allowable as a direct contract charge.

Evidence – the regulations clearly place the burden of proof for meeting the AAR criteria on the contractor. Recognising this, it would be useful to have a section of the guidance on the principles of evidence. For example, we understand that the situation where historic costs cannot be separately identified for referencing should not make them disallowed costs, and it would be helpful to highlight that in such cases apportionment methodologies may be acceptable.

Research and development – the requirement to offset any allowable costs relating to R&D by any tax benefits received relating to that R&D disadvantages defence contractors in comparison to other industries. In normal circumstances, a company could reasonably expect to receive returns on their R&D investments through both sales to customers and tax benefits. We believe it is only fair to replicate this in the guidance. In addition, we a not clear under what circumstances IP would be an allowable cost, when tax credits for IP would need to be applied, or whether it is recognised that the cost of pursuing tax credits is allowable, so should appreciate further clarification on these areas.

Availability type contracts – for contracts where the MoD is requesting availability or open support, specific resource profiles and the timing/quantum of costs may be difficult to calculate due to the nature of when the customer might call on the supplier to provide services. It would be useful to have guidance as to what methodologies should be used to establish allowable costs. This is separate to idle facilities/capacity as the MoD is specifically contracting for an option to call on the supplier, but without setting a demand profile.

Established contracts – we believe that there should be a comment, within section 10, recognising that these cost guidelines should not contradict previously established MoD agreements. In cases where agreements to recover costs from the MoD through future contracts are in place, these should be explicitly allowable in order to avoid unintended penalising of industry.

Damages and compensation – there may be circumstances where damages and compensation costs may be legitimately incurred, for example with relation to sub-contractors, so we believe further detail should be included recognising that these costs may be allowable depending on the contract and the allocation of risk within it.

Risk – as discussed at the workshop hosted by the SSRO on 4 May 2016, we note the guidance on risk is at an early stage of development. We agree with the need to hold a dedicated workshop to look at this and would again request to be in attendance. We would suggest that this should be held before the revised guidance is published so the outcomes can be included. If this is not feasible then we believe the guidance should include reference to this so as not to cause confusion that the guidance is absolute and settled on this area.

AAR example checklist – we applaud the SSRO's intention to provide a checklist to help identify if costs meet each of the three criteria, however we are not sure whether the lists published achieve that aim, and should benefit from a further review. For example, some of the points appear more relevant to other criteria than the one they are listed under or they do not appear to be specifically relevant to QDCs/QSCs any more than they are relevant to any MoD contract. We also do not believe that criteria such as whether something would bear public scrutiny is a relevant measure as long as a cost is required for the performance of a contract.

Single Source Cost Standards
Statutory Guidance on Allowable Costs

Consultation Response Form

Your details

Name:

Organisation:

BAE SYSTEMS PLC

Position:

Consultation questions

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Yes [X] No [ ]

Single Source Cost Standards
Statutory Guidance on Allowable Costs

Consultation Response Form

Introduction

QUESTION 1 - Do you have any comments on the updated Single Source Cost Standards?

Yes [X] No [ ]

Please add comments:

See attached document for BAE Systems plc response.

QUESTION 2 - Do you think there are any other sections of the guidance that would benefit from further clarity?

Yes [X] No [ ]

Please add comments:

All comments are contained in our response to Question 1.

Question 1: Do you have any comments on the updated Single Source Cost Standards?

ADS have submitted an industry wide response which BAE Systems supports. In addition BAE Systems would like to add the following comments in respect of the consultation on Single Source Cost Standards:

Paragraph 4.4 – Sunk costs – Bullet 2 states 'the parties will not seek to reclaim costs or to claim additional costs in respect of the period prior to the Amended Contract becoming a qualifying contract'. Whilst BAE Systems accept the principle, there might be instances where there are outstanding issues at the point the contract becomes a QDC, i.e. disputes, claims, rates etc., the Amended Contract would need to reflect that there were outstanding issues.

The term 'demonstrably linked' is used throughout the Standards i.e. paragraphs 7.3, 8.1and 10.19. In paragraph 7.3 it is linked to the output of the contract, in paragraph 8.1 it is linked to the contract and in paragraph 10.19 to financial benefit to the qualifying contract.

Paragraph 8.1 states 'The total cost, including those costs properly adjusted for applicable variances of a contract, is the sum of the direct and overhead or indirect costs demonstrably linked to the contract, incurred or to be incurred, and includes the value of all options or variations that may apply'. Whilst paragraph 8.6 on Overheads/Indirect costs states 'These costs cannot be directly attributed to a single contract but may be apportioned to individual contracts'. These two paragraphs cannot sit alongside each other, so the words demonstrably linked are unhelpful. In respect of Overhead/Indirect costs how can industry demonstrably link them to a contract? As an example corporates require a board of directors to run/oversee it by law. Whilst accepting that costs must always be Appropriate, Attributable and Reasonable (AAR), in the example given it is not possible to demonstrably link the activity to a contract, but no one would dispute this is an allowable cost.

BAE Systems therefore request removal of the words 'demonstrably linked' throughout the document as previous guidance was adequate.

Paragraph 10.17 covering Pensions mixes both allowable and non-allowable costs. BAE Systems request that paragraph 10.17 simply covers allowable costs and the non-allowable costs are covered once in paragraph 11.

In respect of Marketing and Sales costs, covered in paragraphs 10.18 and 10.19 BAE Systems reiterates its previous comments provided to SSRO. These costs are a normal element of most businesses' operating costs; they are essential for providing opportunities for business growth. In the defence market, this provides our domestic customer with reduced costs due to increased throughput, capacity and capability retention of nationally important skills and facilities, the potential for co-funding of enhancements to operational capabilities of our products, and where applicable, the payment of commercial exploitation levy.

It would clearly not be equitable for MoD to receive these benefits on qualifying defence contracts if marketing and sales costs are to be generally disallowable on such contracts. The proposal that acceptance of marketing and sales costs as allowable on successful bids does not reflect business reality where not all bids succeed. The customer should not and cannot expect to benefit solely from winning bids.

An alternative to your proposal in paragraph's 10.18 and 10.19 would be that marketing and sales costs be generally allowable as incurred so long as they are AAR compliant.

Under this proposal the wording of paragraph 10.18 should be rewritten such that marketing and sales costs are allowable as incurred. The wording demonstrably linked and retrospective would not be required.

Paragraph 10.19 is incorrect in referring to a reduction in overheads. The benefit to MoD is seen through additional throughput that will lead to a lower overhead absorption rate.

It would be helpful if paragraph 10.22 stated that product liability insurance can be an allowable cost in certain circumstances. This is particularly relevant to our submarine and naval ships business where 'prototype' vessels are taken out to sea for sea trials.

The following comments apply to paragraph 11.1 on costs which are generally not allowable.

Bullet six states that entertainment expenses of any sort are not allowable. BAE Systems request additional clarity that states that these costs can be allowable if it relates to the scope of delivery requested by the customer e.g. a launch ceremony for a new ship or submarine.

Bullet eleven covering labour rates should be removed. All costs need to be AAR compliant to be allowable including labour rates as a specific item is superfluous.

Bullet twelve covers inflation. Inflation is not a cost; the costs are labour and materials. For these to be allowable they must be AAR compliant, it is the absolute values that must be reasonable against benchmark data not the inflation %. This is bullet is not required.

Bullet sixteen states 'Cost or premiums and payments for insurance which cover that element of consequential loss that relates to profit are excluded on similar grounds' the words 'excluded on similar grounds' do not relate to any of the previous bullets and so should be removed.

Paragraph 12.11 sets out what is allowable in respect of pensions. This has already been covered under paragraph 10.17 and therefore is not required.

Paragraphs 12.12 and 12.13 cover pension costs that are not allowable these should be covered in section 11.

Paragraphs 12.14 and 12.15 are under the heading Research and development tax credits, but covers allowable and non-allowable costs that have been covered elsewhere in the document so should be removed.

Your details

Name:

Organisation:

The Boeing Company

Position:

Consultation questions

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Yes ☑ No ☐

Introduction

QUESTION 1 - Do you have any comments on the updated Single Source Cost Standards?

Yes ☑ No ☐

Please add comments:

2.1-2.4; Background and 4.1-4.4 Previous Guidance. This is not statutory guidance, nor is it required, except for 4.4 sunk costs (to be moved to appropriate statutory guidance section).

4.3-4.5; sunk costs. 'The parties would make appropriate arrangements such that is should be unnecessary for any question to arise…' Sunk costs must be defined. All committed work should be outside of the SSCS definition. Where contacts are converted to QDCs by agreement on amendment then all costs, pricing, commitments, and liabilities arising from the contract before amendment shall be exempt from the DRA. Each party agrees that it will not make any reference to the SSRO with regard to any matter arising from or related to the contract prior to that amendment. Contract reporting under the DRA shall be limited to the amendment alone. No sub-contract under the un-amended contract requirements shall become a QSC.

5.2-5.7; This is not statutory guidance and the definition is outside of the scope of Statutory Guidance on Allowable Costs. The footnote on 'primary equipment' is an artificial construct and has no application under the Regulations.

7.3; ‘essential…at pricing and contract delivery….costs are…demonstrably linked to the output delivered…’This hurdle is inappropriate for many overhead costs, total business costs, or costs that are for another purpose, however benefit the QDC/QSC through a subsequent potential lowering of cost. Direct costs can be demonstrably linked to the contract. For indirect costs, they benefit the business as a whole at a realistic scale. They may benefit the contract in question or the pricing of future work. Allowance of costs that benefit future work is consistent with the comparability principle.

Remove this requirement for indirect costs and redefine in terms of ‘benefit to the contract or the appropriate business overhead’. Also after ‘are evidenced’ suggest insertion of ‘if requested by the Secretary of State’.

7.4; ‘It is expected that any costing system….allow the identification of costs as they are allocated’. Wording is loose, ‘any costing system’. This is not consistent with many company accounting/ERP/MRP systems. Allocation of cost and incurring cost may be at very different times across multiple projects. Actual costs are often derived using algorithms (usually agreed with MOD and documented in the QMAC). What is meant by the “costing system”? Is costing methodology the correct term? Distinction needs to be made between the core accounting system and the MoD costing system that draws upon the accounting system data.

8.1; Cost identification and measurement; Inclusion of ‘demonstrably linked’ again; Definition of ‘total cost’ here including all options/variations in inappropriate. This requires wider consideration for reporting (separate from threshold testing); ‘In line with International Financial Reporting Standards’. As before, demonstrably linked is an inappropriate test. Suggest Removal of the definition of total cost, the SSCRs should define at least two levels of contract value/cost – for thresholds and reporting, as the requirements are separate. Many contractors do not report under IFRS.

8.6; ‘Overhead and indirect costs which cannot be directly attributed….though necessarily having been incurred during the performance of the QDC’. This is too strong a test for many indirect costs. It also ignores the wider business benefit that may exist:

Selling and Marketing in reducing cost to MoD/Developing product. Some costs will be incurred before/after the performance of the QSC.

9.2; Section missing.

9.4; ‘A cost is Attributable if incurred directly or indirectly in the fulfilment of the QDC in question and necessary to fulfil the requirements of that contract.’

- Bullet 4 in blue box. ‘Does the cost have a causal relationship with the contract, in the

10.2; ‘Costs that are assessed as being allowable….expected to be reconcilable to actual costs incurred.’ This criteria is invalid for estimated allowable costs and in any case not required by the Act. Suggest specifying for actual costs, or estimated costs where the pricing relies on a previous actual.

10.4; Reference to fixed assets. This language is inconsistent with modern GAAP and should refer to ‘non-current assets’. Reference to ‘Changes in valuation of assets…’ needs to define what changes, e.g; fair-value adjustments, impairment, revaluation, depreciation. Reference to ‘No recovery of depreciation charges where the costs have been recovered through other means’ should be limited to no recovery where recovered from the MoD through other means.

10.5; Replace the reference to ‘IFRS’ with ‘GAAP’.

10.6-10.8; New section on risk. This shows a fundamental misunderstanding of risk, and the BPR does not address estimated/programme risk. Contractors must price, so that on average, the outturn is at the priced profit rate (or the contractor/MoD will be advantaged). The variability around that outturn is risk. Contractors cannot influence the price of, say, steel; however they must assess the likely actual costs and price it in. The BPR should assess the variability of this outcome (the shape of the distribution curve) and this methodology would lead to fair and reasonable prices, with reward for variability and therefore riskier contracts.

10.11 and 10.12; Replace the reference to ‘IFRS’ with ‘GAAP’.

10.15; ‘MoD had agreed to it in advance of the research being undertaken’. Research should be replaced by development. Material development programmes only should be agreed in advance.

10.16; ‘Due to the timeframes that research and development programmes can span, it may be difficult to reach final decisions on the treatment for pricing…’. Research and Development are separate issues, this is not relevant for research and ‘research’ should therefore be deleted.

10.17; Pension Costs. ‘Whether pension costs are Allowable……dependent upon whether it is a defined benefit or defined contribution scheme’. Both types of scheme are Allowable, only the quantum/what elements are allowable are in question. Suggest deleting this sentence.

11.1; Inflation (bullet 12) 'with regard to labour or costs of material, which is not evidenced against the appropriate benchmark data'. What is the benchmark data? There will be many different data sets to assess the appropriate level of inflation. This statement is not required, simply part of AAR evidence and so should be deleted.

11.1; Sponsorships (bullet 14). Some sponsorships should be allowable, such as graduate/apprentice sponsorship and Reservists. This is stated Government policy.

12.3; 'Exceptional or abnormal costs will not generally be allowed where they relate to normal commercial business risk and any discussions around closure or rationalisation of plants must ensure that value for money remains the primary consideration. Contractors must demonstrate innovation and efficiency in the proposals they submit for reducing the costs associated with the closure or rationalisation of a plant.' Is this section necessary as plant closures would not normally be part of a normal delivery contract.

12.4; '…net cost of rationalisation/closure must be tested and recovered against the benefits associated with the other sites or joint venture'. The validity and relevance of section is not understood. Any perceived windfall to the contractor from, say, increased volumes and overhead reductions on fixed/firm contracts elsewhere should be addressed in the contract terms.

12.8; Idle Facilities; '…unused due to a change in government or defence policy which could not have been predicted by the contractor'. All facilities will become idle eventually and this can be foreseen, but this should not be a criteria of allowability.

12.9; 'payment'. This is not an AAR matter and should be deleted.

12.12; Pensions 'Any costs that do not relate to current year service costs, and are factors relating to financing costs, investment performance, insufficient contribution levels in previous years and other activities not directly connected with the current year, are generally not Allowable.' This sentence is inconsistent with 12.11. Suggest removing and / or consolidating with 12.11 and 12.12 with 10.17.

12.14; 'Development expenditure that gives rise to an intangible asset should be attributed to the relevant product or products of the contractor'. This sentence conflicts with guidance in section 10. The accounting treatment is not a criterion of allowability and should be deleted.

12.14; 'The costs of this research expenditure would be recovered through the costs of the relevant products when they are sold'. Should 'research' read 'development'. In any case Accounting does not define allowability and this sentence is contradictory to earlier

13 and 14; Sections on Cost allocation and Authority Responsibilities are not statutory guidance and should be deleted.

Single Source Cost Standards
Statutory Guidance on Allowable Costs

Consultation Response Form

Your details

Name:

Organisation:

FinExperts Ltd

Position:

Consultation questions

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Yes [X] No [ ]

Single Source Cost Standards
Statutory Guidance on Allowable Costs

Consultation Response Form

Introduction

QUESTION 1 - Do you have any comments on the updated Single Source Cost Standards?

Yes [X] No [ ]

Please add comments:

I have been involved in the preparation of the list of comments submitted by ADS and fully support them. Please take that list as my response as well.

QUESTION 2 - Do you think there are any other sections of the guidance that would benefit from further clarity?

Yes [X] No [ ]

Please add comments:

I have been involved in the preparation of the list of comments submitted by ADS and fully support them. Please take that list as my response as well.

Your details

Name:

Organisation:

Leonardo-Finmeccanica

Position:

Consultation questions

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Please note, if you do not consent to publication, we will treat your response as confidential to the extent of any disclosure that is required by law. In the event we are required by law to make a disclosure of your consultation response, to the extent we are legally permitted to do so, we will give you as much notice as possible prior to such a disclosure and will take into account all reasonable requests made by you in relation to the content of such a disclosure.

Yes [X] No [ ]

Introduction

QUESTION 1 - Do you have any comments on the updated Single Source Cost Standards?

Yes [x] No [ ]

Please add comments:

General comments
The clarifications and amendments incorporated into this version of the guidance are welcomed. We believe that the guidance now better recognises the environment within which business and costs are incurred and better defines the methods of treatment of costs that are not directly allocated to a contract. There are, however, areas of the guide that could be further improved and these are set out in the answer to Question 2.

QUESTION 2 - Do you think there are any other sections of the guidance that would benefit from further clarity?

Yes [x] No [ ]

Please add comments:

1. Allowable Costs - Principles
At present, the guidance contains a mix of general and statutory guidance. To remove ambiguity, it would be helpful if the guidance covered statutory guidance only, with supplementary general guidance being provided in a separate document, as necessary. Whilst it is correct to insist on International Financial Reporting Standards as the basis of assessment of allowable costs, we believe that costs which: (i) only appear in consolidated financial statements or; (ii) are only required to be computed and disclosed for the group or intermediate holding company, should also be considered. We also believe that bullet 4 of paragraph 7.1 should continue after "incurred" with: "on the basis that a contractor can demonstrate that there are adequate controls in place to be able to assure that costs that do not meet all criteria are excluded". This would helpfully supplement a re-worded paragraph 7.3 along the lines of: "In addition, allowable costs are those that are evidenced and demonstrably linked to the output being delivered under the qualifying defence contract or qualifying sub-contract". In that regards, consideration should also be given to the extent to which costs and credits arising as a consequence of: (i) IAS 39 and the treatment of fair value hedging; and (ii) IAS 21 and the effects of changes in Foreign Exchange Rates should be recognized as costs.

2. Guidance on Appropriate, Attributable and Reasonable Costs

The contractor's costing system for the development of rates as used for its recording of cost will differ from that used for MoD estimating, pricing and reporting, since IFRS require costs passing though inventory to be valued exclusive of period expenses. In the regard, part of the QMAC disclosure is for contractors to advise how the financial accounting rates differ from the rates used to develop MoD rates. This issue is fully understood by the MoD and Industry and should be acknowledged in the guidance. It would be helpful if a few examples on each type of cost were included in the guidance to aid understanding of what is "appropriate", "attributable" and "reasonable and we stand ready to work up some case studies if that would be helpful.

3. Cost Classifications

This section of the guidance conflates depreciation; amortisation; and impairment and needs to be amended to clearly distinguish between these very different accounting treatments. Similarly, the paragraphs on risk are difficult to follow and should distinguish between estimating and programme risk as well as what constitute a contingency. In regards to redundancy payments, the Government does not restrict payments of its own staff that it makes redundant to the statutory minimum but makes a reasonable judgement and follows best practise. Likewise, Industry should be allowed to include redundancy costs that are reasonable in the circumstances. To improve the clarity of the guidance we would recommend that the section on PV Research and Development should follow IAS 38 since this makes better alignment of costs classifications in this area. Similarly, we would recommend that the section on Pension Costs should follow IAS 19 and, in particular, where there are such circumstances of an equitable apportionment of the costs accruing to a reporting entity or Business Unit.

4. Miscellaneous

In regards to marketing and sales, we believe this section requires further thought as it does not take account of the costs of long lead-in times to MOD contracts and the costs that contractors incur over a period of years.

5. Next Steps

When the final document is issued, it would be helpful if the revised guidance came into effect several weeks after publication. This would give the parties responsible for compliant pricing time to accommodate changes needed for estimates prepared for contracts that are not yet awarded. It would also be helpful if the SSRO provided reasonable accounting consideration to those contracts converting from 'Yellow Book' or 'Competitive' to 'Qualifying' contracts.

Your details

Name:

Organisation:

Lockheed Martin UK Ltd

Position:

Consultation questions

When answering the consultation questions, it would be very helpful if you could support your responses with additional explanation and detail, particularly on areas where you disagree. This will help us to understand the basis for your answer and inform our finalisation of the guidance. As a minimum, please include the paragraph number your comment refers to.

Please do not feel that you need to respond to all of the consultation questions set out in the document: we welcome brief or partial responses addressing only those issues where you wish to put forward a view.

Comments on style and formatting are not required.

In the interests of transparency, it is our intention to publish responses to this consultation on the SSRO website upon completion of the consultation. Please indicate whether or not you consent to publication of your response by ticking one of the boxes below.

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Yes [X] No [ ]

Introduction

QUESTION 1 - Do you have any comments on the updated Single Source Cost Standards?

Yes [X] No [ ]

Please add comments:

See attached

QUESTION 2 - Do you think there are any other sections of the guidance that would benefit from further clarity?

Yes [X] No [ ]

Please add comments:

See attached [below]

Para Reference	Comment/Response
4.4	Upon amendment of a contract where the contract becomes a QC, SSRO expects the parties would make appropriate arrangements to agree that sunk costs are allowable and parties will not seek to reclaim costs. While we agree with this position to allow for contract certainty how would this be possible if the Act and Regulations states that upon amendment of a contract, should it become a QDC that the whole contract would fall under the Regulations and the contract would require to be re-priced applying the AAR principles. We believe that a literal interpretation of the regulations would make this whole element of the process unworkable and undermine financial accounting principles
5.10	"…the SSRO will determine definitively whether the costs are Allowable Costs and may adjust the contract price…" Given that the guidance is principles based should the agreement a contractor reaches with MOD and captured in the

	contract be the defining conclusion. It seems that the contract is now being influenced by a third party not party to the agreement. It would be better if the SSRO identified examples where the principles were not being correctly interpreted and that information used as precedence setting for future agreements. Only where the parties had sought a determination should the contract price be subject to adjustment because the act of seeking a determination means the contract price was agreed as a provisional rather than when the parties reached agreement and the contract is enacted as a final position.
7.1 + 14.1	Who determines what evidence is adequate and sufficient? What is the SSRO's definition of this? It would be helpful for a more objective position as the current terminology is far too subjective to be workable.
7.2	The onus is upon the primary contractor of a QDC to demonstrate to SoS that costs meet those requirements set out in the guidance as being allowable. What about QSC and their requirements to meet AAR principles when the Supplier holds detailed information as commercial sensitive and only MOD gets access to the information below the level 1. If costs are unallowable we would expect at that point a directive to flow from the SSRO (or MOD) to the supplier because of the specific nature of such discussions. Our experience to date, albeit limited, is that we are "impotent" in regards to challenging the supplier as we do not have access to the detail required to have such discussions.
8.1	"…The total cost, including those costs properly adjusted for applicable variances of a contract, is the sum of the direct and overhead or indirect costs demonstrably linked to the contract, incurred or to be incurred, and includes the value of all options or variations that may apply. The allocation should be based on a contractor's normal accounting system and policies and in line with International Financial Reporting Standards…." In this context MA and B&P are costs normally part of a company's accounting practice via the "indirect cost" route (Para 8.2) yet they are being disallowed because there is no direct benefit to the contract. In this case spreading costs across all of the cost base reduces the costs to a single customer, how is this not seen as a benefit. Creating a stand-alone rate for QDC which applies all the costs associated with that QDC will have the net effect of increasing costs for a QDC because it should not get the general benefit associated with indirect spreading. In addition, if a QDC will not hold its share of the indirect cost then it should not receive benefit should speculative bids result in new business – you can't treat QDC's one way and then change once the speculative risk has been borne.
8.6	The guidance recognises that overhead and indirect costs are incurred during performance of a QDC and QSC for the conduct of the contractors business in general and cannot be identified and measured as directly applicable to the performance of that contract. However, the last sentence states that the cost meet AAR principles. There is risk that the MOD will question each item of overhead/indirect spend and ask that it meets AAR principles focusing on how the costs are attributable when CAAS has already audited the QMAC and agreed what is applicable. There should be one point of audit and agreement to provide certainty in doing business with MOD.
9.4	States that a cost can be attributable directly or indirectly for the fulfilment of the QDC and necessary to fulfil the requirements of that contract. But how can we prove this? An example of this is S&P spend, where this is an overhead/indirect cost, that although not necessary to a particular contract, it could be reducing the rates in the future by bringing in additional base. If we decide to treat S&P or

	B&P/IRAD costs differently by excluding them, we would not be able to complete the checklist. It will not be consistent with our normal accounting practices.
10.13	Bullet point 5 should exclude funding from the supplier as general R&D. This should be an allowable cost for a project.
10.18	"Marketing and Sales should only be considered allowable if they are demonstrably linked to a QDC or QSC." The SSRO has said that this should be retrospective therefore we can only claim the costs once we can prove that additional base has been created therefore reducing overhead rate, therefore price. In this case, MOD are taking all the benefits but not any risk associated with Marketing and sales spend. How will we account for the retrospective adjustment as part of financial accounting practices? Spend will occur in one year and the recovery of that spend may occur in future years. How are contractors going to manage their overhead spend? A separate accounting system will need to be in place for the MoD and will have less certainty in terms of overall accounting than has hitherto been the case. This cannot be efficient and certainly is not helping a contractor manage its budgets and balance sheets effectively.
10.19	It is not clear how a contractor proves benefit to overheads as a result of marketing spend if the overall benefit of spreading costs across the cost base is not a recognised benefit. Further, assuming retrospective benefit goes against the principle of spreading costs across the cost base.
11.1	A definition of sponsorship would be appropriate here
Section 13	"…A contractor will follow its own normal accounting systems…" ..and "…The contractor's costing system must be the same for MOD work as it is for other work in which it is engaged thus ensuring that the allocation of costs can be relied upon as being both fair and transparent….." By disallowing MA and B&P from the Overheads pool such action is breaking that guidance. We disagree that such costs should be disallowed as the general benefit is reflected in the lower costs across all customers.
13.3	How can our accounting system be the same for MOD work as it is for other work if we have to exclude elements of Marketing and Sales and BP?

Your details

Name:

Organisation:

MBDA UK Ltd

Position:

Consultation questions

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Please do not feel that you need to respond to all of the consultation questions set out in the document: we welcome brief or partial responses addressing only those issues where you wish to put forward a view.

Comments on style and formatting are not required.

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Yes [X] No [ ]

Introduction

QUESTION 1 - Do you have any comments on the updated Single Source Cost Standards?

Yes ☑ No ☐

Please add comments:

As a member of ADS, and with representation on their Defence SSCR Advisory Group, we are aware of both their response to this consultation and of the process of engagement that led to the development of that response. We believe that the ADS submission is clear and well articulated and we are fully supportive of it.

QUESTION 2 - Do you think there are any other sections of the guidance that would benefit from further clarity?

Yes ☑ No ☐

Please add comments:

As a specific comment, and recognising that this point is covered in the ADS submission, we would make the observation that a mix of general guidance and statutory guidance does have the capacity to confuse. It is our view that this statutory guidance should be exactly that.

Your details

Name:

Organisation:

Metasums Ltd

Position:

Consultation questions

When answering the consultation questions, it would be very helpful if you could support your responses with additional explanation and detail, particularly on areas where you disagree. This will help us to understand the basis for your answer and inform our finalisation of the guidance. As a minimum, please include the paragraph number your comment refers to.

Please do not feel that you need to respond to all of the consultation questions set out in the document: we welcome brief or partial responses addressing only those issues where you wish to put forward a view.

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Yes [X] No [ ]

Introduction

QUESTION 1 - Do you have any comments on the updated Single Source Cost Standards?

Yes ☑ No ☐

Please add comments:

See immediately below this box for my comments on question1 (I had no idea how to extend the size of this box without over writing the text immediately below)

General Points

- The document reflects a significant improvement to that which was published in February 2015. There are however still a great deal more improvements to be had.
- The document issued by SSRO should have been clearly marked as "Draft for consultation"
- The pdf file reference should be appropriate to the document. Its current title of "Single_source_cost_standards_-_Statutory_guidance_on_Allowable_Costs _20_April_2016_-_FINAL_FOR_WEB.pdf " risks causing confusion.
- The content of the document should be restricted to what ever constitutes 'statutory guidance on Allowable Costs'. The document as currently drafted contains SSRO's thoughts on a number of topics that are either outside of the SSRO's scope to issue statutory guidance or not within the scope of allowable costs.
- When SSRO issues the final document it would be helpful if the revised guidance came into effect some days or weeks after publication. This would give the parties responsible for compliant pricing time to accommodate changes needed for estimates prepared for contracts that are not yet awarded.
- As the statutory guidance that is applicable to an individual contract is the statutory guidance that was in place when the contract was entered into the date on the header page should be complete e.g. 1st July 2016
- The SSRO needs to give consideration and include consideration as to which version of statutory guidance is applicable to each individual tasks or orders placed under a framework arrangement. The tasks/orders placed under a framework agreement are each separate contracts so does the applicable statutory guidance apply to all contracts placed within the framework or to each contract as awarded?
- The excessive use of bullets (e.g. pages 14 and 15) makes referencing more difficult than it need be. Sub-paragraph numbering should be used.

1. **Introduction**
   - It would be helpful to promote paragraph 4.5 to become paragraph 1.4.

2. **Background**
   - Paragraphs 2.1 through 2.4 are not statutory guidance and should be removed or moved to the dialog that accompanies publication.

4. **Previous guidance**
   - Paragraphs 2.1 through 2.4 are not statutory guidance and should be removed or moved to the dialog that accompanies publication.

- Paragraphs 4.3 and 4.4 should be contained within a separate section. The SSRO have failed to give adequate accounting consideration to the arrangements which could apply to contracts converting by agreement between the parties from 'Yellow Book' or 'Competitive' to 'Qualifying' contracts. I have set out my thoughts on this topic at the end of this submission.

5. **Application of this guidance**

- Paragraph 5.1 is a duplication of paragraph 4.5. Using different words just risks confusion. Additional words may be needed to cover application to (1) tasks or orders placed under a framework arrangement; (2) conversion of a contract from non-qualifying to become a qualifying contract by agreement; (3) undefinitised options (if these are permitted within the framework of a single qualifying contract).
- Paragraphs 5.4 through 5.7 are outside the scope 'guidance whether costs about allowable cost under qualifying defence contracts'. Also the content is, I believe, poorly worded (to the extent that it is incoherent) and erroneous (muddle of costs and price, 'material' rather than what I thought the more normal 'goods' or 'stores', segregation of primary and non-primary equipment when there is no such segregation in the Act or Regulations). Happy to talk further if SSRO feels it needs to include something within statutory guidance 'about whether costs about allowable cost under qualifying defence contracts' as looks to be outside the scope of what the SSRO is required to issue guidance over.
- Paragraph 5.10 should remove 'defence' as the topic also applies to QSCs.

Importance of Allowable Costs

- Paragraphs 6.1 and 6.2 do not provide statutory guidance. I believe that such dialog should be removed from the statutory guidance document and incorporated into the webpage preamble.
- Second sentence of 6.3 lacks dialog as to why the SSRO does not provided such guidance. The SSRO should consider saying that the methodologies employed should be equitable and consistently applied. In fact the SSRO's guidance does say quite a lot about methodology to calculate (e.g. IFRS, section 13) appears to have been missed by the authors and reviewers.

Principles of Allowable Costs

- Paragraph 7.1 looks trite e.g. how does 'fully recorded and reflected' differ from plain 'recorded'. 'Actual costs' are actual costs and the financial records will comprise actual costs regardless if they are allowable or not. Even if the cost is not allowable that is not to say that it was not properly incurred. For the first bullet it is not that each cost needs to be supported by adequate and sufficient evidence but rather that the contractor has to ensure that there are adequate controls in place to be able to assure that cost that do not meet all 3 criteria are excluded.
- Paragraph 7.3 suggest reword as follows 'It is essential to the establishment of Allowable Costs, both at pricing and contract delivery stages, that Allowable Costs, if requested by the Secretary of State, are able to be evidenced and demonstrably linked to the output being delivered under the qualifying defence contract or qualifying sub-contract.
- I've modified paragraph 7.4 before I comment 'It is expected that ~~any~~ the costing system and costing methodology employed by contractors ~~will~~ allows the identification of costs allocated to qualifying defence contracts. This should enable the testing and evidencing of those costs to ensure that they meet the criteria for Allowable Costs.' For those companies utilizing ERP systems that aggregate requirements there will not be the full definition of the costs that arise from kitting or sub assembly manufacture where that parts are returned to common inventory. Actual costs will be derived using algorithms (often previously agreed with MOD and frequently accommodated within the QMAC). The expectation I understand to have been expressed by SSRO may only be achievable for labour based contracts unless the SSRO means 'costs allocated to qualifying contracts' to include bundled costs adjusted for manufacturing variance in accordance with an appropriate algorithm. I suggest that the SSRO engages in full dialog with MoD CAAS to attain an adequate understanding of ERP systems as they are typically used to support manufacturers in the performance of their business.

- Paragraph 7.5 misleads. Actual costs are required for all pricing methods (contract close report, used as basis of estimate for subsequent contract price estimation). I'd separate out the second sentence, as it is an important stand-alone principle.

Costs

- The wording of the final sentence of paragraph 8.1 implies that the SSRO requires IFRS to apply to all contractors (else the contractor's normal accounting system will not be in line with IFRS). I think it better if the SSRO say that the amount of cost that will be considered as allowable is the amount that would have applied if the contractor had prepared its financial reports in accordance with the requirements of full EU adoption of IFRS. I assume that when SSRO says International Financial Reporting Standards (IFRS) it means EU adopted IFRS and not FRS 102. I do not believe that the SSRO has authority to require unlisted EU companies to adopt EU IFRS but it is able to say that the amount of costs that are assessed for allowability need to be corrected to the value that would have been reported if the business had accounted on that basis. The SSRO should not duck this issue; IFRS should be the basis of assessment of allowable costs.
- Staying with the IFRS topic. The SSRO needs to give consideration within the statutory guidance on Allowable Costs to those types of costs that only appear in consolidated financial statements, (e.g. Goodwill impairment and impairment/amortization of those intangible assets that arose as a consequence of initial recognition on business combination), and those costs that are only required to be computed and disclosed for the group or intermediate holding company (e.g. IAS 19 for group schemes). Consideration also needs also to be given by the SSRO within the statutory guidance as the extent to which costs and credits arising as a consequence of (1) IAS 39 and the treatment of fair value hedging, and (2) IAS 21 should be recognized as costs; The Review Board for Governments Contracts contained a page setting out, what I believe to be sensible arrangements (I drafted them).
- Paragraph 8.3 add 'or cost object' after type
- Paragraphs 8.4 through 8.6 are not statutory guidance but rather a lay and overly simplistic overview. US FAR provide a basis for the SSRO to plagiarize. I'd read 31.201-1; 31.202 and 31.203. The FAR also makes to key point that like costs incurred in similar circumstances is to be treated in the same way (direct or indirect). Happy to dialog further if it is helpful.

Guidance on Appropriate, Attributable and Reasonable

- Paragraph 9.2 is missing

Appropriate

- A few examples would assist. Suggest charitable donations, as they should be wholly paid for by the shareholders rather than MoD as a customer.

Attributable

- Again examples would assist.
- Fist paragraph is unnecessarily prescriptive e.g. allocation of depreciation of individual buildings to an overhead recovery rate used in the pricing or reporting of a qualifying contract should not be restricted to those buildings used to fulfill the requirements of that contract else there will be an impossibly high number of rate numerators and denominators. It matters that the basis of indirect cost apportionment is reasonable, equitable and consistently applied; not that each indirect cost is necessary to fulfill the requirement of <u>that</u> contract.
- Second paragraph final sentence needs to be further considered. For overheads the recovery rate estimated for pricing of a contract is dependent upon not only the numerator forecast but also the denominator; any error of estimation will either leave some cost unrecovered or over-recovered.
- Blue box 1st bullet. Suggest 'accounting' rather than 'business'.
- Blue box 3rd bullet. The words used later are 'notional transactions', suggest consistency.
- Blue box 4th bullet. "required' is a harsh test as any cost that could have been avoided is considered as non attributable even if the contract costs would have otherwise have been higher. I'd consider using use 'having a beneficial relationship or maintaining capability' rather than 'being required'; the test should support business costs such as maintenance of an apprentice scheme that has no beneficial impact upon the contract in work at that time.

- Blue box 5th point. I am at a loss to understand this question.
- Blue box 6th point. 'Specification' should be replaced 'requirements' and the test should be restricted to direct costs (see comments on 1st paragraph).

Reasonable

- 2nd paragraph the wording within the US FAR (Part 31) is far clearer. The costs would not exceed those that would be expected to be incurred by a prudent contractor engaged in commercial contracts.

Guidance on costs generally Allowable

- Paragraph 10.2. Rather than 'actual costs incurred' did you mean 'statutory accounts'. If not I don't understand what 'costs …. will be expected to be reconcilable to actual costs' means.

Depreciation, amortisation and impairment

- Paragraph 10.4 is a muddle. Depreciation relates to Property, Plant and Equipment (PPE) whilst amortisation relates to intangible assets other than Goodwill. Impairment in this context relates to either PPE or intangible assets (including goodwill). Intangible assets are either acquired in the normal course of business (e.g. capitalized development costs, procured software) or arise as a consequence of a business combination (IFRS 3). The final sentence is unclear; can the SSRO give examples of what it has in mind.
- Paragraph 10.5 is also a muddle and provides inconsistent guidance. The SSRO needs to separately consider 3 types of intangible assets; (1) assets acquired in the day to day execution of an ongoing business, (2) intangible fair value assets recognised by the acquirer on business combination, (3) Goodwill (accounted for either on the basis of NCI on a net assets or fair value basis). The value of a company on acquisition is what the buyer considers to be the current value of all future cash flows; these future cash flows are largely driven by expectations of the future profit stream. Goodwill (NCI aside) is the difference between the price paid and the fair value of net assets acquired. (3) An impairment of Goodwill occurs when forecast of these cash flows are revised downwards (profits expected from the acquired company are reduced; arguably the SSRO are delivering this through its changes to the methodology in calculating the baseline profit rate). The accounts of the acquired company do not contain Goodwill or fair value Intangible Assets recognised on acquisition; they are included in consolidated accounts of the acquiring company. The SSRO in taking the step not to adjust the calculation of baseline profit rates by exclusion of intangible assets and consequential amortisations and impairment set aside any reasonable basis for profit comparability. The SSRO by inclusion within allowable cost statutory guidance that such amortisation/impairment can be considered an allowable costs fails to have considered how such a cost would pass the SSRO's own statutory guidance as appropriate (by its nature it is not), attributable (again for the reasons set out above it is not), and reasonable (again it fails). Type (2), is essentially a subset of what otherwise would have been goodwill save the acquirer was able to assign a value on acquisition of the business on combination. <u>Two wrongs do not make a right!</u> Type (1), this should be allowable (just as depreciation is allowable).

Risk

- Paragraphs in this section should be more simply expressed. SSRO should state that cost estimates should be based on available empirical evidence (including use of recorded costs of analogous transactions and maintained cost estimating relationships) and developed whereby they amount to the mean expected outturn of cost. The extent of variability in the cost outturn and costs falling above the mean is rewarded through the contract profit allowance (and in particular inclusive of any adjustment to the baseline profit allowance). Evidentially based estimates minimize the use to which management judgement is needed to be incorporated within cost estimates (as risk and/or contingency must only be included within cost estimates to the extent to which the overall cost estimate is consistent with the mean expected outturn of cost and risk to the extent to which it has been previously incurred i.e. risk previously incurred is already contained within in the actual cost experience used to development the estimate). The SSRO is able to make the simple statement that risk should not be included within cost estimates but rather estimates, based on available empirical evidence, should developed to reflect the amount of cost that is, on average, expected to be incurred. Similar arrangements should apply to contingencies.

- The SSRO should revise the 9th 10th bullet points of paragraph 11.1 and move the dialog to this section.

Redundancy Payments

- Add the word 'minimum' before 'rates laid down'. The government does not restrict payments of its own staff that is makes redundant to the statutory minimum. The costs should be allowable if they are reasonable in the circumstances. It must not be that a mean spirited CAAS accountant or MoD contracting officer is able to just say 'no that is more than the statutory minimum and is therefore unreasonable'. The payments need to be considered on the basis of the test of AAR. The statutory guidance should say this if it needs to say anything at all.

Private Venture research and development

- Paragraph 10.12. Suggest add IAS 38 at end of 1st sentence. The 2nd and 3rd sentences are a separate point.
- Paragraph 10.13 5th bullet. This needs far greater consideration; if a product is developed for multiple customers then MoD should only pay in proportion to its take up (see you 1st bullet in this paragraph); any R&D tax credits need to be deducted (see your section 12.16 and 12.17). I think that the point SSRO is trying to make is already fully expressed in the 3rd (and 4th) bullets to section 10.13. To say more just gives rise to confusion.
- Paragraph 10.14. Suggest alter 'research and technology' to either 'development' or 'research or development' so as to be consistent with IAS 38.
- Paragraph 10.15. 'research' should be replaced by 'product development' so as to be consistent with earlier part of the same sentence.
- Paragraph 10.16.'It may be possible' should be replaced by ' MoD and the contractor may agree'

Pension Costs

- Second sentence, to be consistent with other sections should say 'International Financial Reporting Standard' rather than 'accounting standards'.
- The SSRO should consider IFRS standard IAS 19 paragraph 41. In such circumstances an equitable apportionment of the costs should accrue to the reporting entity or BU. 5th primary bullet also needs to be reconsidered in this regard.

Marketing and sales

- Paragraph 10.18. I have no idea what SSRO intends by inclusion of 'and should be retrospective in nature'. Contractors incur costs over several years in the securing of contracts (this is particularly true of MoD and their single source contracts); some contracts are never awarded and some contracts are awarded to a competitor.
- Paragraph 10.19. As contractor's cost rates are in no small part driven by load (the denominator used for calculation of rates) the SSRO should not be so mealy mouthed and require it to be 'proven' as there will never be a parallel universe where this could support such a proof. Financial impact analysis leading to a reasonable expectation that this is the case should be all that is required.

Reworks

- The SSRO should only support classification of costs as unallowable if they do not satisfy appropriate, attributable or reasonable. SSRO's exclusion of 'reworks' should only occur when the tests are met i.e. where the extent or amount of rework is not reasonable under the circumstances. To have any other interpretation is for the SSRO to have issued guidance that is not structured in accordance with the requirements of section 20(2)(a)-(c) of the Act. Similar consideration needs to be given to 17th bullet point of 11.1.

Refunds

- First sentence gives complete coverage of the topic
- To the extent that EU Emissions Trading System needs to be discussed this should be done as separate topic

Insurance

- I have agreed with FinExperts Ltd and Yusani Ltd that they will fully cover this topic including the 15th and 16th bullets from 11.1 below

Guidance on costs which are generally not Allowable

- 4th bullet. Add ', damages' after 'Civil'
- 9th and 10th bullets. Incorporate within 'Risk section' after consideration of my comments made above in that section.
- 11th bullet. This is asinine. The 'labour rates as they comprise a numerator (aggregated employment costs) and a denominator (load)' cannot be evidenced as AAR, it is only the individual elements that should be considered. There can be dialog and even settlement over allowablity of elements of the cost but just render the totality of labour cost as 'not allowable' is crass.
- 12th bullet. As above bullet, costs must not be summarily dismissed as not 'reasonable' and therefore unallowable just because the basis of estimation is inconsistent with CAAS or MoD's contracting officer expectations that were based on benchmarks supplied by SSRO or other body.
- 13th bullet. Consider undergraduate and postgraduate sponsorships. I agree that charitable or non-business sponsorships should be not allowed.
- 14th bullet. Duplicates 4th bullet above.
- Move 15th and 16th bullet to Insurance section10.22 after full consideration of content and any duplication
- 17th bullet move to Reworks section 10.20 after correction and removal of duplicated content
- Paragraph 11.2. First 2 sentences are hardly statutory guidance

Exceptional or Abnormal Costs

- 12.1 does not look like statutory guidance

Costs associated with the closure or rationalisation of a plant

- Paragraph 12.3 'must demonstrate innovation and efficiency' is unnecessary, as the cost needs to be reasonable.
- Paragraph 12.4 'netted off' rather than 'recovered' else I don't understand what the SSRO requires.
- Paragraphs 12.9 and 12.10 look to belong to this section. Paragraph 10 should only need to be advised to the SSRO if the separate agreement is a qualifying contract.

Pensions

- This whole section looks to cover the same ground as section 10.17

Research and Development tax credits

- Paragraphs 12.14 and 12.15 relate to Private venture research and development which is covered in paragraphs 10.12 through 10.16. What is included 12.14 within the first two sentences of 12.14 is wrong and inconsistent with the correct analysis contained with the 4th bullet of 10.14. Paragraph 12.15 is just plain wrong; the research phase of a project is not able to be capitalized as an intangible asset (See IAS 38 of International Financial Reporting Standards) and what is contained within the earlier section
- Paragraph 12.16 add 'or' between 'cash' and 'offsets'
- Paragraph 12.17 is muddled. The 'matching principle' relates to the matching of revenues with its associated costs. Delete 'The matching principle needs to be applied so that'.

Cost allocation practices

- Paragraph 13.1. There is no requirement under the Act nor the regulations for contractors to submit a QMAC to MoD. I would support SSRO implementing such a requirement within the statutory guidance (if such inclusion would not be ultra vires) and for the SSRO to take ownership of the QMAC form. The word 'cost' needs to be added before 'accounting' and the word 'normal' deleted.
- Paragraph 13.2. Replace 'own accounting system' with 'consist ant cost accounting practices'
- The contractor's costing system for the development of rates as used for its recording of cost will differ from that used for MoD estimating, pricing and reporting as International Financial

Accounting Standards require costs passing though inventory to be valued exclusive of period expenses. This is fully understood and part of the QMAC disclosure is for contractors to advise how the financial accounting rate pack differs from the rate pack used to develop MoD rates. The underlying traffic is the same for all. I suggest SSRO engage with MoD CAAS to comprehensively understand this topic.

- Paragraph 13.5 is nothing to do with Section 13 and should be removed as the dialog is covered elsewhere.

Authority and responsibilities

- 2nd bullet. Remove 'primary' 'and where applicable subcontractors' and add 'for qualifying' after 'that'.

QUESTION 2 - Do you think there are any other sections of the guidance that would benefit from further clarity?

Yes ☑ No ☐

Please add comments:

See immediately below this box for my comments on question 2 (I had no idea how to extend the size of this box beyond the end of the page)

Conversion of a pre-existing prime contract to become by agreement between the parties a qualifying defence contract

As I've noted in comments made above in section 4 I wanted to express separately my concerns with the approach taken by the SSRO in 4.4

The Act as approved by parliament cannot be varied by MoD, the contracting authority if it is other than MoD, the contractor, or the SSRO wishing that it said something different than what it says. The regulations, as approved by Parliament apply to those same parties until such time as the regulations are amended (and even then any amendment needs to fit within the framework of the Act). SSRO recognizes that it cannot issue statutory guidance (for those topics it is required to issue supporting statutory guidance) that is inconsistent with either the Act or the regulations.

There is much within the legal framework that could have been differently considered by the Parliamentary drafters but we are constrained by what is there. Further consideration should have been given in a number of areas that are unnecessarily blunt e.g. (1) pricing of non-developmental items with a verifiable market price (the only option today is for the Secretary of State to exempt such contracts wholly); (2) regulation 14 and application where the parties cannot agree that the costs are severable; (3) application of regulation 5 to single source framework agreements.

As I read the law, as approve by parliament, prime contracts (that were not previously exempted by the Secretary of State) are able (upon incorporation of a change and agreement

between MoD and the contractor) to become qualifying defence contracts. In such circumstances the contract price for the whole contract needs to be re-determined in compliance with the pricing formula. The pricing formula comprises (1) allowable costs (consistent with SSRO's statutory guidance unless it is to be set aside as following it would result in perverse outcome) and (2) profit allowance applicable to those costs (also derived in accordance with SSRO's statutory guidance unless it is to be set aside as following it would result in perverse outcome). Even if the SSRO stated in its statutory guidance (on (1) Allowable Costs and (2) Calculation of the Contract Profit Rate) that following statutory guidance to costs (and profit rate applicable to those costs) incurred prior to conversion of the contract to be a QDC we are far from out of the woods even if everyone could convince themselves that this is consistent with what Parliament intends.

> A contact that is converted is subject to a continual progression of estimated costs to become actual costs and in the short term a high proportion of that actual cost is only capable of being an estimate of what is incurred. Examples of why this is likely to be very difficult include (1) anonymised inventory within an ERP accounting system can be considered to have been incurred (sunk) or only incurred at the point of allocation and therefore not incurred (sunk), (2) non-recurring costs may have been incurred and prices previously used for articles or services already supplied may have apportioned this cost to each supply, (3) for article availability inventory laid down (already incurred) would typically be spread across the period of contract performance and therefore not yet recovered by the contractor as income arising from prices for prior periods. If it were easy then it would be simple enough to terminate the early contract for convenience and open a completely new contract, because it is not easy this approach provides no effective solution. I can't easily conceive the circumstances where an informed and prudent MoD or contractor would ever enter into an agreement to convert a contract to becoming a QDC.

There is of course no authority under the law to convert a pre-existing sub-contract to become a QSC.

Ministry of Defence

Allowable Costs consultation
Finlaison House
15-17 Furnival Street
London
EC4A 1AB

Your Reference:

Our Reference:
SSAT
Date: 31 May 2016

Thank you for the opportunity to comment on your paper on "Single Source Cost Standards - SSRO Statutory Guidance on Allowable costs". We have consulted with interested stakeholders within MOD and our consolidated comments are given in Annex A. However, we would like to point out that some parts of the document open for consultation are not, in fact, statutory guidance. We recommend that the SSRO should draw a clear distinction in its documents between what formal statutory guidance as opposed what is explanatory information. The MOD considers that Sections 1 to 5 included fall into the latter category. For the rest of the document, it would be necessary for the SSRO to draw the distinction between formal statutory guidance and guidance in the form of explanatory notes for the regulations.

Single Source Cost Standards - SSRO Statutory Guidance on Allowable costs – Issue July 2016

MOD response to consultation

Page	Ref		Comments
4	**4.2**	Single source defence contracts entered into before 18 December 2014 do not come within the Single Source Procurement Framework unless the contract is amended on or after 18 December 2014 and the parties agree that it is to be a qualifying contract. Contracts under the previous regime which are not brought within the Framework will continue to be governed by such guidance as was provided under the Yellow Book arrangements.	We suggest the following revision: Single source defence contracts entered into before 18 December 2014 do not come within the Single Source Procurement Framework unless the contract is amended on or after 18 December 2014 and the parties agree that it is to be a qualifying contract. Single source contracts under the previous regime signed before 18 December 2014 which are not brought within the Framework by amendment will continue to be governed by such guidance as was provided under the Yellow Book arrangements.
4	**4.4**	If costs have already been incurred when the Amended Contract becomes a qualifying contract (referred to here as 'sunk' costs) the SSRO expects that the parties would make appropriate arrangements such that it should be unnecessary for any question to arise under the SSRO's guidance in relation to the sunk costs. Such arrangements may include stating in the Amended Contract that: • the parties agree that the sunk costs are Allowable Costs; and the parties will not seek to reclaim costs or to claim additional costs in respect of the period prior to the Amended Contract becoming a qualifying contract.	The term 'sunk costs' may need to be defined. MOD would suggest defining or referring to it as 'work that has been committed.' This would cover situations where the work to be carried out and the price has been defined, but not all of the output has been defined. This would be more pragmatic and more likely to lead to an agreement to convert.

4	**4.5**	The parties to qualifying contracts must have regard to the SSRO's statutory guidance in force at the time of entering into the contract. This guidance is issued and takes effect on the date stated on the cover page and applies to qualifying contracts entered into on or after that date.	MOD suggests that MOD and contractors should be able to jointly agree to use updated guidance. We agree that MOD and contractors must assess the allowability of estimated costs using the statutory guidance in force at the time a contract is entered into. Although not stated explicitly here, it follows that during the life of the contract it would be equitable for actual costs to be assessed against the same statutory guidance used for the estimates – even if this guidance had since been updated. To do this, recovery rates would have to be calculated using the same statutory guidance. Following this logic through, it would mean that in future years a contractor with several live QDCs let in different years could require multiple rate decks to be agreed, one for each version of statutory guidance in force at the time each contract was let. This situation was no different under the Yellow Book. However given that in general the changes made from one Yellow Book to the next were immaterial, MOD and contractors 'silently' agreed to a single set of rates each year based on the latest guidance. It could be assumed that the same will happen under the SSPF. However given the new focus on allowability of costs (e.g. sales and marketing) it is not inconceivable that a contractor might want to argue the case for actuals to be computed on earlier guidance if it is to their advantage.
5	**5.2-5.4**	Part of the criteria for qualifying defence contracts is that their value is above the thresholds specified in the Regulations. The total net contract value, including any options, payable to contractors (excluding VAT) is used to establish whether the threshold values have been met. All revenues pertaining to a contract have to be taken into account, including…	This section should be deleted. Definition should be derived from the Act/Regulations.
5	**5.5**	Contract value means the value of a contract (net of VAT) which the contracting authority expects will be payable under the contract:	For consistency with both 5.3 above and the Act, the term 'excluding VAT' should be used in place of 'net of VAT'.

5	**5.6 – 5.7**	For clarity the following contracts and sub-contracts are described in the Regulations as being contracts of an international nature which may not be qualifying contracts: • a contract to which the government of any country other than the United Kingdom is a party; and • a contract made within the framework of an international cooperative defence programme, between sovereign nations.	We suggest that an approach consistent with that used in 5.2 is adopted i.e. rather than repeating wording from the Act or in effect straying into FAQ territory, wording to the following effect should be adopted: "A contract is not a Qualifying Defence Contract if it meets one or more of the definitions set out in Part 2, paragraph 7 of the Regulations."
6	**5.10**	The parties to a qualifying defence contract may apply to the SSRO to determine the extent to which costs are Allowable Costs. If such a referral is made, the SSRO will determine definitively whether the costs are Allowable Costs and may adjust the contract price in consequence of the determination. The SSRO has published guidance as to how it will deal with such referrals for a determination.	(MOD does not consider this statutory guidance)
7	**7.1**	To be Allowable, a cost must meet all three criteria of Appropriate, Attributable and Reasonable. The principles of the criteria are: • That costs are Allowable when supported by adequate and sufficient evidence; • Actual costs should be assigned to contracts only once; • Estimated costs only be assigned and not reflected again once they become actual; and • Actual costs are to be fully recorded and reflected in the books of account as being properly incurred.	This section may cause complication and therefore should be amended to suggest that sufficient evidence is needed for the SofS to be satisfied that the costs satisfy the standards in the legislative framework.
7	**7.3**	It is essential to the establishment of Allowable Costs, both at pricing and contract delivery stages, that Allowable Costs are evidenced and demonstrably linked to the output being delivered …	This should be extended to also include those costs which result in a 'benefit to' the contract.
7	**7.5**	This guidance applies to estimated costs (for example for the firm, fixed, target, and volume-driven pricing methods under Regulation 10 of the Regulations) and to actual costs (as in the cost plus and estimate-based fee pricing methods). It is further recognised that some costs are incurred in advance of a contract.	"It is further recognised that some costs are incurred in advance of a contract". We would appreciate additional clarity on this issue.
8	**8.1**	The total cost, including those costs properly adjusted for applicable variances of a contract, is the sum of the direct and overhead or	Replace 'demonstrably linked' with 'allocated to'.

		indirect costs demonstrably linked to the contract, incurred or to be incurred, and includes the value of all options or variations that may apply. The allocation should be based on a contractor's normal accounting system and policies and in line with International Financial Reporting Standards	Change last sent to : the allocation should be based on date from the contractors normal accounting systems.
8	**8.5**	A direct cost is a cost that can be completely attributed to the production or delivery of specific goods, works or services required to fulfil the qualifying defence contract or qualifying sub-contract. Direct costs may consist of materials, labour or other costs related to the production of a specific product, building or service. The parties must always be satisfied that the cost is Appropriate, Attributable and Reasonable.	We suggest that the word 'completely' should be deleted as it is not always possible to say that a cost is 100% direct. We also suggest that the underlined words are deleted as they are similar but slightly different to the words used in the first sentence of 8.5 and are therefore both unnecessary and potentially confusing.
8	**8.6**	Overhead and indirect costs are defined as those costs which, though necessarily having been incurred during the performance of the qualifying defence contract and qualifying subcontract for the conduct of the contractor's business in general, cannot be identified and measured as directly applicable to the performance of that contract. These costs cannot be directly attributed to a single contract but may be apportioned to individual contracts. The parties must always be satisfied that the cost is Appropriate, Attributable and Reasonable.	We suggest that the words underlined should be deleted. All costs, whether direct or indirect must be "identified" to be allowable
8	**9.1**	Costs are Allowable to the extent they are Appropriate, Attributable and Reasonable. These criteria apply to all costs of a qualifying defence contract or qualifying sub-contract. The guidance and checklists below set out the principles to be followed when determining whether a cost might meet the Appropriate, Attributable and Reasonable criteria. The boxes below provide a checklist of key questions that should be considered when assessing the treatment of costs and the likelihood that they are Allowable.	It is not clearly described how the "checklists" should be used. Must ALL conditions be satisfied? Or are they merely indicative? It is important for a user of the guidance who is assessing a Qualifying Contract for the first time to know this.
Paragraph 9.2 is missing			
9	**9.4**	All costs should be incurred by the contractor and applied to the qualifying defence contract or qualifying sub-contract on a basis that is consistent with the contracting company's overarching cost	The sentence underlined could be clearer by saying 'costs should only be recovered once.'

		accounting practices. The costs should be costs not recovered in any way from another contract, whether past, existing or proposed.	
We do not believe it is helpful to have separate sections for 'Costs generally Allowable' and 'Costs which are generally not Allowable'. Having two sections means that guidance on the same topic (e.g. 'Reworks' and 'Faulty workmanship') is split. In our opinion it would be better to have all the guidance on a specific topic in one area.			
10	**9.5**	A cost is Reasonable if by its nature it does not exceed what might be expected to be incurred in the normal delivery of a contract such as the qualifying defence contract or qualifying sub-contract in question, whether under competitive tendering conditions or as a single source contract.	This should be re-written to reflect Section 13 of the DRA.
10	**10.4**	Depreciation and amortisation charges are to be calculated at the contractor's own rates, provided they are consistent, equitable and relate to the fixed asset values.	Replace underlined with noncurrent assets.
11	**10.5**	The treatment of intangible assets, such as 'Goodwill', held on balance sheets, may be an Allowable Cost if the impairment action has been taken in accordance with International Financial Reporting Standards and should be approved by the Secretary of State. Any increase in value of an intangible asset will not reduce Allowable costs under the contract.	The reference to Goodwill being an allowable cost should be removed. We do not think Goodwill should be an allowable cost.
11	**10.6-10.8**	Estimated risk may be defined as a risk over which the contractor has an element of control. Estimated risk may be an Allowable Cost where it has been modelled and agreed by the Secretary of State as being Appropriate, Attributable and Reasonable. Estimated risk is separate from programme risk which may be defined as a risk over which the contractor has little or no control. Programme risk may be covered under the provision of an adjustment to the baseline profit rate. Any risks identified and managed as estimated risk in the contract as an Allowable Cost cannot relate to a programme risk and vice versa.	Risk and uncertainty are covered in several areas of this guidance and also in the guidance on adjustments to the baseline profit rate. Several different terms are used on the topic e.g. - cost risk - price risk - estimated risk - programme risk - risk based contract - contingency cost - cost contingencies

		Further detail on programme risk is covered in the SSRO's guidance on Contract Profit Rate.	Given that there is no consistant definition of thses terms, and the risk issue is very complicated, we suggest restricting the guidance at this point to saying ' costs associated with compensating the contractor for risk should be clearly set out and only be recovered once. Further guidance on this topic will be issued in due course.
11	**10.9**	Stock losses and obsolescence should be charged directly to the contracts to which they relate as Allowable Costs. In circumstances where it is not possible to identify stock losses or obsolescence costs that specifically apply to contracts then they may be accepted for inclusion as Allowable Costs. This will only apply when the contractor's costing system is able to isolate these stock losses as an indirect overhead. Contractors will be requested to provide evidence to support any claimed obsolescent stock write-offs and be able to demonstrate that these were not as a result of poor storage, handling or control.	Change underlined to reflect that MOD may request. We suggest: "Stock losses and obsolescence are Allowable Costs provided that the Contractor, unless these costs were the result of poor storage, handling or control. These costs should be allocated directly to specific contracts wherever possible. Where this is not possible they should be classified as indirect costs."
11	**10.10**	Redundancy payments made in the normal course of business, and which are in accordance with the rates laid down by statute, may be included in Allowable Costs.	MOD agreement is necessary for payments in excess of those rates, except where they have been made as part of a pre-assessed scheme and subject to materiality threshold.
11	**10.11**	Where employee benefits payments are made for items such as profit sharing schemes, shares or benefits in kind, which are an element of employees' normal remuneration, then these may be included in Allowable Costs. The cost of shares issued to employees at favourable prices, is to be arrived at in the manner prescribed by the relevant International Financial Reporting Standards. Payments of staff bonuses must be in line with company policies. In order for these cost items to be considered Reasonable, contractors must be able to provide supporting evidence. Exceptional bonuses payable following the sale of a company or part thereof are not part of normal remuneration and are unlikely to be considered Allowable Costs.	Not all businesses will report in accordance with IFRS. We suggest that the wording should refer to 'relevant financial reporting standards'.

12	**10.14**	Abortive research and technology expenditure should be treated in the same way as any other research and development expenditure and be admitted for recovery. The charges must be a fair apportionment of the contractor's unfunded private venture product development, meet the Appropriate, Attributable and Reasonable criteria (whether or not these have been carried forward in the contractor's accounts) and be calculated on the basis of the forecast total sales of the product or service.	Paragraph is unclear and unnecessary . It should be removed.
13	**10.17**	Whether pension costs are Allowable and, if so, in what amount, will be dependent upon whether it is a defined benefit contribution scheme. Contractors will account for pension costs under the relevant accounting standards. Any pension costs claimed must reconcile with those shown in the contractor's income statement, otherwise these should not be Allowable	Remove as MOD pay for current year service charges and any admin related costs.
13	**10.18**	Marketing and sales costs can only be considered *Allowable*, if they are demonstrably linked to a qualifying defence contract or qualifying sub-contract. Marketing and sales costs may include such items as salary costs and related staff expenses (travel and subsistence), sales and marketing campaigns and other related commercial activities, and should be retrospective in nature.	(See also our comment re 'demonstrably linked' in 7.3 above). This is another complex area. Suggest replacing it with: S+M costs are allowable if it can be demonstrated that they lead to a net reduction in costs to the contract and are quantifiable.
13	**10.19**	A demonstrable link should evidence some financial benefit to the qualifying contract as a result of the particular sales and marketing expenditure. This may include a reduction to overheads across a qualifying business unit where it can be proven that any such benefit was enabled by successful sales and marketing effort.	We suggest that the words underlined should be replaced with: 'For example, a reduction in the apportionment of fixed overhead allocated to the contract as a result of successful sales and marketing effort'.
14	**10.20**	The cost of rework may be Allowable if it meets the principle of being Appropriate, Attributable and Reasonable, and is agreed between the contractor and the MOD. This may include: • first in class, where rework occurs during the process of manufacturing an item for the first time; • rework that is agreed and is part of a complex process, which is evidenced in the circumstance; and	Should be changed to read: Contractors must have appropriate quality management systems in place and be able to demonstrate the causes of re-work and wastage.

		• re-specification, which occurs due to a change in design from the MOD.	
14	**10.21**	Where reimbursements, credits, grants or refunds are received by contractors and cannot be identified to a particular contract then these should be apportioned to individual contracts to reduce Allowable Costs. For example, where a contractor can demonstrate that as part of its business activities it is taking suitable measures to minimise its emissions then any costs incurred to purchase permits under the EU Emissions Trading System may be deemed as being Allowable. The value of these Allowable Costs will be reduced by the value of any credits received through the sale of permits, whilst the cost of any breaches of emissions regulations will be excluded from any Allowable Cost calculations.	In our opinion the guidance as written is unclear. The example provided concerning spend re Emissions is not a good example and is likely to cause confusion. Carbon allowances/credits are an entirely separate issue, and should be treated as such in the Guidance. We suggest that the guidance should state that: "Credits such as reimbursements, grants, refunds etc. must be included in cost calculations and deducted from Allowable Costs. Where such a credit can be associated with a corresponding cost, it must reduce that specific cost. Any credits that can be identified with a specific QDC/QSC should be treated as direct and reduce the costs of that specific contract. Failing that, credits should reduce the appropriate overhead cost category."
We do not believe it is helpful to have separate sections for 'Costs generally Allowable' and 'Costs which are generally not Allowable'. Having two sections means that guidance on the same topic (e.g. 'Reworks' and 'Faulty workmanship') is split. In our opinion it would be better to have all the guidance on a specific topic in one single section. For ease of reference please could each of the bullet points in 11.1 be numbered.			
14	**11.1**	**Contingency cost** can be included within a contract price, but cannot be an Allowable Cost in non-firm price contracts if the contingency has not arisen and therefore the contractor has not incurred an expense. **Labour rates** which cannot be evidenced as meeting the AAR principles. **Inflation** with regard to labour or costs of material, which is not evidenced against the appropriate benchmark data.	Three items have been removed from the July 2016 version in section 11.1 (the costs which are generally not considered Allowable). MOD thinks that these 3 paragraphs should not have been deleted. The costs described here are not allowable and it is critical that the guidance should clearly state this is the case. Rather than say 'non-firm price contracts' it would be clearer to state in which of the 6 regulated pricing methods contingency costs are allowed. Why have labour rates been singled out? ANY cost that cannot be evidenced as meeting the AAR principles is not allowed. This is written into the Act and does not need to be restated here.

			Why is this specific guidance on inflation required? Furthermore why limit the guidance to inflation of 'labour or costs of material'? Any cost could be subject to inflation.
14	**11.1**	Contingency cost can be included within a contract price, but cannot be an Allowable Cost in non-firm price contracts if the contingency has not arisen and therefore the contractor has not incurred an expense.	The 10th bullet point in this paragraph states that contingency costs can't be Allowable Costs "in non-firm price contracts" if the contingency has not arisen. That principle should only apply to the extent that the pricing method used in the contract permits the recovery of actual Allowable Costs – it shouldn't apply to all other pricing methods which are not firm price because some of those pricing methods obviously use estimated costs. This should therefore be re-drafted along the following lines: "Where the pricing method used allows the recovery of actual Allowable Costs incurred by the contractor, contingency costs cannot form part of the actual Allowable Costs where the contingency event has not arisen and the contractor has not therefore incurred a cost"
15	**11.1**	• Cost or premiums and payments for insurance which cover that element of consequential loss that relates to profit are excluded on similar grounds. • Cost or premiums and payments for insurance which cover the contractor's own defects in materials or workmanship incidental to the normal course of construction or manufacturing, including product liability insurance. This includes the insurance to repair defects in materials or workmanship, for any breach of contract, or consequential loss that relates to profit and therefore will not meet Appropriate, Attributable and Reasonable criteria	Remove " , including product liability insurance," and "and for any breach of contract" Cost or premiums and payments for insurance, ~~including product liability insurance,~~ which covers the contractor's own defects in materials or workmanship incidental to the normal course of construction or manufacturing. This includes the insurance to repair defects in materials or workmanship~~, and for any breach of contract and~~ which, therefore, will not meet Appropriate, Attributable and Reasonable criteria.
15	**12.1**	This guidance is applicable to all contract discussions between the MOD and contractors regarding Allowable Costs in regard to qualifying defence contracts and qualifying sub-contracts. Whilst the majority of discussions about whether costs are Appropriate, Attributable and Reasonable will be resolved without reference to	Should state at the end "or between contractors to a qualifying sub-contract or proposed qualifying sub-contract".

		further guidance there are a number of more complex issues that arise that may require additional guidance and this should be sought from the SSRO if agreement cannot be reached between the MOD and the Contractor.	
Section 12.5 of the July 2016 version has been removed. We consider this paragraph necessary as it describes that fact that what follows are not the only exceptional or abnormal costs that are allowable but are costs that require further explanation.			
18	**13.3**	The contractor's costing system must be the same for MOD work as it is for other work in which it is engaged thus ensuring that the allocation of costs can be relied upon as being both fair and transparent.	This should not be a requirement. Provided there is a consistent system for MOD costs, this should suffice.

Your details

Name:

Organisation:

Serco Limited

Position:

Consultation questions

When answering the consultation questions, it would be very helpful if you could support your responses with additional explanation and detail, particularly on areas where you disagree. This will help us to understand the basis for your answer and inform our finalisation of the guidance. As a minimum, please include the paragraph number your comment refers to.

Please do not feel that you need to respond to all of the consultation questions set out in the document: we welcome brief or partial responses addressing only those issues where you wish to put forward a view.

Comments on style and formatting are not required.

In the interests of transparency, it is our intention to publish responses to this consultation on the SSRO website upon completion of the consultation. Please indicate whether or not you consent to publication of your response by ticking one of the boxes below.

Please note, if you do not consent to publication, we will treat your response as confidential to the extent of any disclosure that is required by law. In the event we are required by law to make a disclosure of your consultation response, to the extent we are legally permitted to do so, we will give you as much notice as possible prior to such a disclosure and will take into account all reasonable requests made by you in relation to the content of such a disclosure.

Yes [X] No [ ]

Introduction

QUESTION 1 - Do you have any comments on the updated Single Source Cost Standards?

Yes [✓] No [ ]

Please add comments:

We support the ADS submissions response on this.

QUESTION 2 - Do you think there are any other sections of the guidance that would benefit from further clarity?

Yes [✓] No [ ]

Please add comments:

Please see the ADS submission

SSCS Statutory Guidance on Allowable Costs

Thales has been involved and contributed to discussions on this consultation and as appropriate has provided feedback to ADS. We fully support the ADS' submission on this matter.

Thales UK

1 Linthouse Road, Glasgow, G51 4BZ

www.thalesgroup.com/uk

Single Source Cost Standards
Statutory Guidance on Allowable Costs

Consultation Response Form

Your details

Name:

Organisation:

Yusani Limited

Position:

Consultation questions

When answering the consultation questions, it would be very helpful if you could support your responses with additional explanation and detail, particularly on areas where you disagree. This will help us to understand the basis for your answer and inform our finalisation of the guidance. As a minimum, please include the paragraph number your comment refers to.

Please do not feel that you need to respond to all of the consultation questions set out in the document: we welcome brief or partial responses addressing only those issues where you wish to put forward a view.

Comments on style and formatting are not required.

In the interests of transparency, it is our intention to publish responses to this consultation on the SSRO website upon completion of the consultation. Please indicate whether or not you consent to publication of your response by ticking one of the boxes below.

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Yes ☒ No ☐

Single Source Cost Standards
Statutory Guidance on Allowable Costs

Consultation Response Form

Introduction

QUESTION 1 - Do you have any comments on the updated Single Source Cost Standards?

Yes ☒ No ☐

Please add comments:

I fully support the detailed comments made on behalf of its members by ADS in its letter and attachment dated 26 May 2016.

QUESTION 2 - Do you think there are any other sections of the guidance that would benefit from further clarity?

Yes ☒ No ☐

Please add comments:

See the detailed comments made on behalf of its members by ADS in its letter and attachment dated 26 May 2016.