

SSRO

Single Source
Regulations Office

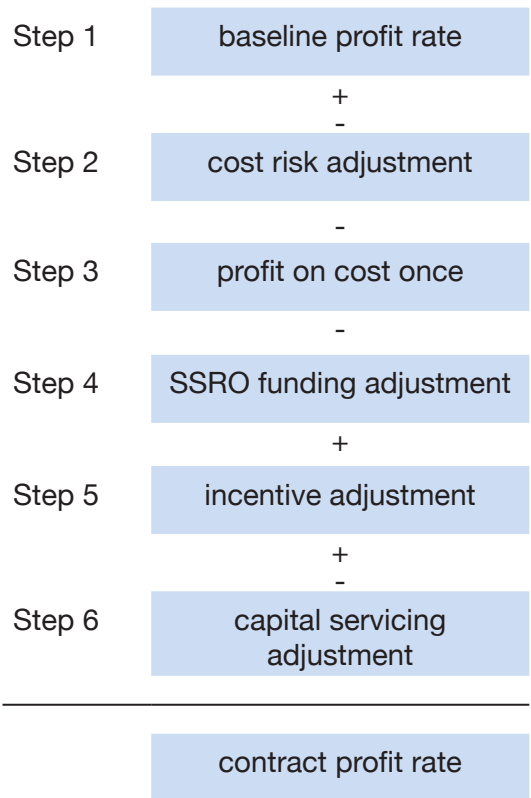
**Guidance on adjustments to the
Baseline Profit Rate
Response to Consultation**

Introduction

1. Background

The Defence Reform Act 2014 provides a legislative basis for the Single Source Procurement Framework. The Act makes the Single Source Regulations Office (SSRO) responsible for issuing statutory guidance on adjustments to the baseline profit rate.

The draft guidance produced by the SSRO is for use by contractors and the Ministry of Defence in calculating the adjustments to the baseline profit rate under qualifying defence contracts and qualifying sub-contracts. Section 17 (2) of the Defence Reform Act (the “Act”) and Regulation 11 of the Single Source Contract Regulations (the “Regulations”) require that the contract profit rate for any qualifying defence contract must be determined by taking the following six steps:



To support this, Section 18 of the Act provides for the SSRO to issue guidance in relation to the steps set out in Section 17(2).

2. Our Approach

In producing the draft guidance on the adjustments to the baseline profit rate, the following approach was taken:

- reviewing all relevant sections of the Act, Regulations and Single Source Procurement Framework and the background to these;
- reflecting on the process in producing and consulting on the guidance on Allowable Costs;
- reviewing guidance from the USA - The Federal Acquisition Regulations;
- reviewing the MOD's interim guidance;
- reviewing the existing Government Accounting Conventions – the 'Yellow Book';
- commissioning a legal review to ensure consistency with Act and Regulations; and
- drafting the document around a logical structure based on 'best practice' examples.

Three of the four approaches to the draft guidance are based on high level principles, whereas profit on cost once (POCO) uses a more prescriptive methodology. One adjustment, the SSRO funding adjustment, will be zero until 1 April 2017.

The Consultation

3. Consultation Process

On 20 February 2015, the SSRO issued draft statutory guidance on adjustments to the baseline profit rate.

In carrying out this consultation we sought to ensure that as many people and groups as possible had the opportunity to contribute their views. The SSRO published the consultation on its website (<https://www.gov.uk/government/consultations/single-source-cost-standards-sscs-statutory-guidance-on-allowable-costs>), and directly emailed its stakeholder contacts. To aid the consultation process, we provided a consultation response form for stakeholders to complete.

In total, we invited 88 stakeholders to respond to the consultation, including: government bodies, defence industry contractors, academics, professional associations, think tanks and regulatory bodies.

To enable stakeholders more time to respond, we extended the consultation period to 13 March 2015, instead of the 6 March 2015 as communicated in our January 2015 newsletter.

The consultation closed on 13 March 2015. This document summarises the feedback we received and the action we have taken.

4. Breakdown of Responses

We are grateful to everybody who responded to the consultation. In total we received 15 responses from a wide range of stakeholders. The breakdown of respondents can be seen in Table 1.

Whereas the majority of respondents used the consultation form provided, some also elected to provide feedback in an alternative format. We have considered the feedback received.

Table 1

	Government	Industry	Regulators/ Other Government Bodies	Trade and Professional Associations and Think Tanks	Research/ Academics	Other	Media	Total
Number of Stakeholders invited to comment	1	68	6	7	3	0	3	88
Total Number of Responses received	1	11	0	1	0	2	0	15
Percentage of responses received	100	16	0	14	0	n/a	0	17

The responses gave the SSRO an understanding of individuals' and organisations' views on the draft guidance on adjustments to the baseline profit rate and suggested some alternative approaches. It has not been possible to include and respond to every comment received in this document, but we have tried to include as many as possible by grouping together the main themes.

As indicated on our consultation response form, replies will be published on the SSRO website, unless the respondent indicated otherwise.

5. Key issues raised by the respondents

The responses included comments on the consultation questions we asked, as well as some additional areas shown below.

Issue	Section	Description of Issue	Response
Definition of the target pricing method	Cost Risk Adjustment	Respondents felt the additional wording included under the target pricing method added confusion.	The wording at 5.3 (4) (b) has been removed.
Clarifications on the approach	Cost Risk Adjustment	Respondents requested clarifications on the approach and principles proposed.	Where relevant the wording has been amended. For example, where “should” has been used this has been amended to “must have regard”.
The methodology is too complex	POCO	Respondents felt the proposed methodology is too complex and could be made simpler. Alternatively, it was suggested contractors and MOD could agree their own methodology on an individual contract basis.	Minor amendments to the methodology have been made. The overall intention of the methodology is to ensure consistency in calculating the POCO adjustment and we do not believe it is too complex. A worked example has now been provided.
Not enough information is included in the guidance on how to make the adjustment	SSRO Funding Adjustment	Respondents requested further information on the SSRO Adjustment and when guidance would be made available.	The wording has been amended to state that the adjustment is currently zero until 31 March 2017. The SSRO will communicate the approach to the adjustment and associated guidance in due course.
Conflicting principles	Incentive Adjustment	Respondents found that some of the principles for incentives were conflicting.	Where relevant we have amended this section to reflect the comments received.
Errors in the diagram and worked example	Capital Service Adjustment	Respondents identified errors in the CSA diagrams. Computation 1 “Divided by” should be “Divided into”. Computation 3 “PLUS”, should read “OR (if negative)”.	These amendments have been made. References to “Allowance” have also been amended to “Adjustment” or “Rate” where appropriate.
Outdated terminology	Capital Service Adjustment	Some respondents felt that some of our terminology and language was outdated and required updating.	We have reviewed and made amendments to the terminology where relevant. The terminology will continue to be reviewed and updated.

Issue	Section	Description of Issue	Response
Section 18 was misleading	Opinions and Determination	Respondents commented that the section on Opinions and Determinations did not accurately reflect the Act and Regulations and could confuse the reader.	The intention of this section was to paraphrase the Act and Regulations and to make users aware they could make referrals to the SSRO. We have taken on board the comments from respondents and split this section up to make a clearer distinction between the SSROs roles on opinions and determinations.

Many respondents commented that worked examples would be a useful addition to the guidance. It is our intention to include these in future.

6. Overall response to feedback

In making its decision on whether to make any changes to the guidance on adjustments to the baseline profit rate, the SSRO considered the intention behind the Act, Regulations and Single Source Procurement Framework. The principles are that the guidance should:

- address shortcomings which may arise from single-source procurement;
- focus on areas where standardisation is of value;
- be proportionate;
- enable a fair and reasonable price is paid under the contract in question; and
- support value for money.

The feedback received was helpful. We have taken a balanced approach to our revised guidance to ensure that future single source contracting is supported, and that a fair and reasonable price is paid to the contractor, while also ensuring value for money for the UK tax payer. On the whole, respondents were supportive of the principle based approach to the guidance.

All comments received were considered, and we have amended the document in response to several – especially those where it was apparent that possible confusion could arise from the original wording.

Overall, we are confident that the guidance on adjustments to the baseline profit rate is a more robust document as a result of the consultation, with clearer guidance that should assist contractors and the MOD when determining the contract profit rate.

Next Steps

The statutory guidance on adjustments to the baseline profit rate was published on 27 March 2015.

In the future the SSRO will consult on the SSRO funding adjustment (step 4) and communicate to stakeholders how this adjustment is to be calculated.

The SSRO will formally review the guidance on an annual or earlier basis to take into consideration any lessons learnt. We will also publish examples of opinions and/or determinations, or other issues on adjustments to the baseline profit rate, as they materialise. Any updates will be published on the SSRO's website.

