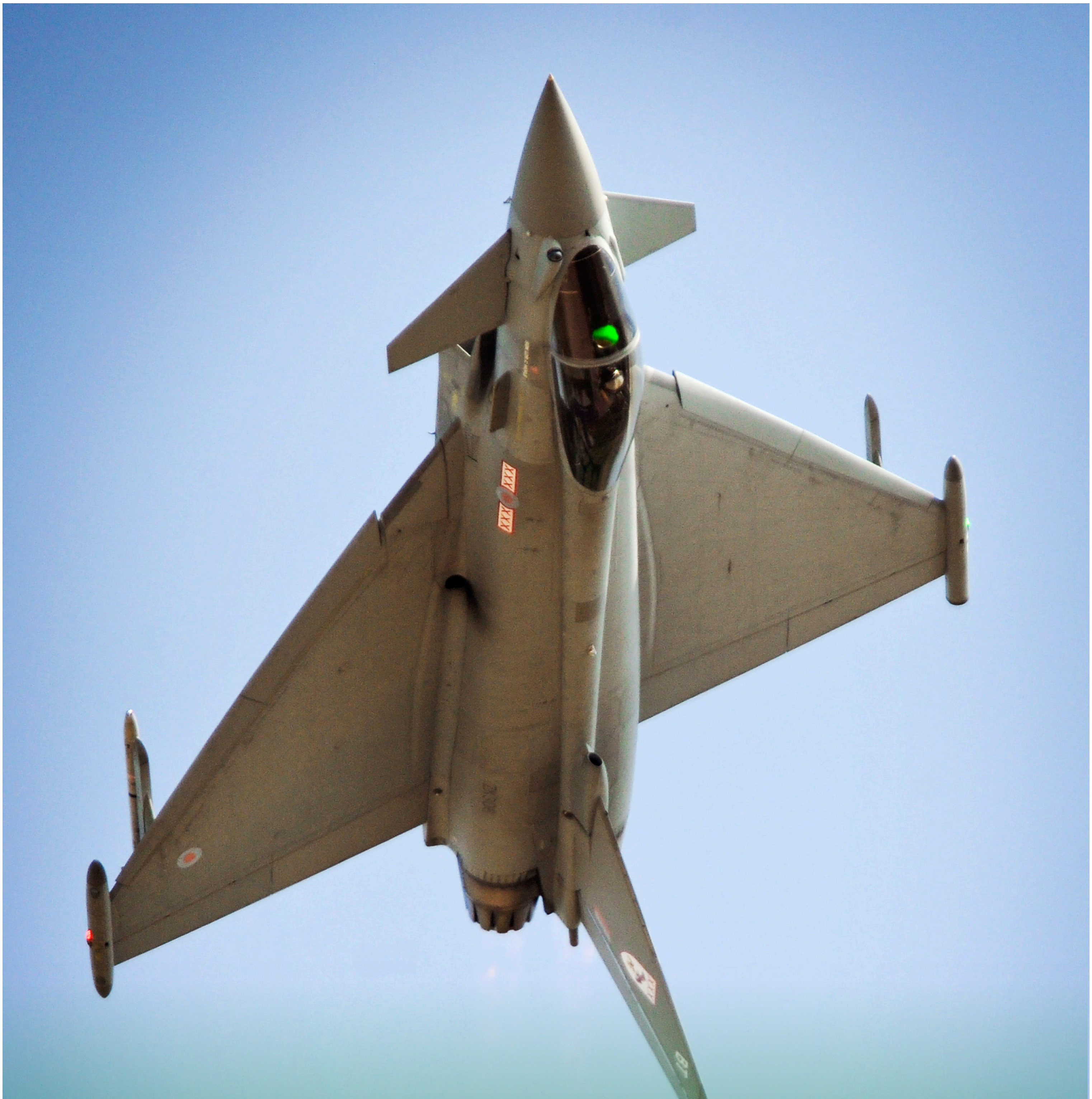

SSRO

Single Source
Regulations Office

Assuring value, building confidence

Review of the Single Source Regulatory Framework

Call for input

Contents

Introduction

1. Single source regulatory framework

1.1 The regulatory framework for single source defence contracts was introduced by Part 2 of the Defence Reform Act 2014 (the Act) and the Single Source Contract Regulations 2014 (the Regulations) and came fully into effect in December 2014. The scheme of regulation aims to strike a balance between value for money and fair prices by subjecting covered contracts to price control and requiring suppliers to report a suite of information designed to give greater transparency to these contracts. Figure 1 summarises the elements of the scheme.

Figure 1: Summary scheme of regulation

SSRO

Independent regulator and custodian

* Review of Act and Regulations

* Statutory guidance
* Assessment of profit rates
* Compliance monitoring

* Maintaining database and analysing data
* Delivery of additional services by agreement

Coverage

- Scheme applies to qualifying defence contracts (QDCs)
- Qualifying sub-contracts (QSCs) are also covered, following assessment and notification

Price control

- Price is controlled by a formula: price = AC + (CPR x AC)
- Costs must be allowable costs (AC)
- Contract profit rate (CPR) determined by a six-step process

Transparency

- Suppliers keep accounting records for audit purposes
- Suppliers submit reports on contracts, overheads and forward planning
- SSRO analyses reported data

Referrals

* Issues resolved by the SSRO on referral
* Opinions
* Determinations

Enforcement

* MOD responsible for enforcement
* Compliance notices
* Penalty notices

2. Review of the legislation

2.1 The SSRO was established to be the independent expert on single source defence procurement and the custodian of the regulatory framework. Its statutory functions are summarised in section 13 below and include keeping Part 2 of the Act and the Regulations under review. The SSRO may recommend to the Secretary of State such changes to the regulatory framework as it considers appropriate.

2.2 The Secretary of State is required to complete periodic reviews of the framework, with the first review to be completed by December 2017. Subsequent reviews by the Secretary of State are to be carried out in five-year cycles. In carrying out a review, the Secretary of State must have regard to any recommendations made by the SSRO, provided these are submitted six months before the date on which the review is to be completed. This means that the latest the SSRO may make recommendations for the Secretary of State's first review of the legislation is 16 June 2017.

2.3 The SSRO proposes to consult widely before making recommendations to the Secretary of State. This will include a public consultation for two months, which is expected to take place in early 2017. Prior to public consultation, the SSRO is seeking the views of key stakeholders, which it will consider before preparing its consultation proposals.

2.4 The SSRO intends to conduct the early stakeholder engagement in two stages, by reference to the key themes set out in Figure 2 below.

Figure 2: Review themes

Theme	Content
Coverage	• Definitions of QDC and QSC • Thresholds
Pricing	• Formula • Allowable Costs • Contract profit rate
SSRO operations	• Governance • Funding • Miscellaneous functions
Referrals and enforcement	• Opinions • Determinations • Compliance
Transparency	• Record-keeping • Reports • Analysis and publication

2.5 This call for input sets out the SSRO's initial thinking in relation to these themes, although detailed engagement on transparency will not take place until September 2016. It is intended to provide a framework for discussion rather than setting out any concluded views on the part of the SSRO.

2.6 When preparing its proposals, the SSRO has conducted a detailed examination of the relevant statutory provisions. We have also taken into account the SSRO's strategic objectives, our learning from operation of the scheme, relevant comparisons with other regulatory schemes and the recommendations in the Currie report which led to the new regime.

2.7 The issues presented for discussion are those considered to be of greater significance, rather than focusing on matters of detail. They have been selected from a larger list of potential items that emerged from consideration of the Act and the Regulations. Appendix 1 sets out a summary of matters considered by the SSRO but in respect of which it is not specifically calling for input.

2.8 The SSRO's call for input is intended to stimulate feedback in key areas. However, the SSRO welcomes representations from stakeholders on any matters they consider should form part of the review.

2.9 To facilitate input, the SSRO will hold an event for interested stakeholders on Wednesday 29 June 2016 at the offices of the SSRO. This event will provide an opportunity to discuss any aspect of the review with us. Stakeholders are encouraged to make their interest in attending the event known as early as possible, as space is limited.

2.10 Stakeholders are requested to provide written responses to this paper by 4.00pm on 15 July 2016. All communications in respect of the review should be directed as follows:

Contacts:

Email: reviewofregulation@ssro.gov.uk

Telephone: 020 3771 4767

Covered contracts

3. Introduction

3.1 The Act and the Regulations apply to qualifying defence contracts (QDCs) and qualifying sub-contracts (QSCs). When a contract is a QDC or QSC, a number of consequences follow:

a. the contract price is controlled, it is determined by the formula: Price = AC + (CPR x AC), costs must be Allowable, and the profit rate must be determined by a 6-step process;

b. the contractor must keep records, including for the purposes of determining whether a cost is an Allowable Cost, reasons for the difference between estimated and actual costs and any other matter relating to the price payable;

c. the suite of contract-specific reports described in Part 5 of the Regulations must be provided to the SSRO and the MOD;

d. sub-contracts to the QDC or QSC may become QSCs (including pre-existing sub-contracts, if they are amended);

e. the Secretary of State may carry out enforcement action against the contractor by issuing compliance and penalty notices; and

f. the SSRO has jurisdiction to give opinions and make determinations, following a referral by one of the parties to the contract.

3.2 It is not proposed to set out the full definitions of QDC and QSC in this document, although Figure 3 summarises key features.

Figure 3: Summary of QDC and QSC requirements

Requirement	QDC	QSC
Purpose	Procure goods, works or services for defence purposes	Providing goods, works or services as part of the supply chain for a QDC or QSC
Threshold value	£5 million	£25 million
Time of contract	Award or amendment on or after 18 December 2014	N/A
Award procedure	Award or amendment not the result of a competitive process	Award not the result of a competitive process
Exclusion	Contract not in a category excluded by the Regulations	Contract not in a category excluded by the Regulations
Exemption	Secretary of State may direct that a contract is not a QDC	Secretary of State may direct that a contract is not a QSC
Amendment	Contract may become QDC by amendment but parties must agree	Contract may become QSC by amendment if a QSC assessment is triggered

3.3 In order for the regulatory framework to apply to a QSC, the contract must additionally have been assessed as being a QSC and a notification given to that effect to both the MOD and the relevant sub-contractor.

Call for input 1
The SSRO invites views regarding the coverage of QDCs and QSCs and raises specific issues for consideration below.

4. Thresholds for QDCs

4.1 In order for a contract to be a QDC, the contract value must be of or above the threshold value specified in the Regulations. The threshold was set at £500 million for a short introductory period from 18 December 2014 to 31 March 2015, but for contracts entered into on or after 31 March 2015, the threshold value is £5 million.

4.2 The SSRO understands the threshold was imposed to ensure a degree of proportionality between the requirements of the Act and Regulations and the number and value of contracts subject to the Act. It reflects the fact that a relatively small number of high value contracts are responsible for the overwhelming amount of expenditure on single source defence procurement. The imposition of the threshold was not wholly in line with Lord Currie's recommendation, which was that simplified arrangements should apply to contracts valued below £5 million.[1]

4.3 The SSRO's own experience is that contractors readily adapt to the reporting requirements, once advantage is taken of the support available from the SSRO. It is also clear that the MOD has extended similar reporting requirements to contracts valued below £5 million through the application of DEFCON 813 to defence contracts that are not qualifying contracts.

4.4 Contracts below the £5 million threshold do not benefit from the protections afforded by the regulatory framework, which are designed not only to ensure good value for money for government but also fair and reasonable prices for contractors. Below the threshold, neither the MOD nor contractors have access to the provisions summarised at paragraph 3.1 above, including: the six steps for determining the contract profit rate (which begin with a baseline profit rate); the test for what costs are Allowable; statutory guidance from the SSRO; and the right to seek an opinion or determination from the SSRO if issues arise.

4.5 The SSRO considers there may be good reasons for removing the QDC threshold, as it would:

- bring all single source defence contracts within the statutory regime, improving the understanding of costs and savings to taxpayers;
- apply appropriate price control to more single source contracts; and
- avoid the possibility of contract prices being artificially set below the threshold;
- remove the need to duplicate the statutory framework in contractual provisions for contracts below the existing threshold;
- ensure that smaller contracts (and contractors) benefit from the protections offered by the framework.

1 Review of Single Source Pricing Regulations, October 2011, page 57.

4.6 The impact of the change would be mitigated as follows:

- contractors should already be capturing the required information, reducing any administrative burden;
- reporting requirements may be simplified for contracts below £5 million; and
- the SSRO will continue to support contractors to report and to access the DefCARS database.

Call for input 2

The SSRO invites views on removal of the current £5 million threshold for QDCs, with the price formula to apply along with a proportionate level of reporting.

5. Amended QDCs

5.1 According to the definition of qualifying defence contract, a contract (not previously a QDC) that is amended in a non-competitive way may only become a QDC if the parties agree that it should come within the regime. The SSRO is concerned about this aspect of the definition for the following reasons:

- this leaves the application of the regime in the hands of the parties to the contract;
- there is significant potential for contracts to be amended non-competitively and amended contracts may be substantially different from the original contract;
- there has been only one amended contract brought within the regime by agreement;
- most major acquisition contracts last for more than five years, and indeed many for longer than ten years; and
- there is potential for significant amounts of data on single source contracts to be lost to the system.

5.2 The policy basis behind the approach is not entirely clear, although one possible reason concerns the treatment of costs which have already been incurred under the contract at the time of amendment (sunk costs). As the Act is currently drafted, if a contract is brought within the regime then all the costs used to calculate the contract price must be Allowable and included in the contract reports. This includes sunk costs.

5.3 The SSRO considers that it is appropriate for sunk costs to be included in contract reports, so that there is a clear picture of the total contract value. However, the SSRO sees little utility in costs which have already been incurred when the contract becomes a QDC being subject to further review as to whether the costs are Allowable. That would have the potential to unduly interfere with established rights.

Call for input 3

The SSRO invites views regarding the treatment of contract amendments and, more particularly, whether:

- the requirement for joint party agreement should be removed so that amended contracts become QDCs if they are amended in a way that is material and not the result of a competitive process and otherwise meet the requirements of a QDC;
- the legislation should be amended to ensure that when a contract becomes a QDC following amendment sunk costs are reported but are not subject to further review as to whether they are Allowable.

6. Qualifying sub-contracts

6.1 Sections 28 to 30 of the Act cover the application of the legislation to sub-contracts. The purpose of these sections is to ensure that if sub-contracts are awarded on a non-competitive basis, they will be subjected to the regulatory framework created by the Act in the same way as primary contracts are, with appropriate modifications as set out in Part 11 of the Regulations. The obligations to which a QDC is subject are intended to 'flow down' to its sub-contracts if those sub-contracts are themselves not competed. Sub-contracts that are subject to the Act are called 'qualifying sub-contracts' (QSC).

6.2 Regulation 61 typically makes it the responsibility of the primary contractor to assess whether a sub-contract is a QSC and to keep a record of this assessment. In the event that the primary contractor makes a positive assessment (that the sub-contract meets the conditions of Section 28 of the Act) they must notify the Secretary of State of that assessment. Once a positive assessment has been made the contract in question becomes a QSC and is treated as such by the SSRO.

6.3 QDCs are often large and complex and it is common for elements to be sub-contracted. These sub-contracts may themselves be of very substantial value. For this reason it is essential that primary contractors make timely and correct assessments when determining whether sub-contracts are QSCs. Any failure to do so could prevent the legislation from 'flowing down', resulting in large portions of single source government defence expenditure falling outside of the single source regulatory framework.

6.4 The SSRO has advised prime contractors on how to reasonably assess whether sub-contracts are QSCs. By advising in this manner the SSRO has had the opportunity to see first-hand how prime contractors are interpreting the legislation when assessing whether sub-contracts fall under the Act. There have been instances where the legislation may not have been interpreted correctly by prime contractors.

Call for input 4

The SSRO invites views regarding the definition and assessment of QSCs and raises specific issues for consideration below.

QSC threshold

6.5 One of the requirements of the definition of qualifying sub-contract is that the contract value must be at or above the threshold value prescribed in the Regulations. This amount is currently set at £25 million by Regulation 58(1) and is significantly higher than the £5 million threshold for QDCs.

6.6 When the Act and the Regulations were introduced, the principal argument for a higher threshold for QSCs was to encourage small and medium-sized enterprises (SMEs). It was thought the higher threshold would avoid SMEs being subject to a burden from significant reporting requirements, which might serve to dissuade their development as defence suppliers.

6.7 The SSRO questions the assumption that the reporting requirements of the single source regulatory framework present any real barrier to the development of SMEs. As set out above, the SSRO's own experience is that contractors readily adapt to the reporting requirements, once advantage is taken of the support available from the SSRO. It is unclear why reporting at one level is proportionate for QDCs but is assumed to be disproportionate for QSCs and a barrier for SMEs.

6.8 The SSRO considers that QSCs are just as important as QDCs if the Act and the Regulations are to deliver on their objectives. The contract notification reports on the first 25 QDCs disclose 100 sub-contracts valued at £1 million or more (contracts below that value do not need to be notified). Single source sub-contracts should be equally subject to price control and reports on such contracts are required in order that the SSRO may provide the MOD with the information required to achieve value for money in single source defence procurement.

6.9 Very few QSCs had been reported to the SSRO by the end of March 2016. At that time only 4 QSCs had been notified, compared with 30 QDCs. In each case, the contractor with the reporting obligation was either a prime contractor or a subsidiary of a prime contractor. The SSRO is of the view that the vast majority of QSCs would still be with large companies, even if the threshold was reduced significantly. Only 20 of the 100 sub-contracts referred to in paragraph 6.8 are considered to be with SMEs, with the contracts being held by 10 contractors.

6.10 Alignment between the treatment of QDCs and QSCs, with thresholds being removed would make reporting requirements clearer for contractors. It would bring all single source contracts within the regime and provide a better foundation on which to deliver the objectives of the Act and the Regulations.

Call for input 5
The SSRO invites views on alignment between the treatment of QDCs and QSCs, with thresholds being removed.

Contractual amendments

6.11 A prime contractor has made the case that there is a distinction between 'entering into' a contract and 'amending a contract', and that the test to determine whether a sub-contract is a QSC should only be undertaken at the time it is initially entered into.

6.12 The SSRO considers, supported by leading counsel, that this interpretation of the legislation is incorrect. The effect of agreeing to significantly amend the terms of an existing contract is to enter into a new contract on the amended terms. As such an assessment as to whether a sub-contract is a QSC should be undertaken if a sub-contract is amended, providing that the amendments are material (something more than a minor matter).

Timing of entry into the contract

6.13 A prime contractor has stated that as the definition of a QSC hinges on whether a sub-contract involves the provision of anything 'for the purposes of a QDC', a sub-contract cannot be a QSC if it was entered into prior to the QDC being signed. The logic of this position is that, if a QDC technically did not exist at the time the sub-contract was entered into, the sub-contract could not be for the purposes of a QDC and could not therefore be deemed to be a QSC.

6.14 The SSRO considers, supported by leading counsel, that this interpretation of the legislation is incorrect. In our view the fact that a sub-contract was signed before the QDC does not remove the obligation to carry out an assessment under Regulation 61 and does not have the effect that the contract fails to satisfy the definition of a QSC. Any other approach would expose the framework to avoidance. The explanatory notes to Section 29 of the Act (which covers the determination of whether a contract is a QSC) identifies the risk of avoidance and references the provisions of the Act which aim to mediate against this risk. The passage in question states:

"One possible way a contractor could deliberately avoid flowing down the obligations to a sub-contractor that would otherwise be subject to them would be to enter into conditional sub-contract or similar arrangement prior to the signing of the primary QDC. Subsections (3) and (4) are designed to address this possibility, and provide equivalent provision to subsections (1) and (2)".

Call for input 6

The SSRO invites views on whether the legislation should be amended to make clear that:

- material contract amendments trigger the requirement to assess whether a contract is a QSC; and
- a contract may be a QSC if it relates to a proposed QDC.

Oversight by the SSRO

6.15 The person who carries out the QSC assessment is required by Regulation 61 to keep a record. The Secretary of State may inspect the record of the assessment for the purposes of assessing compliance.

6.16 The SSRO receives information about sub-contracts in the reports submitted for QDCs, notably the contract notification report and, as applicable, the quarterly contract report and interim contract report. This means that in respect of the 20 highest value sub-contracts under the QDC, provided the sub-contract value exceeds £1 million, the SSRO will be informed of the outcome of the QSC assessment.

6.17 The SSRO has no power to require the contractor to provide a copy of any QSC assessment. As a consequence, the SSRO may be aware of the outcome of a QSC assessment but be unable to determine whether the assessment was carried out in accordance with the requirements of the Act and Regulations. It would help to promote compliance if the SSRO were able to access relevant records. This should present little burden on contractors as they are already required to keep a record of the assessment.

Call for input 7

The SSRO invites views on whether it should be given the power to require provision of any QSC assessment.

7. Exclusions

7.1 The Regulations prescribe categories of contracts that may not be QDCs or QSCs, which will be referred to as “excluded contracts” for the purposes of the review. Excluded contracts should be differentiated from contracts that would fall within the regulatory framework but for a direction from the Secretary of State that they are not QDCs or QSCs. Contracts the subject of such a direction will be referred to for the purposes of the review as “exempt contracts”. A significant point of distinction between excluded and exempt contracts is that there are no grounds expressed in the legislation to delimit the Secretary of State’s power of direction.

7.2 The SSRO has received a number of queries regarding the description of two of the categories of excluded contracts:

- contracts made within the framework of an international cooperative defence programme; and
- contracts made wholly for the purposes of intelligence activities.

7.3 There is no definition in the regulatory framework of either “international cooperative defence programme” or “intelligence activities”, both of which are terms that may be open to different interpretations. The SSRO is concerned there should be sufficient definition to ensure contracts are appropriately brought within the regime and exclusions are neither overused nor applied inconsistently.

Call for input 8
The SSRO invites views on whether the application of the exclusions would benefit from further description or amendment and, if so, how this should be effected.

7.4 There is a category of exclusion for contracts to which the government of any country other than the United Kingdom is a party. Such contracts may not be QDCs. The SSRO understands the exclusion is intended to deal with situations such as the US foreign military sales programme under which governments purchase directly from the US government rather than from contractors. The SSRO is concerned that the exclusion should not be misapplied such that the regulatory framework disproportionately covers contracts of suppliers based in the UK and would welcome feedback from stakeholders in this area.

Call for input 9
The SSRO invites views on how the exclusion in respect of government to government contracts is being applied and any suggestions for amendment.

Pricing

8. The pricing formula

8.1 The basis of the pricing approach adopted by the Act is a formula. The price payable under a QDC must be determined in accordance with the following formula:

price = (CPR x AC) + AC,

where CPR is the contract profit rate for the contract and AC means the Allowable Costs under the contract.

8.2 The formula must be applied to re-determine the price payable under a QDC if the contract is amended in a way that would affect the price previously determined in accordance with the formula.

8.3 The requirement for the formula to be applied in determining the price payable under a contract is set out in Sections 15(2) – 15(5) of the Act and implemented by Regulation 10. The Act permits the Regulations to provide for the formula to be applied at specified times, which may differ for different kinds of contract.

Call for input 10
The SSRO invites views on whether any different approach would be preferable to the current pricing formula, and what such an approach might be.

9. Determining the contract profit rate

9.1 Section 17(2) of the Act and Regulation 11 require the contract profit rate (CPR) for a qualifying defence contract to be calculated by a six-step process. The six steps may be summarised as follows:

Step 1	baseline profit rate
	+ –
Step 2	cost risk adjustment
	–
Step 3	profit on cost once
	–
Step 4	SSRO funding adjustment
	+
Step 5	incentive adjustment
	+ –
Step 6	capital servicing adjustment
	contract profit rate

9.2 Part 2 of the Act and the Regulations "apply to qualifying sub-contracts (and to sub-contractors) as they apply to qualifying defence contracts (and to primary contractors)". This means that the six steps also apply to calculating the profit rate for QSCs.

Call for input 11

The SSRO invites views regarding the six-step process for determining the contract profit rate and raises specific issues for consideration below.

Step 1: Baseline profit rate

9.3 In order to determine the contract profit rate, the parties must begin with the baseline profit rate. The baseline profit rate is determined annually by the Secretary of State. The parties must choose the baseline profit rate that is in force at the relevant time.

9.4 The Act presently permits no disapplication or modification of step one in its application to a QDC. The Regulations may disapply or modify steps two to six of the six-step process in their application to contracts with a value below a specified amount, but no such modification is permitted in respect of step one.

9.5 The Act allows for multiple baseline profit rates to be set and this is something the SSRO has considered, consulting on a proposal for multiple rates in September 2015. The SSRO did not recommend multiple rates for 2016/2017, following statutory guidance from the Secretary of State that the methodology used to calculate profit rates for single source contracts should result in setting a single baseline profit rate for that year, but will be recommending multiple rates in 2017/2018.

9.6 The SSRO's consideration of multiple baseline profit rates identified that the ordinary and natural construction of the six-step process is that it is applied once to each contract and that it follows that no more than one baseline profit rate can be applied to any single contract. This highlights a lack of flexibility and has the consequence that a 'blended' baseline profit rate may not be applied to a contract.

9.7 The inability to apply multiple baseline profit rates to a single contract may impede the regulatory framework from delivering value for money for the taxpayer and a fair and reasonable return for industry. In order to achieve these aims:

- profits for companies need to reflect the risks they take in carrying out work;
- profits need to reflect the diversity of equipment and services delivered and therefore the type of work undertaken; and
- the regime needs to be transparent about profit rates expected and achieved.

9.8 The SSRO has already indicated its view that value for money and fair and reasonable prices can best be achieved by having multiple baseline profit rates and permitting these to be applied in appropriate cases to defined components of a contract, effectively resulting in a blended profit rate for the contract.

9.9 The limitation on blended rates could be overcome by amending the Act to make it explicit that a baseline profit rate, and thus a contract profit rate, may be applied to a defined component of a contract. Alternatively, the Act may be amended to permit the Regulations to dis-apply or modify any or all of steps one to six (rather than just steps two to six). The Regulations may then be amended to provide for the application of multiple baseline rates to a contract.

Call for input 12

The SSRO invites views on greater flexibility in the application of the six-step process so as to clearly permit blended rates.

Step 2: Cost risk adjustment

9.10 Step 2 requires an adjustment to the baseline profit rate, either up or down, to reflect the risk of the primary contractor's actual Allowable Costs under the contract differing from its estimated Allowable Costs (Section 17(2) of the Act). The cost risk adjustment is to be agreed by the Secretary of State or an authorised person and the primary contractor (Section 17(4)(a)).

9.11 The Act provides for the Regulations to prescribe the parameters within which the baseline profit rate may be adjusted in light of the cost risk. Pursuant to Regulation 11(3), the cost risk adjustment should be an agreed amount within the range plus or minus 25 per cent of the baseline profit rate and it may be zero.

Step 3: POCO

9.12 The SSRO considers the principle of Profit on Cost Once is sound and should remain part of the process for determining the contract profit rate. There have been some compliance issues in respect of compliance with the SSRO's statutory guidance, but these do not appear to require amendment of step 3.

Step 4: SSRO funding adjustment

9.13 Step 4 is addressed in detail in the following section of this paper.

Step 5: Incentive adjustment

9.14 The SSRO considers that it is appropriate for the incentive adjustment to continue to form part of the process for determining the contract profit rate. There have been some compliance issues with how the step has been applied, but these do not appear to require amendment of step 5.

Step 6: Capital servicing adjustment

9.15 Step 6 requires the addition or subtraction of an agreed amount (the capital servicing adjustment or CSA) to ensure that the contractor receives an appropriate and reasonable return on the fixed and working capital employed to enable performance of the contract.

9.16 It is for the Secretary of State and the primary contractor to agree the CSA for the purposes of a QDC (Section 17(4)(a) of the Act). In doing so, the parties:

- must have regard to the capital servicing rates in force at the time of agreement;
- must not apply the adjustment in respect of the costs of any fixed and working capital which are Allowable Costs under the contract; and
- may use an average fixed and working capital for any business unit which is likely to be performing the primary contractor's obligations under the contract (Regulation 11(8)).

9.17 The capital servicing rates are published annually by the Secretary of State. The rates are assessed by the SSRO, following its published methodology, looking at the interest rates achieved by sterling denominated debt and statistics on interest for short term deposits. As such, the rates reflect the cost of servicing borrowings.

9.18 The amount agreed as the capital servicing adjustment may be zero (Section 17(4)(b) of the Act). However, as a consequence of the way step 6 is framed, there will generally be a positive capital servicing adjustment calculated by reference to the published capital servicing rates. The SSRO's published methodology for calculating the baseline profit and capital servicing rates reflects this, removing capital servicing from the baseline profit rate, effectively so that it may be added back in at step 6.[2]

9.19 The Act seeks to ensure that the contractor receives an appropriate and reasonable return on capital. The SSRO considers that this may be achieved primarily through the baseline profit rate, which would remove the need for a bespoke capital servicing adjustment in most cases. A consequent change would be required to step 6, so that there is no over-provision for return on capital.

9.20 The SSRO considered the possibility that costs associated with servicing borrowings in respect of capital engaged on defence contracts may be claimed as Allowable Costs. However, it may not be thought appropriate and reasonable for profit to apply to such costs, in which case they would not satisfy the test of Allowable Costs set out in Section 20(2) of the Act.

Call for input 13

The SSRO invites views on whether:

- step 6 should remain part of the process for determining the contract profit rate;
- the onus should be clearly changed so that the expectation is that there will be no capital servicing adjustment unless there are exceptional circumstances;
- the SSRO should continue to recommend capital servicing rates, which could be applied in the exceptional cases.

2 Single source baseline profit and capital servicing rates methodology, March 2016, paragraph 5.6.

SSRO funding adjustment

10. Background

10.1 Step 4 of the six-step process for determining the contract profit rate requires the parties to deduct the SSRO funding adjustment. The adjustment is zero until 31 March 2017, but from 1 April 2017 it will be an amount determined annually by the Secretary of State.

10.2 The SSRO is funded by the MOD through Grant in Aid, based on an assessment of its needs. The SSRO funding adjustment is concerned with recovering a contribution to the SSRO's running costs, rather than determining the amount of funding the SSRO receives.

10.3 The Secretary of State will determine the SSRO funding adjustment after considering a recommendation from the SSRO. The SSRO will communicate its first assessment of the appropriate level of the SSRO funding adjustment to the Secretary of State by 31 January 2017 and the rate for 2017/18 will be set by 15 March 2017.

11. Methodology

11.1 The SSRO is not bound by the legislation to take any particular approach to calculating the appropriate adjustment. The Ministry of Defence has indicated however that the SSRO should seek to recover 50 per cent of its actual running costs using the following methodology:

a. take the average actual running costs of the SSRO over the last three years;

b. deduct the average of any SSRO costs over the last three years incurred in relation to specific tasks and analyses requested by the Secretary of State

c. divide this by the average of the last three years' total value of qualifying contracts, to get to a percentage; and

d. divide this by two, to represent a 50/50 split of these costs between the MOD and suppliers with qualifying contracts.[3]

11.2 The strength of this approach is that, once available, it uses actual data about SSRO costs and past numbers and values of qualifying contracts to calculate a forward estimate. By taking a three-year rolling average, there will be some moderation of the variability which can occur in individual years.

11.3 The approach has a number of weaknesses. With regard to the full year audited costs for the SSRO, this will only be available from 2015/2016 and budget projections will need to be included in the calculation up until 2019 if a three year average is to be used. Adjustment may need to be made for significant or one-off costs.

3 The MOD Single Source Procurement Framework, Version 3.0, May 2014.

11.4 Similarly, initial contracting data is limited and unrepresentative. Early contract notifications have been low and an average over a shorter period will be required for 2017. In the longer term, past contracting levels will never be a perfect estimate of the number and value of contracts let in a forthcoming financial year and there will almost certainly be a degree of over-recovery or under-recovery on individual contracts. Overall cost recovery will be over the life of the individual contracts, which can vary significantly. This detracts from the ability of the Ministry of Defence to account for and demonstrate the recovery of 50 per cent of the SSRO costs in the medium term.

12. Review

12.1 The approach adopted in the legislation of having a percentage adjustment to the contract profit rate has the theoretical virtue that contractors will contribute to the SSRO's funding in proportion to the value of their single source contracts. The reality, however, is that cost recovery will take place over contract periods and there will likely be over-recovery or under-recovery on individual contracts.

12.2 The over-recovery or under-recovery on individual contracts may not be significant, taking into account the fact that the adjustment itself is expected to be less than ten basis points (0.10 per cent). However, the value that this might represent on an individual contract will not become clear until after the year in question. The differences may even-out over time for a particular contractor but this would take longer to determine and there would be a disproportionate administrative burden if this was required to be reconciled across all contracts.

12.3 An alternative and more straightforward approach would be to remove step 4 of the six-step process and instead impose an annual levy on contractors with single source contracts. Such an approach would be more in line with the funding of other economic regulators. It would be based on a rolling average of past numbers and annual values of qualifying contracts, but would result in a simple annual payment rather than a reduction in the contract profit rate. In order to ensure a degree of proportionality, the levy could be determined in bands depending on the value of the contracts held by the contractor. An example is given in the following table.

Figure 4: Possible levies

Value of contracts	Levy
Up to £10 million	Level 1
Up to £50 million (but at least £10 million)	Level 2
Up to £250 million (but at least £50 million)	Level 3
Up to £500 million (but at least £250 million)	Level 4
£500 million or more	Level 5

12.4 This approach would provide for greater clarity and certainty for both contractors and the Ministry of Defence and would ensure that recovered funds were received annually rather than over the life of contracts.

12.5 As the SSRO funding adjustment is built-in as step 4 of the six-step process by Section 17(2) of the Act, that step would need to be removed or dis-applied. There is facility in the Regulations to do this. However, the Act does not provide for the Regulations to introduce a levy and some amendment of the legislation would be required to achieve this.

12.6 If implemented, this proposal would not be implemented in time for 2017. If this was planned the SSRO would seek to agree with the MOD that the SSRO funding adjustment should be set at zero until such time as the necessary new legislation could be enacted and a levy applied and issued. Such a change would be the subject of later and more detailed consultation.

Call for input 14

The SSRO invites views regarding the SSRO funding adjustment, in particular the option of dis-applying step 4 and introducing a levy.

SSRO functions and independence

13. Introduction

13.1 The SSRO has a number of functions under the Act and the Regulations, through which it discharges its role as the independent regulator of single source defence procurement. These may be summarised as follows:

- providing statutory guidance on Allowable Costs, the steps for determining the contract profit rate, the preparation of reports and the amount of any penalty;
- assessing annually the rates and the adjustment used to determine the contract profit rate and recommending these to the Secretary of State;
- maintaining an up-to-date record of QDCs, QSCs and the duration of those contracts;
- assessing compliance with reporting requirements under the Act and the Regulations;
- analysing reports submitted by suppliers in response to requests from the Secretary of State and providing the results of analysis;
- keeping Part 2 of the Act and the Regulations under review and recommending changes to the Secretary of State;
- dealing with referrals from the parties to qualifying contracts (and in some cases the Secretary of State where not a party to the contract) by making determinations and giving opinions;
- providing services to the Secretary of State in accordance with agreed arrangements.

13.2 Additionally, the SSRO may do anything which is calculated to facilitate the carrying out of its functions, or which is incidental or conducive to the carrying out of its functions.

Call for input 15
The SSRO invites views regarding its functions as the independent regulator and raises specific issues for consideration below.

14. Value for money and fair pricing

14.1 The SSRO is charged, in carrying out its functions, with trying to ensure that:

a. good value for money is obtained in government expenditure on qualifying defence contracts, and

b. that contractors are paid a fair and reasonable price under qualifying defence contracts (Section 13(2) of the Act).

14.2 These are sound objectives for the SSRO to pursue. It is not clear, however, why the value for money and fair pricing aims are not expressed to govern other aspects of the regulatory scheme. It may be that these aims would be relevant to other functions under the legislation, such as those carried out by the Secretary of State.

14.3 For example, one of the SSRO's functions is to assess each year the appropriate baseline profit and capital servicing rates and the SSRO funding adjustment for use in the six-step process for determining the contract profit rate. In making that assessment the SSRO must be guided by its value for money and fair pricing aims. It is not clear, however, what considerations guide the Secretary of State when considering the SSRO's assessment and determining what the actual rates and adjustment should be.

14.4 There are many functions under the regulatory framework that are not carried out by the SSRO and it may be of assistance for the discharge of these to be guided by clear aims. These include:

a. consideration of whether an amended contract should be a QDC or whether to exclude a contract from being a QDC (Section 14);

b. determination or redetermination of the contract price, including application of the six steps and consideration of whether costs are Allowable Costs (Sections 15, 17 and 20);

c. agreement of the amount of any target price adjustment (Section 16);

d. determining the baseline profit rate, the SSRO funding adjustment and the capital servicing rates each year (Section 19);

e. seeking a final price adjustment, agreeing a final price adjustment or dis-applying a final price adjustment (Section 21);

f. carrying out a performance audit (Section 23);

g. consideration of whether to exclude a contract from being a QSC (Section 28);

h. deciding whether to give a person a compliance notice or penalty notice (Sections 31 and 32);

i. deciding whether to seek an opinion or determination; and

j. deciding whether to request analysis reports from the SSRO or to make arrangements for the provision of services by the SSRO (Sections 36 and 37).

14.5 The value for money and fair pricing objectives have broad application and may be considered equally relevant to the discharge of other functions under the Act.

Call for input 16

The SSRO invites views as to whether the aims of value for money and fair pricing should be stand-alone aims under Part 2 of the Act, rather than applying only to discharge by the SSRO of its functions.

15. Access to information

15.1 The SSRO does not have power to access information and stands out from other regulators in this respect. It is, in fact, provided with a range of information in the prescribed reports which suppliers are required to provide to the SSRO and the MOD to promote transparency. If the SSRO needs additional information in order to carry out its functions, it may request that information but is dependent on the person being willing to provide a response.

15.2 The SSRO's inability to require information to be provided may frustrate its regulatory role. It is possible to illustrate instances where this has been the case in respect of each of the functions summarised in section 12 above. Two examples are set out below for the purposes of this call for input.

15.3 The first example concerns the SSRO's responsibility for assessing compliance with reporting requirements. One of the mandatory reports is the contract pricing statement, which must set out the Allowable Costs and the contract profit rate used to determine the contract price, together with the associated facts, assumptions and calculations. If some irregularity in the Allowable Costs or the contract profit rate appears from a contract pricing statement, the SSRO may reasonably wish to see additional information, such as the contract, in order to ascertain whether the reported information is in accordance with the Act and the Regulations. If the SSRO is not provided with the additional information, then the effectiveness of its oversight may be undermined.

15.4 A second example where the SSRO may need to access information is in relation to referrals. The Act and the Regulations provide circumstances in which issues that arise as to the proper application of the regulatory scheme may be referred to the SSRO to give an opinion or make a determination. In such cases the SSRO is dependent on the parties involved to provide it with the information it needs to deal with the referral. If one or more of the parties does not wish to co-operate, then the SSRO may left in the unsatisfactory situation of making a determination or giving an opinion based on incomplete information.

15.5 The Currie report recommended that the SSRO should have powers to gather information on single source defence contracts from both the MOD and contractors.[4] In particular, it was considered that the SSRO should have access to the following:

a. details of all single source defence contracts;

b. copies of contracts for all contracts valued at £50 million or more and others on request;

c. post-costing reports;

4 Review of Single Source Pricing Regulations, October 2011, key recommendation 7 and paragraphs 37 and 271.

d. notification of the application of contractual terms; and

e. details of independent costing exercises (date, total cost, risk and material changes).

15.6 The recommendations on access to information were connected to the regulatory role envisaged for the SSRO: overseeing the framework, carrying out analysis, giving guidance and managing change.

Call for input 17

The SSRO invites views on amendment of the legislation:

- to give the SSRO powers to effectively access information which it may require to discharge its statutory functions;
- to expand the information required routinely to be reported to the SSRO, in particular for the SSRO to be provided with copies of qualifying contracts.

16. SSRO independence

16.1 The SSRO is established as a body corporate by Section 13(1) of the Act. The membership of the SSRO and procedural provisions dealing with its decision-making are set out in Schedule 4 to the Act.

16.2 As a corporate entity, the SSRO is to consist of executive and non-executive members (Schedule 4 to the Act, paragraph 1). This defines the structure of the Board. On the non-executive side there is to be a Chair and at least two other members who must outnumber the executive members.

16.3 The Chair and non-executive members are appointed by the Secretary of State. Ministerial appointments to the SSRO are subject to oversight by the Commissioner for Public Appointments and to the code of practice which the Commissioner has published.

16.4 The role of the Chair of the SSRO is pivotal within an independent regulator that oversees more than £8 billion of spending annually on defence procurement. There is an established procedure for pre-appointment hearings for key posts by a Parliamentary Select Committee, which depends on agreement between the Secretary of State and the Chair of the Parliamentary Select Committee. The pre-appointment hearing procedure has not yet been applied to the Chair of the SSRO, but it may be beneficial to subject the appointment to such scrutiny. The list of posts which may be subject to such scrutiny includes the Chairs of the other economic regulators.

Call for input 18

The SSRO invites views on whether there are changes which should be made to enhance the independence of the SSRO.

Referrals and enforcement

17. Compliance with the regulatory framework

17.1 As appears from Figure 1 above, there are essentially three mechanisms provided in the Act and the Regulations for bringing about compliance.

17.2 First, there is oversight by the SSRO, acting as the custodian of the regulatory framework and the expert on single source procurement. The SSRO assesses compliance, provides guidance, gives opinions (when asked) and keeps Part 2 of the Act and the Regulations under review. The SSRO's oversight is influential, but cannot compel compliance.

17.3 Secondly, the SSRO may determine issues regarding the application of the regulatory framework to individual contracts. These determinations may affect the legal rights of the contractual parties, for example by requiring contracts to be amended to remove costs or adjust the contract profit rate.

17.4 Thirdly, the MOD may issue compliance and penalty notices for breaches of some provisions of the Act. A compliance notice may be issued if there are steps that can be taken to remedy a contravention. If a contravention cannot be remedied or if the requirements of a compliance notice are not met, then a penalty may be imposed by penalty notice.

Call for input 19
The SSRO invites views on the compliance provisions in Part 2 of the Act and the Regulations and raises specific issues for consideration below.

18. Referrals

18.1 The Act and the Regulations provide circumstances in which issues that arise as to the proper application of the regulatory scheme may be referred to the SSRO to make a determination of various kinds. A summary of the relevant circumstances is set out in Figure 5 below.

Figure 5: Determinations by the SSRO

Provision	Initiation	Function	Subject matter
Section 16(2), Regulation 64(3)	Referral	Determination	Target price adjustment
Section 18(3), Regulation 18(2)	Application	Determination	Appropriate adjustment under steps 2, 3 or 6
Section 20(5)	Application	Determination	Extent to which costs are Allowable
Section 21(3)(b), Regulation 16(7)	Referral	Determination	Final price adjustment
Section 23(6), (7), Regulation 20	Application	Review and declaration	Whether the Secretary of State acted unreasonably in a performance audit
Section 27(3), Regulation 47(3)	Referral	Investigation and finding	Whether a confidentiality obligation is genuine
Section 29(5), Regulation 62	Appeal	Determination	Whether a proposed contract would be a QSC
Section 30(4)(b), Regulation 63	Notice	Overrule or confirm notice	Whether the 50 per cent value condition continues to be met for a QSC
Section 32(6), (8)	Application	Determination	Penalty notice matters[5]
Section 35(1), (2), Regulation 52	Referral	Determination	Defined pricing structure and output metrics
Section 35(6), (7), Regulation 55(1)	Referral	Determination	Matters under the old regime, as provided in the contract

18.2 The SSRO may give opinions about qualifying and proposed qualifying contracts if it receives a properly constituted referral. There are prescribed grounds on which nominated persons may seek an opinion from the SSRO. There is provision for the SSRO to give an opinion on “any matter” relating to a qualifying contract or proposed qualifying contract, but this is dependent on receiving a joint referral from nominated persons. Finally, the SSRO may give opinions on contracts previously subject to the jurisdiction of the Review Board for Government Contracts, if the contract provides for such a referral.

5 The matters are: whether there has been a relevant contravention of the Act; whether the recipient of a compliance notice has failed to take the specified steps; whether the recipient has a reasonable excuse; and the amount of the penalty.

18.3 There are aspects of the regulatory scheme that may not be the subject of referrals to the SSRO. For example, steps 1, 4 and 5 of the process for determining the contract profit rate may not be referred. In relation to step 4 (SSRO funding adjustment) this may be due to the lack of discretion available in the application of the step. However, there seems potential for issues to arise both at step 1, where multiple baseline profit rates may be available for selection, and step 5, where substantial discretion applies to whether an incentive adjustment is paid, in what amount and for meeting which contractual provisions.

18.4 Other questions which may not be referred to the SSRO are those concerning when a contract is a QDC. In order to be a QDC, a contract must satisfy the requirements of the definition set out in section 14 of the Act and the Regulations, must not fall within one of the exemptions in the Regulations and must not be excluded from the regulatory framework by direction of the Secretary of State (this potential for exclusion also arises in respect of QSCs). There is considerable scope for issues to arise in respect of these requirements. It may be a weakness in the single source regulatory framework if there is no mechanism for challenging fundamental questions as to whether a contract is a qualifying contract or not, and thus whether the regulatory framework applies or not.

Call for input 20

The SSRO invites views as to whether the grounds on which the SSRO may make determinations and give opinions should be extended to:

- all steps of the process for determining the baseline profit rate;
- whether a contract is a QDC; and
- directions that contracts are not QDCs or QSCs.

19. Enforcement

19.1 The Secretary of State may issue a compliance notice if there has been a relevant contravention of the Act and if there are steps that can be taken to remedy the contravention. A compliance notice will require specified action to be taken to remedy the contravention and specify a time period within which those steps will be taken.

19.2 If a person fails to comply with a compliance notice without lawful excuse, or if the relevant contravention is such that there are no steps which can be taken to remedy the contravention, then the Secretary of State may issue a penalty notice to the person responsible for the failure to comply or contravention.

19.3 The maximum penalty which may be imposed in a penalty notice depends on the value of the contract and the nature of the contravention. The lowest penalty band is for contracts valued at less than £50 million, for which the maximum penalty ranges from £20,000 to £60,000. The highest penalty band is for contracts valued at more than £1 billion, for which the maximum penalty ranges from £500,000 to £1.2 million. For contraventions involving the provision of misleading reports, or failing to comply with a duty of notification, the penalty is determined in the same way as damages would be calculated for breach of contract. The Secretary of State must have regard to the SSRO's guidance in fixing the penalty.

19.4 Not every contravention of the Act or Regulations may be the subject of a compliance or penalty notice. The Secretary of State may only issue a compliance notice in respect of the following (Section 31(1) and (3) of the Act):

a. failing to keep records as required by Regulation 20, or to permit examination by the Secretary of State or to provide copies or reasonable further information or explanation (see Regulation 48(1));

b. failing to comply with a reporting requirement under Part 5 or Part 6 of the Regulations (see Regulation 48(2));

c. providing a report under Part 5 of the Regulations (a contract report) that is misleading in a material respect, knowing the report is misleading or reckless as to whether it is misleading (see Regulation 48(3));

d. failing to comply with the notification duty under Section 26 (the duty to report relevant events and circumstances that may materially affect the contract and information which may be materially relevant to the contract);

e. failing to make an assessment of whether a contract is a QSC under Section 29;

f. making an incorrect negative assessment under Section 29 (i.e. that a contract is not a QSC); and

g. failing to notify a positive QSC assessment as required under Section 29.

19.5 The fact that compliance notices may only be issued on specified grounds gives rise to a question whether these are the right grounds in order to support the effective functioning of the single source regulatory framework, or whether grounds have been included that should not be, or important matters have been left out.

19.6 The SSRO's published Compliance Rating methodology measures a number of matters relating to the timeliness, completeness and accuracy of reports. One of the matters the SSRO considers is whether pricing control appears to have been correctly applied. If the SSRO discovers a deficiency in the calculation of the profit rate, or identifies costs included in the price which are not Allowable, there is no provision for a compliance notice to be issued requiring the defect to be remedied, or for a penalty notice if the defect cannot be remedied or is not remedied.

19.7 Another matter which is not directly a ground on which a compliance notice may be issued is an incorrect decision as to whether a contract is a QDC. This is most likely due to the fact that the decision about whether a contract is a QDC will be made by the Ministry of Defence, which is also responsible for issuing compliance notices. However, the question of whether contracts are being brought within the regime in the way that Parliament intended may be considered fundamental to the operation of the scheme.

Call for input 21

The SSRO invites views on whether:

- the grounds for compliance and penalty notices should be amended;
- failures to notify a QDC or to correctly apply pricing control should be grounds for compliance and penalty notices.

20. The SSRO's role in compliance

20.1 The regulatory framework gives the SSRO an oversight role, but no power to take enforcement action. The SSRO may offer guidance and support to the MOD and defence contractors. It may also report on breaches of the regulatory scheme, highlighting cases where its guidance and support has not led to effective remedial action. However, the SSRO is not empowered to enforce its views. The SSRO may only give opinions and make determinations in relation to contracts when asked to do so and it has no power to issue compliance or penalty notices.

20.2 If the single source regulatory framework is to achieve its objectives, then the right single source defence contracts need to be brought within the framework, pricing controls must be correctly applied and data robustly collected. There are reasons for giving the SSRO the power to take enforcement action, which include the following:

- the SSRO is uniquely placed by reason of its oversight role to identify where action needs to be taken to ensure compliance;
- the SSRO is independent and less subject to the sorts of pressures that may face the Ministry of Defence as the buyer (or ultimate buyer) under single source defence contracts; and
- other economic regulators have power to take enforcement action in support of the schemes they oversee.

20.3 Within the current scheme of the Act, the SSRO could be given an effective enforcement function by enabling it to initiate the giving of opinions and the making of determinations, empowering it to issue compliance and enforcement notices, or both.

Call for input 22

The SSRO invites views as to whether the SSRO should be given an effective enforcement function by:

- enabling it to initiate the giving of opinions and the making of determinations;
- empowering it to issue compliance and enforcement notices; or
- both of the above.

Transparency

21. Introduction

21.1 One of the principal ways in which the regulatory framework seeks to deliver value for money and fair and reasonable prices is by creating a window onto the prices of defence contractors and their associated delivery. It requires a number of standard reports to be submitted across single source contracts and by single source contractors and provides for a form of open book accounting to enable appropriate oversight.

21.2 The SSRO intends to engage with stakeholders again in September 2016 regarding the detailed transparency provisions of the Act and the Regulations. The SSRO has chosen to delay that engagement in order to give stakeholders as much opportunity as possible to experience the reporting process. However, in advance of that further engagement, it is proposed to raise two matters which arise from the SSRO's experience to date.

22. Reporting and analysis

22.1 The Act specifies that the Regulations must require the provision of contract-specific and supplier-specific reports to both the SSRO and the MOD. Parts 5 and 6 of the Regulations set out in detail the types of standard reports that must be submitted, when the reports must be submitted and what they must contain. As presently framed, any change in the information provided for transparency purposes will require amendment of the Regulations.

22.2 The intention is that the SSRO will be able to analyse a database of information reported by contractors to provide independent, expert insights into defence procurement. Reports and information from the SSRO may inform negotiations, the development of statutory guidance, effective enforcement and reviews of the legislation.

22.3 The SSRO has identified instances where information would be useful for analysis but is not prescribed in the Regulations for inclusion in contractor reports. At the same time, there are instances where information is prescribed that is not particularly useful for analysis. As the scheme is currently framed, the Regulations would need to be amended to change the information required to be reported. It may be preferable to have a more flexible arrangement pursuant to which the SSRO may prescribe the required information after consultation with relevant stakeholders.

Call for input 23
The SSRO invites views on whether a more flexible arrangement should be introduced for prescribing the information to be included in reports, pursuant to which the SSRO has the ability to control what is required.

23. Open book accounting

23.1 The Act requires contractors to keep sufficiently up-to-date and accurate accounting and other records. These must be made available for examination by the Secretary of State. The MOD has the ability to:

- audit reports submitted under the Act and Regulations;
- verify whether a cost is an Allowable Cost, the reason for difference between an estimated and actual Allowable Cost or any other matter relating to the price payable;
- monitor the primary contractor's performance; and
- determine whether a contract between the primary contractor and another person is a QSC.

23.2 By contrast, the SSRO is not given access to the accounting and other records that contractors are required to keep. The reason for this is unclear, particularly as access to the records would facilitate delivery of the SSRO's various oversight functions and the records must be kept in any event.

Call for input 24
The SSRO invites views on whether a more flexible arrangement should be introduced for prescribing the information to be included in reports, pursuant to which the SSRO has the ability to control what is required.

A final word…

24. Deregulation

24.1 The SSRO is concerned that the regulatory framework should achieve its aims efficiently. With this in mind, the SSRO has called for input on matters that have the potential to simplify or streamline the operation of the scheme. These include:

- removing thresholds, which would avoid the operation of separate regimes and the need for anti-avoidance provisions around contract value;
- reducing reporting requirements for low-value contracts;
- preventing sunk costs from further review as to whether they are Allowable when a contract becomes a QDC or QSC following amendment;
- clarifying exclusion definitions;
- clarifying the definition and assessment provisions in respect of QSCs;
- reducing the need for bespoke capital servicing adjustments;
- removing the step 4 SSRO funding adjustment and replacing it with something more straightforward;
- giving the SSRO access to records which are required to be kept in any event; and
- introducing a more flexible way to review the information required to be reported.

24.2 The SSRO is interested in suggestions that have the potential to increase efficiency without compromising the functioning of the regulatory framework.

Call for input 25

The SSRO invites views on reforms that may increase the efficiency of the regulatory framework.

Appendix 1 – Matters considered by the SSRO on which it is not specifically calling for input

The SSRO has conducted a detailed examination of the provisions of the Act and Regulations relevant to the following themes:

- coverage;
- pricing;
- SSRO operations; and
- rulings and enforcement.

We have taken into account the SSRO's strategic objectives, our learning from the operation of the scheme, relevant comparisons with other regulatory schemes and the recommendations in the Currie report, which led to the new regime.

The issues on which the SSRO has called for input are those considered to be of greater significance, rather than focusing on matters of detail. They have been selected from a larger list of potential items that emerged from consideration of the Act and the Regulations. A summary of matters considered by the SSRO but in respect of which it is not specifically calling for input is set out below.

Coverage

1. Whether the Secretary of State's power of exemption is sufficiently defined (Sections 14 and 28).

2. Whether the test of contract award being the result of a competitive process is sufficiently clear and whether it should be brought more closely in line with the Defence and Security Public Contracts Regulations 2011 (Regulations 9, 59 and 60).

3. Whether proposals should be developed to ensure the aggregation provisions function effectively (Regulation 5).

4. Whether the definition of contracting authority should be amended to avoid any confusion caused by argument over who is liable to pay the contract price (Regulation 57).

5. Whether amendment is required to clarify how to deal with the circumstance in which the contracting authority is not the person who conducted the award process (Regulations).

6. Whether the Act and the Regulations should be amended to deal with QSCs on a stand-alone basis.

7. Whether a greater role should be given to the contracting authority in referrals for opinions or determinations (Regulation 64).

8. Whether an amendment should be made to clarify the outcome if the SSRO does not overturn a contractor's notice (Regulation 63).

9. Whether the QDC and QSC exclusions should be subject to greater limitation (Regulations 7 and 58).

Pricing

10. Whether the pricing methods are sufficiently defined (Regulation 10).

11. Whether the choice of pricing method should be left to the MOD's discretion (Regulation 10).

12. Whether there should be further clarification of the position where a QDC or QSC is amended to place a further group sub-contract under the QDC or QSC (Regulation 12).

13. Whether greater clarification is required in the POCO adjustment steps (Regulation 12).

14. Whether there should be an increase in the cap for incentive adjustment (Regulation 11).

15. Whether greater clarity is required in the steps for re-determining price (Regulation 14).

16. Whether greater clarity is required in the provisions for annual rate setting (Section 19).

17. Whether the approach to group contracts is satisfactory (Regulation 13).

18. Whether legislative change is required to deal with situations where there is a price list (Section 20).

19. Whether the pain/gain balance in the final price adjustment is reasonable (Regulation 16).

20. Whether the modifications made in respect of QSCs are considered sufficient (Regulation 64).

SSRO operations

21. Whether the Currie recommendation for the SSRO to review MOD budgets should be implemented.

22. Whether the Currie recommendation for the SSRO to set the profit rate should be pursued.

23. Whether powers are required to enforce procedures adopted by the SSRO (Schedule 4).

24. Whether the primacy provisions are sufficiently clear (Section 43).

Referrals and enforcement

25. Whether the grounds on which the SSRO's opinion may be sought are overly restricted (Section 35).

26. Whether the matters the SSRO is required to consider in respect of determinations are appropriate (Regulations 18, 19 and 54).

27. Whether machinery provisions are required to enforce cost orders made by the SSRO (Section 35).