SSRO

Single Source
Regulations Office

Assuring value, building confidence

Annual report on the single source regime 2017

Contents

Introduction

This report presents the findings from our review of the operation of the single source procurement regime for military goods, works and services.

This report brings together our work over the past two years relating to:

1. The requirement under Section 36(2) of the Defence Reform Act 2014 for us to keep under review the extent to which persons subject to reporting requirements are complying with them.
2. The requirement under Section 39(1) of the Defence Reform Act for us to keep under review the provision of the regulatory framework established by the Act and associated Regulations.
3. Our stated intention of providing a public commentary on the ten factors we have identified as important indicators of the impact and operation of the framework.

Publication of this report supports the delivery of our statutory functions and our two statutory aims, to ensure that good value for money is obtained for the UK taxpayer in the expenditure on qualifying defence contracts (QDCs), and that single source suppliers are paid a fair and reasonable price under those contracts.

Key findings

Compliance

- Contractors have made progress since the publication of the SSRO's interim compliance statement in July 2016 with respect to the submission of contract report data. The SSRO is committed to making the reporting process as easy and as clear as possible. To date, it has done so by:
    1. improving the way data is collected via the Defence Contract Analysis and Reporting System (DefCARS);
    2. implementing an ongoing review process to ensure reporting guidance is fit for purpose;
    3. standardising an on-boarding process for new contractors every time a contract notification is received;
    4. providing a Helpdesk service for contractors; and
    5. meeting with contractors new to the regime to improve their understanding of reporting requirements.
- 78 per cent of submissions are made within the reporting timetable set out in the Regulations. Most late submissions are made within four weeks of the reporting timetable and only a small proportion were delayed beyond this. In almost all cases, delays relate to contractors that are a Small or Medium sized Enterprise (SME) or hold only one QDC or QSC. We will work to make the contract reporting process more familiar to new contractors, through onboarding and training on the DefCARS system.
- The data quality of initial submissions remains an area for contractors to focus on. We identified one or more potential issue in 87 per cent of the initial contract submissions made. However, following the resolution of initial queries raised with contractors, the percentage of submissions with potential issues reduced to 51 per cent. The inbuilt validation checks within DefCARS and our planned programme to update the reporting guidance will assist contractors in improving the quality of submissions first time round.
- Resolution has proved more difficult for some categories of queries raised, particularly around risk (both the CRA adjustment and risk included in Allowable Costs) and Allowable Costs (the make-up of labour and overhead rates). We will work with the MOD to better understand the application of pricing controls to keep the provisions of the regulatory framework with respect to the pricing of contracts under review.
- The MOD's responses to our queries have been helpful. There are some matters concerning the application of price controls that require further consideration to inform our review functions.

Change in contract milestones

- For 2015/16 contracts, where updated contract reports were available, 45 per cent of milestones had different forecast completion dates to the milestones initially reported by contractors. For 2016/17 contracts, the equivalent figure is 13 per cent. Updated contract reports are not available for the significant majority of contracts. Looking across all contract reports submitted, milestone information is often missing, incomplete or inadequately describes milestones relating to the delivery of contracted goods, works or services.

Variations in costs

- For both 2015/16 and 2016/17 contracts, where updated contract reports are available, forecast variances to costs (either an increase or a decrease in cost) are being reported in some contracts. Analysis of the variations in contract costs, particularly in relation to fixed and firm price contracts, will provide an insight into the operation of the regime. However, based on the limited information available, it is not possible to conclude on any trends from this indicator at this stage.

Change in profit rate

- In contracts that became QDCs/QSCs in 2015/16, 18 per cent have reported a forecast reduction in profit rate, while 6 per cent have reported an increase, and 15 per cent have reported no change in expected profit rate. For 2016/17 QDCs/QSCs, the proportion reporting a forecast increase in profit rate is 7 per cent, while those reporting a forecast decrease in profit is 13 per cent. However, data is not available for the significant majority of contracts, and it is not possible to draw definitive conclusions.

Financial indicators

- These indicators are a synthesis of the SSRO's published discussion document on developing its approach to calibrating profit rates. They show that all but one of the sample of contractors reviewed has an investment grade credit rating, and that share price variability is close to that of the market average.

Next steps

The SSRO has undertaken work over the two reporting years to keep under review the extent to which persons subject to reporting requirements are complying with them and the provision of the regulatory framework established by the Act and associated Regulations. There are areas, however, as detailed in the main body of this report that the SSRO will look at in more detail to consider what further work is required to discharge its duties around its review of the regulatory framework.

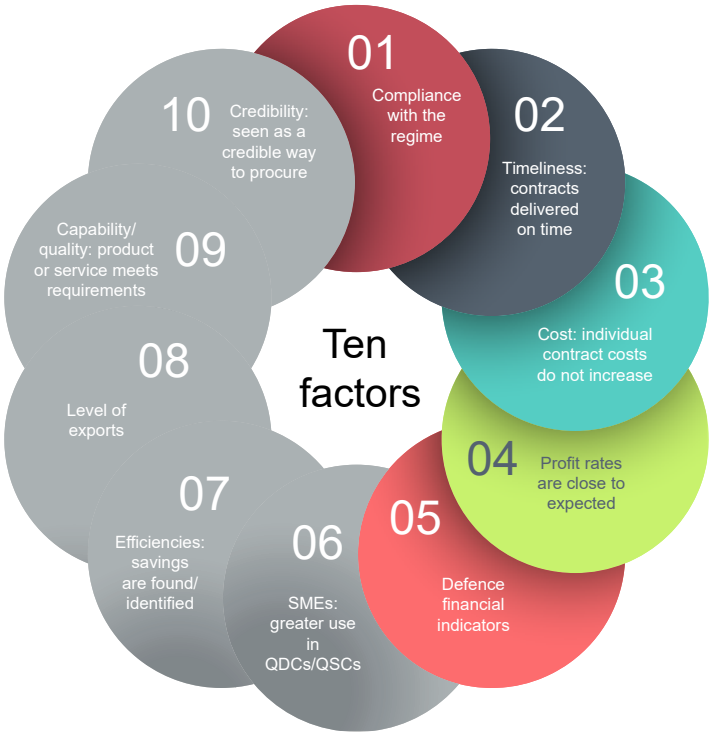
The SSRO's application of its compliance methodology will be developed further and focus more on specific themes of recurrent issues that have been identified and will contribute to improvement in the operation of the regime. As part of this the SSRO will work with both the MOD and contractors to ensure that issues identified are raised and resolved in an effective and efficient manner.

While the SSRO's actions will assist contractors to meet reporting requirements, there is work that can be undertaken by contractors and Project Teams at the MOD to better understand and meet the requirements of the legislation.

Approach

This report covers the extent to which persons subject to reporting requirements are complying with them and a commentary on the factors that measure the impact and operation of the single source procurement framework for the period 2015/16 and 2016/17.

In our July 2016 publication *Monitoring the impact and the performance of the single source regulatory framework*, we set out a series of measures that we developed having taken account of the objectives of the regulatory framework. The measures help monitor the success or otherwise of the regime, and help the SSRO to keep the Act and the Regulations under review, while informing our other statutory functions such as issuing statutory guidance.



Defence suppliers are required to submit data about QDCs and QSCs to the SSRO, along with reports on qualifying business units (QBUs). Five of the ten factors rely on this data, which is returned to the SSRO by defence suppliers, while the other five draw on data generated by the SSRO or publicly available information.

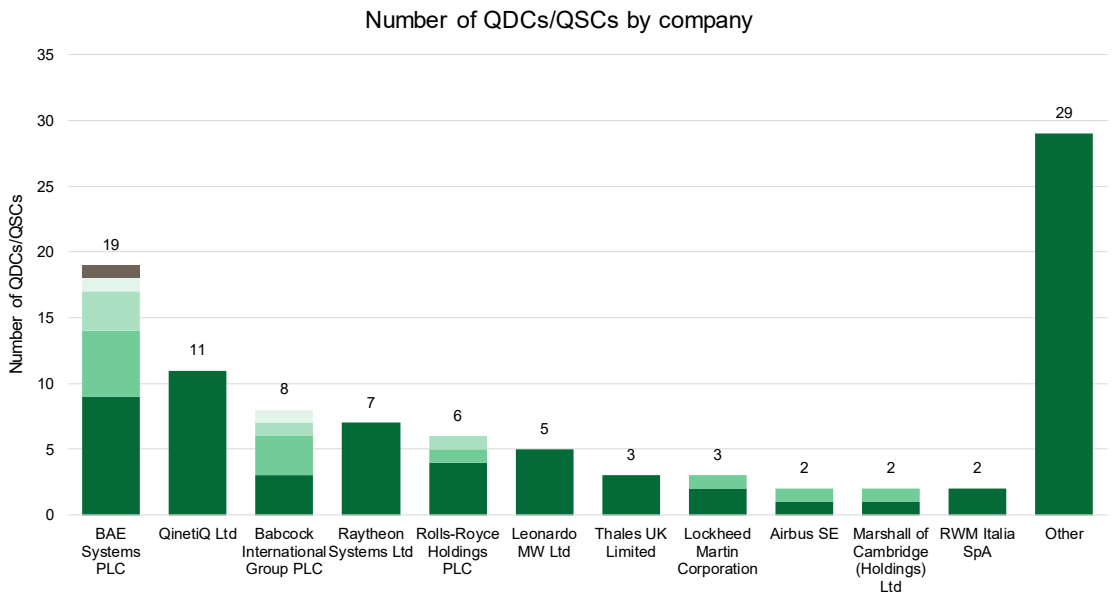
Our analysis has identified that there is insufficient data available at this time to enable comment on five of the ten indicators. The SSRO plans to undertake further work in future on the SME, efficiency, exports, capability and quality, and credibility indicators.

This report considers all QDCs and Qualifying Sub-Contracts (QSCs), for which contract reports were received by 30 April 2017, entered into between 1 April 2015 and 31 March 2017. As of 31 March 2017, the SSRO had been notified of 97 QDCs and QSCs, and as of 30 April 2017 the SSRO had received reports for 88 contracts.

The key statistics relating to these contracts have been reported on in the **SSRO's Annual qualifying defence contract statistics: 2016/17**.

Our review of the report submissions shows that the MOD places single source contracts with a limited number of defence contractors. Figure 1 sets out the pattern of the 97 QDCs placed by ultimate parent company.

Figure 1: Number of QDCs / QSCs ultimate parent company



Note: Contracting companies have been grouped into their parent companies where possible.

For the QDCs and QSCs listed the SSRO had received 347 contract reports as at 30 April 2017[1]:

- 264 Initial Contract Reports (88 sets of contract notification reports, contract reporting plans and contract pricing statements);
- 78 Quarterly Contract Reports; and
- 5 Interim Contract Reports.

In addition, we had received 87 supplier reports[2].

1 As required in line Part 5 of the Single Source Contract Regulations

2 As required in line Part 6 of the Single Source Contract Regulations

Figure 2: Contract report submissions by month

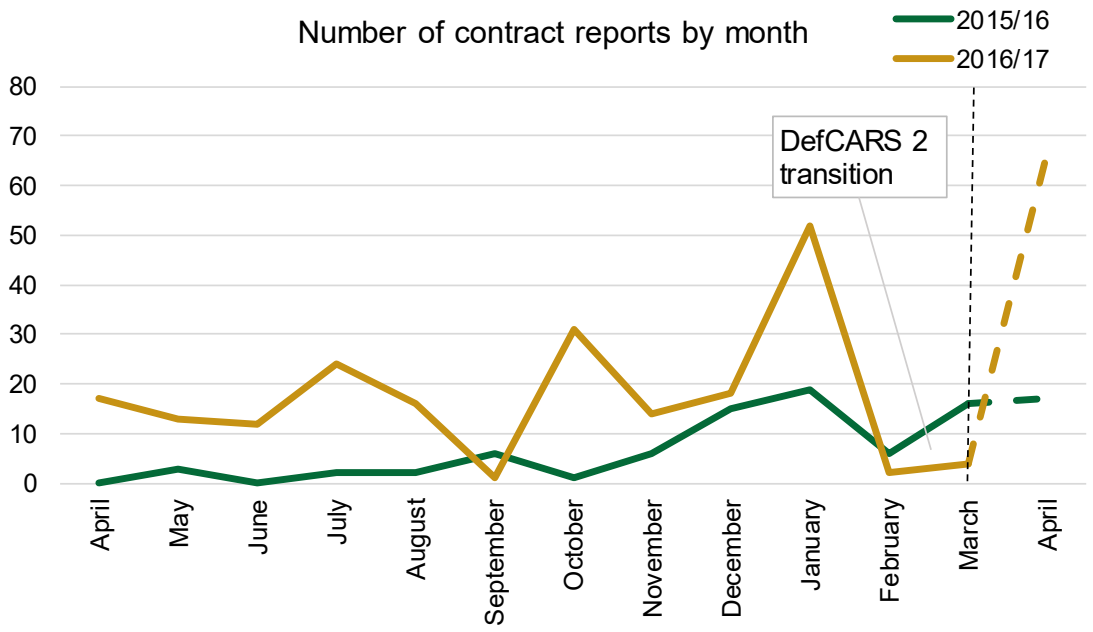


Chart displayed from April to April in order to capture the volume of reports submitted in April. The figure to the right of the dotted line represents the number of reports submitted in April of the following financial year.

The supplier report submissions are less varied over time than contract report submissions and over 90 per cent were received at the end of the government's financial year of 31 March.

Indicator 1: Compliance

The aim of this indicator is to identify whether contractors are complying with regime requirements.

The Defence Reform Act 2014 places obligations on the SSRO to keep under review the regulatory framework and the extent to which organisations subject to reporting requirements are complying with them. The submission requirements are detailed in the Regulations.

Contractor compliance against statutory reporting requirements is measured by the SSRO by using two specific indicators:

1a) "All required reports have been submitted within the relevant deadlines".

1b) "Reporting obligations have been met for all reports submitted in accordance with the Regulations and relevant statutory guidance".

1a) "all required reports have been submitted within the relevant deadlines"

For the 97 QDCs and QSCs reported as being entered into between the period 1 April 2015 and 31 March 2017, the total number of **contract reports** expected by the SSRO was 464:

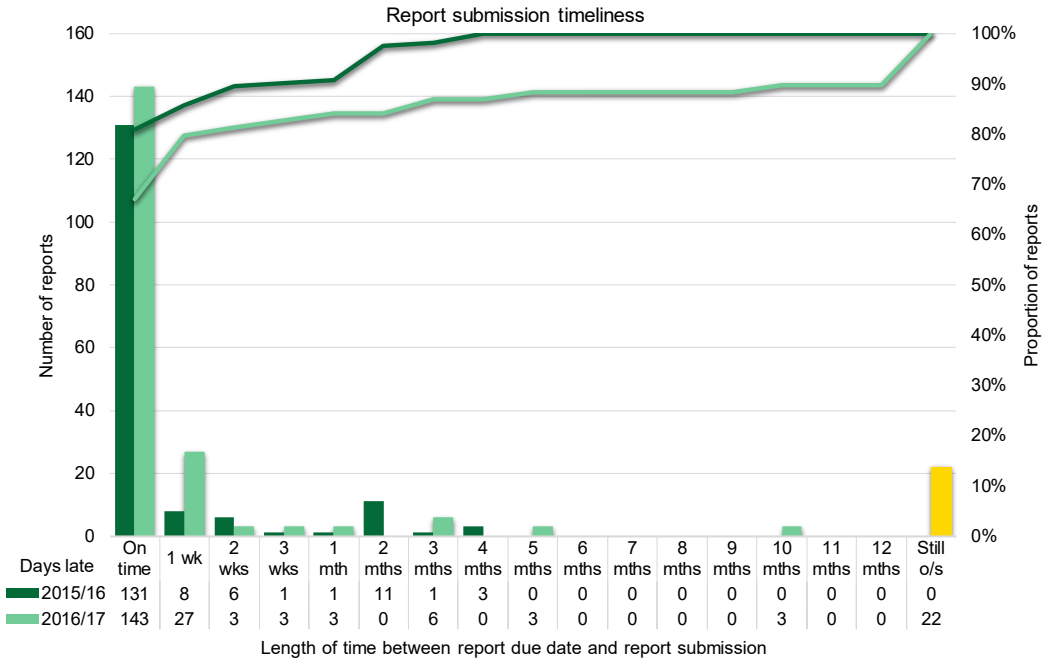
- 291 initial contract reports;
- 79 Quarterly Contract Reports;
- 5 Interim Contract Reports; and
- 89 supplier reports.

In total, 78 per cent of these reports were submitted in accordance with the reporting deadlines set out in the Regulations.

Initial contract reports were not submitted by 30 April 2017, the cut-off date for inclusion of reporting matters in this publication, for a total of nine contracts. These were all 2016/17 contracts. Two of the nine submissions were subsequently made within three weeks of the required submission date.

With respect to the submission of **supplier reports**, for the 12 Qualifying Business Units and six Ultimate Parent Undertakings reported as meeting the threshold for reporting requirements in the period 1 April 2015 and 31 March 2017, the total number of contract reports expected was 89. In total, 96 per cent of these reports were submitted in accordance with the reporting deadlines set out in the Regulations.

Figure 3: Analysis of contract report submissions



Most late submissions are made within four weeks of the reporting timeframes set out in the Regulations and only a few were delayed beyond this. In three instances, initial contract submissions have been outstanding for three months or more. We have reported these as non-compliance matters to the MOD. The Secretary of State has discretion under Sections 31 and 32 of the Defence Reform Act to issue a compliance notice or a penalty notice. The MOD has not issued a compliance or penalty notice in respect of these matters as at June 2017.

In almost all cases, contractors with contract report delays are SMEs or those with only one QDC or QSC in the regime, which is the case with the three submissions noted above. The SSRO is aware that, for these types of contractor, reporting requirements may be both unfamiliar and challenging.

1b) "reporting obligations have been met for all reports submitted in accordance with the Regulations and relevant statutory guidance".

Contract reports

The SSRO's approach to monitoring compliance with reporting obligations is to query errors that impact data quality (such as internal inconsistencies or arithmetical errors) and to raise queries on matters that appear to be erroneous (for example incomplete information) directly with contractors, upon whom the reporting obligations fall. Where the contractor fails to response, or provides an unclear or unsatisfactory response, to queries the SSRO passes these matters to the MOD.

In total, the SSRO identified one or more potential issue in 87 per cent of the initial contract submissions made. Following resolution of initial queries raised, the percentage of submissions with potential issues decreased to 51 per cent[3].

Table 1: Total number of reporting queries raised with contractors on contract submissions (June 2017)

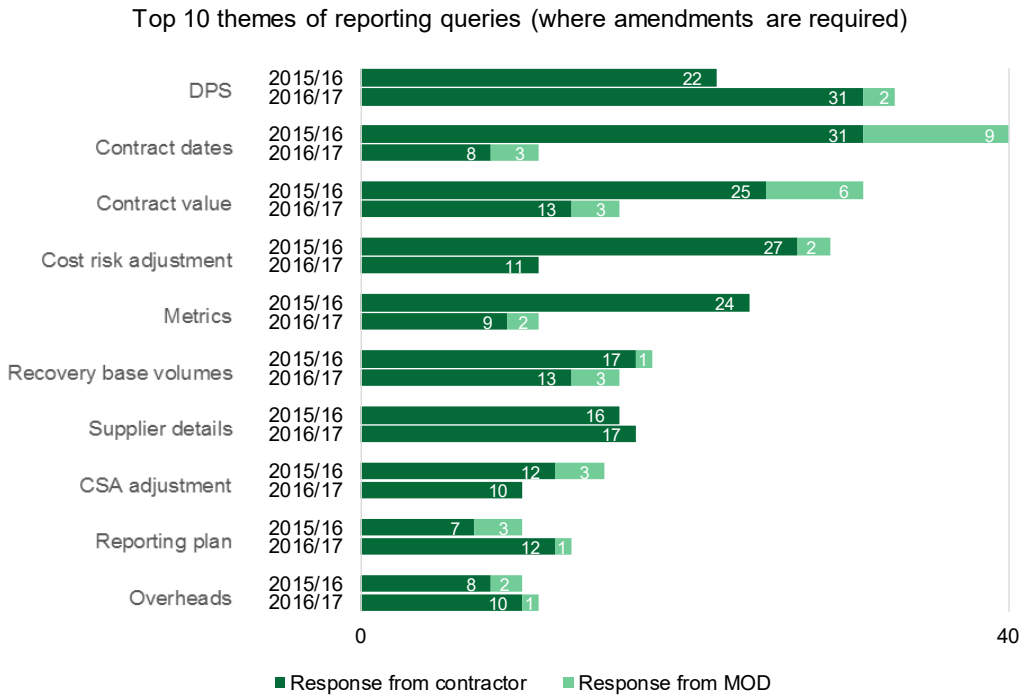
Year	Number of queries raised	Number of queries resolved	Number of queries in progress
TOTAL	**1,603**	**911**	**692**
2015/16	532	454	78
2016/17	924	411	513
Supplier reports	147	46	101

As at June 2017, the SSRO had raised a total of 1,456 reporting queries with contractors with respect to the contract report submissions made. In total, 865 (59 per cent) of the contract reporting queries have been resolved. Of these, in 514 cases (59 per cent) the query led to a resubmission of the report or submission of additional data.

Figure 4 details the top ten themes that have resulted in amendments to the contract reports submitted, or the submission of additional information to meet the reporting requirements of the Regulations, for both 2015/16 and 2016/17 QDCs and QSCs.

3 The compliance methodology followed by the SSRO allows for only a 'pass or fail' of an entire submission once made, regardless of the number of errors that may be apparent in the initial submission. In addition, if an issue arises and is applicable to each of the three initial submissions, it is counted as three individual issues raised.

Figure 4: Top ten reporting themes resulting in amendments



There remains room for improvement in the data quality of the submissions made by contractors. In cases, basic contract details are reported on an inconsistent basis. For example, initial contractor submissions have not included the required information on recovery bases; a description of the calculation for the CSA adjustment; contract metrics; and the facts, assumptions and calculations concerning overhead amounts as required by the regulations.

The completion of the Defined Pricing Structure (DPS) also remains challenging for contractors. The SSRO has published a **statistical bulletin** on the DPS, published in March 2017, which presents an analysis of the DPS structures reported in QDCs.

Reporting matters referred to the MOD

Across the two years 2015/16 and 2016/17, the SSRO raised 376 reporting queries with the MOD where initial queries raised with a contractor were not satisfactorily resolved or responded to.

Table 2: Number of reporting queries raised with the MOD on contract submissions (June 2017)

Year	Number of reporting queries raised	Number of reporting queries resolved*	Number of reporting queries in progress
TOTAL	**376**	**123**	**253**
2015/16	96	41	55
2016/17	280	82	198

*Cumulative of MOD action required and MOD response of no further action.

Figures 5 and 6 detail the status of the reporting queries raised.

Figure 5: Status of all 2015/16 reporting queries

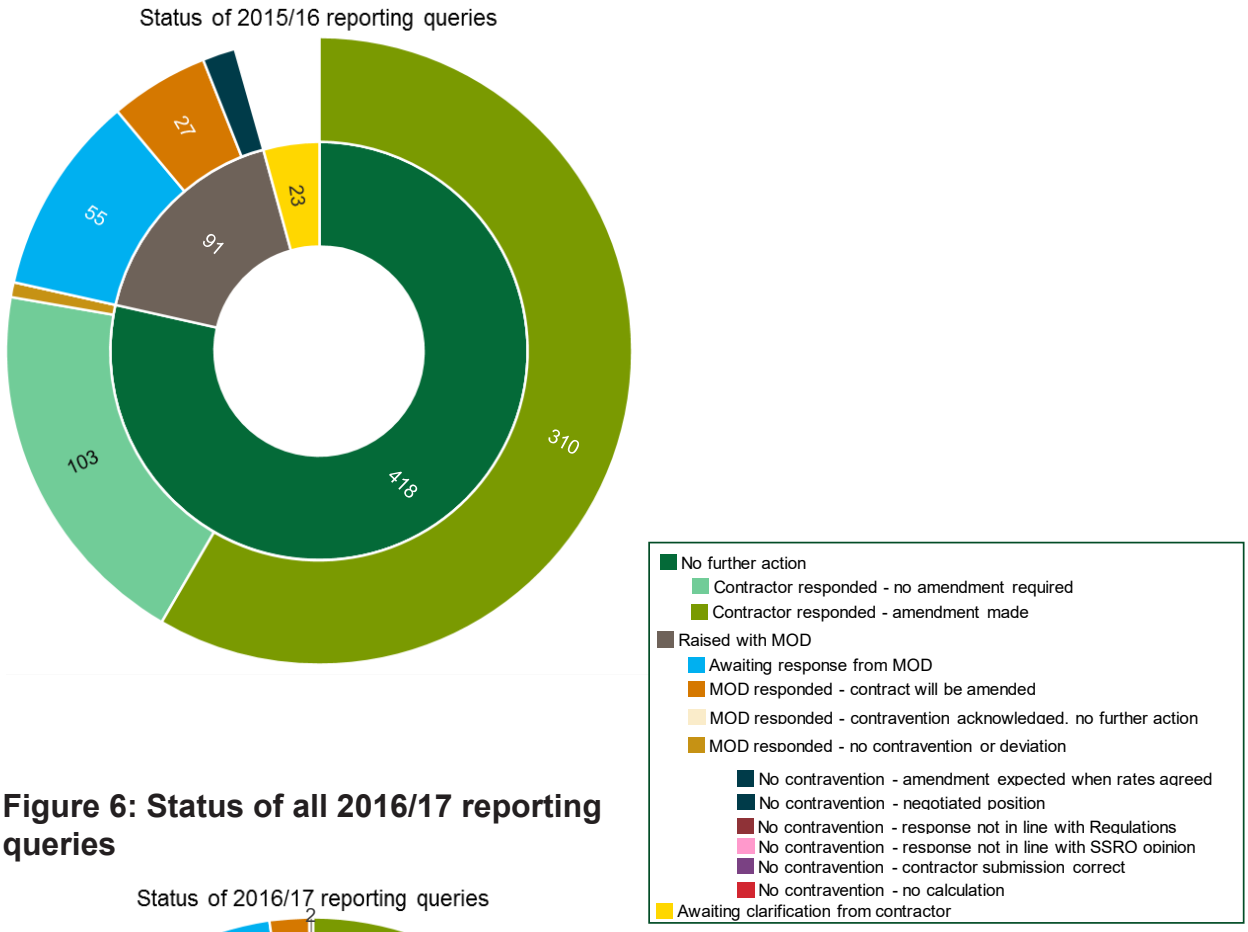
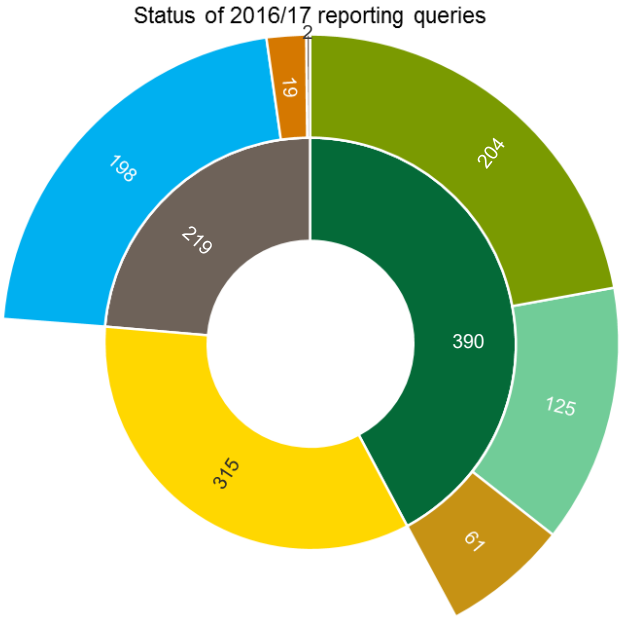


Figure 6: Status of all 2016/17 reporting queries



The MOD has confirmed that for 46 issues referred to it by the SSRO, contractors will be requested to amend their submissions. As at June 2017, however, none of these amendments had been made by contractors.

The MOD has indicated that it believes no action is required in response to 67 of the queries raised by the SSRO. In some cases, the SSRO is engaged in further dialogue with the MOD to better understand its response. Areas being explored include where an adjustment has been made to the baseline profit rate but:

- no description has been provided of the calculation to determine the contract profit rate; or
- the adjustment has been said to represent a negotiated position without further description.

These are areas that the SSRO will look at in more detail as part of keeping under review both the provision of the regulatory framework under review and the extent to which people are complying with reporting obligations.

There remains a need for improvement in the data quality of report submissions and the SSRO will continue to monitor this and report on performance. We will continue to work with stakeholders to ensure that our guidance addresses identified issues.

The SSRO is committed to making the reporting process as easy and as clear as possible. To date, it has done so by:

- improving the way data is collected via the Defence Contract Analysis and Reporting System (DefCARS);
- implementing an ongoing review process to ensure reporting guidance is fit for purpose;
- standardising an on-boarding process for contractors every time a contract notification is received;
- offering a Helpdesk service for contractors; and
- meeting with contractors new to the regime to improve their understanding of reporting requirements.

While the SSRO's actions will assist contractors to meet reporting requirements, there is still work to be undertaken by contractors and, indeed, Project Teams at the MOD to understand the requirements of the legislation.

Pricing matters

The Act requires that:

- contract prices are determined according to the formula "Contract Price = Allowable Costs + (Contract Profit Rate x Allowable Costs)" and in accordance with one of the six regulated pricing methods;
- costs are only determined to be Allowable Costs where they satisfy the test of being *Appropriate, Attributable* to the contract and *Reasonable* in the circumstances (the AAR test); and
- the contract profit rate for each contract is determined by a six-step process that starts with the baseline profit rate set annually by the Secretary of State (the six steps).

In making submissions in line with the Act and Regulations, contractors are obliged to report the *facts, assumptions, and calculations relevant to each element of the Allowable Costs and to describe the calculation* used to determine the contract profit rate, including all adjustments to the baseline profit rate. To keep the provisions of the framework under review, the SSRO seeks to understand relevant explanations in relation to Allowable Costs and adjustments to the baseline profit rate.

The SSRO may raise queries on information reported on individual contracts, but it is not the SSRO's role to audit reported costs or profit rates on a contract by contract basis. The SSRO does not provide assurance that individual contracts have been priced in accordance with statutory requirements and it remains for the MOD to ensure that the contracts it enters into comply with the legal framework. The SSRO may only positively determine a matter of price (such as whether a cost is Allowable) if such a question is referred to it under the framework.

A total of 274 pricing queries were raised by the SSRO across both years with contractors or the MOD and 63 of these were resolved without the need for any further action following further explanation from the contractor. 189 queries were, however, then referred onto the MOD.

Table 3: Total number of pricing queries raised with contractors or the MOD on contract submissions (June 2017)

Year	Number of queries raised	Number of queries resolved	Number of queries in progress
TOTAL	**274**	**141**	**133**
2015/16	110	87	23
2016/17	164	54	110

Pricing matters referred to the MOD

The SSRO raised 189 queries with the MOD on pricing matters, in line with its compliance methodology

Table 4: Number of pricing queries raised with the MOD on contract submissions (June 2017)

Year	Number of reporting queries raised	Number of reporting queries resolved*	Number of reporting queries in progress
TOTAL	**189**	**78**	**111**
2015/16	74	51	23
2016/17	115	27	88

*Cumulative of MOD action required and MOD response of no further action.

Figures 7 and 8 detail the status of the pricing queries raised.

Figure 7: Status of all 2015/16 pricing queries

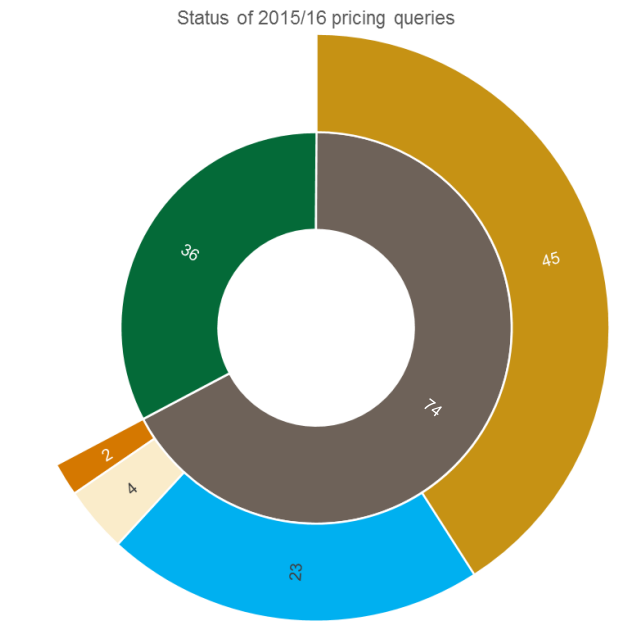
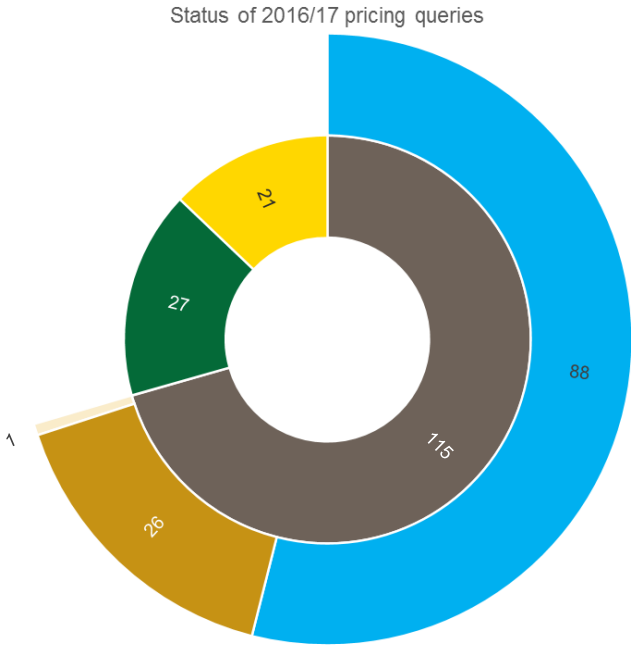
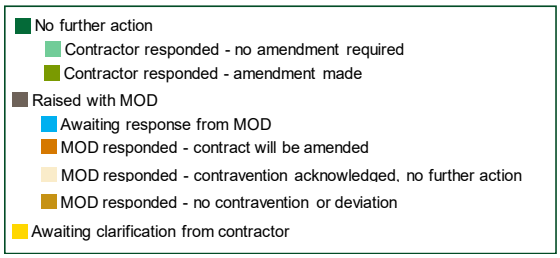


Figure 8: Status of all 2016/17 pricing queries





The MOD has provided 78 responses to the 189 pricing queries raised by the SSRO. In two cases the SSRO's queries led to contractual amendments and in five cases issues were identified with application of the POCO adjustment. The SSRO raised queries in respect of contract reports where a clear description had not been provided of the calculation to determine the contract profit rate. In some cases, the SSRO remains unclear as to how contract profit rates have been calculated after considering the MOD's responses and has sought some further explanation from the MOD. These are areas that the SSRO will look at in further detail as part of its review functions.

Indicator 2: Changes in contract milestones

The aim of this indicator is to analyse changes in known contract milestones.

Changes in contract milestones can only be identified through quarterly contract reports, interim contract reports, or contract completion reports.

Of the 34 contracts that became QDCs/QSCs in 2015/16, 12 have provided an update in the form of a quarterly contract report or interim contract report, and have therefore been included in this analysis. Across these contracts, 355 milestones were reported and 159 (45 per cent) had different forecast milestone completion dates to those initially reported by contractors. In 2016/17, 54 contracts became QDCs/QSCs, and we have received update reports for 13 of these. Across these 13 contracts, 367 milestones reported and 47 (13 per cent) had different forecast milestone completion dates to those initially reported by contractors.

Analysis of the data shows that the information submitted on delivery milestones needs to be improved and that contractors' interpretation of what milestones are relevant to report is inconsistent. In many cases the milestones reported relate to the delivery of QDC and QSC reports required under Part 5 of the Regulations rather than the delivery of contract milestones such as the completion of flight trials or the delivery of the final product as would ordinarily be expected. Looking across all contract reports submitted, milestone information is often missing, incomplete or inadequately describes milestones relating to the delivery of contracted goods, works or services and so it is not possible to draw any conclusions on the operation of the regime at this stage. The SSRO will seek to improve its reporting guidance to assist contractors with complying with the reporting requirements in this area.

Indicator 3: Variation in costs

The aim of this indicator is to identify any variation in the cost reported in the delivery of contracts against the latest agreed contract price, at an aggregate level.

Cost variation can only be identified through quarterly contract reports, interim contract reports, or contract completion reports.

Most 2015/16 QDCs/QSCs (65 per cent) have not yet provided any update reports, either because they are not required or have not yet fallen due, and so have not provided any information regarding changes in contract costs. Of the 34 contracts that became QDCs/QSCs in 2015/16, 12 have provided an update in the form of a quarterly contract report or interim contract report, and have therefore been included in this analysis. Across these 12 contracts, 58 per cent have reported forecast variances to costs (either an increase or a decrease in cost). In 2016/17, the proportion of QDCs/QSCs that have not yet provided any update increases, to 76 per cent. In this year, 54 contracts became QDCs/QSCs, and we have received update reports for 13 of these. Across these 13 contracts, the proportion of QDCs/QSCs forecasting a variance is 69 per cent.

Analysis of the variations in contract costs, particularly in relation to fixed and firm price contracts, will provide an insight into the operation of the regime. However, based on the limited information available, it is not possible to conclude on any trends from this indicator at this stage.

Indicator 4: Change in profit rate

The aim of this indicator is to identify how contract profit rates have changed, or are expected to change, from the level agreed at contract signing.

A change in profit rate can occur when there is a difference between estimated and actual Allowable Costs. The application of one or more of the six 'regulated pricing methods' to Allowable Costs determines whether and how the MOD and contractors are exposed to a change in profit rate. For example, if the contract is priced using the "firm price" method, a reduction in actual costs compared to estimated Allowable Costs results in a higher profit for the contractor but the price of the contract to the MOD does not change.

This analysis does not examine other circumstances in which profit may change during the life of a contract, including if elements of the six-steps of the profit rate are adjusted after the contract has been signed. While there is a high degree of confidence that the changes in the profit rate are due to changes in contract costs, and not changes to the six-step calculation, the format of the submissions does not make this explicit.

Figure 9 shows the proportion of QDCs that are forecast to achieve a profit rate that is above or below the agreed contract profit rate (after any anticipated final price adjustment has been applied).

In contracts that became QDCs/QSCs in 2015/16, 18 per cent have reported a forecast reduction in profit rate, while 6 per cent have reported an increase, and 15 per cent have reported no change in expected profit rate. The majority of QDCs/QSCs in 2015/16 (65 per cent) have not yet provided any update reports, either because they are not required or have not yet fallen due, and so have not provided any information regarding changes in profit rates.

In 2016/17, the proportion of QDCs/QSCs that have not yet provided any update increases to 76 per cent. The proportion of QDCs/QSCs reporting a forecast increase in profit rate is 7 per cent, while those reporting a forecast decrease in profit is 13 per cent. Those reporting no change in profit rate reduces from 12 per cent in 2015/16 to 4 per cent in 2016/17.

Figure 9: Proportion of QDCs/QSCs that have reported variance in actual/ forecast profit earned against agreed profits

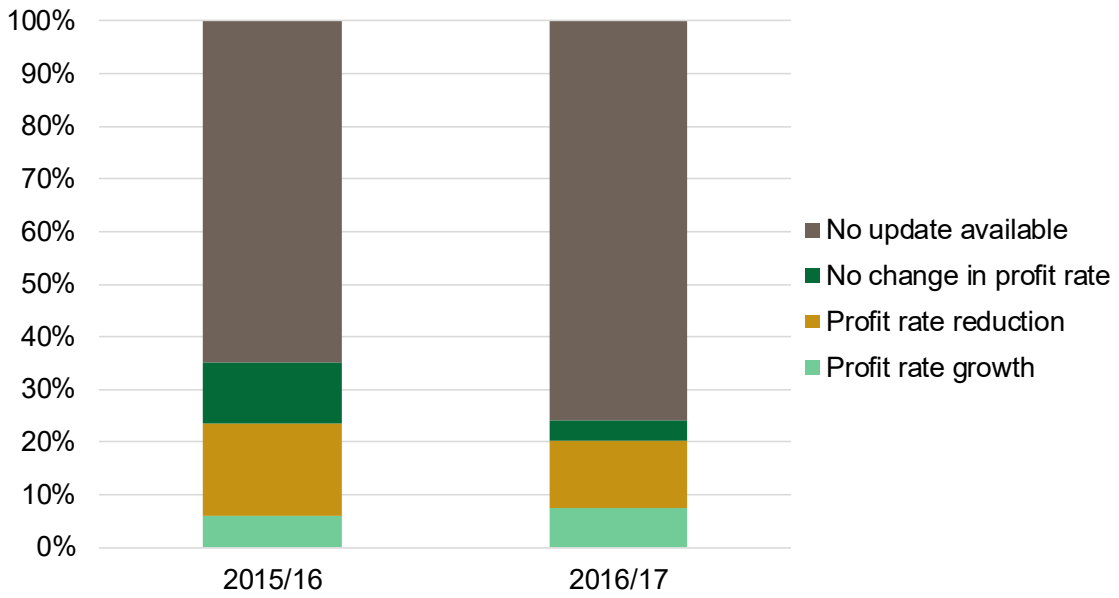
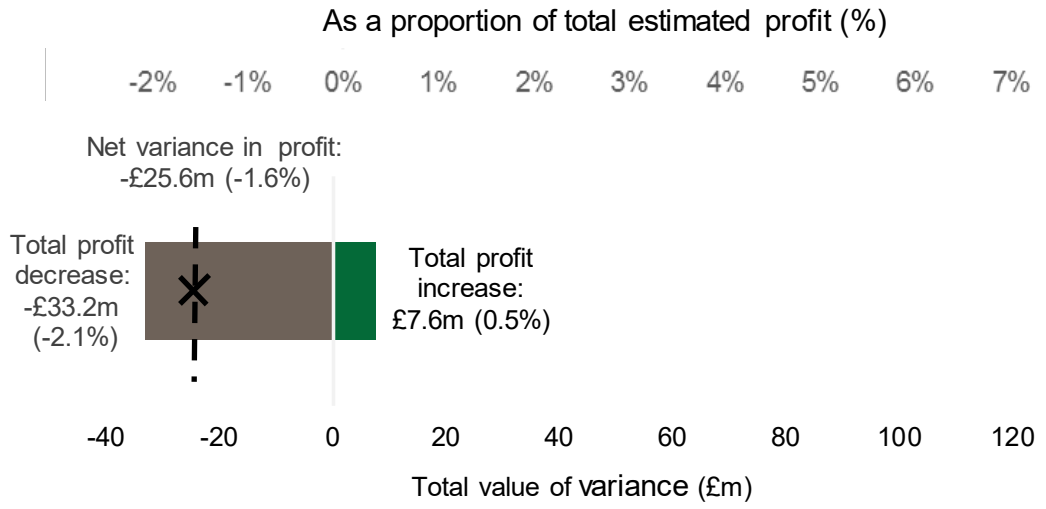


Figure 10 below shows the aggregate value of all contracts for which profits have increased, the aggregate value of all contracts for which profits have decreased, and the net position.

Figure 10: Aggregate value of all profit increase, profit decrease and net position



Based on the limited information available, it is not possible to conclude on any trends for this indicator.

Indicator 5: Financial indicators

The aim of these indicators is to illustrate the risk that capital markets associate with providing capital (through debt or equity) to defence contractors.

The SSRO has a duty to ensure that contractors are paid a fair and reasonable price, therefore contributing to the financial health of the defence sector. Public financial market indicators provide insights about the financial health of companies from the perspective of investors.

This analysis focuses on the ten holding companies that, through their subsidiaries, received the highest contract payments from the MOD in 2015/16 (referred to below as 'the suppliers'). The MOD's data show that these ten holding companies earned a combined total from all MOD contracts of £10.2 billion in 2015/16. This was over 42 per cent of the MOD's total procurement spend. Two-thirds (67 per cent, £6.8 billion) of the payments to this group of holding companies were the result of non-competitive contracts. This accounted for 78 per cent of all (£8.8 billion) non-competitive contract payments in 2015/16.

Credit ratings

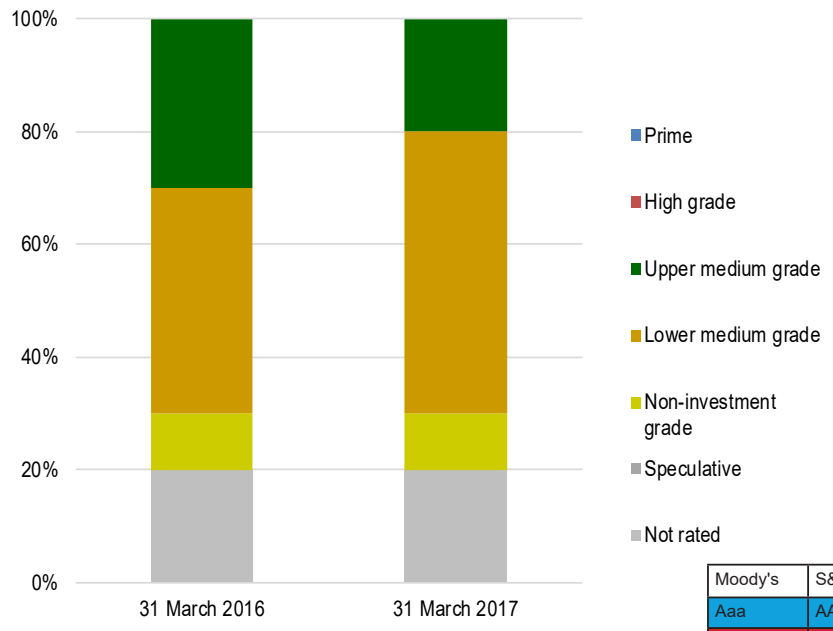
Credit ratings are opinions issued by ratings agencies on the likelihood that providers of debt capital to companies will be repaid. There are three main credit ratings agencies: Standard and Poor's (S&P), Moody's and Fitch. Each uses a similar classification system. Higher grades are intended to represent a lower probability of default.

This indicator considers the proportions of companies in the analysis group with credit ratings in pre-defined bandings. The credit ratings used are the Bloomberg composite of Moody's, S&P and Fitch (or the lower of the three where a composite is not available) taken as of the 31 March in each year.

There is no expectation or licence condition that the MOD's contractors will maintain any particular level of credit rating.

All but one of the suppliers had investment grade credit ratings in each year. In the year 1 April 2016 to 31 March 2017 one supplier's rating was upgraded and one downgraded, both within the investment grade band.

Figure 11: Credit ratings for the MOD's top ten suppliers



Moody's	S&P	Fitch	Rating description
Aaa	AAA	AAA	Prime
Aa1	AA+	AA+	High grade
Aa2	AA	AA	
Aa3	AA−	AA−	
A1	A+	A+	Upper medium grade
A2	A	A	
A3	A−	A−	
Baa1	BBB+	BBB+	Lower medium grade
Baa2	BBB	BBB	
Baa3	BBB−	BBB−	
Ba1	BB+	BB+	Non-investment grade
Other	Other	Other	Speculative
			Not rated

Equity market betas

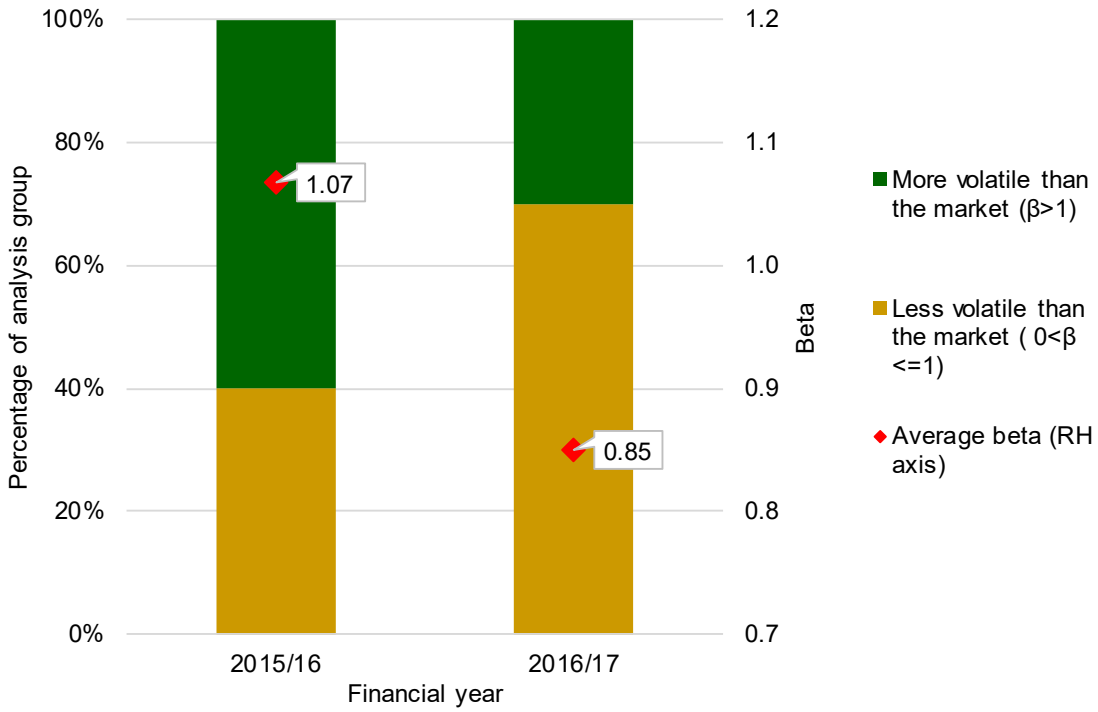
Beta is a measure of the variability of a share's price relative to the overall variability of share prices in the stock market on which it is traded. Accordingly, beta values provide an indication of the additional level of risk shareholders face that the value of their investments will fluctuate, compared with the wider share market. It is a measure of the risk of an investment that cannot be reduced by diversification. Beta risk is the only kind of risk for which investors should receive an expected return higher than the risk-free rate of interest.

- A positive beta means a stock tends to move with the market and a negative one means it moves against it.
- A beta value of one implies no difference from the variability seen in the market.
- An absolute value lower than one and above zero signals less variability than the market.
- An absolute value higher than one reflects greater variability than the market.

This indicator considers the proportion of companies in the analysis group whose shares are perceived to be more risky than (beta>1), less risky than (0<beta<1) or move against (beta < 0) the market on which they trade. Average betas were calculated based on weekly share price movements relative to the market on which the equity trades for each year to 31 March.

The proportion of companies whose shares are less volatile than the market on which they trade was higher in 2016/17 than the previous year. The average beta fell to 0.85 in 2016/17, indicating that, on aggregate, the suppliers were seen as lower risk investments than the market as a whole. This is in contrast to the previous year where the risk was seen to be marginally higher than the market (1.07).

Figure 12: Share price volatility for top MOD single source suppliers



Value	Interpretation	Risk compared to investing in the market as a whole
β < 0	Asset movement is in the opposite direction of the market	Hedge against market risk
β = 0	Asset movement is uncorrelated to the market	No risk or unknown
0 < β < 1	Asset moves in the same direction, but in a lesser amount than the market	Less risky
β = 1	Asset moves in the same direction and in the same amount as the market	As risky as investing in the market as a whole
β > 1	Asset moves in the same direction, but in a greater amount then the market	More risky than investing in the market as a whole

Source: SSRO analysis of data from Bloomberg

Interpreting beta values

Appendix 1: Data sources and Methodology

The data in this report is sourced from a number of different contract reports submitted to the SSRO by contractors. The contract data in this report is sourced from the latest of the Contract Pricing Statement, Contract Notification Report, Quarterly Contract Report or Interim Contract Report.

Adjustments to data

All data is as reported by defence contractors, except in some circumstances where there are known, and significant, data quality issues.

Contractors were previously able to submit contract and sub-contract values in currencies other than pounds sterling. Where this has occurred, values are converted into pound sterling using the exchange rates published by the Bank of England as of the first day of the month in which the contract became a QDC/QSC.

Definitions and clarifications

The 'time of agreement' is either the date in which a QDC/QSC is entered into, the date of an amendment it if is a QDC/QSC by amendment, or if the price payable is re-determined, the date of that redetermination.

The SME status of a contractor or sub-contractor uses data as submitted by the contractors themselves.

The Defence Reform Act 2014 (the Act) requires that the price payable under a QDC/QSC must be determined in accordance with the formula: price = (CPR x AC) + AC. CPR is the contract profit rate for the contract and AC is the Allowable Costs under the contract. When agreeing the contract profit rate, contractors and the MOD must follow a six-step process set out in section 17(2) of the Act and Regulation 11 of the Single Source Contract Regulations 2014 (the Regulations).

A QDC is a non-competitively procured defence contract with a value of £5 million or more. If a sub-contract of a QDC is also awarded without competition, and has a value of more than £25 million, it becomes a QSC.

Reporting on compliance issues

While a separate compliance report was initially proposed for January 2017, in updating its compliance and review methodology the SSRO considered that there were a number of benefits to amending the reporting cycle to align with the financial year rather than a calendar year. These included:

- the flexibility to report on all QDCs notified in a full financial year;
- additional time for parties to respond to SSRO queries raised;
- additional time for regime compliance to improve; and
- a better alignment with the SSRO's plans for statistical bulletins, which are based on financial years.

The SSRO is therefore publishing, in this report, work on all QDCs reported to the SSRO as being entered into in the period 1 April 2015 – 31 March 2017.

The SSRO has monitored whether contractors are meeting their reporting obligations under section 36(2) of the Act by considering if the required submissions:

- were delivered on time; and
- contained the information prescribed in the Regulations and any relevant statutory guidance issued by the SSRO.

The compliance approach included querying obvious errors (for example internal reporting inconsistencies) as well as raising any matters if completed reports seemed to be erroneous (for example reports containing incomplete or limited information). Where specific issues were raised with a contractor but not resolved satisfactorily, the SSRO informed the MOD asking that it considered its responsibilities in accordance with respect to the issue of compliance and penalty notices.

Additionally, the SSRO has reviewed the reports submitted by contractors to understand the operation of the provision of the Act and Regulations with respect to the pricing of contracts. While the SSRO has sought to understand the operation of the pricing provisions of the regulatory framework by reference to information reported on individual contracts, it has not audited reported costs or profit rates on a contract by contract basis, nor provided any assurances that individual contracts have been priced in accordance with statutory requirements.

The SSRO raised concerns with the MOD on pricing matters, particularly as to how the price control provisions of the Act and the Regulations were being applied. Concerns were raised for the following circumstances:

- the facts, assumptions and calculations relevant to an element of the Allowable Costs suggested a breach of the Act and the Regulations or deviation from the statutory guidance which was neither reported nor explained;
- the calculation made under Regulation 11 of the Regulations, including any adjustment under the six steps, to determine the contract price of a QDC appeared to be a breach of the Act, and the Regulations or a deviation from the statutory guidance but was neither reported nor explained;
- an unsatisfactory explanation was provided for a contravention of the Act or the Regulations;
- a deviation from the statutory guidance was reported by a contractor; and other information material to the pricing of the contract was reported and this appeared to suggest a failure to comply with the Act, the Regulations or deviation from the statutory guidance.