

Board members present:

Jeremy Newman (Chair)
Jane Attwood
Marta Phillips
Clive Tucker
Marcine Waterman (Chief Executive)
Neil Swift (Director of Corporate Resources)

Others present:

Malcolm Botting (Head of Governance)
David Galpin (Head of Legal)
Colin Sharples (Head of Regulatory
Policy)
Simon Mahony (Chief Analyst)
Anton Hume
Duncan Nott
Sion Jones

1. Welcome, Apologies and Announcements

- 1.1. The Chair welcomed Board members and colleagues to the 6th SSRO Board meeting.
- 1.2. There were no apologies or announcements.
- 1.3. Jane Attwood declared that she held four ordinary shares in BAE Systems at 2.5p each. She was seeking to divest the shares, but the process for selling a small shareholding of this nature was not straightforward. A copy of her letter to an intermediary seeking the immediate sale of the shareholding would be retained on file at the SSRO.
- 1.4. There were no other declarations of interest.

<p>The declared shareholding was noted, but was not considered sufficient to constitute a potential conflict of interest.</p>
--

2. Minutes of Board meetings

- 2.1. The minutes of the 2 October 2015 Board meeting were approved as a correct record.

3. Chief Executive's Report

- 3.1. The Chief Executive presented her regular report to the Board, which focused on significant issues that were not covered by papers elsewhere on the agenda.
- 3.2. The Minister for Defence Procurement, Philip Dunne MP, had visited the SSRO's offices on 27 October. This had been welcomed and well received by the Board and staff at the SSRO. The Chairman and Chief Executive had met several times with senior Ministry of Defence officials, and would be meeting with the Permanent Under Secretary on 17 December 2015.

- 3.3. As part of the SSRO's continued programme of stakeholder engagement, the Chair and Chief Executive had also met with or visited the facilities of several contractors, including recently with BAES, Rolls Royce, Lockheed Martin and MBDA. Such meetings were a useful opportunity to meet industry to discuss our work and the key challenges for the SSRO to consider.
- 3.4. The SSRO had postponed the recruitment process for two additional non-executive Board members, and the Chair was due to meet representatives from the Cabinet Office in the week following the Board meeting to discuss the commencement of a new recruitment process.
- 3.5. The SSRO had launched a consultation on its proposed programme of value for money studies on 30 October 2015. These studies would focus on specific issues that might be impacting on the achievement of value for money in single source contracts, and would use a range of evidence to generate comparative management information and defence benchmarks and parametrics. Several responses had been received that were largely supportive of the programme and had made additional suggestions for topics. The Board delegated approval of the final programme of VFM studies, following the consultation, to the Chairman and Chief Executive.
- 3.6. The Board welcomed the confirmation from BIS that the SSRO was to become a 'prescribed person' under the Public Interest Disclosure Act, so that whistleblowers in the MOD and industry who make disclosures to the SSRO would be protected.

The Board:

- a) **approved the delegation of approval of the final programme of VFM studies to the Chairman and Chief Executive; and**
- b) **noted the information provided in the other sections of the report, including meetings with stakeholders, the SSRO's publications and speeches, and the recruitment of non-executive members.**

4. Baseline profit rate – substantial methodology

- 4.1. The Chief Analyst, Simon Mahony, introduced a paper on the methodology for the SSRO's calculation of the baseline profit rate. Section 19 of the Defence Reform Act 2014 stated that, for each financial year, the SSRO must provide the Secretary of State with its assessment of the appropriate baseline profit rate and capital servicing rates. The SSRO Board had agreed at its meeting on 14 January 2015 to conduct a full review of the principles and methodology used to calculate an appropriate rate or rates.
- 4.2. The SSRO had consulted on its proposed methodology for an eight week period, closing on 20 November 2015. The SSRO had not received the government's response at the time of the Board meeting (9 December).

- 4.3. Two thirds of respondents were supportive of moving from a single baseline profit rate to multiple rates, although many respondents did not agree with the six rates or activity types proposed by the SSRO. While some had suggested additional baseline profit rates, others expressed concerns about how to apply the multiple rates to contracts, in particular whether the proposed categories might make implementation too complicated.
- 4.4. The consultation had resulted in many helpful responses and the Board was persuaded by many of the arguments put forward. In discussion, the Board agreed that the SSRO would recommend multiple rates for 2016/17, but also set a clear direction towards more granularity in future. The multiple rates would include activity types for:
- a) 'develop and make', covering all the early aspects of the MOD's CADMID cycle up to manufacture, and additionally any disposal work;
 - b) 'provide and maintain', covering any work undertaken that either provides the MOD with a capability where the contractor owns the assets, or where the contract covers work on in-service equipment;
 - c) 'ancillary services', for which a separate profit rate would apply; and
 - d) a zero rate, applying to public sector bodies.
- 4.5. All respondents to the consultation had been opposed to the proposed approach to capital servicing, which used the new baseline profit rates to reflect capital servicing and therefore set the capital servicing rates to zero. Following discussion, the Board agreed that the SSRO would adjust the baseline profit rate to remove capital servicing. This would then be added back to the contract profit rate at step 6, as that step requires an adjustment to the contract profit rate to ensure the contractor gets an appropriate and reasonable return on capital, having regard to the capital servicing rates published by the Secretary of State. It would look to review this position in future.
- 4.6. The Board agreed to set three capital servicing rates, based on interest and corporate bond rates. In the main, this mirrored the approach carried out in the past, although the Board agreed that it wished to review the interest and corporate bond rates to ensure appropriate ones were used. A particular concern was whether BBB- corporate bonds were the right comparator.
- 4.7. The Board agreed that the SSRO should publish the comparable companies used within each activity type reference group. It was agreed the methodology document should also set out the search criteria used.
- 4.8. The Board would further consider the methodology and the consultation response at its extraordinary meeting for this purpose on 8 January 2016. The methodology would therefore not be published, as originally envisaged on 18 December 2015. The SSRO would issue a statement to that effect following the meeting.

The Board:

- a) **considered the summarised responses to the consultation;**
- b) **considered what changes were needed to the proposed methodology following the consultation and analyses;**
- c) **considered the right level of transparency;**
- d) **considered the results of the search strategy; and**
- e) **considered the draft methodology document and draft SSRO response to the consultation.**

5. Baseline profit rate - guidance

- 5.1. The Chief Analyst presented a paper on the baseline profit rate guidance. The existing guidance should be updated to reflect the proposed recommendation to the Secretary of State of multiple baseline profit rates, rather than a single rate. New guidance was required for 'step 1' in calculating the contract profit rate. Changes were also proposed to 'step 2' (the cost risk adjustment), to bring a sharper focus on the level of risk of actual Allowable Costs differing from estimated Allowable Costs. Other changes proposed would generally clarify or make minor corrections.
- 5.2. The consultation on the revised guidance would be commenced once the Board had considered the guidance at its meeting on 8 January 2016. The Board would be asked to consider the responses to the consultation at its meeting on 16 March 2016, to allow publication of the updated guidance ahead of 1 April 2016, when the proposed new baseline profit rate or rates announced by the Secretary of State would apply.

The Board:

- a) **considered the proposed changes to the SSRO's current guidance on the process for determining the contract profit rate;**
- b) **agreed that the SSRO should consult on the changes; and**
- c) **considered the draft consultation document.**

6. Compliance Report

- 6.1. Colin Sharples, Head of Regulatory Policy, introduced a presentation on the SSRO's annual Compliance Report. The Board had previously agreed only to publish a full Compliance Report, including individual compliance ratings, should the SSRO receive a "sufficient and representative" volume of QDCs. As the number of QDCs signed and reported on to date was insufficient, the Board agreed that the report would be narrative based, commenting on trends the SSRO had observed in the QDCs reported on to date, rather than a report published in the full format. A full report on the QDCs within the reporting period would be included in the data for the following year's report.
- 6.2. In discussion, the Board agreed that the report would cover themes including the interpretation of the SSRO's guidance; Allowable Costs; the assessment of risk and its impact on contract profit; QSCs and the supply chain; and contracting methods. It would include a case study on lessons learnt from the first QDC, a summary of the SSRO's first Opinion, and the savings identified in the SSRO's first year. The report would also include a section referencing the SDSR, stating that it contained many initiatives that could result in single source procurement of equipment and services in the coming years.

The Board:

- a) **agreed that the number of QDCs signed and reported on to date is not sufficient to warrant naming or ranking contractor or MOD compliance in the Compliance Report;**
- b) **agreed that the Compliance Report should instead be a narrative report;**
- c) **approved the report's direction and content; and**
- d) **agreed that the Chairman and Chief Executive should sign-off the final version, before publication on the SSRO's website in January 2016.**

7. SSRO organisational structure

- 7.1. The Chief Executive introduced a report on the SSRO's organisational structure. Following the resignation of the Director of Regulation, the report proposed to restructure the Regulation Directorate into three separate teams.
- 7.2. The proposed structure would be similar to the Executive Committee structure that the Board had agreed at its first meeting, incorporating three Directors: the Director of Corporate Resources (already in post); a Director of Analysis and Reporting (to be recruited); and a Director of Investigations and Compliance (to be recruited). In addition, the policy and guidance team currently managed by the Head of Regulatory Policy would report directly to the Chief Executive. The teams currently within the Regulation Directorate required strong management and leadership and the proposed new structure would provide this, as well as clarity on roles and functions in the medium to long term.

- 7.3. The appointment of an additional post would have budget implications, but this was factored into the budget requirements paper elsewhere on the agenda.

The Board:

- a) **approved the restructure of the Regulation Directorate; and**
- b) **approved the immediate recruitment of 2.0 FTE Director posts, with the SSRO then having 3.0 FTE Directors in total.**

8. 2015/16 forecast update

- 8.1. The Director of Corporate Resources, Neil Swift, introduced the paper on the budget 2014/15 update. The SSRO had agreed with the Ministry of Defence and published in its Corporate Plan a 2015/16 budget of £4,707,000. This covered expenditure for revenue and capital items. The SSRO had also brought forward Grant in Aid of £240,000 from 2014/15, which related mainly to one-off IT project costs. These costs were not included in the original 2015/16 budget, but were expected to be incurred in the early part of the 2015/16 financial year.
- 8.2. The SSRO's incurred costs at the end of October were broadly in line with budget expectations. The forecast review for the remainder of the financial year stated that, should it continue to incur costs as planned, the SSRO was in line with its 2015/16 original budget and the planned utilisation of the remaining 2014/15 Grant in Aid. Together these provided total funding of £4,947,000 against a forecast spend of £4,854,000, which would result in a net underspend of £90,000.
- 8.3. The Board discussed the detail of the budget, including staff, accommodation, IT and other costs, and risks relating to slippage of projects underway.

The Board:

- a) **noted the 2015/16 SSRO latest corporate forecast outturn; and**
- b) **noted the impact that delays in recruitment, IT projects and other areas may have on the 2015/16 final outturn.**

9. 2016/17 budget proposal

- 9.1. The Director of Corporate Resources presented the 2016/17 budget proposal. The report sought approval for the SSRO's indicative corporate budget for 2016/17, for which the SSRO would request Grant In Aid funding from the Ministry of Defence. The budgeted expenditure covered recurrent operating costs with provision for some one-off costs relating to ongoing IT developments and the implementation of the final Defence Contracts Analysis and Reporting System (DefCARS).

- 9.2. The report projected a funding requirement of £5.5 million, which reflected an accurate understanding of the SSRO's budget requirements going forward, following consideration of the risks and uncertainties inherent in the forecast expenditure levels.
- 9.3. Staffing costs formed the majority of the SSRO's resource requirements. Accommodation costs were largely fixed and not subject to significant change. Recurrent IT and associated costs had risen marginally as expectations and requirements to meet information security standards had been clarified. Professional and expert support had been reviewed in light of the SSRO's movement towards building greater internal capacity and resilience, as reflected in staffing costs.
- 9.4. Following a discussion of the assumptions, issues and risks set out in the paper, the Board agreed to an indicative corporate budget of £5.548 million. The Chief Executive would write to the Ministry of Defence confirming the Board's decision.

The Board:

- a) **approved the proposed 2016/17 SSRO corporate budget.**

10. Corporate Performance Report

- 10.1. The Director of Corporate Resources introduced the regular update on how the organisation was delivering against its corporate priorities. The report set out all relevant matters relating to the SSRO's performance, including progress against key performance indicators, budgetary updates and the delivery of corporate priorities with associated objectives and tasks.
- 10.2. The Board discussed the successful recruitment of permanent staff to advertised posts. The interviews and associated appointments process had been completed by the end of November 2015.

The Board:

- a) **noted progress to date.**

11. Annual review of Corporate Governance Framework and Code of Conduct for Board Members

- 11.1. The Director of Corporate Resources presented the SSRO's review of its Corporate Governance Framework, which was required annually. The Corporate Governance Framework set out the organisation's arrangements and processes for governance, which it used to ensure it was governed to a high standard. The Corporate Governance Framework and the Code of Conduct for Board Members had been reviewed, drawing on the lessons learned by the SSRO in its first year of operation, and by reference to external sources and best practice.
- 11.2. Changes proposed to the Corporate Governance Framework included two additional responsibilities being inserted to the Board's roles and responsibilities; the insertion of additional accountabilities for the Chief Executive to reflect the oversight of compliance with the Freedom of Information Act and Environmental Information Regulations; and confirmation that the formal annual review of the Board's effectiveness would contain independent input at least once every three years.
- 11.3. The Board approved the changes to the documents, subject to drafting amendments.

The Board:

- a) **approved the proposed changes to the Corporate Governance Framework; and**
- b) **approved the updated Code of Conduct for Board members.**

12. Annual formal review of Board effectiveness

- 12.1. The Chairman introduced the annual formal review of Board effectiveness. This was the first annual review of the SSRO Board's effectiveness, following the establishment of the SSRO in July 2014. The review was led by the SSRO Chair, who held individual discussions with each executive and non-executive member of the Board. The report also considered the conclusions and recommendations in the Audit Committee's report to the Board on the Committee's own effectiveness, as well as the provisions within the Corporate Governance Framework, Framework Document, and HM Treasury's *Corporate governance in central government departments: code of conduct 2011*, which set out the principles and provisions of an effective Board.
- 12.2. The recommendations within the report had been drawn from the SSRO Chair's discussions with Board members. The report found that that the SSRO Board was operating effectively and independently. All executive and non-executive members of the Board agreed that the Board was operating well; that it was "effective and efficient"; and that discussions were open, appropriate and relevant, focusing on the right issues. There was also agreement that papers were well prepared and helped ensure effective meetings.

12.3. The Board welcomed the report and discussed the individual recommendations, all of which were accepted.

The Board:

- a) **approved the annual formal review of Board effectiveness.**

13. Minutes and updates from sub-committees

13.1. Marta Philips provided an update on the Audit Committee meeting on 18 November 2015. Substantive issues included the assessment of the Audit Committee's effectiveness, the consideration of the timetable for the Annual Report and Accounts 2015/16 and the regular review of the corporate risk register. The Audit Committee was content with the SSRO's continuing low risk appetite, and the Board was in agreement with the Committee's assessment.

13.2. Clive Tucker introduced the minutes of the Referrals Committee on 19 November 2015. The Committee had considered the lessons learnt from the SSRO's first issuing of an Opinion, and had approved the summary for publication.

13.3. Jane Attwood provided an update on the Regulatory Review Committee meeting on 2 December 2015. The Committee had considered progress on several work programmes, including the DefCARS project.

14. Any other business

14.1. The Chairman informed the Board of recent developments with regard to independent referral panel members, and signalled that the Board may need to consider further recruitment in the New Year.

15. Date of the next meeting

15.1. An extraordinary meeting of the Board would take place on 8 January 2016 in Finlaison House. The next full meeting would be on 25 January 2016.