
**Single Source Regulations Office
Minutes of the 12th Board Meeting
Board Room, Finlaison House,
15-17 Furnival Street, London EC4A 1AB**

**Thursday 8th December 2016
1:30pm to 5:00pm**

Board members present:

Jane Attwood
David Johnston
Marta Phillips
Marcine Waterman (Chief Executive)
Neil Swift (Director of Corporate Resources)
Ian McPherson (Director of Compliance and Investigations)
Matthew Rees (Director of Analysis and Reporting)

Others present:

Malcolm Botting (Head of Governance)
David Galpin (Head of Legal)
Ben Johnson (Senior Analyst) (item 4)
Simon Mahony (Chief Analyst) (item 4)
Anton Hume (BDO) (item 4)
Duncan Nott (BDO) (item 4)
Andrew Stewart (BDO) (item 4)

1. Welcome, apologies, announcements and declarations of interest

- 1.1. The Chief Executive informed Board members that she had written to the MOD setting out the legal advice provided to the SSRO, to the effect that a Board meeting could be held without a Chair appointed by the Secretary of State. The SSRO's Head of Legal informed the Board of his advice and issues to consider. The Board agreed that the meeting should go ahead, and that the advice and decision should be set out in the Governance Statement of the Annual Report and Accounts 2016/17.
- 1.2. The Board appointed a Chair for the meeting. The SSRO's Corporate Governance Framework stated at Standing Order 3.13 that "In the absence of the Chair, a member chosen by the members present, or by a majority of them, will preside." All Board members agreed that Marta Philips would chair the meeting.
- 1.3. The Chair of the meeting welcomed members to the 12th meeting of the Board.
- 1.4. The Chair of the meeting announced that Clive Tucker had resigned as Interim Chair and non-executive Board member in October 2016. No additional non-executive Board members had yet been appointed.
- 1.5. The Board was concerned about the length of time it had taken to appoint a Chair, and agreed that one of the non-executive members should be designated as a senior member, to provide advice and oversight to the executive, until a Chair was in post. The senior member would be the focal point for interaction between the non-executive members and Chief Executive. It would be a limited role, dealing with operational issues, and the senior member would report back on issues to the next meeting of the Board. The Board asked Marta Phillips to fulfil this role.

- 1.6. In the absence of the Chair, the Board authorised a person to appoint persons to the Referrals Committee, as provided for at Paragraph 10(4) of Schedule 4 of the Defence Reform Act. The Board appointed Marta Phillips to fulfil this role.
- 1.7. Marta Phillips subsequently appointed David Johnston as a member of the Referrals Committee. **Action:** Marta Phillips would write to David Johnston confirming his formal appointment to the Referrals Committee.
- 1.8. No apologies had been received.

There were no declarations of interest.
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2. Minutes of 11th meeting of the Board

- 2.1. The minutes of the 11th meeting of the Board were approved as a correct record.

3. Chief Executive's report

- 3.1. Marcine Waterman, Chief Executive, presented her report to the Board, which provided an update on items not included elsewhere on the agenda.
- 3.2. The Chief Executive's Report included a full description of the SSRO's stakeholder engagement since the last meeting. The report included details about meetings with the MOD and ADS, site visits, meetings with industry and international contacts, along with other external stakeholders. The report highlighted the main discussion areas, giving Board Members an insight into what each meeting entailed. The Board would be asked to approve an updated stakeholder engagement strategy at its June 2017 meeting. In the context of broader stakeholder engagement, David Johnston reported that he had been invited by the MOD to meet for an 'exchange of views'. The meeting chair encouraged Board members to be similarly transparent in sharing information about such meetings.
- 3.3. The Chief Executive thanked non-executive members for attending the SSRO's appearance before the Defence Committee on 6 December 2016. The appearance had been an opportunity to put on record several points of strategic importance for the SSRO. The SSRO had agreed to write to the Committee on two points, and would do so in the coming fortnight. Members of the Board commented that the appearance was well prepared, articulate and gave strong answers to the questions asked. It had also appeared well received by the Committee, and the Board recorded its thanks to the Chief Executive and Director of Analysis and Reporting for providing evidence.
- 3.4. The SSRO had been informed by the MOD that there had been an appointable candidate for the permanent Chair position during the recent recruitment. The MOD had also acted to fill two non-executive vacancies, with appointable candidates having been put to the Minister but subject to comment from the incoming Chairman.

- 3.5. The Chief Executive reported that the NAO was commencing a study on “Securing VFM from non-competitive procurement in defence”. The Board provided views on the issues covered.
- 3.6. The Board discussed the recommendations from the Committee on Standards in Public Life’s report *Striking a balance*, and requested that they be reflected in the SSRO’s Corporate Plan for 2017-2020.

The Board:

- a) considered the scope of the NAO’s proposed study on “Securing VFM from non-competitive procurement in defence”;**
- b) approved the membership of the SSRO Board’s sub-committees;**
- c) agreed to postpone the planned communications survey until a Chair is in place; and**
- d) noted the information provided in other sections of the report.**

4. Baseline profit rate 2017/18

- 4.1. Matthew Rees, Director of Analysis and Reporting, introduced the report on the assessment of the appropriate baseline profit rate (BPR), SSRO funding adjustment and capital servicing rates (CSR).
- 4.2. Matthew Rees gave a presentation setting out a detailed analysis to allow the Board to consider the provisional rates. The presentation covered the SSRO’s review of the methodology; steps taken to increase transparency; and how the SSRO was working to facilitate replicability.
- 4.3. Regarding the review of the methodology, the SSRO had run each comparator search in full for 2017/18. The SSRO had also undertaken a review of the company search criteria, including NACE codes used, and recommended some minor changes to these. The SSRO had additionally reviewed the impact of different geographic areas in the new sets, which did not indicate any concerns. The set of companies proposed to be used was presented, alongside information on those companies joining and leaving the sets, and information on the geographic breakdown.
- 4.4. Full information on the provisional rates resulting from the calculation were presented to the Board. The supporting information also included different types of average, and different turnover thresholds, rates by geography, and rates for companies that were MOD suppliers and ‘defence companies’, and the composite rate.
- 4.5. In order to facilitate replicability, the SSRO was also capturing a full audit trail of its decisions on the profit rates and the methodology. The proposal was that for 2017/18 the SSRO should adopt a third party index for the fixed capital servicing rate (CSR), to facilitate replicability and ensure it aligned the approach to the

three CSRs. The SSRO would write in December to the MOD's prime contractors to explain how the numbers could be reconciled to their accounts, in order to facilitate replicability.

- 4.6. Work was also being undertaken to consider approaches to examining defence industry health, as a means of calibrating the profit rates for single source contracts. This work related to the SSRO's second statutory aim of ensuring a fair and reasonable return to industry. The work had been included in the SSRO's published ten factors for measuring the impact and performance of the single source regulatory framework.
- 4.7. The Board was provided with a preliminary external quality assurance assessment by BDO of whether the principles of the comparables analysis were transparent, the process was consistent and that the delivery was robust.
- 4.8. The first step of the review was to consider whether the analysis undertaken aligned with the intended purpose for which it was developed. BDO reported that transfer pricing was an appropriate method to assess levels of profitability, and that targeting a broad pool of comparables was the most effective way to minimise volatility and avoid the circularity of looking only at major defence businesses. Overall their view was that the rationale was good and the framework was appropriate.
- 4.9. The second step was to consider whether the analysis has been conducted accurately. Regarding delivery, BDO had considered the various process steps for identifying a comparable set and found that a good clear process was in place for doing so. A sample of companies from each study had been reviewed against the documented search and manual review process, and it was found to be consistent with this.
- 4.10. The third consideration was whether the analysis could be replicated using the published SSRO methodology. It was reported that the approach was clear, and it was straightforward to replicate the same results.
- 4.11. The Board was informed that the conclusion of the preliminary review by BDO was that the approach taken by the SSRO was reasonable and well documented; detailed consideration had been given to key risk areas and the challenges of consistency and subjectivity; and that questions had been raised as work progressed and comments had been incorporated. BDO would present its final review to the January 2017 Board meeting.
- 4.12. The Board reviewed the preliminary recommendation on profit rates, including the SSRO funding adjustment, and considered several aspects relating to it.
- 4.13. The Board had resolved at its 26 September 2016 meeting that recommending multiple profit rates was the right approach and that work to calculate the multiple profit rates should commence. In the absence of statutory guidance from the MOD, the Board's position on multiple rates remained the same.

4.14. The provisional rates would be subject to further quality assurance before the final recommendation was considered at the January 2017 Board meeting. The January Board meeting would consider the final recommended rates for publication, alongside the final methodology and guidance, also for publication. The Board thanked the team for its work in reaching this position.

The Board:

- a) noted how the approach reflected comments from stakeholders and the request from the Secretary of State to ‘further to develop’ the methodology;**
- b) noted the methodology on company search criteria (including activity descriptors and the NACE codes) and the selected companies;**
- c) agreed to the approach to transparency;**
- d) agreed to the approach to facilitate replicability including the introduction of a Bloomberg published bond index for calculating the fixed capital servicing rates proposed;**
- e) considered the Preliminary Recommendation on profit rates (to be presented at the meeting) and requested the Final Recommendations for the January 2017 Board meeting;**
- f) considered the assessment provided by BDO (presented at the meeting);**
- g) noted that risks around multiple rates remain, in particular that the MOD may not support the introduction of multiple rates this year and may issue statutory guidance to the SSRO on this matter; and**
- h) noted that the SSRO had separate work underway to assist it in calibrating the baseline profit rate in future.**

5. Review of legislation consultation draft

- 5.1. David Galpin, Head of Legal, presented the paper regarding the SSRO’s review of Part 2 of the Defence Reform Act 2014 and the Single Source Contract Regulations 2014. The Board had responsibility for agreeing the consultation document and any recommendations that were made to the Secretary of State. The Board was asked to consider a draft consultation document and agree that it should be published. After the consultation, the Board would consider the responses to the consultation and the final recommendations in May, before they were submitted to the Secretary of State in June.
- 5.2. The process for reviewing the legislation had taken over a year to this point. The Regulatory Review Committee had overseen the process on behalf of the Board, and the Chair of the Committee had provided regular updates to the Board. Members of the Board participated in a workshop on 21 November 2016 to discuss the review.

- 5.3. The draft consultation document set out how the SSRO had engaged with stakeholders, and the responses received to the SSRO's calls for input had been summarised in a separate document. There had been refinement and selection of recommendations throughout the process, and the end result was a package of recommendations that were considered best suited to improving the regime.
- 5.4. The recommendations for consideration were in three broad baskets, with eight categories within them. These had been communicated to the Defence Committee at the recent hearing. David Galpin described the recommendations within each basket in turn.
- 5.5. The first basket included recommendations around the theme of coverage. This included the following recommendations:
- Contract amendments: the SSRO proposed to recommend that material contract amendments should be treated as new contracts and brought within the regime if they meet the relevant QDC or QSC definitions.
 - Definition and assessment of QSCs: the recommendation was to address a timing issue that at least one contractor had argued, by amending the definition of QSC to make it clear that a contract may be a QSC if it provides anything for a proposed QDC or QSC. There was currently no deadline for the assessment of a QSC, and the recommendation was that this should be resolved. Furthermore, where an assessment had been carried out, it should be reported to the SSRO and the MOD.
 - QSC thresholds: the recommendation was that the current price threshold for QSCs should be reduced to £10 million, to bring it closer to alignment with that for QDCs.
 - Exclusions: there were several recommendations related to tightening the legislation around exclusions. They included removing the exclusion for intelligence activity if the subject matter of the contract does not disclose the associated operational purpose; restricting the international cooperative defence programme exclusion to contracts made wholly within the relevant framework; and recommending that government to government contracts are not excluded from the regime, except in appropriate circumstances.
- 5.6. The second theme was transparency. This included:
- Reporting of sub-contracts and QSCs. It was proposed to recommend increasing transparency in a number of ways: by removing the 20 sub-contract limit on the number of sub-contracts reported; by requiring reasons to be given for negative QSC assessments; and requiring notification of a QSC assessment if the timing has been such that it was not included in a contract notification report.

- Access to information. The SSRO relied on standard reports, which are helpful but provide a set and inflexible data set. The SSRO has had to ask for additional information and has been refused. The recommendation was that the Act should be amended to empower the SSRO to require by notice in writing that contractors provide the SSRO with information, where it was needed to enable the discharge of the SSRO's statutory function; the request was proportionate; and the information was not included in reports.

5.7. The third theme was enforcement. This included:

- Grounds for referral. The SSRO proposes to recommend that all steps of the contract profit rate calculation should be specified as grounds of referral to the SSRO, as should questions relevant to whether a contract is a QDC or a QSC. Steps 1, 4 and 5 of the contract profit rate assessment were not currently applicable for referral to the SSRO.
- Enforcement of price controls: at the moment, price controls were largely a matter of self-regulation, with the parties deciding whether to refer issues to the SSRO. The proposed recommendation was that the SSRO should be able, as a last resort, to initiate determinations in relation to pricing issues if particular conditions were met. The power should be available in relation to QDCs and QSCs, rather than proposed contracts. Its exercise should be: conditioned on the failure to provide a satisfactory explanation; exercised after a notice of intention, in response to which the parties may submit that there should be no determination and may seek a review if the SSRO is minded to proceed; and subject overall to a requirement that the SSRO publishes and has regard to a statement of policy as to the circumstances in which the power will be exercised.
- Compliance and penalty notices: the recommendation was that the responsibility for issuing compliance and penalty notices should be transferred to the SSRO in respect of reporting and QSC assessments. Responsibility for issuing notices relating to the duty to keep records and the duty to notify would remain with the MOD. The SSRO would be required to issue a statement of enforcement policy, and also make reference to the composition of the Referrals Committee.

5.8. The Board discussed the recommendations and agreed that they should be included in the consultation document. It was noted that, because this was a consultation document, the Board would be required to approve the final recommendations before they were issued to the Secretary of State.

5.9. **Action:** The Board would be shown the press release and questions that would be asked of consultees before they were published. These would also be shared with the MOD for information, alongside the final consultation document, before publication.

The Board:

- a) considered and commented on the consultation document and the recommendations it contains;**
- b) agreed that the document should be consulted on for a period of 12 weeks from 19 December 2016;**
- c) agreed that the summary of call for input responses should be published on 19 December 2016; and**
- d) delegated final approval of the consultation to the Chief Executive and (if in post before 19 December) the Chair of the SSRO.**

6. Final compliance and review methodology

- 6.1. Ian McPherson, Director of Compliance and Investigations, introduced a report setting out the updated compliance and review methodology, post-consultation. The SSRO had drafted a response to the consultation, to be published on the SSRO website, and has made amendments to the Compliance Methodology document following review of the consultation responses.
- 6.2. There had been ten responses to the consultation. Responses had been broadly in four areas: views on the SSRO's compliance approach to reporting; views on the compliance approach to pricing controls; views on ratings, and views on the format of the annual report. Ian McPherson provided an overview of responses with regard to these areas. The responses received were largely positive. Drafting changes had been received from the MOD, which had asked for no fundamental changes to the approach that was consulted on, just changes to wording. The MOD had indicated that it did not want the SSRO to raise matters of substance with contractors. Ian McPherson stated however that the SSRO's position was that it should be able to raise matters of fact with contractors, in respect of which he gave an example, and that this was agreed with the MOD.
- 6.3. The Board considered the report, and responses received. It discussed issues including ratings, and the ability to name parties that were not compliant. The report was approved for publication.
- 6.4. The report proposed that the annual reporting cycle should be moved to align with the financial year rather than the calendar year. The Board discussed the timing of the report's production, and whether this would impact on the production of the Annual Report and Accounts. The executive assured the Board that there were different teams working on the two projects, and that both could be completed at the same time. The Board discussed the proposed change to the reporting cycle and agreed to it.
- 6.5. It was also proposed that the title of the annual report should be changed, to clarify that it was an annual publication reporting on the operation of the regime.

The Board:

- a) approved the consultation response document;**
- b) approved the updated compliance rating methodology document;**
- c) agreed that the reporting cycle for the annual compliance report should align with the financial year; and**
- d) agreed that the title of the annual Compliance Report should be changed.**

7. 2017/18 Budget

- 7.1. Neil Swift, Director of Corporate Resources, presented a report on the SSRO's budget. The first section of the report presented the forecast outturn for the 2016/17 SSRO corporate budget, and showed that the SSRO's outturn was on target against budget. It identified the potential risk areas that could affect the final outturn figures and options to mitigate them. Risks included that staff continued to operate at capacity, and frameworks and support were used to supplement the SSRO's resources. Project costs were being managed, but accommodation costs were increasing.
- 7.2. The second part of the report focused on the proposed 2017/18 budget, which had been compiled based on delivery of the Corporate Plan and the need for key work areas agreed by the Board to be adequately resourced. At its previous meeting, the Board noted the MOD's position that the baseline budget for the next two years would be indicatively set to 2016/17 levels (i.e. capped with no inflationary increase). The Board noted that this posed significant challenges, as the SSRO remained in the early stages of its organisational establishment and development, and discussed a range of options to address the shortfall of projected funding against possible resource requirements.
- 7.3. The Board had asked the executive to develop a budget proposal based on need, and the executive had done so. The budget put to the Board included a 1 per cent pay award, unavoidable cost pressures that could not be managed internally, additional staff posts necessary to meet the challenges ahead and some minor accommodation costs.
- 7.4. The Board noted that from 2017/18 the MOD would plan to recover 50 per cent of the costs of the SSRO through the funding adjustment, representing a net gain to the MOD overall that would help offset the impact of any funding requirement for the SSRO.

- 7.5. The Board accepted that the executive has undertaken a thorough process in developing this budget, in response to the Board's request at the previous meeting. The Board challenged the extent of additional resources required to deliver the Corporate Plan, in particular the number of additional regulatory posts and a separate and discrete development budget in respect of the core IT infrastructure. As the organisation was facing an increased workload, it required a greater budget. The Board requested that the budget be amended to include an additional request in this regard. **Action:** The Board agreed the recommendations subject to the requirement for further additional resources being incorporated, and asked for a letter to be sent to the MOD.
- 7.6. **Action:** The Board asked that the Chief Executive ask for DG Finance's views on the content of the next Corporate Plan at a forthcoming meeting.

The Board:

- a) noted and commented on the planned forecast outturn for 2016/17;
- b) noted and commented on the update to the financial risks and ongoing mitigating action; and
- c) commented on the 2017/18 proposed budget.

8. Annual review of Corporate Governance Framework and Code of Conduct

- 8.1. Neil Swift, Director of Corporate Resources, introduced the annual review of the Corporate Governance Framework and Code of Conduct. Both documents had been reviewed drawing on the lessons learned by the SSRO in the past year, and by reference to external sources such as the Defence Reform Act 2014 and Single Source Contract Regulations 2014, the Framework Document, and current good practice.
- 8.2. The proposed changes to the documents were discussed and agreed. The Board discussed the publications that the Board was required to approve, and requested two changes to the text of the Corporate Governance Framework. **Action:** the term 'Compliance Report' would be amended, and the title 'Role of members' would be re-named.
- 8.3. Following approval, both documents would be published on the SSRO website.

The Board:

- a) approved the updated Corporate Governance Framework; and
- b) approved the updated Code of Conduct.

9. Board effectiveness review

- 9.1. Neil Swift, Director of Corporate Resources, introduced the annual review of Board effectiveness, which was required by the Corporate Governance Framework. The review was also included in the Governance Statement of the Annual Report and Accounts.
- 9.2. The previous review had been discussed at the Board's December 2015 meeting, after which all recommendations had been implemented. However, with the resignation of the SSRO's interim Chair in October 2016, a permanent Chair not yet appointed, and potential further changes in the Board's composition, it was not considered appropriate to conduct a formal review for 2016 at this time. The Board therefore agreed to set aside the requirements of the Corporate Governance Framework for a Board effectiveness review until it could be discussed with the new Chair.
- 9.3. The Audit Committee had reviewed its own effectiveness and the governance of the SSRO, and this was included in the report.
- 9.4. One of the Chair's roles was to conduct an annual performance appraisal of non-executive members. It was agreed that the appraisals should be postponed but would be conducted before the end of the financial year. The Board discussed methods for briefing the new Chair about non-executive performance over the period. The Board agreed the appraisal criteria included in the report, which would be used by the Chair in assessing performance of individual non-executive Board members.

The Board:

- a) noted the Audit Committee report to the Board;**
- b) agreed that the 2016 Board effectiveness review is postponed until a new Chair is in post;**
- c) agreed that performance appraisals of non-executive members should be postponed until a new Chair is in post;**
- d) approved the appraisal criteria, for publication on the SSRO website; and**
- e) approved the Board and Committee terms of reference.**

10. Corporate Performance Report

- 10.1. Neil Swift, Director of Corporate Resources, presented the regular Corporate Performance Report to the Board. The report described 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 SSRO had met all relevant corporate performance targets up to 18 November 2016. Work during this period included: distributing and publishing a formal opinion; reviewing responses to the compliance and review methodology and considering subsequent changes; the development of the consultation document on the review of the legislation; the SSRO's written submission to the Defence Committee's inquiry on defence acquisition; conducting compliance assessments; and responding to helpdesk queries. Progress also continued on the development and implementation of DefCARS 2 during October and November.
- 10.3. Overall performance was on target and, where it could be measured against the KPIs in the SSRO's published Corporate Plan, had been rated 'green'.
- 10.4. The Board discussed the Corporate Plan for 2017-2020 and a potential development of the SSRO's objectives and KPIs. This would be discussed further at the January 2017 meeting.

The Board:

- a) noted the progress to date.**

11. Minutes from the Audit Committee

- 11.1. Marta Phillips, Chair of the Audit Committee, introduced the minutes from the last meeting of the Committee. The Committee had discussed the corporate risk register, and particularly the risks around stakeholder engagement, capacity and compliance. The risk appetite for all risks on the register remains low.
- 11.2. The Committee had discussed and agreed its annual report to the Board on the SSRO's governance and the Committee's own effectiveness.
- 11.3. It had noted the Director of Corporate Resources' report, and in particular the sections on the budget, information security and business continuity. It had also reviewed the prime and detailed financial policies, and the preparations for the annual reporting cycle.
- 11.4. The Committee had also received reports from the GIAA on the follow up of previous recommendations, IT controls and project management, and from the NAO on its audit planning report.

The Board:

- a) noted the draft minutes.

12. Minutes from the Regulatory Review Committee

12.1. Jane Attwood, Chair of the Regulatory Review Committee, introduced the minutes from the meeting of the Regulatory Review Committee on 26 September 2016. An oral update had been provided to the previous Board meeting, but due to the timing of the meetings the minutes had not yet been formally presented to the Board.

12.2. The Committee had been provided with a full update on DefCARS. It had also discussed at length the review of the legislation. It had considered responses to the first Call for Input, and discussed the second Call for Input, which had subsequently been put to consultation.

The Board:

- b) noted the draft minutes.

13. Any other business

13.1. There was no other business.

14. Date of the next meeting

14.1. The next meeting of the Board would take place on 23 January 2017 at 2:00pm in Finlaison House.