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SSRO

Single Source
Regulations Office

Responses to the SSRO's consultation on the Review of Legislation

June 2020

1. ADS Group

ADS Response To Matters on Which Input is Sought

Para.	Question	ADS Response
5.8	We invite stakeholders' views on whether and how §17(2) and Regulation 11(3) might usefully be amended to better state the intended purpose and therefor facilitate more appropriate application.	ADS believes it would be helpful to amend the regulatory framework to clarify that the purpose of §17(2) and Regulation 11(3) is to compensate or reward contractor for profit volatility not cost volatility. However, ADS also believes that further work is required to ensure the parties fully understand who bears each risk and how this is allowed for in the Price. It may give rise to a cost base adjustment or a profit adjustment or MOD bearing the risk instead of the contractor.
5.20	We invite views on whether there should be additional direction in the SSRO's guidance and/or rules within the legislation to specify the range for contracts with different pricing methods.	ADS considers that a more important task is to ensure that the Comparator Group is established appropriately and that the way the financial results of Comparator Group companies is used to calculate the Baseline Profit Rate is a more pressing task. Risks faced by contractors are often more complex than those faced by Comparator Group companies e.g. system integration risks, and in many cases are unique to defence business e.g. design for safety in munitions systems. ADS believes that neither the regulatory framework or the SSRO's guidance should constrain the ability of the parties to negotiate within the full CRA range. The key consideration is for the guidance to allow risks to be considered properly and compensated appropriately.
5.30	We welcome views from stakeholders on the development of such guidance.	ADS believes that further work is required on the definition of 'contingency', 'risk' and 'management reserve' and when and how they are used; and this should be carried out before the SSRO considers developing the guidance described. The principle should be that if an allowance for these items can be agreed then it should become part of the cost base clearing the way for the CRA to be used for the purpose defined in §17(2) i.e. to reflect the risk that the actual Allowable Costs may differ from the estimated Allowable Costs. The Risk Register will evaluate a confidence point costing, however, the CRA is still required to allow for the variability around that confidence point as priced. ADS believes this topic needs further discussion and agreement before considering guidance on how to locate a CRA within its range.

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5.64	We welcome stakeholders' specific proposals for changes to the range of the CRA, with supporting evidence or information which explains the rationale for the proposals. We also welcome alternative proposals for achieving a wider range of available contract profit rates.	ADS believes the range should remain unchanged until the issued described above are resolved.
6.20	We welcome view on the various points raised in paragraphs 6.7 to 6.20 about the definitions of GSCs and FGFCs, together with any specific proposals for changes to the Regulations.	The issues raised in 6.7-6.20 are complex and numerous aspects require further discussion and clarification before ADS can form a view e.g. 1. How POCO issues are dealt with by comparator group companies. Any new process for identifying GSCs and FGSCs must be consistent with their approach. 2. Joint ventures and special purpose vehicles will need careful consideration to ensure this approach to contracting, which has many benefits for MOD, remains attractive. 3. The treatment and application of POCO to group subcontracts that were not contemplated at the time of Contract Award (or amendment) but were subsequently entered into. ADS believes great care needs to be taken before making any changes to the current POCO regime and much thought given to avoiding rules that may encourage contractors to restructure their businesses or alter their procurement policies to maximise any advantage available from the new arrangements. If this happens it may result in the UK defence industry disaggregating and leading ultimately to greater risks and costs for MOD.
6.25	We welcome views from stakeholders on the potential benefit or impact of changes to how the adjustment is determined together with any specific proposals for related changes.	ADS believes there may be merit in amending the regulatory framework to permit alternative approaches to adjusting the profit earned in GSCs and FGSCs as suggested in paragraph 6.23. However, several members have advised there may be tax implications which need to be considered and have suggested consulting HMRC to make sure that whatever is developed is consistent with their rules.
6.28	We welcome proposals from stakeholders on how greater transparency about POCO adjustments might be achieved in a way that is not unduly burdensome for contractors.	ADS notes that in paragraph 6.26 the SSRO states that it considers '… *there would be merit in improved reporting about POCO adjustments'.* However, no explanation or supporting evidence is provided for this view,

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		and the benefits derived from the 'improved reporting' and who will receive them are not addressed. If MOD requires further information regarding POCO adjustments in a contractor's price it can request the information directly invoking its DEFCON 802/812 rights if necessary. ADS also notes the comments in paragraph 6.27 regarding the amount of POCO information being reported under the current regime and believes putting more effort into making this work as intended would be more valuable than making changes at this time.
7.17	Stakeholder views are invited on whether the characteristics in Table 2 provide the right basis for future review of the DPS. Any further input on the proposed pace of change would be welcome.	The issue is when and how often information supplied via the DPS is used, what it is used for and who uses it. ADS believes requiring a DPS to be submitted at contract award and contract completion is reasonable as it will allow pricing expectations at the start of the project to be compared with actual outcomes. Interim DPSs should be provided on an 'on demand' basis to suit the parametric estimating programme for which the information is required. This will ensure the latter is always using the latest information. ADS also notes that the data provided in the DPS has little utility unless it is accompanied by a narrative or some other form of supporting information. Fundamental misunderstandings can be made if DPS data is used out of the context that will be provided by the supporting information. The Regulations should be amended to require Interim Cost Reports to be based on the Contractor's Work Breakdown Structure. At the same time, the QCR should be reviewed to ensure that anyduplication between it and the revised ICR is removed and that both reports deliver useful information.
7.25	Recognising that this a complex area, the SSRO is seeking further input on its suggested proposals before making changes to its reporting guidance the DPS templates in DefCARS	ADS questions the statement in 7.32 that '*Maintaining a link between in-service support and the equipment to which it relates seems appropriate for estimating purposes …'.* The reasons for this are: 1. No reasoning or supporting evidence is given for the statement it '*seems appropriate'*. ADS and its members believe the techniques

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		used for equipment maintenance and support are often different to those used for original manufacture and make this statement highly suspect. 2. Support activities may take place when the equipment is deployed or in the field and may be carried out by service personal or a third party contractor. In the case of the latter confidentiality considerations will make it unlikely the third party doing the maintenance and support would have access to the DPSs produced by the original contractor. It is also possible that spares and other consumables may be provided from MOD stocks. The contractor will have no say or control over these costs and they may not be recorded thereby distorting the information provided in the DPS. 3. It is unclear how MOD would use the information.
7.33	The SSRO proposes changing paragraph 5.30 in its current reporting guidance to that proposed in Table 4. We welcome stakeholder view on this proposal.	ADS suggest the following changes to the drafting: Table 4 – Revised Guidance Column Para 1: Amend to read: The Contractor should *report only against relevant DPS headings and* …'. The Contractor '*and MOD'* should consider the following: Bullet 4: Evidence is required to support the requirement that that cost data should be accurate to the nearest £10,000. ADS believes that given the judgements and other opportunities for discrepancies inherent in mapping the WBS onto the DPS format the threshold should be £100,000. It also notes that when DPS data is used for parametric pricing purposes, any lower granularity has no utility. ADS suggests that the Guidance should be amended to clarify who in MOD has responsibility for agreeing the DPS with the contractor.

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		Several ADS members report difficulty trying to find someone in MOD to engage on this task.
7.36	We are proposing a change to DefCARS to allow reporting against more than one template where this is appropriate in response to stakeholder feedback that the single equipment type structure may be unsuitable for a small number of contracts. This might include for example, framework agreements where more than one equipment type will be provided or supported under the contract (for example, allowing the selection of fixed-wing aircraft alongside that of rotary-wing aircraft). We acknowledge that reporting in this way will be the exception rather than the rule and a change to the reporting guidance and DefCARS will be required to accommodate this. Stakeholder views are sought on this proposal.	ADS is content with this proposal.
7.43	The SSRO considers it should proceed with its working paper proposal to make it easier for contractors to explain their mapping within DefCARS by adding an additional field within DefCARS to allow contractors to explain their approach. Stakeholder are invited to share any views on this,	ADS believes this is unnecessary as MOD already understands the data. The proposal is likely to result in additional reporting and cost without generating proportional benefits. A case needs to be built for why contractors should expose their WBS mapping to the SSRO. ADS sees this would open the way for interminable arguments over a document which does not appear to be used.
7.47	The SSRO has decided not to proceed with the proposals on additional categorisation within the DPS which was presented in the working paper, though this is something we may explore in future reporting guidance work on the contract description. Stakeholders are asked to share any views on this.	ADS supports the decision not to proceed.
7.56	Stakeholder views are welcome on these proposals or any other matter addressed in this section on DPS metrics.	The proposals in the DPS Metrics section are based mainly on supposition which is reflected in the use of phases such as '… *may be used…', '…may not be consistently providing…', '…MOD may have to*

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		combine datasets…'. ADS believes that it is up to MOD to state whether or not the approach being suggested will benefit its parametric estimating activities in a way that is justified by the cost of producing the information and data. If it is decided to go ahead as described, ADS believes it is essential that the revised Guidance identifies who within MOD hold the responsibility for agreeing the metrics with the contractor.
7.66	At this stage, the SSRO would like to seek further input on whether the current arrangements which allow the parties to agree the frequency of the interim contract reports remain fit for purpose. It would be helpful to receive feed back on whether the interim DPS reporting in the ICR regime remains appropriate of whether a different mechanism is required.	ADS believes the DPS should be decoupled from the ICR and that the latter should be produced on the basis of the Contractor's Work Breakdown Structure. ICRs in DPS format should be produced only on an 'on-demand' basis. In practice, it is likely that a person engaged on a parametric estimating exercise will call for an interim DPS so that he/she has confidence that he/she is working with current information.
8.12	The SSRO welcomes views on possible changes to the guidance to reflect definitions and examples.	It has been clear from conversations with members and discussions in various fora that: 1. A clear definition of terms is required in order to ensure consistency in reporting of amendments and definitions. 2. A fundamental review of the Reports and Reporting regime, including reporting requirements under the SSCRs and individual contracts, and ICPT and CAAS information requirements, is required. These need to be rationalised into a coherent whole to produce a single version of the truth, and eliminate duplication and nugatory effort. 3. Amendments and variances are already reported via the reporting requirements of individual contracts. This will include analysis of the causes of the change(s) in the detail required by the project. 4. A clear case needs to be built for duplicating reporting which is taking place elsewhere. The case must include descriptions of how the information will be used, who will use it, and the improvements that will be made in the management of the project and control of its costs as a result of having the information.

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8.24	The SSRO invites input from stakeholders on its proposal to modify DefCARS and reporting guidance to collect details of material pricing amendments, using the requirement to report material events and circumstances and the facility for on-demand reporting.	Paragraphs 8.20 and 8.21 make the case for reporting changes in price resulting from amendments (and variances?) on grounds that it may help MOD when estimating future requirements, and in the SSRO's view, summary information is required in order to understand the change in cost. ADS believes these arguments are weak and that evidence of the benefits that will be gained must be demonstrated before they are made. It also notes that this information will already be available ADS believes the proposed changes are in any case unnecessary as they will duplicate information provided as part of the contract amendment process under DEFCON 620 – Contract Change Control Procedure, DEFCON 502 – Specification Changes, and DEFCON 503 – Formal Amendments to Contract. It is for MOD to identify the information it requires for estimating the cost of future requirements and this should form part of the fundamental review of the Reports and Reporting regime recommended previously. Notwithstanding this, ADS notes that DefCARS is unable to facilitate multiple Contract Profit Rates and as a result it is not possible to reflect individual Contract Prices. For benefits to be gained, 10.4 would have to be implemented as well as 8.24. This will ensure that both an original contract containing multiple Contract Profit Rates and contract amendments containing different Contract Profit Rates are all recorded in DefCARS and align with the Contract Price. This will avoid reconciling each Contract Price against the Cost and Profit shown in DefCARS which is a time consuming and costly task. ADS agrees with the statement '*the SSRO is not persuaded that mandatory reporting of detail about each and every amendment would be beneficial'*.
8.29	The SSRO is interested to hear view on whether this would provide and effective materiality threshold for explaining variances.	ADS's preference would be to amend the Regulations to delete the requirement to provide a quantified analysis of the causes of the variance in 26(6)(f), 27(4)(i) and 28(2)(i) and for MOD to rely on the contract reports which detail this information. However, if the requirement is to be retained then the additional provision that a variance need only be

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		explained if it meets or exceeds the lower of £100,000 or 1% of the contract price is supported.
8.31	The SSRO is interested in views on the above categorisation. The SSRO would also be interested in evidence on how easy or difficult it would be for contractors to use categorisation when reporting variances.	ADS believes the case needs to be built that MOD will value and use the additional information generated as this is unclear at present. The analysis being proposed is based on supposition and the information is already provided as part of the contract reports. ADS has difficulty seeing how duplicating it in the SSCR reports will add utility or value. On balance, ADS prefers a free form analysis that permits the richness of the possible causes of the variance to highlighted and described.
9.18	We welcome stakeholder feedback on whether referrals to the SSRO for opinions and determinations about rates should be expressly provided for in the legislation and whether this may facilitate the agreement of rates. The SSRO would welcome further input on the typical timetable of agreeing the rates and the points at which delays occur.	ADS believes the current framework for referrals for opinions and determinations is adequate and that extension in the manner suggested in paragraph 9.18 is unnecessary. ADS disagrees with the statement in paragraph 9.18 that '*It may not always be possible to identify a contract that will serve as a suitable vehicle for the referral.'* It's position is that if the parties are unable to identify a suitable contract, then the rates are either not used or not material. The SSRO's guidance on 'Attributable' is clear and complying with its requirements will avoid a need to make a referral.
9.19	The SSRO would appreciate input from stakeholders about the merits of it being able to give advice or opinions on request on matters of general application to the operation of the regulatory framework. These requests would not need to be linked to a particular contract.	ADS supports this proposal and notes that it has on several occasions previously recommended that the SSRO issue General Guidance as well as Statutory Guidance. This approach would facilitate the proposals. ADS considers the proposals are a step in the right direction in recognising some overheads are not contract specific but are needed to maintain the enterprise as a whole. A decision would be required to determine if referral should be by both parties or be capable of being made unilaterally by one party.
9.32	We invite feedback on how arrangements can be modified so that the overhead reports received in DefCARS best support the MOD to determine rates and price contracts and on how the overlap between the information provided	The information required by the ICPT is a manifestation of how the Reports and Reporting regime has evolved since it was developed some five to six years ago. At this time no consideration was given to ICPT information requirements as it had yet to come into existence. The

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	in DefCARS and the information requests of the ICPT can be minimised.	current situation reflects the piecemeal development of the Reports and Reporting regime and adds weight to ADS's argument that it should be subject to a thorough review whose principle aim is its rationalisation and the production of a coherent set of reports that reflect experience to date. ADS believes the £50M threshold should be reviewed and reconsidered. At present, a contractor with a 20 year, £51M contract is required to provide reports whereas a contractor with a one year, £49M contract is not. It should also be noted that the ERCR is based upon budget which is not agreed until early in the new calendar year and would not be available for DefCARS submission one month after calendar year end.
9.37	These have not been the subject of our analysis but the SSRO would welcome feedback from MOD and Industry as the whether there may a rationale to require this data for the preceding years. The SSRO is also seeking feedback on any suggestions to address the issue.	The rules regarding whether a contractor has qualified for entry under Part 6 of the legislation are complex if its financial year end is other than 31 March. MOD and Industry discussed this issue as part of the 2017 Review and agreed the current arrangements gave rise to perverse reporting requirements which would be resolved if the assessment date was changed to the contractor's financial year end. ADS believes this approach should be taken.
9.38	The SSRO proposes to recommend to the Secretary of State that Regulation 37(7) is amended by inserting the words '*the accounting period immediately following'* before the words '*the relevant accounting period'.* We would welcome any further feedback on the proposed recommendation.	ADS supports the proposed change.
9.45	The SSRO is prepared to recommend a legislative change to require reporting of agreed rates and costs. Before doing so would like to receive further information in relation to how MOD is using the data or intends to use the data. The further information that the SSRO has called for in relation to the rates programme would assist with the further consideration of the issue. The SSRO would also	ADS believes the main issue is one of utility of the information and who and how it will be used. Paragraph 9.39 attempts to make a case that the explanatory notes to the Act indicate an intention that overhead reports should be submitted again once costs [rates?] have been agreed by MOD. However, as the SSRO notes, it is only an indication and not a definite requirement and ADS believes the omission of this in the Regulations is

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	welcome feedback on the impact of capturing the agreed rates and costs information including the associated costs.	deliberate and not accidental. It also notes that MOD will already be in possession of the information having agreed the costs [rates?] with the contractor and inputting them again will increase the burden on the contractor and add cost without commensurate benefit. Interim reports should be looking trends and spikes in costs, something for which actuals are not required. These are only needed at the end of the contract to determine the Final Price Adjustment. ADS would support this issue becoming part of the wider review of the Reports and Reporting regime with a view to establishing if a sound case can be made for including agreed costs [rates?] and if so, how the information can be provided electronically directly into DefCARS.
9.55	We welcome any further feedback on the SSRO view on QBU compliance.	ADS recognises that the SSRO has a duty to keep the extent to which persons subject to reporting requirements are complying with them (9.47). However, it also believes the way in which the SSRO fulfils this duty must be proportionate and deliver benefits that are material when juxtaposed with the cost and administrative burden contractors will incur in doing so. The process described in paragraphs 9.46-9.55 is effectively asking the contractor to prove the negative – that it does not have any business units that have crossed the reporting threshold and have not been identified. Providing this information would be a significant piece of work for contractors notwithstanding that the SSRO's assertion in 9.51 that the contractor will already have carried out the exercise to determine if the qualifying threshold has been met. When performing this task, the contractor will make a broad-brush assessment to determine which BUs have anywhere near the £10M threshold of work for a QDC/QSC and focus and report only on those that do. This is a very different task from reporting all BUs. As well as getting visibility of a contractor's BUs via the SICR, MOD will also be able to identify its structure from information provided to CAAS and the ICPT during pricing exercises and the rates programme. These sources will provide MOD with confidence that the exercise is being

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		completed properly. MOD can request further information if required and if necessary use its rights under DEFCON 80212 – Open Book. On balance, ADS believes it should be for the contractor and MOD to agree which BUs will be reported and proceed accordingly. It also notes that a number of members have reported that the number of rates they use is different from the number of QBUs, and that they consider standardising QBUCAR reports will be difficult as each contractor will prefer to have a format that matches their own accounting systems. ADS also believes that a key factor to be considered when contemplating changes to the current arrangements is the likelihood they will encourage contractors to perform acrobatics with their organisational structures and competition policies with the aim of circumventing reporting requirements or maximising their positions.
9.66	We welcome feedback stakeholders may have on the SSRO views on benchmarking and standardisation.	ADS has always had reservations about the using SSCR reporting to collecting information and data to use for benchmarking purposes and been sceptical about benefits that may be obtained. Whilst theoretically a good idea, the concept overlooks the fact that single source procurement is used only when there is no other reasonable alternative. This means that at the platform level there is usually nothing to benchmark costs against and comparisons must be made at the tier one or lower level usually on systems or equipment or both. For this to be effective, there must be: 1. A reasonable number of sources whose data is or can be made available for the benchmarking exercise. 2. They must collect costs in the same (or very similar) manner so that comparisons will be meaningful. ADS strongly believes that comparing the costs of one single source contractor for a task or function against those of another single source contractor will be meaningless unless their QMACs have been standardised. For example, one contractor may have its own IT structure and facilities, and another will subcontract out this function retaining only

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		a small inhouse expertise. This is something ADS believes should be avoided at all costs as it will be seen by contractors as an invitation to be creative with the way they structure their businesses and collect costs. Paragraphs 9.56-9.66 raise many questions which need to be discussed and answered before a comprehensive answer can be provided.
10.4	The SSRO is inviting feedback on the matters that have been raised on segmentation of profit rates in contracts. The SSRO is particularly interested in receiving input on the impact that segmented profit rates would have in contractors and the extent to which this should be reflected in reporting.	ADS believes that having a facility to use more than one Contract Profit Rate in a contract is unnecessary, and disagreements over classifications etc. will increase the amount of time required to reach contract award. The existing methodology already has a six by six matrix within which the profit rate must be determined i.e. the six pricing methods and the six-step process for determining the Contract Profit Rate. It is assumed the SSRO is advocating the four activity-related profit benchmarks given in 5.62 are used for this purpose i.e. 1. Develop and make 2. Provide and maintain 3. Construction; and 4. Ancillary services Amending the regulatory framework to allow multiple Contract Profit Rates to be used in a contract will add a 'third dimension' to agreeing the overall Contract Profit Rate. It is also likely to lead to contractors altering their cost structures to maximise the profit they earn and declining to include in contracts activities they perceive as 'low paying' e.g. a construction element of a Through Life Support contract. ADS suggests tripartite MOD, SSRO, Industry discussions are held to tease out the practical implications of multiple profit rates.
10.9	We invite comment from stakeholders on the need for any changes to the Regulations related to this matter and proposals for how any changes should be implemented.	ADS supports the suggestion made in paragraph 10.9.

Supplement to ADS's Response to the SSRO's Consultation Paper: 2020 Review of the Procurement Framework for Single Source Contracts

Introduction

The structure of the SSRO's consultation document and the way in which responses were requested made it difficult for ADS to raise what is believes are a number of important issues. These are described below and should be considered as part of, and together with, ADS's response to the consultation document.

Baseline Profit Rate (BPR) and Contract Profit Rate (CPR)

General Comments

1. ADS notes the remarks in sections 5 and 6 of the SSRO's consultation document regarding the Step 2 – Cost Risk Adjustment (CRA) and Step 3 – Profit on Cost Once (POCO). However, it believes that it is premature to contemplate changes to these adjustments until such time as the BPR is calculated in a satisfactory manner.

2. The process for calculating the BPR based on the performance of the median company in the Comparator Group has been in place since year one of the regulatory framework coming into force, and since then experience has been gained by all stakeholders in its operation and use. It has become apparent over this time that the methodology has inbuilt biases and that these operate to depress the outcome to the disadvantage of ADS members and undermine the principle of fair and reasonable prices.

3. ADS members have reviewed the websites for all the Comparator Group companies listed in the SSRO's Recommendation Factsheet 2019. The purpose of the review was to gain a better understanding of the type(s) of work performed by Comparator Group companies and the conditions under which they operated. This was then juxtaposed against what was considered typical activities and conditions under which companies performed MOD single source contracts. The main issues identified were:

   3.1. <u>Selection of Comparator Group Companies</u>

   The review identified that in a significant number of cases the work of Comparator Group companies bore little, if any, resemblance to that undertaken by Contractors performing QDCs or QSCs. A significant number were found to be:

   - Component suppliers (rather than suppliers of engineered products and services)
   - Merchants, retailers or distributors
   - General leasing or rental companies
   - Operating in non-relevant market sectors e.g. decorative goods
   - Non-inclusive or representative of the IT sector computers (hardware and software, including COTS software), telecoms, cloud, software services etc. were not represented or included.

   In addition, there were several instances where it appeared that the company selected because of its NACE Code was part of a group that operated under a different NACE Code.

The most notable feature was that many Comparator Group companies were performing work that was significantly less sophisticated or complex or both than what would be expected or required in typical QDCs/QSCs. Comparator Group company quality and reliability standards etc. were able to be lower because of the commercial nature of the end product and the demands of the market.

There appeared to be very few instances where a Comparator Group company's products and services would be required to meet stringent standards such as airworthiness certification, or demonstrate they could operate satisfactorily and reliably under harsh environmental conditions e.g. noise, vibration, low temperature etc. which is a regular feature of defence contracting. A company able to work to demanding defence standards and perform QDCs/QSCs is very different to the run-of-the-mill engineering company typical of those in the Comparator Group.

Tool hire and plant leasing plays a negligible role in defence contracting and the inclusion of leasing/financing/rental companies in the Comparator Group is inappropriate and should be removed.

3.2. Comparator Group Company Turnover

Whilst ADS welcomes the decision to increase the sales threshold for inclusion in the Comparator Group to £10.2M, ADS believes this is still too low and does not recognise the realities of subcontracting. It overlooks the unwritten rule(s) of purchasing that a buyer should not:

- Place a single order on a supplier with a value greater than 10% of the supplier's annual sales; or
- Place orders with a supplier that in aggregate amount to more than 25% of the supplier's turnover.

Doing either of these is usually seen as creating the risk of the supplier becoming too reliant on the contractor for its business.

The threshold for a contract to become a QDC and subject to the SSCRs is £5M. This implies that MOD should not, in the course of its normal business, place QDCs with a contractor whose annual sales is less than £50M. There will, of course be exceptions to this, however, a review of QDCs placed to date show that very few (two?) have been placed with SMEs. On this basis, the minimum sales threshold for inclusion in Comparator Group should be raised to at least £50M.

3.3. Risk

It was also evident from the review that most Comparator Group companies had lower and less demanding risk profiles than companies performing QDCs/QSCs. Only a very few companies appeared to be performing work that might give rise to something akin to a systems integration risk, and it seemed likely that their warranty and other post delivery risk exposure would be less than those for contractors performing QDCs and QSCs.

3.4. Amortisation of Intangibles

ADS recognises that amortisation of intangibles, particularly the costs of business integrations, are disallowed in the pricing single source contracts. However, Comparator Group company financial results are not adjusted to add these costs back in which distorts the basis of comparison. Recent work carried out by ADS

member companies has shown that the information to make the adjustment is available and believes it should made when calculating the BPR. An inequitable situation which disadvantages Contractors and undermines the principle of fair and reasonable prices will be created unless the adjustment is made as Comparator Group profit outcomes will be depressed by permitting their costs of business combination to be treated as Allowable Costs.

4. ADS suggests that method of determining the Price specified in the Act is reviewed. This is currently limited to (AC x CPR) + CPR. However, experience over the five years the regulatory framework has been in operation suggests having greater flexibility would have benefits for all stakeholders, subject always to the outcome being fair and reasonable prices for the contractor and value for money for MOD. Greater flexibility could, for example, allow all or part of a price to be determined by reference to commercial prices etc.

Reports and Reporting

Principles

ADS has adopted the following principles for the development of the Reports and Reporting regime and are reflected in its comments on these matters in the Consultation Document.

5. The aim of the Reports and Reporting regime (includes SSCR reports and contract reports, and information provided to the Indirect Costs Project Team and the Cost Analysis and Assurance Service) should be to collect and report the minimum amount of data that will enable MOD to manage the contract and control costs effectively, and the SSRO to fulfil its statutory duties. Reporting information exceeding the minimum required for these purposes will add cost without adding benefit.

6. Collecting the information and data required by the Reports and Reporting regime is expensive and a burden for contractors. How each element of information and data will be used, and benefit it will provide in terms of improving contract management and the control of its costs or those of the Contractor, should be known and specified prior to the requirement to supply it being set.

7. MOD should articulate how it intends to manage projects and control costs in a manner that allows the information and data required for these purposes to be recognised and the best method of collecting them agreed.

8. Contractors are required to provide information and data for SSCR Reports, Contract Reports, information to the Indirect Cost Project Team (ICPT) and the Cost Accounting and Advisory Service (CAAS). The work of these different groups, their functions and the way in which their outputs contribute to the management of contracts and the control of costs should be reviewed with the aim of reducing duplication and the cost of reporting.

9. An evidenced case should be produced when it is proposed Contractors should provide new or additional information or data. This should describe the need for the new or revised information or data and the benefits that will be obtained in terms of improved contract management or control of costs or both. Supporting evidence should be included. Uncertain phrases such as '….it may be useful … ', 'MOD may find it helpful …', there may be merit …', '…seem appropriate …' should not be used as they indicate there is little, if any, evidence to support what is being proposed, and that it is being done on the basis of surmise, personal preference or guesswork.

10. Information should be provided once and used many times. Modern technology allows information and data to be input once and then accessed by many users. The practice of providing the same information or data several times should be discontinued as it is wasteful and costly; creates opportunities for errors, differences and variances; and does not support the value for money principle.

Defined Pricing Structure (DPS)

General Comments

11. ADS recognises the thinking behind the DPS and that it also features in US defence single source contracts. It views the DPS as lying outside the main reporting framework as it is not used for managing the contract being performed. Rather it is a vehicle for collecting information and data that will allow broad brush comparisons to be made between pricing expectations and assumptions at contract award, intermediate times during performance of the contract, and the actuals at completion. The information in the DPS also plays a role in MOD's parametric estimating for future or follow-on requirements.

12. ADS questions the value obtained from information reported in the DPS on grounds of:

    12.1. Members are unable to detect any signs that the information is being used. It is accepted that it will take some time to build a body of data that can be used, however, reports based on DPSs have been supplied for over five years and it is expected that there would have been some indications of use by now e.g. queries on the data supplied.

    12.2. The DPS will reflect how things <u>were</u> done, however, parametric estimating needs to reflect how things <u>will</u> be done in future. ADS has many reservations about the usefulness of information and data that may be 10 or more years old. Defence technology is changing rapidly and design methodologies, materials, manufacturing processes, IT techniques etc. will have changed during the period which will question the relevance of the data collected earlier. Advances in Artificial Intelligence, autonomy and unmanned systems, block chain technologies etc. mean that the next generation of defence capabilities will be very different to what is currently in service. These changes will be reflected in the way systems and equipment are supported and maintained when deployed and at home bases. ADS has difficulty seeing how information collected via the DPS can make a meaningful contribution to parametric estimates when the successor system or equipment is likely to be radically different from its predecessor.

    12.3. ADS members believe the DPS should be decoupled from the Interim Contract Report (ICR) and that the regulatory regime should be changed so it should be supplied on an 'on demand' basis only. ICRs should be produced based on the Contractor's Work Breakdown Structure. Reports based on DPSs supplied at Contract Award and on completion will allow MOD to make broad brush comparisons of the pricing expectations at the start of the contract and the actual outcomes.

Amendments and Variances

General Comments

13. ADS disagrees with the SSRO's statement in paragraph 4.6 that details of amendments are '*not being well captured*'. This information is always recorded by contract change

control process, in contract reports and the Contracting, Purchasing and Finance (CP&F) process. ADS does, however, believe that improvements are possible and that this should form a core element of the proposed comprehensive review of the Reports and Reporting regime. It expects that the revised reporting regime will give greater prominence to differences between the previous Estimate at Completion and the current Estimate at Completion. This will highlight where differences have occurred over the period, provide an opportunity for explanation and avoid layering new reporting requirements on the existing structure. In turn, this will illuminate problem areas and improve understanding of projects.

The revised reporting structure will also provide an opportunity to consider how pending amendments should be treated. Work is often carried out ahead of formal approval of the change and the costs associated with it can distort actual cost figures at the reporting date.

14. ADS believes the key to understanding and reporting amendments and variances is for there to be a common definition of the terms used by all stakeholders. ADS's view is that the terms should be defined as follows:

    14.1. Amendment: A Contract Amendment means a written alteration in the terms or conditions of a contract accomplished by mutual action of the parties to the contract or to record a unilateral exercise of a right contained in the contract or to record the effect of an autonomous feature of the contract.

    In practical terms, any change whether agreed or unilateral which changes scope or the value on the face of the contract must be covered by an amendment. This is particularly important as the Defence Billing Agency will only pay in accordance with the value(s) shown in the order. Unilateral changes e.g. the exercise of an option, still require a contract amendment to record the new circumstances. Changes is price(s) arising from the application of inflation or some other index also require a contract amendment to allow payment.

    MOD has a well proven process for initiating and progressing contract amendments arising from a scope or specification change. Details are contained in DEFCON 620 – Contract Change Control Procedure, DEFCON 502 – Specification Changes, and DEFCON 503 – Formal Amendment to Contract. These DEFCONs and MOD's Contracting, Purchasing and Finance (CP&F) process ensure that the contract is only amended when the approvals have been received.

    14.2. Variance: Any change in a cost or the price of the Contract that is not attributable to an amendment.

15. ADS has reviewed the different types of change given in paragraph 8.9 and offers the following comments:

    1. Bullets 1-4 are scope change (change price and cost), via amendment
    2. Bullet 5 is a change of price not cost and is contractual.
    3. Bullet 6 is a change in price not cost, via an amendment.
    4. Bullet 7 is unclear. If the availability change is requested and leads to a contractual price change, then it is a scope change which may affect price and cost. The change may be effected by either an amendment or contractual provision depending on the circumstances.

Overheads

16. ADS believes the purpose of overhead reporting has morphed from its original intention as expressed by MOD at the time the legislation was being developed which was that it would be applied only to the major contractor sites in the UK (approximately 10). The process would give MOD early visibility of potential significant costs e.g. restructuring or redundancy and avoid it being caught off balance by unexpected claims. Its application was intended to be proportionate to the benefits from the information sought rather than a blanket requirement.

17. Whilst ADS recognises that times change and requirements evolve, it believes the broadening of the requirement to report overheads to encompass a much wider range of companies should be done as part of the overhaul of the Reports and Reporting regime advocated elsewhere in this response. This will help ensure that the outcome is a proportionate, integrated, coherent set of reports and avoid fragmented outcomes which are likely to result from a piecemeal approach.

18. One aspect Industry would seek to improve as part of the review is the timescales for submitting overhead rates and then reaching agreement. Paragraph 9.12 suggests whether to consider if there is merit in bringing deadlines forward, however, ADS members believe the current three months from [*what?*] already represents the practical minimum period. Another factor to be taken into consideration is that for many contractors, this will coincide with their year ends which are already very busy periods.

19. Many members also note that most of the delay in agreeing and approving rates can often be laid at MOD's doorstep and the length of time it takes them to review and audit contractors' submissions and address their findings with the companies concerned. This is an issue ADS believes should be addressed as part of the wider review of the Reports and Reporting regime advocated previously.

The Strategic Industry Capability Report (SICR) and the SME Report

General Comments

20. ADS believes that the review of the Reports and Reporting regime advocated previously should consider the SICR with a view to reducing and simplifying reporting requirements. Members also advise that increasing the period of the reporting cycle from one year to three should be considered as experience shows that very little changes when the reports are produced annually. A further improvement would be to make the reporting person the highest tier of the UK operating company structure. This will make the report more meaningful by eliminating the influence of overseas element of the group on the UK financial picture. The Report should also be integrated with the Strategic Supplier Programme reporting requirements to avoid duplication and unnecessary costs.

21. The need for the SME Report has been superseded by MOD's introduction of DEFCON 678 – SME Spend Data Collection in contracts. This new requirement overtakes the SME Report and the opportunity of the 2020 Review should be taken to amend the regulatory framework to remove the requirement for it to be produced.

Provisional Prices

22. Contracts let with provisional prices have been an accepted feature of single source contracts for many decades. The main reason for their use stems from delays in agreeing rates which in turn would threaten a delay to contract award and thereby project programmes if awards were made only on agreed rates. The approach is to

agree rates on a provisional basis to get the work moving and adjust the Contract Price to reflect the approved rates when they become available.

23. Issues have arisen because Regulation 14 and its Schedule which require that the profit rate to be applied to the costs under the amendment shall be that in force at the time the amendment is agreed. When a contract is amended to reflect a transition from provisional rates to approved rates it can have the effect of changing all the prices that have a labour or overhead element. Several contractors have experienced situations where having agreed what they thought was the price for the contract, it becomes lower than that expected or originally agreed because the BPR has changed from when the provisional price was agreed. ADS considers this undermines the bargain that was originally agreed and produces perverse results that undermine the principle of fair and reasonable prices.

24. ADS considers this situation was not foreseen when the regulatory framework was being developed and has resulted in an inequitable situation in which the fundamental objective of achieving fair and reasonable prices is not met. ADS believes:

    1. Replacing provisional pricing with firm pricing is not an amendment, rather the parties undertaking a process agreed at the outset of the contract.

    2. The regulatory framework does not recognise Provisional Pricing as a 'regulated pricing method' and as a result, the way in which the price is re-determined when converting from provisional to firm pricing is not covered by the legislation.

25. ADS believes the regulatory framework should be amended to:

    1. Introduce 'Provisional Price' as a new pricing type and amend the Regulations Schedule 1 to specify how profit is to be re-determined when converting from a Provisional Pricing type to one of the other pricing types.

    2. Amend the Regulations Schedule 1 to require that when a provisional price is being converted via a contract amendment to another price type then any changes to the Contract Profit Rate is applied only to the differential between the total costs in the provisional price and the costs in the amended price. Alternatively, the original profit rate should apply to maintain the bargain agreed at the outset.

2. C I Consultants Ltd

From: Paul Shields
To: Consultation Responses
Subject: Review of the single source regulatory framework 2020: Consultation
Date: 26 February 2020 13:34:03

CAUTION: External Email

Dear Sir/Madam

As the managing director of a small consultancy business operating almost exclusively in the aerospace and defence sector, and as a business consultant who has written SSCR compliant processes for DE&S and assisted defence contractors in submitting SSCR compliant bids, I have assisted in achieving the two statutory aims of: ensuring that good value for money is obtained in government expenditure on qualifying defence contracts; and that parties to qualifying defence contracts are paid a fair and reasonable price under those contracts. I believe, therefore, that I am well placed to contribute to the above referenced consultation, firstly by recognising the bulk of the issues raised in the consultation paper as being valid together with the proposed range of resolutions, and secondly to comment specifically in two significant areas as follows.

1. The Cost Risk Adjustment as addressed in section 5 of the consultation paper.

   Most contractors are struggling to achieve a balance between: the uncertainty within the Allowable Cost estimate for activities that will happen but whose impact may vary; costed risk within the risk/opportunities register for events that may or may not happen; and the cost risk adjustment (+/- 25% of baseline profit rate) within the 6-step Profit Formula "to reflect the risk that the contractor's actual Allowable Costs in delivering the requirement will differ from the estimated Allowable Costs included in the contract price."

   Many of the issues arising are due to the fact that 2-parallel negotiations are taking place between industry and the Authority: the "legal" Allowable Cost investigation between the contractor and the cost engineers based in CAAS or Project Controls, and the "commercial/contractual" negotiation between the contractor and the commercial officers in the project Delivery Team which includes the structuring of the Profit Formula.

   Pre-DRA, CAAS would have conducted a single source price investigation (including profit). Under "no price agreed, no offer of contract" (NAPNOC) guidelines the CAAS price investigation would have concluded with a Contractor Exit Review to disclose investigation findings before the commercial negotiations commenced. The contractor therefore knew the baseline from which the negotiation was to start. Since the Exit Review has been dropped from the cost engineering process (to avoid prejudice in the event of a later legal dispute on Allowable Cost) the clarity of what risk/uncertainty provision is in the Allowable Cost and what CRA needs to be in the Profit Formula (to make corporately approved minimum prices achievable) is blurred.

   So, in addition to the discussions in section 5 regarding expending the CRA adjustment range, making it independent of BPR, the reintroduction of a Contractor Exit Review to discuss the outcome of the Allowable Cost Review seems to be a sensible proposal.

2. The Incentive Adjustment

There is a lack of clarity within the statutory guidance as to when this allowance is operational; is it included at the time of contract let on the basis that the condition being incentivised will be achieved? Can it be included/excluded in successive years?

The range could be extended to increase overall project margins to the levels that shareholders and investors expect (and which are being achieved on some competitively bid projects) on the basis of value.

Value (value for money) is not often well understood by the parties to contracts. For example, to be topical, a product or service that uses sustainable sources or environmentally friendly processes in manufacturing and /or disposal could be regarded as having a distinct environmental value that could be rewarded through the incentive adjustment. Some similar examples could be included in the statutory guidance.

Please feel free to seek further clarification from me as necessary.

Best regards

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Ref: JAS/VPF/2019/
Date: 28th February 2020

Mr D Galpin
Director of Legal and Policy
Single Source Regulations Office
Finlaison House
15-17 Furnival Street
London EC4A 1AB

Dear David

The 2020 review of the procurement framework for single source defence contracts

Thank you for inviting Leonardo's input to this review, we remain at your disposal to discuss any of our responses.

We believe this review of the framework, for single source defence contracts, should take the opportunity to consider the effectiveness of the regime as a whole, as was posed by the SSRO in their questions to stakeholders for the corporate plan. To paraphrase:

- What will a successful single source regulatory framework look like in 2023?
- What should be prioritised to achieve that target?

We proposed a successful single source regulatory framework might be where:

- The MOD:
  - obtains the capabilities it requires, to;
  - the timetable it requires
- Value for money to the taxpayer and a fair price to the contractor is achieved (section13)
- UK prosperity is maximised
- The regulatory office role is light touch as the regime is effective and efficient

And suggested this will require:

- MOD to provide clear, well specified contractual/capability requirements
- Pricing to be agreed in a timely and efficient manner. Hence,
  - Regulation and guidance will need to be agreeable to all stakeholders to facilitate timely agreement
  - Statute may need change to facilitate alternate pricing approaches such as Commercial Off The Shelf (COTS) pricing.

- Compliance with section 13 of the Act: Value For Money (VFM) *to the tax payer* and a fair price to the contractor, whilst also supporting the UK prosperity agenda:

    - Reassess the BPR methodology
        - The current methodology excludes intangible assets and therefore should use EBITA instead of EBIT.
        - The current methodology does not provide a return comparable to activities the defence contractors perform (but in a competitive market).
            - The range of companies is not comparable, many being too small.
            - The use of Median rather than weighted mean further distorts the BPR when coupled with the effect of current range of companies.
        - If the BPR was a more appropriate return it would facilitate speedier contractual agreement and reduce emphasis on the CRA, agreement of which has proved problematic.

    - Develop, with government
        - A definition of VFM that supports the UK prosperity agenda, taking account of:
            - The “net cost” to the treasury after tax receipts generated by the purchase (i.e. Gross Value Added approach).
            - Employment generated (and its regional distribution).
            - Technology/knowledge development that could generate further opportunities to the UK.
            - Potential to generate export sales.
        - A business case assessment process that includes VFM assessment.
        - A budgetary regime that can flex departmental budgets to accommodate where a VFM assessment shows a higher headline “sticker price”, but a lower net price after Treasury tax receipts/opportunity costs and potential export sales.

In terms of the above proposals impact on: statute, regulation and statutory guidance this would include:

- Baseline Profit Rate methodology
- Alternate pricing methods towards achieving section 13 requirements
- Possible changes to the Contract Profit Rate Incentive Adjustment if this facilitates agreement and improved performance.
- A Government wide definition of Value for Money and budgetary and business case methodology that supports it and also supports UK prosperity

We feel the SSRO’s consultation, as set out, focuses too much on operational issues and whilst we understand the MOD will run a parallel activity including other topics our preference is for a consolidated stakeholder engagement process.

Responding to your specific consultation questions:

Cost Risk Adjustment (CRA)
Overall purpose

"We invite stakeholders' views on whether and how Section 17(2) and Regulation 11(3) might usefully be amended to better state the intended purpose and therefore facilitate more appropriate application"

- We believe a clear, agreed, understanding of risk and uncertainty within Allowable Costs, supported by statutory guidance that facilitates operational application thereof, including contingencies, management reserve, etc. is required before a constructive discussion of the CRA can be achieved.
- Currently the regime only allows price to be calculated as (CPR X AC) +AC, price being a factor of cost plus a profit rate. The regulations afford 6 pricing methods, all of which must use the above formula.
  Step two of the contract profit rate is the Cost Risk Adjustment (CRA), applicable to any of the 6 pricing methods, expressed as the risk the "primary contractor's actual allowable costs under the contract differ from its estimated allowable costs".

  Where the wording in step two might be questioned is the CRA being a factor of Baseline Profit Rate (BPR). Each time the BPR changes, the value of the CRA changes, even though the estimated allowable costs and risk the actual allowable costs will differ has not changed. Should the CRA be a percentage of allowable cost then applied as +/-% added to the BPR?

Effect of contract pricing method on risk allocation

"We invite views on whether there should be additional direction in the SSRO guidance and/or rules within the legislation to specify the CRA range for contracts with differing pricing methods"

- We believe any guidance on the operation of CRA should be included in statutory guidance and not statute/regulation. The CRA is a problematic area, where changes to regulation could easily result in unintended consequences which are then harder to remedy.
- As stated above the CRA, as written, is applicable to all pricing methods.
- SSRO have previously explained "Allowable cost guidance review 2019" 2.47 "we do not consider the cost risk adjustment should be regarded as a contingency for uncertain costs. To do so would imply an expectation that the profit element in the contract price was in fact an element of cost… Accordingly, all risk must be considered in forming that estimate…… ..Where cost risk adjustment is considered to act as a contingency for uncertain costs….this would effectively reduce the contractor's agreed profit and lower its reward for taking risk. We consider this would impact on the achievement of a fair and reasonable contract price".

    - If all cost risk is to be included in estimated costs then we believe statutory guidance needs to better facilitate agreement of risk by explaining the principles and logic tests that achieve AAR for all risk types, within allowable costs. Without such clarity agreement of what CRA covers, its range etc. will be problematic.
- We believe a review of BPR methodology is more fundamental to achieving section 13 obligations in relation to the CPR, than the CRA.

Navigating the range

"We welcome views from stakeholders on the development of such guidance"

- Answers to the previous questions require resolution before this question can properly be answered.
- If there is no change to statute or regulation then we believe current statutory guidance on the contract profit rate and Allowable Costs require review to support the SSRO's assertions in their Allowable Cost "uncertainty and risk" review. If guidance facilitates correct inclusion of cost risk in the allowable cost estimates then the CRA is an expression of the estimating error in valuation (not specific risks omitted) and "environmental" issues that may affect those valuations. In this case the CRA discussion would likely be by senior commercial parties who are familiar with the contract and the broader environmental and political issues. We do not think this discussion/agreement would be facilitated by a multi criteria approach/spreadsheet. Such an approach might sit better with the parties discussing the risk register and contingency/management reserve which the SSRO propose should be part of the cost estimate (not the profit rate).

Range of the CRA

"We welcome stakeholders' specific proposals for changes to the range of the CRA, with supporting evidence or information which explains the rationale for the proposals. We also welcome alternative proposals for achieving a wider range of available contract profit rates".

- If statute and regulation do not change in terms of the CRA purpose and if the SSRO proposal, that all cost risks should be within the costs estimate, such that it is only valuation "error" that the CRA is to deal with, and to that end SSRO amend statutory guidance to facilitate inclusion of all costs risks including management reserve, then we propose the range remains -25%/+25% of BPR.
- If changes to statute or regulation are agreed then the CRA method and range would require fresh consideration.

POCO

"We welcome views on the various points raised in paragraphs 6.7 to 6.20 about the definition of GSCs and FGSCs, together with any specific proposals for related changes to the regulations"

- You discuss in 6.4 the difficulties found in applying or reporting POCO. 6.9 further comments that identifying whether a person is a group undertaking can be complex.

  - We believe the annual reports of ultimate owning companies have dealt with issues of ownership and control and should be the basis of assessment.
  - We do not agree with proposals for inclusion of a POCO adjustment for part owned companies or JV's not under the control of the contracting group company.

- As included in our opening comments on actions towards a successful regulatory framework, alternate pricing methods ought to be considered providing they still demonstrate compliance with Section 13. To that end POCO might also rely on alternate tools such as COTS to demonstrate a "fair price" has been paid without use of the POCO adjustment (6.18).

"We welcome views from stakeholders on the potential benefits or impacts of changes to how the adjustment is determined, together with any specific proposals for related changes"

- Regulation 12 requires the POCO value is agreed by the Secretary of State and the contractor. There is merit in exploring alternate approaches to reaching agreement of the POCO value, depending on circumstances and readily available information. As mentioned above, there can sometimes be difficulties in understanding group subcontract profit in large international groups. Options might include building the price up as cost and just adding profit at the top level, to excluding profit, at the top level, on inter group supplies (assuming profit is added at the lower levels but the consolidator does not have perfect knowledge of profit within the GSC/FGSC). In all cases the method would need to be sensitive to inclusion of CSA, risk allowances and incentive adjustments at group subcontract level within the final price.
- In any consideration of alternate approaches to POCO we would need to consider:
  - International transfer pricing
    - Fair levels of profit in each tax geography.
  - Instances where knowledge of contract profit, across group companies, often in differing countries, is incomplete.

"We welcome proposals from stakeholders on how greater transparency about POCO adjustments might be achieved in a way that is not unduly burdensome for contractors"

- We see regulations as sufficient, see previous response.

Reporting

Contract reporting

We feel the user (DE&S) needs to mature its use of DefCARS contract reports and provide their recommendations, along with other stakeholders, before changes are proposed/made.

Defined Pricing Structures

"Stakeholders views are invited on whether the characteristics in Table 2 provide the right basis for future reviews of the DPS. Any further input on the proposed pace of change would be welcome".

- We agree with the themes of Relevance, Consistency and Proportionality.
- We wonder about the benefit of such reporting as compared to the cost of producing the reports. As discussed in earlier consultations, purchase of major equipment is very infrequent. In the intervening periods technology moves on and simple comparability reduces. In terms of the DPS's use for parametric estimating, we suggest engagement with specialists in that field to confirm its suitability and their requirements. It is our impression that parametric estimating relies on detail that differs to the DPS approach (i.e. capabilities, weight etc.).

"Recognising this is a complex area, the SSRO is seeing further input on its suggested proposals before making changes to its reporting guidance and DPS templates in DefCARS".

- We are not aware of any use being made of these reports in terms of benchmarking and parametric estimates. If use is being made what is the feedback? We are concerned this discussion remains theoretical and recommend, before any changes are considered, practical evidence is captured, tested and shared in a consultation.

"The SSRO proposes changing paragraph 5.30 in its current reporting guidance to that proposed in table 4. We welcome stakeholder views on this proposal".

- Whilst regulation does not call for agreement of the DPS, we agree, the DPS (if required, see earlier comments) should be agreed prior to contracting.
    - But who in the MOD is responsible for benchmarking/budgeting and nominated as the party to agree the DPS with?
        - We are aware some contractors have explained the MOD have not engaged in DPS discussions and the bid has been constructed/agreed and management of the contract has used, an alternate WBS structure.

- Assuming the requirement for DPS reporting is validated and parties to its agreement are nominated, then recognising the DPS is for MOD benchmarking/budgeting (MOD annual equipment budget is circa £16b pa), we suggest levels of detail should be proportionate to both MOD budgeting and contract size. As such we see £10,000 as too low a value.

"We are proposing a change to DefCARS to allow reporting against more than one template where this is appropriate in response to stakeholders feedback that the single-equipment type structure may be unsuitable for a small number of contracts. This might include, for example, framework agreements where more than one equipment type will be provided or supported under the contract (for example allowing the selection of fixed-wing aircraft alongside rotary wing aircraft). We acknowledge that reporting in this way will be the exception rather than the rule and a change to the reporting guidance and DefCARS will be required to accommodate this. Stakeholders views are sought on this proposal".

- We have no experience of this issue, its: size, frequency, or problems caused.

"The SSRO considers that it should proceed with its working paper proposal to make it easier for contractors to explain their mapping within DefCARS by adding an additional field within DefCARS to allow contractors to explain their approach. Stakeholders are asked to share their views on this"

- The SSRO and MOD have explained the purposes of the WBS and DPS differ. The former is used for programme management/execution and the latter is used for benchmarking and budgeting. As the use is, and users are, likely to be different we wonder why there is a need for further explanation of mapping?
- We would reiterate our previous requests for the rotary wing DPS to be changed to aircraft assembly by stage, by aircraft, rather than as currently required (current is reporting aircraft build by system, not by aircraft).
- We would also point out the complication in reporting of actual and forecast cost at pricing rates. This requires all direct hours and material uplifts to be recalculated from internal costing rates (for accounting purposes inventory is valued at "production cost") to pricing rates. Such restatements have to be made throughout the "Bill of Material", not just to the hours booked directly to a contract WBS.
- To achieve mapping WBS to DPS and restate costs to pricing rates, systems and processes have to be developed, if reporting deadlines are to be met. It is important there is a clear understanding of the benefit of any change to reporting along with the cost of change to systems through a VFM assessment.

Distinguishing contract types in DefCARS

"The SSRO has decided not to proceed with its proposals on additional categorisation within the DPS which is presented in the working paper, though this is something we may explore in future reporting guidance work on contract description. Stakeholders views are asked to share any views on this".

- We support the decisions not to proceed.
    - We would welcome consideration VFM on all of areas of reporting and whether the reporting burden can be reduced.

- To that end we recommend greater use by, and engagement with, the MOD (DE&S) regarding existing reports to confirm: purpose, "operational" suitability and avoidance of duplication.

"Stakeholders views are welcome on these proposals or any matters address in this section on DPS metrics".

- As with the discussion on the DPS, we agree that there should be MOD engagement in agreeing relevant contract metrics, but would again ask confirmation as to whom in the MOD?

- What are these metrics for?
  - Regulation 2 explains "output metrics means a quantifiable description of any goods, works or services (including a number, weight, dimension, time or physical capability but not including a monetary value), whilst
  - Regulations 24 (contract reporting plan) calls for "a list of the output metrics that will be used to describe deliverables in the reports…." and
  - Regulation 25 (contract notification report) calls for "a list of the key deliverables specified in the contract, with a brief description of each", whilst
  - Regulation 26 (quarterly contract report) calls for "a list of—
    (i) all delivery milestones set out in the contract; and
    (ii) where the contract sets an expected date for a delivery milestone to be completed, that date;"
  - Regulation 27 (Interim Contract Report) references the metrics and purpose in regulation 24.

Whilst regulation 2 provides a "broad definition of output metric it is regulations 24, 25 & 26 that provide purpose to those metrics, which appears to be the measurement of performance in achieving outputs as compared to planned date and cost. Understanding the MOD's requirement for metrics and who the users are would support a better discussion of metrics.

DPS frequency

"At this stage the SSRO would like to seek further input on whether the current arrangements which allow the parties to agree the frequency of interim contract reports remain fit for purpose. It would be helpful to receive feedback on whether interim DPS reporting in the ICR remains appropriate or whether a different mechanism is required".

- Are ICR's required?
  - Larger contracts require Quarterly Contract Reports (QCR). We therefore question the real value added of having ICR's, in addition to QCR's, on larger contracts.
  - Smaller contracts, often shorter in duration may also not require ICR's
  - MOD can always ask for certain on demand reporting if needed

- Interim reporting using DPS

The DPS, as explained, is a tool for bench marking and price estimating. Therefore we see value in reporting:

- At the point of pricing, to provide a benchmark for that contract's actual costs, and
- At contract completion, to compare to contractual estimate and to provide a benchmark for pricing of future contracts for the same, or very similar, capability

We do not believe there is value in "benchmark" reporting until costs are complete and comparable to capability delivered.

Amendments and variance

"The SSRO welcomes views on possible changes to the guidance to reflect definitions and examples".

"The SSRO invites input from stakeholders on its proposal to modify DefCARS and reporting guidance to collect details of material pricing amendments, using the requirement to report material events and circumstances and the facility for on demand reporting"

The purpose of contract reporting is explained as both "benchmarking" (using DPS) and contract control (using WBS).

DPS reporting

- We proposed above, benchmark is recommended at bid and contract completion. Comparing the estimated cost of that contracted with the cost at completion, for the capability delivered.

WBS reporting

- WBS reporting is explained as facilitating control of progress and cost, of that contracted.

Both the above approaches are comparing that contracted with actual outturn, the contractor being responsible for delivering that contracted: on time, to cost and quality.

- Cost growth to the contractor being any variance in cost forecast/actual cost against the estimate cost for that contracted.

Currently in DefCARS:

- The CIR records that originally contracted,
- Subsequent contract reports provide comparisons of the latest contracted costs, which establish the latest contract price, with the actual and forecast costs for the latest contracted scope.
- A combination of these two reports provides a picture of the change in contract value and baseline due to contract amendments placed by the customer.

We hope the above provides adequate information and do not welcome further expansion of reporting.

Variances

"The SSRO is interested to hear views on whether this would provide an effective materiality threshold for explaining variances"

We are uncertain how the proposal of "a variance need only be explained if it meets or exceeds the lower of the following amounts: £100k or 1% of contract price" would work in conjunction with the 26(6)(f) requirement to explain "not less than 90% of the variance between the estimated costs used to determine the contract price and the total actual and forecast costs". The requirement to explain 90% of the total variance may oblige analysis below the £100k or 1%?

"The SSRO is interested in views on the above categorisation. The SSRO would also be interested in evidence on how easy or difficult it would be for contractors to use this categorisation when reporting variances".

Quarterly Contract Reporting is to support management of contract execution and so far MOD use has been limited. We suggest any change to reports and variance analysis should only be considered when usage has matured.

Duplication

"It seems premature to contemplate proposals for legislative change at this time, but the SSRO continues to welcome evidence of unnecessary duplication"

We would recommend that the SSRO engage with the MOD to obtain examples of existing MOD reports to compare to those required in DefCARS, in order to understand any duplication.
As part of that process we also recommend that SSRO engage with DE&S about their plans for contract reporting and forecasting in order to confirm suitability of DefCARS reports and to ensure duplication is avoided.

Overheads

"We welcome stakeholder feedback on whether referrals to the SSRO for opinions and determinations about rates should be expressly provided for in the legislation and whether this may facilitate agreement of rates. The SSRO would welcome further input on the typical timetable of agreeing the rates and the points at which delays occur**".**

We think this proposal relates to allowable "indirect" costs, which will be attributed to a contract through a "rate". However, definitions of what is and is not a direct or indirect cost may vary by contractor, as explained in their QMACs. There may be a few cost types that are always likely to be indirect (sales and marketing), however, with the potential for varying treatment of the same cost type we would not recommend complicating regulations.

"The SSRO would appreciate input from stakeholders about the merits of it being able to give advice or opinions, on request, on matters of general application to the operation of the regulatory framework. These requests would not need to be linked to a particular contract".

We support this proposal.

"We invite feedback on how arrangements can be modified so that overhead reports received in DefCARS best support the MOD to determine rates and price contracts and on how the overlap between the information provided in DefCARS and the information requests from the ICPT can be minimised".

In consultation meetings it was explained there are various overhead reports with various purposes: some are strategic (SICR/SME), some for benchmarking (e.g. BUCAR), and others support the pricing, reporting and post costing of contracts (rate reports). The purposes of these reports and hence information contained therein differ to that the ICPT/CAAS require to conduct detailed rates agreement (that is not to say the information within such as the SICR and BUCAR is not of interest and help to broader plans and perspectives of the ICPT).
By means of example: the design of BUCAR "benchmarking" reports requires costs to be reported in a way that, for many contractors, differs to their organisational structure. Also, whilst some QBU's may classify a cost indirect, others may classify it as direct. Hence, detail required to support the agreement of costs and rates will be more specific to the QBU (organisation and QMAC).

We understand the need for cost/rate submissions to be made, to the ICPT, in a timely manner and agree this should be included in the regulations, but we recommend the overhead reports, designed for a different purpose, should be required once costs and rates are agreed. The "agreed" rates reports can then be used as a reference for: pricing, post costing and final pricing purposes and the "agreed" cost BUCAR for benchmarking.

"These have not been the subject of our analysis but the SSRO would welcome feedback from the MOD and industry as to whether there may be rationale to require this data for the preceding years. The SSRO is also seeking feedback on any suggestions to address the issue".

We would support the proposal made by ADS "the requirement should move from government financial year to contractor financial year" and for ADS, MOD and SSRO to meet and work through the proposal.

"The SSRO proposes to recommend to the Secretary of State that regulation 37(7) is amended by inserting the words "the accounting period immediately following" before the words "the relevant accounting period". We would welcome any further feedback on the proposed recommendation".

We agree.

"The SSRO is prepared to recommend a legislative change to require reporting of agreed rates and costs. Before doing so would like to receive further information in relation to how the MOD is using the data or intends to use the data. The further information that the SSRO has called for in relation to the rates programme would assist with the further consideration of this issue. The SSRO would also welcome feedback on the impact of capturing the agreed rates and costs information, including the associated costs".

For reasons discussed above, if legislation is to change to capture agreed rates and costs we see no value in inputting into DefCARS the original submissions and any iterations.

QBU Compliance monitoring

"We welcome any further feedback on the SSRO views on QBU compliance monitoring".

We believe current processes are adequate without further reporting. The MOD and supplier, through the rates agreement process, have a shared view of business unit size. The SICR also provides confirmation.

Benchmarking and standardisation

"We welcome any further feedback stakeholders may have on the SSRO views on benchmarking and standardisation".

We agree that the MOD should first outline its approach to benchmarking, their objectives, how their proposals will work in practice and gain stakeholder agreement.

Other matters

Segmented profit rates

"The SSRO is inviting feedback on the matters that have been raised on segmentation of profit rates in contracts. The SSRO is particularly interested in receiving input on the impact that segmented profit rates would have on contractors and the extent to which this should be reflected in reporting".

We reflect on SSRO's advice that 90% of any Contract Profit Rate is determined by the SSRO through the setting of the Baseline Profit Rate (BPR) and Capital Servicing Adjustment (CSA). Therefore we question the value of developing extra reporting for profit and reflect on Lord Currie's advice to focus on cost.

If multiple profit rates within one contract (caused by amendments being let in differing years) are seen as such a significant problem, should alternate solutions be considered to remove this issue?

- If it is a material amendment, for which a separate profit rate is desired, place a separate contract?
- If it is a minor amendment why doesn't it use the original contract profit rate?

This would simplify reporting and remove complications in final price adjustments

Contract pricing methods

"We invite comment from stakeholders on the need for any changes to the Regulations related to this matter and proposals for how any changes should be implemented".

We think that the regime would benefit from a broader review of pricing methods including the potential to price on a basis other than that currently set out in the Act (CPR X AC) + AC e.g. such as Commercial Off The Shelf (COTS) prices.

Final price adjustment

Regulation 17(1), (2), (3), (4) when read in conjunction with 17(6) we think already achieves that explained by the SSRO. However, if the SSRO believe 17(2),(3) and (4) would read better as percentage points then we would agree that is the intent of the regulation.

Strategic Industrial Capacity Report

As explained in the DRA explanatory notes, the SICR is a *"strategic planning report that requires details of the key industrial infrastructure that is being paid for out of QDC prices. Any forecast investment and rationalisation plans will also be provided where the contractor expects to recover consequential costs from the MOD, as well as current throughput compared with capacity. This will allow the MOD check that it is not paying for unnecessary capacity, and to be advised of significant costs and the risk of losing key industrial capability before this occurs.."* Current legislation does not deliver the intent, instead it requires reporting at the ultimate parent undertaking. We recommended legislation is amended to require the report is based upon the highest tier of the UK operating company structure.

QDC's by amendment

In order to facilitate agreement of QDC's by amendment for such as long term "framework" contracts against which various multi-year pricing periods are negotiated/let, it may be preferable to for legislation to accommodate the pricing periods being treated as separate QDC's. Inclusion of prior periods as part of the QDC would discourage agreement to QDC's by amendment and complicate any already agreed final price arrangements under DEFCON 648A.

QSC Notification period

As any appeal, against a subcontract being a QSC, must be made before the earlier of: the subcontract being let, and 6 months from notification the contract is assessed as a QSC, regulations ought to oblige notification of assessment, by the contracting authority to the subcontractor, a suitable time before contract award.

We hope our responses are helpful to your review.

Yours sincerely

James A Schofield
VP Finance

cc: A Brennan
M Kochanowska-tym
L Hawkins

4. Metasums

December 2019 Consultation
The 2020 review of the procurement framework for single source defence contracts

Overall comments relating to the consultation

Structure of the consultation paper

Much of the content of the consultation document looks to extend beyond what is required to be laid before parliament. Topics and proposals that lay within the authority of the SSRO to include within its statutory guidance should be the subject of a separate consultation on annual update to the relevant statutory guidance.

The subject matter included within the consultation is unexpectedly very narrow. After 5 years of overseeing the provisions of the Act and regulations to over 200 qualifying contracts I'm both surprised and disappointed that the contents of the consultation suggest that SSRO has a limited understanding of where changes to the legislative framework should be considered.

The SSRO's excessive focus in this review upon greater depth in reporting requirements does little to dispel the image of 'when they don't know what to do, they do what they know how to do'. There is something very wrong with the regulations in Part 5 and Part 6 if reports that are produced are not used by MoD and are only used by SSRO to ensure validation and detailed compliance issues are resolved. A fundamental review of utility and VfM of the reports to MoD should have been performed and completed within the first 5 years of the Act and regulations coming into force.

The second area of SSRO's focus is the contract profit rate. I firmly believe that the SSRO needs to correct its methodology for calculating the BPR. I've included where and why I believe this is necessary and I'd like to draw the readers specific attention to my comments on Appendix 2 'Paper on profit principles'. Much of what is discussed in Section 5 looks to result from an MoD/SSRO (I suspect the former) desire to fix the problem through a two-wrongs make a right strategy; which won't work.

The SSRO §39(4)(a) 2017 review was largely dismissed and changes subsequently made to the regulations between 2017 and 2019 had not featured in that review. Furthermore, there was no public consultation of the changes that were presented and approved by Parliament. §39(4)(b) continues to show the next review is due in December 2022 and not December 2020. SSRO has striven, particularly over the past few years to be an open and transparent organisation. If, once again, further legislation is lead by SSAT and implemented without public consultation then, I believe that, SSRO's nascent reputation to perform an effective and comprehensive review of the legislative framework would be further marred. Public consultation of changes proposed to the Act/regulations is necessary to give contractors, who are not otherwise routinely engaged in ongoing discussions with SSRO and SSAT, an opportunity to provide input and council.

Given the magnitude and seriousness of what ought to be considered in the 2020 review, the timescales for the public consultation ought not to have been accelerated to be an effective 8-week, consultation. However, given the scope and depth of the topics that the SSRO has included, the proposed 8 weeks looks ample.

I am also concerned that the consultation document does not seek views on the SSRO's detailed proposals for change but rather looks as if it is seeking views on what the SSRO should be considering including as a change topic and content. This coupled with the narrow

range of topics, where SSRO sees changes to the Act and regulations are beneficial to operation of the framework, was very unexpected.

As ever I worry about smaller and non-typical single source contractors and my responses below makes clear where I think there is a risk that the proposals will be excessively onerous to such businesses. I also expect that MoD will incorporate, by DEFCON, the changes implemented for regulated contracts into new lower value single source contracts that are otherwise outside of the regulatory framework. The growing complexity of the framework is in danger of providing an ever-increasing barrier to entry to new suppliers who find themselves offered a single source contract.

I have set out after Section 10 a list of items I had expected to be included within the 2020 review.

5. Cost risk adjustment

Overall purpose of the CRA

We invite stakeholders' views on whether and how Section 17(2) and Regulation 11(3) might usefully be amended to better state the intended purpose and therefore facilitate more appropriate application.

I agree with those who believe that the intention of the legislation framework is to restrict the CRA to be an adjustment solely to reflect the residual cost risk retained by the contractor in performance of the qualifying contract. Furthermore, I agree that the Act and regulations together with the explanation notes to the Act currently restricts consideration of the cost risk to the allowable costs of the qualifying contract and not the business at large.

If the question is 'should this have been more clearly expressed in the Act and regulations so that the legislation is more accessible' then my response is an emphatic yes. If, however, I was to rank where the Act and regulations are opaque, byzantine or lacks the qualities of expression in plain English, then this issue would not rank in the top 10. Bringing the §17(2) and Regulation 11(3) together with the supporting explanatory note to the 2014 Act is a matter that could easily and speedily be addressed by SSRO in its "Statutory guidance on baseline profit rate and its adjustments".

If the question is 'should scope to be considered in the adjustment to the BPR be extended beyond the risk to the contractor of allowable cost risks retained by the contractor in the performance of the qualifying contract' then my answer is an equally emphatic yes. In these circumstances an amended §17(2) and Regulation 11(3) together with explanatory notes would need to be included in the package of changes to be presented to Parliament for approval. MoD (SSAT) look to support revisiting of the narrow focus of the CRA to allowable cost risk within qualifying contracts.

Investors not only require greater returns for additional uncertainty, investors also require greater returns when a contract requires higher levels of scarce resources and management to be applied. Market prices of contracts that require proportionally more scarce resource should yield higher profit returns than ones that require less. It is through the application of scarce resource that a company differentiates itself in the market and optimises its return to its investors. Scarce resource includes; use and acquisition of employed skilled labour, technical/operational know how, and management expertise. A contract cost/schedule overrun ties up scarce resource and scarce management time and this has a negative impact on not just the contract in question but also all contracts where this resource would otherwise have been available.

Contracts that are a cost-plus contract pricing type can contain significantly different levels of management and scarce resource allocation e.g. a cost over-run on simple cost-plus article repair contract may have little potential to impact upon the business at large whilst an overrun on a cost-plus contract for a new weapons system may be highly disruptive to a company's capacity management of its employed skilled resource (e.g. digital signal processing engineers) and cause increased management effort. The DFAR Weighted Profit guidelines address this issue fully within 215.404-71-2. The issue I describe is additional to consideration to (a) contract cost risk, and (b) contract type.

I trust that SSRO is aware that when comparing FAR/DFAR profit rates to the DRA equivalent, the FCCM [akin to FCSA in the UK framework] in the US framework is treated as an allowable cost and that profit is also allowed on that FCCM cost. I have a simple spread

sheet I use in training that sets out the range and weighting of DFAR guidelines for a contract (similar duration and undertaken by contractor PPE asset velocity of 3 to COP) as and compares the US range (including FCCM) of a 3% minimum and a 24.3% maximum with the lower and narrower UK framework of adjustments and outcomes.

Effect of contract pricing method on risk allocation

We invite views on whether there should be additional direction in the SSRO's guidance and/or rules within the legislation to specify the CRA range for contracts with different pricing methods.

I agree that the cost risk to which the contractor is exposed is affected by and includes; the contract's terms and conditions, the contract pricing method and any final price adjustment. However, the risk to the contractor is not just restricted to these elements but also other risks including; (a) other types of incurred costs and not just allowable costs e.g. liquidated damages, unrecovered costs on a termination for default, or (b) costs that are allocated or apportioned to a single qualifying contract e.g. excess consumption of scarce systems engineering resource will impact upon the performance of concurrent contracts that were scheduled to have that resource made available. As noted in the question above, the availability when needed of scarce management and other skilled resource impacts upon the business at large.

The contract's terms and conditions together with the contract pricing method(s) are largely driven by MoD. For example, MoD may seek a cost-plus pricing type where the work to be performed is cutting edge technology and likelihood of changes and evolution of the SoW is high and also seek the same cost-plus pricing type where the work is for routine technical support and maintenance but the SoW only becomes clear during the progress of the contract performance. A simple -25% CRA cannot be considered appropriate for all statements of work undertaken if the management effort, the sacristy of resource anticipated to be required, technical challenge and impact on business resource risk is different. The US Weighted Profit Guidelines recognise more than just an overly simplistic scope currently addressed within the UK framework.

The SSRO recognises that the USA have a distinct element within the weighted profit guidelines that relates to the Contract Type [pricing type]. SSRO will also recognise that the USA lists 12 Contract Types [pricing types] and that each of these pricing types has a range of either 1 or 2 percentage points from the base value.

US FAR/DFAR cost plus fixed fee contracts [CLINs] the pricing type range in the weighted profit guidelines is 1 percentage point (within the overall profit). The profit for Technical and Management/Cost control for that same cost-plus fixed fee contracts is additional and has a separate range of 3% to 11%. FCSA (FCCM) is an allowable cost and therefore not included within profit but profit is allowed on the FCCM cost at between 10% and 25%. Working capital adjustment (WCSA) is not applicable to cost-plus fixed fee contracts. Cost efficiency factor of up to additional 4% is addressed in 215.404-71-5.

SSRO may wish to recognise that FAR 48 CFR § 15.404-4.(4)(i) states: *The contracting officer shall not negotiate a price or fee that exceeds the following statutory limitations:-*

> *(A) For experimental, developmental, or research work performed under a cost-plus-fixed-fee contract, the fee shall not exceed 15 percent of the contract's estimated cost, excluding fee. and*
>
> *(C) For other cost-plus-fixed-fee contracts, the fee shall not exceed 10 percent of the contract's estimated cost, excluding fee.*

I do not believe that the current BPR of 7.63% gives any realistic scope to salami slice a ± 25% (currently less than 2%) and even if the BPR were still the 10.6% that the Review Board for Government Contracts calculated for 2014 I still don't think that a ± 25% or 2.7% profit should be dissected. The USA Framework weighted profit guidelines gives a range (prior to

inclusion of FCCM in the cost base and working capital adjustment in the profit rate) for firm/fixed pricing type of 3% to 23%. The USA framework employs qualitative factors to give effect to the majority of this range.

I do not believe (a) that additional transparency should not be an end in itself, or (b) that 'the CRA should be the same for all contract types.'

The parties to a qualifying contract are required to have regard to SSRO's statutory guidance when pricing contracts and, I believe, that this should be sufficient. SSRO should progress changes that are within the existing legislative scope for SSRO to issue guidance and changes should be subject to the normal public consultation.

Were the SSRO to issue statutory guidance that gives direction to the parties to the contract as to which of the pricing types should apply in which circumstances then SSRO would have entered the field of play. Legislation should not include hard wired bright-line tests for the CRA; that is why SSRO have the task to issue statutory guidance after public consultation. Paragraph 5.19 is mistaken in its analysis of the 215.404-71. SSRO should consider adopting 215.404-71 into the Act and regulations in entirety to secure the benefit of fully tested and working framework.

Navigating the range –

We welcome views from stakeholders on the development of such guidance.

As this matter looks to be able to be addressed without need to make changes to the Act or the regulations I'm lost as to why it is included in a consultation of recommendation of changes to the Secretary of State. These matters are the stuff of SSRO's statutory guidance on the contract profit rate.

I have always considered that the whole debate about opening up the CRA range was driven by a need to ameliorate the SSRO driven reductions to the BPR. However, I have also always believed that that two wrongs to not make a right.

I strongly believe that any computational approach to ascribe a value to the CRA is unlikely to succeed. These reasons include that it would require a level of data analysis and computational sophistication that would render agreement to any outcome difficult to achieve; furthermore, any standard process is either likely to be too opaque or too open to technical challenge. For these reasons, I agree with SSRO, that a highly structured computational approach should be dismissed. Assessment of the CSA should remain based upon a qualitative analysis. During discussions with MoD and the Review Board for Government Contracts in the noughties, consideration was given to a qualitative assessment of factors which could indicate a tendency to greater or lesser risk profile. There are very good reasons why the USA uses a qualitative for key elements of is weighted profit guidelines.

I fundamentally disagree with those who act as if they believe 'that if enough rules could be written then all would be well in the world'. The exiting legislation and supporting statutory guidance are required to be applied equally to (1) the initial contract and then separately for every subsequent contract pricing action (e.g. changes), (2) each contract and subsequent contract pricing action regardless of the value of the contract pricing action, and (3) both QDCs and QSCs. Contract pricing actions can be of a very low value; furthermore, a contract pricing actions may comprise several pricing types or that the pricing types for contract changes lay in different proportions to those of the initial contract.

The phrase "the relative likelihood of actual Allowable Costs being higher or lower than estimated Allowable Costs" in 5.21 remains unclear. I see that the quotation is taken from SSRO (2019) Guidance on the Baseline Profit Rate and its Adjustment 2019/20 (Version 5) paragraph 3.15.e however the computational basis for such an assessment is unclear. Where a cost estimate is based upon samples taken from skewed distribution the resultant distribution of the means of these samples will form a normal distribution (mean, and median falling at the same value) and the resultant distribution of the medians will also form a normal distribution; however to two distributions will differ as the first will be normal about the mean of the skewed distribution and the later will be a normal about the median of the skewed distribution. See Central Limit Theory.

I do not believe that an adoption of a simplified approach that reduces the profit allowance paid to contractors for smaller contracts as reasonable. SSRO does not indicate what it means by 'contract' and neither does the legislation to which SSRO refers. Regulations and the Act currently uses the word 'contract' to have any of three completely different meanings i.e. (1) as stand-alone contract is referred to as a contract, (2) a contract change is a contract, and (3) the multiple contracts entered into with the same person (or persons associated with that person) for the purpose of fulfilling that requirement.

The options for simplification should therefore limited to the pricing of contract changes

that fall below a certain value. This could be as simple as the profit rate applicable to a change to a contract, where only one pricing type is employed, is required to be the same as the profit rate as agreed for the initial contract. Implementation of such a simplification would require substantial change to both the primary and secondary legislation. Consideration should also be given to achieving simplification to contracts that employ more than one pricing types by requiring that each of the pricing types is severable and allocated to separate CLINs. Consideration should also be given to pricing of changes on pre-existing qualifying contracts, I've set out a basis for simplification later in my consultation response. The dialog contained in the consultation document suggests that either such a change has not been considered by SSRO or MoD.

Lessor levels of simplification SSRO could also have considered e.g. that pricing of contract changes be required to calculate profit by use the latest BPR, the CRA (step 2) from the original contract, set POCO adjustment at 0.00%, use the latest SSRO funding adjustment, use the step 5 incentive from the original contract, and the CRA % from the original contract. This would also obviously require change to the Act and the regulations.

Again, this is why the US FAR/DFAR framework utilises a qualitative assessment to establish the bulk of the profit allowance and not quantitive assessment. The current legislative requirement to price all changes arising on qualifying prime and sub-contracts by use of the six-step process has always looked to me to be ill-considered.

Disapplying any or all of steps 2 to 6 for lower value contracts and changes would be wholly unreasonable. I look forward to seeing the further public consultation on this topic at a later date. If the second review in accordance with the Act is to be brought forward from 2022 to 2020 will the next review alter to 2025 or will the SSRO be recommending a change to the review programme to be included in the update to the Act.

Range of the CRA

We welcome stakeholders' specific proposals for changes to the range of the CRA, with supporting evidence or information which explains the rationale for the proposals. We also welcome alternative proposals for achieving a wider range of available contract profit rates.

You are already aware that I disagree with the SSRO's use of EBIT achieved by listed companies that comprise the comparator group to inform calculation of the BPA as I believe that EBITA would be the correct basis.

Specifically, I continue to engage in dialog with contracting group companies to support continued engagement on this topic. EBIT is struck after annual write down of profits arising from impairment and amortisation of goodwill and intangible assets recognised as a consequence of a business combination. Consequently, I find SSRO's comparison of profits achievable under the regulations, with PBIT corporate profits earned by the global ultimate owners of QDC/QSC contractors to be as flawed as SSRO's use is of EBIT rather than EBITA in development of the BPR. Goodwill and intangible assets recognised as a consequence of a business combination, represent the expected current [discounted] value of future cash flows to the acquirer of the acquired business i.e. profit expected to be secured from the acquisition.

Attempting to fix the BPR being calculated at too low a value by opening up the CRA range is building on poor foundations. A 70% BPR reduction for any cost-plus contract means that scarce resource managed by the corporation is sold for next to no return. If the contractor was an acquired subsidiary undertaking of a global ultimate owner, then the value goodwill and intangible assets recognised on business combination may need to be impaired and EBIT reduced as soon as the contract is executed.

I agree with the SSRO when they say that 'the ability of a contract as a whole to achieve the minimum or maximum profit rates available in those overseas regimes is limited'. However, I do not recognise the values the SSRO report as the profit range applicable to the USA framework. The US procurement regime does not recognise that FCCM is an allowable cost (FCSA in the UK framework is an element of profit in the US framework it exists as an element of cost and as a further element of profit)). The US framework is complex to compare with UK's, the range is very wide and whilst the extremities may be rarely, if ever, seen in practice the average rate negotiated is higher than that under the UK framework. I have a paper that sets out the range, I can share if it helps.

The composition of the comparison group should not be looking at nace codes but rather at characteristics of global ultimate owners of QDC/QSC contractors. Characteristics I see are:

(1) A high multiple of shareholder market value to book value of the equity. This means that the market value is based upon a high return on net assets. SSRO's comparison group should be chosen whereby the weighted average multiple of market value of equity to its book value is similar to the weighted average multiple of global ultimate owners of QDC/QSC contracts. and
(2) Very large corporate revenues. Use a comparison group where the weighted average revenues of companies are similar the weighted average revenues for global ultimate owners of QDC/QSC contracts.

For this reason and several others, I wholly disagree with the SSRO's thoughts set out in 5.61 through 5.63

I agree that any change in the range will require a change in the regulations and as stated above I believe this issue is caused by SSRO reducing the BPR and thereby making it difficult to secure execution of contracts and a level playing field amongst contractors executing qualifying contracts.

6. Profit on cost once adjustment

Defining GSCs and FGSCs, Value, and Competitive process

We welcome views on the various points raised in paragraphs 6.7 to 6.20 about the definition of GSCs and FGSCs, together with any specific proposals for related changes to the Regulations.

Either the Annual Report of global ultimate owner says it has control of an entity in which it has a significant holding of shares (subsidiary undertaking), or it does not. Accordingly, the accounts included within the Annual Report are either prepared on the basis of control (revenue is fully consolidated, separate recognition of minority interest profit), or it does not have control and treats the shareholding as equity accounted investments (where revenues are not consolidated and consequently minority interest profit is not recorded). To suggest in 6.9 that either some global ultimate owners are misleading their shareholders or that the SSRO knows better, was an unexpected and unsubstantiated inclusion within the paper.

The USA in its equivalent of POCO (FAR 31.205-26(e)) states the requirements in plain English and simply says "…. *of the contractor under a common control shall be on the basis of cost incurred* ….". The same US FAR also states "*However, allowance may be at price when -*

> *(1) It is the established practice of the transferring organization to price interorganizational transfers at other than cost for commercial work of the contractor or any division, subsidiary or affiliate of the contractor under a common control; and*
> *(2) The item being transferred qualifies for an exception under 15.403-1(b) and the contracting officer has not determined the price to be unreasonable."*

The lack of commercial item pricing within the regulated framework has remained outstanding since 2013.

When SSRO refers to sub-contractors 'who are part owned by the primary contractor but are not 'group undertakings' it is referring to businesses that the prime contractor's global ultimate owner does not have effective control over. Part ownership without effective control may be as simple investment shares of the entity or it may result in influence through non-executive representation on the board of directors; never an effective control of the corporation. As with any investor in voting shares it will be a beneficiary of any dividends approved by shareholders. The investor does not '*have rights to extra profit that it would not have earned if the sub-contract was with a completely unrelated person*' they receive dividends approved by the shareholders at large in proportion to their shareholding and have no control over the size or frequency of such payments.

The Act and regulations, quite properly, only require a POCO adjustment for businesses under common control. SSRO's suggestion of adding 'or that is part owned by a group undertaking' is inappropriate. The information required by the contracting authority to make the POCO adjustment would not be made available by the sub-contractor. Even if the sub-contract was a qualifying sub-contract the potential of layering of POCO adjustments through further group sub-contracting in the sub-contractor's group would make assessment at best an unsupported WAG. Your sentence '*The Regulations should also direct how the proportion of profit that is attributable profit is to be determined*' suggest that SSRO has little idea either.

I am sure that 12(8)(b) is already completely clear, I've tried to see how it could be contorted but I failed. The POCO regulation paragraph 8 currently states that attributable

profit does not include any profit which is received by a person which is not associated with the primary contractor. Nor does the regulation need to set out how the proportion of profit is to be determined and the value can easily be established by reference to the proportion of voting shares that are owned by the contractor or its associated undertakings.

It has always been unclear to all but MoD what regulation 5 means by the term 'requirement'. The meaning of 'requirement' may be clear to MoD's Contracting Officers but as it is not a defined term contractors are able to develop their own interpretation. The partial tidying up of Regulation 5 in SI 2019 No. 1106 excluded "contracts which are not the result of a competitive process' from inclusion within the valuation of 'the requirement'. Even after this tidy-up their remain difficulties for prime contractors in establishing the 'value of a contract' i.e 'where the purpose is to fulfil a requirement for goods, works or services and the contracting authority has also entered into [even before the Act came into force?], or proposes to enter into [even if it does not happen], one or more other single source contracts with the same person (or persons associated with that person [SSRO is considering extensions of this scope to include investments]) for the purpose of fulfilling that requirement'. What is a requirement? SSRO will notice that the word 'contract' assumes two or more completely different meanings throughout regulation 5. POCO only exists in a sub-contract placed by a contracting authority to extend its application to contracts placed for the purpose of fulfilling that requirement will require full consideration of regulation 5 and way more. SSRO needs to think beyond Part 5 reporting.

I welcome SSRO's consideration for commercial item pricing. I draw your attention to definition of commercial item in FAR 2.101 and the FAR/DFAR treatment of commercial items within organisational transfers between BU's of the same legal entity. SSRO should also give consideration to commercial item market pricing as was committed by MoD during ongoing consultations before the Act and regulations were sent to Parliament.

You ask for comments on 'competitive process'. I agree that the methodologies you set out could and should be used to demonstrate price reasonableness by comparison to 3rd party transactions. I do not think that it would be appropriate to use prices paid by external 3rd party customers where MoD paid for the development of the article under question.

I also suggest that SSRO consider if price reasonableness for acquisition of articles from 3rd parties (i.e. not associated undertakings) should be able to be evidenced from previous competitions. It cannot represent VfM for the tendering process set out in the regulations to be conducted for each individual order, this is not how business does business or how it should do business.

Determining the adjustment

We welcome views from stakeholders on the potential benefits or impacts of changes to how the adjustment is determined, together with any specific proposals for related changes.

I continue to believe that R12(8)(b) makes clear that the regulations do not require all of the profit un GSCs or FGSCs to be adjusted for i.e. where the contracting authority's global owner has effective control the adjustment excludes the proportion of the minority interest. SSRO's suggestion at paragraphs 6.24 6.25 will not assist where the sub-contract with the associated company is not a QSC and that associated company does not establish its prices by reference to MOD non statutory guidance on pricing of single source Non-qualifying contracts and therefor the attributable profit included in the sub-contractor's price will remain unknown. The contracting authority can estimate what the profit allowance would have been under such arrangements and deduct that amount, similarly it knows what the sub-contract price is and can exclude profit on that sub-contract price from its price. Consideration also needs to be given to commercial item pricing and use of inter-governmental MOU's for pricing assistance; it should be noted that the USA MOU mandates that FAR cost allowability regulations are used and NATO MOU uses the rules of the nation performing the 'assist'. I am unclear what SSRO intends in the final sentence of 6.25.

Transparency of adjustments

We welcome proposals from stakeholders on how greater transparency about POCO adjustments might be achieved in a way that is not unduly burdensome for contractors.

If SSRO seeks additional reporting, then the regulations in Part 5 need to be amended through Parliament. The reports in Part 5 should be to inform MoD. MoD have rights under Part 4 regulations to require the contractor to give information. MoD should perform post award audits under this Part to ensure the veracity and compliance by contractors in the adherence to the obligations set out in the legal framework. There is too much reporting today. If something looks like it is available for free, then typically more is sought even if there is no utility. The reporting is not free; MoD (and therefor taxpayers) pay for the reporting in the contract prices.

7. Defined pricing structure

Various topics raised in section 7

I believe that the whole basis of reporting against a DPS should be reconsidered. I do not believe that DPS reporting provides, or will ever provide, VfM to MOD. There is little evidence of it being used by MOD, nor do I believe that it is fit for purpose or that it can be made to be fit for purpose.

I admire SSRO for their attempts to find a reason for continued production of applicable reports.

Post award truthful pricing audits have utility to MoD and reports should be restricted to support the same. For very nearly all contractors Mil Stan 881C WBS is not incorporated in the companies operating system of cost and schedule control and I therefor remain sceptical that its use, regardless of the detail of the cost categories, structure or granularity will ever provide answers or insights.

The content of SSRO's guidance at Table 4 does not require any change to the Act or Regulations and therefor I would have expected it to be included in a separate consultation on SSRO's contract reporting guidance.

As a matter of historical accuracy, MOD made clear during the ongoing consultation that lead to the Act and the regulations that contractors have the option to use either the DPS or their own WBS. The offer was made as an easement to contractors and not as a mistake in drafting.

8. Amendments and variance

Purpose and definitions

The SSRO welcomes views on possible changes to the guidance to reflect definitions and examples.

I can see that one or two of the contract reports can be used to inform discussions on contract management but only where the contract pricing types are simple and limited. By way of examples (there are many more) the reports detailed in Part 5 of the regulations do not support contract management: (1) PEPL adjustments where cost-plus or target pricing types , or (2) TCIF adjustment where other pricing types are also used, or (3) finalisation of cost-plus prices where other types are also used. For PEPL regulation refers to 'the contract profit rate' when there will be as many 'contract profit rates' applicable to the contract as there have been contract pricing actions. The profit rate at initial contract execution for a mixed pricing type contract will result from the *6-step* process undertaken at that time e.g. BPR at that date, and CRA from the then mix of work. When a contract change is priced for that same contract the BPR may differ and the mix of work across pricing types may cause a changed CRA. The purpose to MOD of QSC reporting is even more obscure

The regulations as originally approved by Parliament included regulation 14 which required the whole contract price to be redetermined if the change was not severable from the previous contracted work. MOD and contractors immediately understood that this was completely useless (in the words of MOD 'unhelpful') and MOD policy was to price all changes as if they were severable (see KiD guidance on pricing changes of qualifying contracts) even where it was clear they were not. As far as I am aware no contracts have ever been repriced because a change was not severable. In 2019 regulation 14 was amended to remove the need to reprice contracts where changes were not severable. Few contract changes were ever severable so actual costs incurred as consequence of the change could never be separately established. It is not only that contract management is not supported by the reports but also that the previous DEFCON framework and supporting processes and norms have been retired and not replaced. Contract pricing statement can be used to inform a post award pricing audit if it is performed before there are too many contract changes and the contract pricing facts does not comprise information that is not segregated into the pricing elements. A contract cost statement is not required to be split between pricing types nor indicate the contract price.

I have no expectation that the 7 reports will enable MOD to improve cost estimation through the identifying the causes of cost growth.

The SSRO should look at the regulations anew to set out what information it believes is needed for contract management and the MOD programme teams should specify and agree contract specific reports with individual contractors that address their information needs.

§26 of the Act should provide the basis for notification to MOD by the prime contractor of relevant events.

MoD should review its data requirements and advise SSRO. For pre-existing qualifying contracts any change to the scope of the reporting requirements (as set out in the regulations) will need to be scarfed in and contract prices adjusted for the changed requirements. Where the reporting requirement is altered through a change in the statutory guidance a then similar adjustment to contract prices (either up or down) should be agreed.

Distinguishing between variances in requirements and variances between actual and estimated costs looks to require a change to the regulations which needs also to address prior reporting completed on a different basis.

Definitions

The SSRO welcomes views on possible changes to the guidance to reflect definitions and examples.

DEFCON 803 allows MOD to require contract amendments to be taken into work before the price is agreed, there I believe that the variance could only be measured against the latest contracted work including work that is currently unpriced. I recognise that the SSPR framework does not allow contracts to be entered into prior to a price, or pricing mechanism, being agreed e.g. firm pricing type, cost-plus pricing type For contracts and elements of contracts that are cost-plus pricing type the value of changes taken into work but where the estimated cost is not yet agreed would have to estimated by the contractor as under the existing legislation there is no limitation of funds applicable to the cost-plus pricing type.

Tasking orders may represent a new contract if a framework agreement was established under which the tasking orders are issued. New work under a framework agreement is an additional (new) contract that is required to be separately reported. A framework contract (as defined in KiD) exists where the contract contains a contractual commitment to buy (minimum quantity). Changing provisional rates to final should be under the fixed pricing method where a contract amendment is needed to allow the contractor to be paid the revised price. Changes is article availability, where the pricing mechanism is agreed within the contract, should be processed as a simple amendment (sometimes after the event) if one of several pricing types was used. Is MOD in 8.10 looking at a third category of amendment where the 3rd type is a mechanistic amendment that is recognised in the contract pricing type construct e.g. fixed price.

I'm uncertain if SSRO's working paper referenced in 8.12 has been made publicly available.

Amendments

The SSRO invites input from stakeholders on its proposal to modify DefCARS and reporting guidance to collect details of material pricing amendments, using the requirement to report material events and circumstances and the facility for on-demand reporting.

For some contract there is a very high volume of amendments e.g. article availability contracts. I agree with SSRO that this would be administratively burdensome. Scarfing for pre-existing contracts and pricing for additional reports is not discussed in SSSRO's consultation paper.

I am unclear as to what SSRO means by the 'contract' within 8.22. The term contract within the regulations has three different meaning including a single priced change. I agree that any change to the reporting requirements would require amending affected regulation(s).

At 8.23 the Secretary of State will already be aware of the contract amendment that MoD has agreed and priced; I disagree that there is anything to report under §26. By SSRO's provocative interpretation an uplift in the price as a consequence of updated ONS indices or GBP:USD exchange rate on a fixed price contract would also have to be notified. There is no such argument that is a reasonable interpretation of §26.

In 8.23 and 8.24 additional reporting requirements should be included in the regulations and pre-existing contracts prices amended to incorporate the revised reporting requirements.

Variances and others in this section

The points I would raise have already been addressed elsewhere in my response to the consultation.

9. Overheads

Timing of overhead report submissions

1. *We welcome stakeholder feedback on whether referrals to the SSRO for opinions and determinations about rates should be expressly provided for in the legislation and whether this may facilitate agreement of rates. The SSRO would welcome further input on the typical timetable of agreeing the rates and the points at which delays occur*.
2. *The SSRO would appreciate input from stakeholders about the merits of it being able to give advice or opinions, on request, on matters of general application to the operation of the regulatory framework. These requests would not need to be linked to a particular contract*.

I draw SSRO's attention to FAR52.216-7(d) where under the US framework contractors have 6 months to prepare and submit indirect cost rates to DCMA. I month is completely unrealistic.

Even if the contractor is not subject to Part 6 reporting but the QBU has qualifying contracts a determination should be able to be sought on overhead cost allocations to contracts where the price could be subject to adjustment. Examples include: PEPL adjustments, TCIF adjustment, pricing on ascertained costs, or a post award audit of the accuracy, completeness and currency of facts disclosed at the time of contract price agreement. Where a qualifying contract is expected to be awarded no change is required to allow an opinion to be sought, the same applies to costs related to a proposed contract change. However, a reference or an opinion relating to a contract change that has been taken into work (contract SoW amended) prior to any price being agreed is, I believe, a problematic area.

Overlap between the regulatory framework and the rates programme

We invite feedback on how arrangements can be modified so that overhead reports received in DefCARS best support the MOD to determine rates and price contracts and on how the overlap between the information provided in DefCARS and the information requests from the ICPT can be minimised.

I agree with SSRO's comments at paragraph 9.29 that further consideration needs to be given to establishing the case for legislative change. I do not believe that SSRO should seek an extension of QBU's unless there is utility to MoD's information needs and therefor a clear case for legislative change.

Sequence of reporting periods for estimated and actual claims

1. *These have not been the subject of our analysis but the SSRO would welcome feedback from the MOD and industry as to whether there may be rationale to require this data for the preceding years. The SSRO is also seeking feedback on any suggestions to address the issue*.
2. *The SSRO proposes to recommend to the Secretary of State that regulation 37(7) is amended by inserting the words "the accounting period immediately following" before the words "the relevant accounting period". We would welcome any further feedback on the proposed recommendation*.

1. I look forward to seeing MOD's input reported in the consultation outcome.

Reporting agreed rates

The SSRO is prepared to recommend a legislative change to require reporting of agreed rates and costs. Before doing so would like to receive further information in relation to how the MOD is using the data or intends to use the data. The further information that the SSRO has called for in relation to the rates programme would assist with the further consideration of this issue. The SSRO would also welcome feedback on the impact of capturing the agreed rates and costs information, including the associated costs.

Industry input to prior discussions appears to be very sound. I fail to utility in providing information to MOD under a statutory obligation when MOD will already be aware that information, a reader of the legislation will be left to wonder why the requirement exists e.g. is MOD afraid it might misfile it and may need access to a back-up record of the same.

QBU compliance monitoring

We welcome any further feedback on the SSRO views on QBU compliance monitoring.

R 32(6)(b) has always looked to be an excessive ask to require the ultimate parent undertaking for a group that is headquartered overseas to submit reports for its QBUs. I have been informally told that MOD is relaxed to receive the SICR report from a UK entity rather than from US global corporate centre. MOD can review the completeness of Part 6 reports, including the SICR, conduct a compliance review under Part 4 regulation 20, and issue compliance notice if there are shortcomings. I recognise that certain overseas governments have laws that restrict disclosure of some of the information sought in Part 6 reports.

Benchmarking and standardisation

We welcome any further feedback stakeholders may have on the SSRO views on benchmarking and standardisation.

I have no expectation that benchmarking through use of Part 6 reports will ever provide VfM or any meaningful utility at all to MOD. Companies have different cost accounting practices that they use to record, allocate or apportion cost to intermediate and end cost objects. Countries have differing approaches e.g. the approach to recovery rates of US Government contractors differs greatly from that prevalent in UK companies.
If MOD seeks to require contractors to split out direct labour rates from overhead recovery rates then SSRO/MOD need to: (a) understand that will probably not cause the method the company uses to prepare its accounting records to alter so everything is now a conversion, (b) if the recovery rates change for pricing purposes then the attractiveness of individual contracts will increase or decrease because the price will change but the contractor's perception of cost will not, and (c) be prescriptive of the requirement e.g. (1) blended rates for groups of employees or a labour rate per each individual, (2) a US style fringe rate for holiday, overtime premium, sick pay or what, (3) overhead recovery rates inclusive of period expenses or separate G&A rate, (4) overhead recovery rates for evaluated overheads such as B&P, PV IR&D or not. MOD's second suggestion is so inadequately specified I'm at a loss to understand what information they seek and upon what basis they look for it to be prepared.

10. Other matters

Segmented contract profit rates

The SSRO is inviting feedback on the matters that have been raised on segmentation of profit rates in contracts. The SSRO is particularly interested in receiving input on the impact that segmented profit rates would have on contractors and the extent to which this should be reflected in reporting.

Not only should different pricing types used in a contract have different profit rates, but the pricing types should be separated by CLIN and a contract pricing statement prepared for each. All estimated costs and actual costs must be allocable to the CLIN assigned for the pricing type i.e. each CLIN must be severable else there will be inconsistency between estimating, accumulating and reporting costs See 48CFR § 9904.401. The contractor's Q-MAC provides an obligation to be consistent in allocation of costs incurred for the same purpose See 48CFR § 9904.402. The price of contract changes should be established by use of the original CPR agreed for that CLIN and use SSRO's statutory guidance (and any agreed deviations) on allowable costs that was used for the original pricing. This will support subsequent contract management. Many changes to the legal framework will be required.

Contract pricing methods

We invite comment from stakeholders on the need for any changes to the Regulations related to this matter and proposals for how any changes should be implemented.

Restriction to just 6 pricing methods was unnecessarily restrictive. Consideration should also have been given to contracts; with prospective price redetermination (pricing periods) that could be either firm of fixed, TCIF contracts (either fixed or firm) with a maximum price (to make clear this can be achieved without use of a 0/100 share-line, cost-plus (limitation of funds, spend up to in pursuit of), commercial items where prices are agreed by reference to market prices. As noted above I believe that pricing types should be separated by CLIN and should be required to be severable so that costs can be separately reported.

Final price adjustment

I believe that MOD should replace FPA with post award audits of the completeness, accuracy and currency of facts made available by the contractor to MOD at the time of pricing. The asymmetry of the final price adjustment formula penalises those contractors with sound estimating systems and incentivises contractors with poor estimating systems and processes to continue with their practices.

Appendix 2: Stakeholder responses to a working paper on profit principles

I remain to have serious concerns about SSRO's methodology for determining the baseline profit rate both in respect of companies included in the comparison group, choice of means and medians as a measure of central tendency, and use of EBIT rather than EBITA.

I do not agree that the small number of completed contracts provides a need to delay nor that economic principles that inform methodologies in use of empirical data should be set aside. The correct data used correctly should produce a reasonable result, my concern is that SSRO's process does not select the correct data and does not use it correctly.

Principle 1

Good value for money and fair and reasonable prices are supported by a contract profit rate that gives the contractor an appropriate and reasonable return on the fixed and working capital it employs in performing the contract (and the satisfactory determination of Allowable Costs).

There should be an appropriate and reasonable return to investors. The return to investors should be a reasonable return on the market value of their investment and not the book value of fixed and working capital. A share price of £7.15 needs to provide its owner with a reasonable return on that investment through the expected payment of dividends and/or expected increases in the market value of the share price. Conflating an understanding of financial reporting and economics will lead to a distorted understanding of what comprises an appropriate methodology to derive the BPR.

I disagree with MOD at 2.17. When MOD talks to 'the contractor's exposure to the risk of loosing its capital assets' I can only assume that it refers to the book or carrying value of those assets. A contractor does not loose its capital assets in the sense of mislaying them, rather they reduce in value when either carrying value of assets is less than the current value of future cash flows deriving from ownership of those assets. The current market value of a company's shares is the current value of all its future cash flows this is effectively the same as the return, to shareholders, that would be required to attract new capital. A company does not exist as an independent entity without obligations to its owners to provide a market return on the current value of their investment.

Principle 2

The contract profit rate, when applied to Allowable Costs, should enable the contractor to earn a return commensurate with that achieved by firms in a competitive market for the supply of goods and services which are the product of comparable economic activities.

See my comments made in Principle 1 above which also apply here. I would add that returns on QDCs/QSCs should be comparable to the returns on competitive contracts carrying a comparable level of risk but that BPR should be based on listed entities that are comparable in size and know how (as evidenced by the ratio of market value of shares to the book value of equity (shares, share premium, reserves/retained earnings less NCI).

Principle 3

The return on a QDC/QSC is appropriate and reasonable where it fairly contributes to meeting an investor's long-term expectations for returns on capital invested, given the risks to that investment.

I disagree with MOD at A2.17. Historical returns can be used as a quick proxy for evaluating future returns but it's the future returns that drive the share price. Economic theory that is inconvenient should not be ignored. The value of a company is the current value of future cash flows; which is why a business acquisition (business combination) is based upon

forecast future cash flows and not the book value of assets (difference is held in the books if the acquiring company as goodwill and intangible assets recognised on a business combination)

Principle 4

Where contractors perform at the expected level of efficiency, they should earn the contract profit rate that was estimated at the time of contract agreement.

I agree with MOD at A2.31 that using the profit rate estimated at the time of contract agreement may hinder ability to transfer risk to contractors, however this is why I believe that the contract profit rate should be established by use of separate CLINs for each pricing type. Consideration could be given to separate CLINs for contract change where they are both significant and severable.

I also agree with MOD at A2.32 that pricing contract cost at the median of a range of estimates would not take account of skewness and that the mean should be used.

Principle 5

Fairness requires consistency in the determination of contract profit rates (and Allowable Costs) such that relevant differences are consistently considered while irrelevant differences are consistently ignored.

It's difficult not to agree with MOD's comment at A2.26

Other comments

The relative size of profits paid under national frameworks impact upon the attractiveness of the UK regulated single source market to global companies. A company that is willing to undertake single source work under a regulated system that provides lower returns, risks adversely impacting the returns it would otherwise have received for similar single source work under a more generous framework. I refer not just to investments in knowhow and tangible assets but also the willingness to undertake contracts because of the attendant risk to pricing of contracts for other governments. This is why US FMS is generally the preferred contracting route for US entities and commercial item pricing is an essential, but missing, element of the UK regulated framework.

Quick listing of further changes to the legislative framework I thought I may see in SSRO's consultation paper.

The Act

§13(2)(a) Deletion as the it is for MOD to determine if the expenditure represents good value for money to the Crown. SSRO's role is to ensure the contractor's price fair and reasonable price, and to keep the Act and regulations up to date

§15(2) Add use of market prices for commercial items as alternative to pricing formula at (4).

§15(3) a complete rewrite to recognise requirement to segregate pricing types by CLIN and for this CLIN structure to be maintained as severable.

§15(3) Delete subsection (a) re-determination of contract price and consolidate (b) within first sentence

§16(1)(a) include reference to TCIF CLIN (currently implies the whole contract)

§17(1) Refer to pricing CLIN other than commercial item market price

§17(2) step 1(a)(ii) alter 'amended' to be 'when the contract is amended to become a qualifying defence contract'

§17(2) step 1(b) alter 'amended' to be when the contract is entered into

§25(3)(a) Reconsider 'ultimate parent undertaking'

§28(3)(a) Reconsider 'involves the provision of anything for the purposes of a qualifying defence contract to which the primary contractor is a party'

§28(4)(a) Reconsider (see above)

§29(1)(b) Reconsider 'involves the provision by the prospective sub- contractor of anything for the purposes of a qualifying defence contract to which the primary contractor is a party'

§43(1) Add definition of 'contract'. This word has 3 distinct meanings and consequently is use is often unclear and uncertain

The regulations

R2. Alter 'contract price to delete (b).

R2. Also add definitions for various meanings of the word contract by establishing a unique phrase for each usage.

R2. "The relevant time" as defined in §17(2) differs only slightly from "the time of agreement" and addresses contract amendments. The proposed change to §17(2)1(b) should be incorporated into R2.

R5 (5) should be amended such that the other contracts referenced are to be excluded from the value of the contract unless the contract has been sub-divided to fall below the threshold.

R9 Delete in its entirety. Orders awarded under a framework agreement are separate contracts that should not be subject to Part 5 reporting nor the SSPRs. If the value of a contract placed under a framework agreement is >£5m then it will be a QDC.

R10 Separate pricing type usage by CLIN and require contract types to be severable (capable of being reported separately)

R10 Add commercial item at market prices as a pricing type.

R13 Delete as this is not being used. I had thought it may be used for pricing of contract changes (where ‘contract’ is taken to mean ‘contract pricing action’.

Part 5 A complete review to align with utility for MOD e.g. CPS for each pricing type (to support post award audits

Part 6 A complete review to align with utility for MOD e.g. SICR to show information only for UK BU’s

R45 Delete requirement as addressed elsewhere

R58(4) and others. Replace ‘enable the performance’ with ‘consumed in the performance’

R59 Enable use of prior competitions to evidence price reasonableness

R60 Delete for reasons set out in R9 above

Other matters that should be considered in the update of the Act and regulations

Requirement for MOD to notify prime contractors before contract award that a proposed contract, if awarded, will be a QSC and right of contractor to appeal MOD's assessment before contract award.

Currently MoD incorporates DEFCON 800 into contract terms where MoD believes that that the contract, if awarded, will be a QDC. DEFCON 800 simply states "T*he Authority has notified the Contractor that it believes that the Contract is a Qualifying Defence Contract for the purposes of the Defence Reform Act 2014 and the Single Source Contract Regulations 2014*.". Inclusion of DEFCON 800 in the contract does not make the contract a QDC, any more than exclusion of DEFCON 800 in the contract terms renders the contract a 'non qualifying contract'.

The risk of failings by MoD in correctly classifying contracts is clearly set out in MoD's KiD guidance (paragraphs 9 through 14 of Chapter 2 Qualifying Defence Contracts) e.g. inclusion of inappropriate and conflicting pricing DEFCONs in the contract terms when the SSPRs and SSRO's statutory guidance applies as a consequence of §14 of the Act or the opposite where no terms included in the contract and SSRPRs do not apply. SSRO is aware that contracts are awarded under the authority of the Secretary of State by other than DE&S.

I therefore believe that § 14 should be amended to add additional paragraphs along the following lines " *Where the Secretary of State determines that the proposed contract would be a qualifying contract if it were entered into, the Secretary of State must give notice in writing of that fact to the prospective contractor*" and " *Single source contract regulations may contain provision entitling the prospective contractor to appeal to the SSRO against an assessment that a proposed contract would be a qualifying contract if it were entered into*" and "*The regulations must contain provision about the procedure to be followed by the SSRO in determining an appeal by virtue of subsection (x)*."These additions would bring the section in the Act on "qualifying defence contract" into line with the section on "sub-contracts". Associated changes will also need to be made to the SSPRs

Notification to sub-contractors of assessment by contracting authority that a proposed contract, if awarded, will be a QSC[1]

SSRO infer in its consultation outcome on sub-contractor referrals that there is no express requirement in the Act or the Regulations for a notice of assessment to be given before the sub-contract is awarded.

SSRO also infers that the Act only requires that the assessment must be undertaken before the contract is entered into.

SSRO is clear that regulation 62 means that no appeal may be brought after the proposed contract is entered into.

The regulations need to be amended such that the contracting authority must advise the sub-contractor a suitable time before contract award that 'the proposed sub-contract, if awarded, will be a qualifying sub-contract'.

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[1] SSRO 's stated interpretation of the Act and regulations

In section 3 of the "*Consultation Response, February 2020, Referrals guidance on appeals against assessment as a QSC* …." SSRO states in their 5th bullet point to paragraph 3 "…. *there is no express requirement in the Act or the Regulations for a notice of assessment to be given before the sub-contract is awarded"* but rather that the Act only requires that the assessment must be undertaken before the contract is entered into. R61(3) and R61(4) it says "would be a qualifying sub-contract if it were entered into" and does not go onto say " or is a qualifying a qualifying sub-contract if it has been entered into and the sub-contractor had not been informed until after contract award that the assessment had been carried out prior to contract award that the sub-contract would be a QSC.

If the contractor was not informed before contract award that the contract had been assessed as a QSC, then after contract award the sub-contractor has no right to appeal the assessment to SSRO. One is left to consider if the Act and regulations apply in the same way as they would for a prime contractor who had not been advised by MOD that a prime contract if awarded would be a QDC. This lack of clarity in the following regulations needs to be addressed.

Currently regulation 61 requires: -

R61(1) and R61(4) requires the contracting authority [A or C, or E] to *"…. access whether the proposed contract with [B or D, or F] would be a qualifying contract if entered into*."

R61(2) or R61(5) *"[A or C, or E] …. (as the case may be) must keep a record of the assessment*."

R61(3) or R61(6) requires "Where the assessment is that the proposed contract *would be a qualifying sub-contract if it were entered into [A or C, or E] (the contracting authority) must give notice in writing of that fact …. to [B or D, or F]"*

And regulation 62 makes clear that: -

R62(3) (a) and (b) that "*No appeal may be brought - …. after the proposed contract is entered into*"

Change required to regulation 61: -

In R61(3) or R61(6) *require that [A or C, or E] notify [B or D, or F] not less than 30 days before the sub-contract is entered into that the contract if awarded will be a QSC*. The 30 days gives the potential sub-contractor time to consider (a) if it is willing to enter the contract on these terms, (b) prepare a price iaw the pricing formula, or (c) appeal to SSRO.

Whereby a single source amendment to a pre-existing competitive prime contract is a QDC if conditions in the Act and regulations are met

§14(6) unexpectedly includes 'an amendment' within its structure. "*Single source contract regulations must make provision for determining whether the award or amendment, of a contract is the result of a competitive process*.".

Notwithstanding the unrestricted scope of §14(6) regulation 8 only addresses contract amendments of pre-existing competitive contracts i.e. the SSRPs do not address competitive amendments made to a QDC[2].

"*Where the Secretary of State is party to a contract with a primary contractor the award of which is the result of a competitive process, any amendment to that contract is the result of a competitive process if—*

(a) the Secretary of State either —

(i) published (in the Official Journal or elsewhere) a notice of intention to seek offers in order to obtain the goods, works or services provided under the amendment or amended contract; or

(ii) invited one or more persons other than the primary contractor, and not associated with the primary contractor, to negotiate or provide offers in relation to those goods, works or services;

(b) the material terms of the amendment or amended contract are wholly or substantially the same as were offered by the primary contractor in its tender for, or in negotiations relating to, those goods, works or services; and

(c) at the time of making its offer, the primary contractor did not consider it likely, or could not reasonably have considered it likely, that its offer would be the only offer reasonably capable of acceptance by the Secretary of State."

The Act and regulations as currently constructed require any amendment of a pre-existing competitive contract which is not the result of a competitive process iaw R8(2) is required to be treated as a stand-alone QDC[3] where other tests[4] for a QDC are met.

The Act clearly gives scope for part of a single source contract to be included within the scope of SSPRs and the pricing framework, and for other parts of that same contract to sit outside the regulatory framework[5]. This scope could have included competitive amendments to QDCs.

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[2] An order under a framework agreement (regulation 9) is a separate (stand-alone) contract and not an amendment of a contract.

[3] e.g. the overall 'value of the contract' as required in R5(5)

"Subject to paragraph (6), where—

(a) the purpose of the contract is to fulfil a requirement for goods, works or services, and

(b) the contracting authority has also entered into, or proposes to enter into, one or more other contracts which are not the result of a competitive process with the same person (or persons associated with that person) for the purpose of fulfilling that requirement,

(c) the contracting authority must disregard a contract, or a proposed contract, which has a value of £250,000 or less ….

the value of the contract is the aggregate of the consideration which the contracting authority has paid or expects to be payable under the contract and all of those other contracts or proposed contracts.

[4] An amendment is not a contract and therefore the £250k test is not relevant and the exclusion does not apply

[5] Once the concept of contracts being part a qualifying contract and part a non-qualifying contract (§14(6)) consideration needs to be given to §15. Here §15(2) can relate only to that part of the contract that is a qualifying contract e.g. the non-competitive change to a competitive contract. §15(3) only works if one recognises that the Secretary of State and the primary contractor do not propose to amend the contract in a way that would affect the price determined by virtue of subsection §15(2) as the price of competitive contract was not determined in accordance with §15(4). An amendment to a qualifying contract could be excluded from the qualifying element of the contract iaw §14(6).

A review is required of R14 (re-determination of contract price) to establish how it fits with the above (as many/most contract amendments are not severable).

The differing uses of the word 'contract' also needs to be carefully considered.

Several issues arise and each should be considered in the update to the Act and the regulations.

1. If competitive contracts are required to be segregated between contracted scope that is a non QDC and amended scope that was not competed and is therefore a QDC, then the arrangement could equally apply to commercial items with a verifiable market price for within a single source prime contract that would otherwise require to be wholly classified as a QDC
2. If an amendment can be competed for a competitive contract, then there should be no inhibit for the same arrangements applying to a pre-existing QDC.
3. Contract amendments can comprise a change to the Statement of Work i.e. something added, and something removed. Currently these are always priced as a net change. In that the something added could be competed and the something removed never can be it is only the something added that could sit outside of the qualifying contract as an integral non-qualifying contract.
4. How should a reduction to a competitive contract be priced as the 'actual' cost avoided will never be known, the wording used suggests all non-competitive amendments (increase or decrease) are QDCs.
5. Regulation 14 (re-determination of contract price) has undergone major revision as the provisions were seen as inoperable (unhelpful'). See my footnotes. The combination needs to be considered in any further update of either. Severable and non-severable contract change issue.
6. The conflict between R8 and R14 does not look to apply to regulations under Part 10 as R8 only applies to prime contracts.
7. SSRO's non-statutory guidance on FAQs 3.6 should either be withdrawn (my preferred option) or the Act and regulations amended to give authority to a requirement
8. MoD's commercial guidance to its Contracting Officers has similar, but different, issues to 4 above at paragraphs 30 through 32 of Version 1.13 of Chapter 2 Qualifying Defence Contracts.

§14(6) of the Act (*qualifying defence contracts*) talks to testing of whether the amendments of a contact is the result of a competitive process; and regulation 8(2) (*Competitive process for single contracts*) talks to the test applicable to determination if an amendment to a competitive contract is the result of a competitive process.
From the Act §14(6) and regulation 8(2) one is left to infer that an amendment to a prime competitive contract that is not the result of a competitive process is, if other tests such as value thresholds are met, a stand-alone QDC sitting inside of a non-qualifying contract.
The amendment as a stand-alone QDC is not only required to be priced iaw Part 3 of the SSRPs (e.g. the pricing formula, PEPL) but also subject to Part 4, 5, 7, 8 and 9.
Firstly, only a minority of amendments to competitive prime contracts are severable from the pre-existing content.
For example, (a) where amendments to competitive prime contracts alter the SoW whereby something is changed there is a reduction and an augmentation that are not, by logic, be severable (b) amendments that are simple reductions (cannot have a negative value QDC) (c) amendments that extend the contract timescales.

Secondly other regulations in Parts 1, 2 and 3 do not address contract amendments but rather qualifying defence contracts or tests to determine if a contract is a qualifying defence contract. Regulations in Parts 1, 2 and 3 that give inadequate consideration to a QDC being a stand-alone contract amendment to a competitive contract include:
R2 - Definition of contract price
R4 - Meaning of “contract completion date”
R5(5) through R5(8) - Calculating the value of a contract (requirement and amendment issue)
R9 - Competitive process for contracts made under a framework agreement
R14 - Redetermination of contract price
R16 - Procedure for determining final price adjustment
I believe that the sensible approach will be for “amendment' to be deleted from§14(6) and for R8(2) to be deleted in its entirety.

Narrative on the existing framework on contract changes

The Act

§14(6) Regulations relating to qualifying defence contracts

Single source contract regulations must make provision for determining whether the …. amendment[6] of a contract is the result of a competitive process.

This section only applies to prime contracts

§15[7] Pricing of contracts

(3) The regulations must provide that where the Secretary of State and the primary contractor propose to amend the contract[8] in a way that would affect the price determined by virtue of subsection [the pricing formula] or this subsection—

(a) the price payable under the amended contract must be re-determined[9] in accordance with the [pricing formula], or

(b) the price payable in respect of the amendment[10] must be determined in accordance with that formula.

SI 2018 No. 1350 PART 3 Repricing of contracts

Regulation 2 – Contract price

"contract price", in relation to a qualifying defence contract[11], means—
(a) the price payable under the contract to the primary contractor as determined in accordance with regulation 10, or
(b) if the contract is amended in a way that affects the price payable under it, the price payable under the contract to the primary contractor as determined or, as the case may be, last determined in accordance with the Schedule;";

Regulation 14 Redetermination of contract price

The Schedule makes provision for the re-determination of the contract price for a qualifying defence contract[12]

Schedule Regulation 14 Redetermination of contract price

Part 1 Application of Schedule

Application of Schedule 1.—
(1) This Schedule applies if the parties to a qualifying defence contract[13] propose to amend the contract in a way that would affect the original contract price. Such an amendment is referred to in this Schedule as a "pricing amendment".
(2) In this Schedule—
"original contract price", in relation to a qualifying defence contract, means—
(a) the price determined in accordance with regulation 10, or

[6] Problems start here
[7] This section applies to regulated contracts
[8] Should this be taken to mean the contract amendment or the whole of the legally enforceable contract?
[9] Whole contract to be repriced. Difficult to read the word contract as other than the whole of the legally enforceable contract.
[10] Where the amendment is priced separately from the rest of the contract
[11] This restricts use of "contract price" to qualifying defence contracts, also neither (a) nor (b) refers to non-qualifying contracts and therefore not single source amendments to competitive contracts.
[12] Unless the phrase 'a qualifying defence contract' is separately applied to contract amendments it does not apply to single source amendments to competitive contracts
[13] A single source amendment to competitive contracts is not change to a qualifying defence contract and regulation does not, therefore apply.

(b) where the contract has previously been amended in a way that affects the price payable under the contract, the price determined or, as the case may be, last determined in accordance with this Schedule;

"the parties", in relation to a qualifying defence contract, means—

(a) the Secretary of State, and

(b) the primary contractor.

PART 2 Single pricing amendment to a qualifying defence contract

Application of Part 2

3.—

(1) If the parties propose to make a single pricing amendment to a qualifying defence contract[14], the price payable under the amended contract is to be determined in accordance with this Part.

<u>*EXPLANATORY NOTE to* SI 2018 No. 1350</u>

(This note is not part of the Regulations)

Section 15(3) of the Defence Reform Act 2014 (c. 20) ("the Act") requires regulations to make provision for the re-determination of the price payable under a qualifying defence contract[15] ("QDC") if the contract is amended in a way that would affect that price.

That section requires that regulations make provision either for the price payable under the QDC as amended to be redetermined or for the price of the amendment to be determined. This provision is currently made by regulation 14 of the 2014 Regulations. Regulation 14 provides for the method to be used for repricing a QDC to be determined by severability of costs.

These Regulations replace regulation 14 of the 2014 Regulations with a new Schedule which sets out how the price of a QDC is to be re-determined by reference to the type of amendment being made to the contract, the pricing method used and the number of amendments being made to the contract (see regulation 8 of and the Schedule to these Regulations).

<u>Regulations unchanged from 2014[16]</u>

<u>Regulation 8 Competitive process for single contracts</u>

(2) Where the Secretary of State is party to a contract with a primary contractor the award of which is the result of a competitive process, any amendment[17] to that contract is the result of a competitive process if ….

<u>Regulation 9 Competitive process for contracts made under a framework agreement[18]</u>

[14] A proposed amendment to a completive contract is not an amendment to a qualifying defence contract and therefor all that follows does not apply

[15] A proposed amendment to a completive contract is not an amendment to a qualifying defence contract and therefor all that follows does not apply

[16] §14(6) refers

[17] This says that amendments to a competitive contract is not a QDC if the amendment meets the criteria set out in R8(2). By implication if the conditions for exclusion are not met then unless there are other reasons for exclusion the amendment is a QDC. This interpretation requires that all amendments are severable

[18] Framework agreement is not a framework contract. Thus, orders under a framework agreement are separate contracts which may individually be QDC's iaw regulation 5 if the value is greater than £250k and the overall requirement for single source content is greater than £5m and other tests are met.

Orders placed under a framework contract are contract amendments where minimum quantities for those articles are included in the contract.

Regulation 5(5) through5(8) Calculating the value of a contract[19]

(5)(b) the contracting authority has also entered into, or proposes to enter into, one or more other contracts[20] which are not the result of a competitive process with the same person (or persons associated with that person) for the purpose of fulfilling that requirement, the value of the contract[21] is the aggregate of the consideration which the contracting authority has paid or expects to be payable under the contract and all of those other contracts[22] or proposed contracts.

(6) For the purposes of paragraph (5)(b)—

(a) the contracting authority may disregard a contract if conditions A and B are met in relation to it;

(b) the contracting authority may disregard a proposed contract if, were it entered into on the terms proposed, conditions A and B would be met in relation to it.

(c) the contracting authority must disregard a contract, or a proposed contract, which has a value of £250,000 or less where it is reasonably satisfied that the procurement has not been subdivided in order to avoid the requirements of the Act and these Regulations.

(7) Condition A is that the contract[23] has a value of more than £250,000 but less than £1,000,000.

(8) Condition B is that the aggregate value of—

(a) that contract, and

(b) any other such contract within paragraph (5)(b), each of which has a value of more than £250,000 but less than £1,000,000,

is less than 20% of the aggregate of the consideration which the contracting authority has paid or expects to be payable under all contracts entered into, or to be entered into, for the purpose of fulfilling the requirement mentioned in paragraph (5)(a).

(8A) A contract which has a value of £1,000,000 or less shall not be treated as a qualifying defence contract by virtue of this regulation unless the contracting authority is reasonably satisfied that the procurement has been subdivided in order to avoid the requirements of the Act and these Regulations.

[19] Here 'contract' refers to the value of contracts and not individual contracts
[20] Here 'contracts' refer to individual legally enforceable contracts i.e. not contract amendments
[21] Here all relevant contracts
[22] Here 'contracts' refer to individual legally enforceable contracts i.e. not contract amendments
[23] Nowhere in R5 does a contract mean 'a contract amendment'.

5. MOD

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26 February 2020

David Galpin
Director of Legal and Policy
Single Source Regulations Office
Finlayson House,
15-17 Furnival Street
London
EC4A 1AB

By e-mail consultations@ssro.gov.uk

Dear David

Single Source Contracts Regulations Review 2020

I am writing in response to your consultation on the Single Source Regulations Office (SSRO) proposed recommendations for the 2020 review of the regulatory framework for single source defence contracts.

The MOD will not be submitting a detailed response on the questions asked in the consultation. As the purpose of the consultation is to develop recommendations to put to MOD, it would not be appropriate to give a view at this stage.

I should emphasise that the work the SSRO is carrying out through this exercise will play a valuable part in the MOD's overall review of the legislation and the recommendations that emerge will be given full consideration. I look forward to continuing constructive engagement with the SSRO throughout the review process.

I am content for this letter to be published.

Yours sincerely

Charly Wason
Head, Single Source Advisory Team

6. Paul Walker

From: Paul Walker
To: Consultation Responses
Subject: 2020 review of the regulatory framework for single source defence contracts
Date: 26 February 2020 17:48:23

CAUTION: External Email

I have a general academic interest in secondary legislation, its increased use over time, and the burden it can place on business without parliamentary scrutiny.

I am interested in the approach taken in these regulations by having an independent body review the legislation in addition to the government. This would seem to me to reduce the risk that over time the framework would tend to favour government and become burdensome on business.

However, what is missing from your regulations, which would be helpful in understanding how this approach is working, is a requirement for the minister to publish a report of their review.

I have asked the MOD for a copy of their last review of the legislation, which they have confirmed exists, but they are still reviewing my request under the Section 35 (Formulation of Government Policy) FOI exemption and do not expect to respond before your consultation deadline.

In the meantime, I suggest the following amendments to bring your legislation more in line with common practice for
reviews carried out under The Small Business, Enterprise and Employment Act 2015 (although I acknowledge your legislation pre-dates that Act and is not within its scope).

In section 39 of the Defence Reform Act 2014:
- in paragraph (3)(a) omit "and"
- after paragraph 3(b) insert "; and (c) publish a report setting out the conclusions of the review."
- after sub-section (3) insert:

"(3A) A report must, in particular—
(a) set out the objectives intended to be achieved by the provision mentioned in subsection (1),
(b) assess the extent to which those objectives are achieved,
(c) assess whether those objectives remain appropriate,
(d) if those objectives remain appropriate, assess the extent to which they could be achieved in another way which involves less onerous regulatory provision, and
(e) if any recommendations made under subsection (2) have been disregarded, the reasons for disregarding them."

You may publish my submission.

Regards,

Paul Walker

7. Thales

Single Source Contract Regulations

Thales responses to 2020 consultation review of the Regulatory Framework

The regulatory framework was introduced by the Defence Reform Act 2014 and the Single Source Contract Regulations 2014 and aims to strike a balance between achieving value for money on government expenditure and fair and reasonable prices for contractors, by subjecting qualifying contracts to price control and by requiring suppliers to provide an increased level of transparency.

Thales fully supports the ADS response to the review of this framework but would like to add the following points mainly in respect to the practical issues of implementation of the legislation and guidance.

1. The ability to confirm a Price of a Qualifying subcontract (QSC)

Commented [WU1]: Not sure the message is clear in this section.

The principal obligation on the parties to a QDC is set out in Section 20 (2) of the Act, which requires that the parties (i.e. the primary contractor and the Secretary of State) must be satisfied that the costs are Appropriate, Attributable to the contract and Reasonable in the circumstances. Section 20 (3) of the Act requires that in doing so the parties must have regard to guidance issued by the SRRO (e.g. Single Source Cost Standards: Statutory Guidance on Allowable Costs).

Section 20(4) of the Act places the onus upon the primary contractor of a QDC to demonstrate to the Secretary of State (if required) that costs (including obviously those of the QSC) are Appropriate, Attributable and Reasonable. The burden of proof rests with the primary contractor.

In summary it is the responsibility of all parties to a QDC that all costs under the contract satisfy the requirement to be Appropriate, Attributable and Reasonable. This does cause an issue with the confidentiality and sharing of pricing information between industry peers. The practicalities of this in respect of time and cost must not be understated.

2. Poco. (step 3 of the profit rate calculation)

The legislation refers to the requirement for Step 3 in calculating the contract profit rate:
Deduct an agreed amount from the amount resulting from step 2, so as to ensure that profit arises only once in relation to those allowable costs under the contract in respect of which the regulations provide that a deduction may be made (and see section 20 as to allowable costs).

We understand the requirement to ensure profit is only applied once, but this is not straightforward when dealing with Non UK Group cross border transactions i.e. transfers of property, stock, or financial and commercial obligations between related entities resident or operating in different tax jurisdictions.

We suggest a practical solution could be just to ensure no additional profit is added to the price received from a group subcontractor.

Furthermore, the extraterritorial reach of the legislation is, in some cases, in conflict with other nations own legislation. Where this is the case, government to government agreements, communicated promptly to industry are recommended.

3. Applicability of the legislation to Non QDCs and QSCs

Currently the Secretary of State is intending to apply the legislation to the pricing of non-competitive contracts under £5m. The practicalities, and associated costs, of such agreeing a contract profit rate on a case by case basis for what is small value should not be understated.

4. Supplier reporting

The supplier reporting requirements are understood but at the moment complying with the legislation means supplier reports include say actuals in relation to a financial year, but do not reflect the rates agreed for that year (rates agreed in arrears) nor necessarily the rates used for pricing a particular contract (negotiations still in place where not all cost incurred is deemed AAR). The SOS is keen today to provisionally price contracts, but we recognise this is not an accepted pricing method. Thales recommends supplier reports could be due only when the business unit rates are promulgated and that contract reports are due when we have a contract that is priced in accordance with a regulated method to avoid any duplication and nugatory effort.

5. Sunk costs.

Reg 14, section 5. Thales acknowledges that a whole contract becomes a QDC by amendment when both parties agree as such, but there may be delay in the agreement of any sunk prices which today impacts our ability to initiate reporting within 30 days of contract award. We recommend reporting should be initiated *post the period of change* and only to the aspect of the contract that is the QDC/QSC i.e not include any past sunk costs.

Thales remains committed to supporting both the Secretary of State and the SSRO to ensure the legislation achieves the objectives intended.

Alison Hexter
28th Feb 2020

8. Respondent 1

The 2020 review of the procurement framework for single source contracts

As part of the 2020 Single Source Contract Regulations (SSCR) and Defence Reform Act (DRA) review the SSRO have issued a paper highlighting specific areas that they believe warrant change and invited input from Industry. This paper provides the xx input which also supports the ADS views expressed separately.

General Comment

The paper provides a lot of page count to the issue of the baseline profit and also cost risk adjustment. There has been an ongoing difference of opinion between Industry and the SSRO over the methodology adopted to calculate the baseline profit, which needs to be addressed before any further debate over the effectiveness of the baseline profit and the adjustments that may apply to it.

Industry has argued consistently for a more appropriate assessment of what would be applicable to a viable, dynamic defence market. Although the methodology chosen by the SSRO is not directly attributable to the regulations or the Act it is important to get the methodology more representative of the market it is seeking to address.

Setting a median which has represented inappropriate entities (such as a hire car company) underpins the view that the current methodology is not credible. In addition, setting a threshold of £10M (previously £5M) for the lower end of the comparator list undermines the whole basis of what a QDC would be. For instance, it is inconceivable that MoD would place a QDC (even at a £5M value) with a company that operates at a £10M turnover, the imbalance of risk and ability to absorb any impact to the programme would likely result in a frustrated contract. A more appropriate threshold should be considered that represented a more realistic context for the market in which it is meant to apply as a comparator. It is recommend at least setting the lower threshold at £50M which would be a better representative of the likely lower end scale of the extremes; a more realistic assessment of the gearing needed to absorb a £5M QDC (i.e. 10% of the annual turnover). To underline this further, would a £10M revenue for an Italian Company manufacturing agricultural machinery be an adequate comparison to a large prime contractor with revenues globally in excess of say £10Bn.

Previous challenges by Industry have largely gone unaddressed although the SSRO have declared that changes have been made for the 2020/21 baseline profit that have taken cogniscence of the issues raised by Industry (the increase from £5M to £10M), but this is still not representative of the market or indeed the requirement to pass a pre-qualification questionnaire (PQQ) that established the financial substance of a contractor).

Further as part of the creditability of the comparator, it is an important factor that the comparator list represents a predominance of companies that can rely on volume to absorb risk and achieve reasonable returns for the market segment that they represent. In 2016/17 when a greater share of Defence Companies was introduced into the comparator exercise the underlying trend changed positively suggesting that the arguments put forward by the Defence Industry at the time over representation had merit. Therefore, the relevance and credibility of the comparator is important.

The regulations review should be an opportunity to consider the broader aspects of the DRA and the SSCR; namely a fair price for the contractor while achieving value for money. In the latter case so far value for money seems to have focused disproportionately on the achievable profit, which is around 10% of the actual equation and is, after all, a consequence of cost. While the SSRO have issued guidance on Allowable Cost as an attempt to address the broader issue, the real test of value for money has largely been ignored. In this context, there is no evidence that the regime provides for

sufficient attention to be paid to cost drivers (as opposed to cost). In most cases the costs are derived from the elements of the contract that drive the cost base. Duplication of reporting, delays to the agreement of rates and perceived lack of effective recognition of the cost of requirements are all legitimate areas for further investigation on value for money, however, some of these may sit outside the terms of reference for the SSRO.

The SSRO demand for reports seems to serve only the compliance to the regulations. Evidence from executing contracts shows that MoD (at the working level) does not always recognise the SSRO reports, or use the DefCARS database, believing that they are for the SSRO only. Contract requirements demand a separate set of reports that serve the MoD's own purpose, yet they are in addition to the SSRO reports. For instance, a contractor will create a cost base through a work breakdown structure that represents the various functional elements of the execution. This is used by MoD to establish the basis of a price agreement. Yet when considering the structure of information required for the DPS a separate exercise is undertaken to map the costs into the DPS by the Contractor. If MoD wish to use the DPS for comparison and data analysis, they should have a much greater role in performing this task, rather than the contractor being left to make their own decisions on the applicability of cost types etc.

Furthermore, there has been little intent to review where MoD are using Social Value as part of their assessment for appropriate value for money as per the Social Value Act 2012. The Act required public bodies to consider how they can secure wider social, economic and environmental benefit through their procurements; yet this could be incompatible with the current guidance on allowable costs. A consultation exercise was conducted by Government during March/June 2019 period on how to improve their performance in this area. Naturally, any investment in social value will be predicated upon the ability to recover such costs. It is not clear whether any such costs incurred would be deemed allowable or not, probably not if there is no direct benefit to the contract, which means any compliance by a contractor would see its profit eroded yet again. In considering the comparator list where this is unlikely to be an issue then it is clear that the list remains unrelated to the market context in which Defence operates.

The previous regime ("Yellow Book") took account of market context through using a weighted average to avoid a bias towards the lower end of the comparator list and provide more credibility to the use of a baseline profit rate for use in Defence. The broader use of Western Europe and North America comparators in the new methodology further skews the outcome as the circumstances are different outside the UK. For instance, in Western Europe there are still state owned, or state interests held in certain companies which detracts from the need to maintain shareholder value. In North America sufficient granularity on available data to make a fair comparison is not accessible to the appropriate degree necessary because of the way the information is published.

All of these issues need to be addressed if the setting of a profit rate is credible. Certainly, when global companies are bidding for internal investment and funding to undertake R&D and pursue new opportunities the UK, while having to compete against more lucrative markets, will loose out in the medium to long term. Within LM for instance, it is not so easy to secure necessary funding whether through single source or competitive tenders for that very reason.

Matters on which input is sort

A fair portion of this paper has been given over to a general comment around the need to get the baseline profit methodology sorted so that it is much more representative of the Defence market

because it is important for the rest of the consultation process. The following comments against the input requested should be considered in this context.

Cost Risk Adjustment

The +/- 25% was set as an arbitrary range that had no link to any logically defendable case for setting the range. Industry have considered a more representative range that can be justified against some logic. To this end it would be better if the range was more representative of the extremes represented by the comparator list, which would incentive the need to make that list more representative of the risks and complexity in the Defence market. For instance, if the range was set against the extreme above and below the median, which defines the baseline profit, then at least it is more representative of the available profit in the general market. In 2018 this would have been approximately -30% and +100%. MoD's stated preference over the last year has been to set the range at -70% and +100%, the negative adjustment – we were told – was based on the ability by MoD to force a contractor to accept a contract with a -70% adjustment. This again casts doubt on the logical application of a risk adjustment and further ignores the need for Industry to achieve a fair price.

The use of the Cost Risk Adjustment (CRA) is intended to address the potential risk profile of a particular contract in order for the Contractor to secure a fair price. There is no empirical evidence to determine what fair and reasonable or for that matter value for money are as concepts within this adjustment. There is only the subjective view that each party has reached an acceptable position, based on the information available at the time the agreement was reached. There is no doubt that the overall contract profit rate delivered under SSPF is lower than that expected by many companies internal rate of return. It has in the past been suggested that an element of Weighted Average Cost of Capital (Bloomberg suggest average is between 8 to 10%) should feature more in the overall application of profit, which could also influence the use of a CRA adjustment; although in reality the baseline profit rate should use this more effectively as an indication of what return would provide a contactor for a sustainable market presence.

While the application of the CRA has been maturing since the DRA, there remains too much subjectivity in the current method for agreeing the adjustment applicable to the contract. While MoD have been piloting a "points based" model for calculating the risk profile and hence the adjustment, it remains to be seen how it would work out when used "in anger" in real situations. The initial pilots (2 contracts so far) suggest that for both parties the model allows for informed debate and quicker time to agree, the "artificial" context of the exercise makes agreement much less emotive.

The CRA also needs to take into account certain intangible and unallowable cost risk. Intangible cost risk is becoming a growing area of concern for businesses and demonstrating there is an allowable financial impact of such risk can be difficult. These risks are often not well understood by Government or where there is a lack of empathy for the impact of these risks from the commercial team the ability to come to a fair assessment of the risk profile delays the outcome and often results in intransigence rather than a willingness to understand the issues. In addition, in terms of unallowable cost there is still a reasonable expectation that a contractor should be rewarded for accepting a contract where unallowable costs exist but cannot be charged. There is still a cost of doing business where some if not all of that cost is dismissed due to the limited ability to show a specific benefit to a particular contract.

The only statement in the regulations that define the application of the CRA relates to the uncertainty of the estimates being similar to or different from the actuals. While this still features in the assessment of the adjustment it is impacted by the lack of progress on agreement of rates and indirect costs applicable to the application of cost. For some time now Industry has suffered from retrospective agreements on rates and typically several years' worth of assessment leading to agreement to catch up on. The application of the CRA was meant to apply to forward rates estimated and therefore the contract could be executed with some certainty over the final outcome. Where the agreement is delayed and follows a year or more ahead of the contract award then applying the regulations where the profit rate applicable at the time of agreement applies changes the expectation and outlook when the contract was entered into. This is a further example of intangible risk that the CRA needs to recognise. And a range greater than 25% would go some way to compensate for this uncertainty, which is not something experienced by the comparator list.

In para 5.54 reference is made of using the Insurance Industry to provide insight into how parties might value the transfer of risk. ADS view that this is not appropriate for Defence is supported. Insurance tends to be of a specialist nature and borne out of the assessment of likely exposure based on data collected on a range of incidents that the insurance provider would cover, together with both a level of premium paid and an assessment of probability together with the ability to pool any exposure over a wide range of assets. This is not the same model for Defence where in most cases each contract stands alone and the volume is not there to pool any impacts. A business would need to show the viability of any contract based on the ability to absorb any risk and generate reward from within that contract. The volume is not there to do anything else in the current market.

In the same paragraph comment was made to the assessment of the premium paid for the transfer of risk. In reality no contract is without risk and the application of CRA could apply equally to a cost reimbursable type arrangement as it does to a firm price one. For instance, where there is uncertainty of cost because the rates have yet to be agreed which may be towards the end of the contract the actuals incurred versus what the customer pays could differ, yet the current adjustment does not allow for that eventuality; especially not in a cost reimbursable arrangement.

MoD have accepted that the CRA in its current form and range does not adequately encourage, or appropriately incentivise risk transfer. However, while the transfer of such risk should be manageable and reasonable the increase in any available adjustment should not be at the expense of unreasonable expectations. For instance, most firm price contracts are agreed at a level of probability (calculated through Monte Carlo simulations) at around the P70 or above position on the probability curve, yet we are aware that MoD would prefer a P50 position which aligns with their budget assumptions. By its very nature a contract let at a P50 position is as much likely to fail as it is to succeed, whereas a P70 position allows a level of risk to transfer (P90 giving much more certainty but at a much higher price) that is predictable as well as manageable.

Profit on Cost Once

In most cases, due to the complexity of supply chains, it is very difficult to get visibility to tiers beyond tier 1. Increasing the transparency of the supply chain beyond tier 1 would require extensive resourcing at each level driving cost for minimum benefit. Further, arrangements between third parties tend to be confidential with limited ability to influence the provision of appropriate information beyond the immediate parties to an agreement; take for instance the drive to collect data to support the SME agenda, it has proved very difficult to gather that information beyond tier 1; and certainly at an additional cost and resource burden.

In addition, due to the inconsistency of this element of the SSCR with tax law appropriate measures have had to be adopted to avoid subsidiaries falling foul of the "tax avoidance" criticism; an issue that was brought to the attention of the SSCR team before the regulations were passed into law. This is further compounded by cross border international trading. Consequently, this has resulted in any adjustment being applied at the prime contract level by applying zero profit on that workshare which is provided by a subsidiary. While this may limit visibility into the application of POCO it remains a balance between compliance with one law against another.

The benefit of applying POCO beyond the interpretation of a subsidiary to include Joint Ventures and potential investment mediums (such as in the case of pension funds) is questionable. In context where for each £100K (at the current baseline profit of 7.68%) the POCO adjustment would be around £7.6K – or less than 0.2% at a QDC of £5M (for the regulations to apply) the real benefit is questionable when more resources (and hence cost) would be required to accommodate it always assuming that access to the relevant data could be achieved. And when the reality is that much more can be saved from looking at the cost drivers the benefit of spending time on this area is questionable and just extends the perception that there is a disproportionate focus on such a small element of the overall price and a bias towards rebuking profit as a reward for the acceptance of risk and weakening overall shareholder value. Is it any wonder that the application of SSCR has been received so negatively?

In para 6.10 reference to JVs or companies not part of a group is not clear why the SSRO would want to seek a change to extend application of the regulations to these entities. A prime contractor is unlikely to have any control over or consolidate the potential profit (instead benefiting from dividends) of such entities to warrant a POCO adjustment. Further, with reference to the above paragraph the likely outcome would be minimal at best notwithstanding the likely offset of the cost of applying the necessary processes and resources to try and force the access to appropriate data. The value for money here would be questionable and continue to promote the perception that profit, rather than being a legitimate reward and incentive, is instead seen as an anathema.

Defined Pricing Statements

The Defined Pricing Statements (DPS) should be more aligned to the provision of contract related information, such as a work breakdown structure. MoD are usually responsible for defining the contract work scope (such as SoRs, SOWs, etc) that form the basis of the work break down structure that is used to price the contract. It is clear from the request for alternative formats that MoD (certainly at working level) does not pay due regard to the DPS when formulating the contract structure or indeed when asking for a price breakdown. It is our experience that once a price is agreed it is seen as a contractor effort to map the work breakdown structure and price into a DPS with no involvement or input from MoD. It is therefore questionable whether the value of a DPS is appropriate; especially as anecdotally we have heard that the DPS and associated SSRO reports are for "SSRO use only".

There is an issue around the DPS for support or service-based contracts where the categories do not align to the specialist support services that some contracts require. So, in the particular case of a support contract when we attempted to use the submarine DPS too high a proportion of costs were being mapped to too few lines, reducing the effectiveness of the exercise. And when investigating other DPS's none were suitable for the work we were performing. It is worth recording that from a contractor's perspective there is little to no value in completing a DPS, especially as there is a need to make decisions for each work breakdown structure mapping from contract elements to the DPS,

with no assistance from MoD. This is a disproportionate use of resources when the use and benefit of a DPS is not clear or obvious.

Table 2 goes some way to set out a basis for future review of the DPS, but it should include all stakeholders in that review to create an acceptable pricing structure where one input serves several purposes, otherwise it becomes a cost driver with questionable value.

In regards to table 4 and the proposed changes to DefCARs it is again worth emphasising that it should be for MoD, not the contractor, to drive the selection of the DPS and at least assist in the mapping if it is to be used by all parties as the single point of reference for allowable cost. While it has been recognised that single equipment type structures may be unsuitable reference only to framework agreements, which typically attract a level of competition, is the wrong focus. Systems Integration or in Service Support contracts should be taken into account in this area of change – it is not so exceptional as suggested in the box under para 7.36.

9. Respondent 2

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Our reference: ■■■■■■/■■/028/02/2020

Your reference:
Review of the procurement framework
for single source contracts

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28th February 2020

Review of Procurement Framework for Single Source Defence Contracts – Consultation

■■■■■■ appreciated the opportunity to participate in the SSRO workshop on 29th January which was helpful in summarising the context of the areas under consideration in the consultation. The SSRO presentation provided a useful categorisation of the changes between those requiring amendments to the Legislation and others which can be accommodated with Guidance and DEFCARS. The ■■■■■■ preference is where possible, it is better to have additional Guidance rather than have more Legislation. We feel that any requirements for the introduction of new Legislation should be as a consequence of the need to address significant changes in the original recommendations of the Currie Review. We are not aware that there any such requirements and that the Legislation introduced with the Defence Reform Act may only require limited amendment to improve the application and clarity of the original purpose.

■■■■■■ has engaged extensively with ADS and industry partners in the preparation of a detailed response to the specific matters on which input is sought in the consultation and have engaged with ADS in the production of their supplement to the consultation response. The ADS responses are reflective of ■■■■■■'s views and we support the approach that before any regulatory changes are considered there are wider reviews undertaken in the areas of the pricing methodology and reporting requirements, we understand and are supportive of these objectives being addressed in the SSRO Corporate Plan 2020 -2023.

Industry and investors do not want to introduce uncertainty in the Regulatory Framework and believe it is important that any necessary amendments are managed and considered over a reasonable timeframe that aligns to the SSRO Corporate Plan and avoids unintended consequences of solutions that are disjointed and not comprehensive.

In response to the six areas addressed in the consultation document the ■■■■■■ considered position is as follows:-

Cost risk adjustment:

■■■■■■ is of the view that when there is resolution on the BPR methodology and make-up of the comparator group there will be a better foundation for resolution of an equitable CRA. In addition the significance and difficulties of finding a solution for the CRA should be moderated with further work on the definition and approach to addressing the issues on 'contingency', 'risk' and 'management reserve'.

The option to decouple the CRA value from the BPR has some benefits in simplifying the adjustment, but there would need to be provisions to prevent the BPR becoming not fair and reasonable in circumstances for a cost plus arrangement.

Profit on cost once adjustment:

■■■■■■ has to date very limited exposure to circumstances where profit on cost once adjustments have been required. The guidance and adjustment required is quite mechanistic and has lasted the course of time pre the Regulations. If MoD and the SSRO require more transparency for work that is undertaken by related companies a proportionate and practical solution is required, if this cannot be achieved under the provisions that are currently available.

Defined pricing structure:

To date there seems to be questionable benefit in the DPS reporting obligations; our engagements with the MoD delivery teams would confirm this view. However, at this stage in the process, with very little feedback from Contract Completion Reports, the DPS may eventually provide MoD with some useful information, but at a significant cost to industry and MoD.

■■■■■■ supports a requirement that limits the DPS reporting obligation to Contract Initiation and Contract Completion Reports and any other required DPS reporting is on the basis of requesting an 'On Demand' report.

Amendments and variance:

It is clear from discussions on QDC reporting and in the reporting workshops there is a lack of clarity in the variance reporting and treatment of contract amendments – the potential solution here is not to request more reporting, but should be to clarify and simplify the requirements. While some of the matters raised in the consultation seem to indicate that more information may be useful, our view is that the materiality levels need elevating with more of a focus on the big picture contract outturn with the lower level detail reduced. This aspect of reporting should form a core element of the suggested

comprehensive review of the Reports and Reporting regime and avoid layering new reporting requirements on the existing structure.

Overheads:

Many of the issues that have caused issues with the supplier and overhead reports originate from the delay, and additional information being requested by the Authority, to agree contractor's rates. This is an evolving landscape that if the SSRO, CAAS and the ICPT were completely joined up could avoid industry unnecessarily producing similar information to multiply government departments.

■■■■■■ supports the inclusion of providing all the necessary overhead information once, with access available to multiple users. Again this can be combined as part of an overarching overhaul of the Reports and Reporting regime.

Other matters:

In respect of identification of other matters that are not specifically addressed in the consultation, but are considered in the ADS supplementary response; ■■■■■■ supports the concern and potential inequitable situation that could arise when replacing provisional pricing under Regulation 14 and the new Schedule. If contractors are to continue with the concept of provisional pricing to expedite the delivery of contract, a change to the regulatory framework is required to include Provisional Pricing as a Pricing Type. Additionally in the Schedule of the Regulations, the relevant Contract Profit Rate should only be applied to the differential in the provisional price and amended price.

■■■■■■ have discussed the specific questions raised in the working paper with Industry partners and our responses are incorporated in the comprehensive ADS submissions that you will receive this week.

■■■■■■ continues to be supportive of the SSRO's activities in this area and are available to provide any further assistance necessary as we progress into the next phase of the Framework Review. In our response to these public consultations ■■■■■■ wish to remain anonymous but are happy for the content to be included in any relevant SSRO publication.

Yours sincerely,

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10. Respondent 3

Cost risk adjustment

We agree and support the proposal that there should be more guidance given on how the CRA adjustment is calculated so that the Contractor is not exposed in terms of risk. This should include consideration of whether the adjustment in certain circumstances should be in excess of 25% and whether there should be a separate range for differing contracts types reflecting the uncertainties involved, eg development contracts vs build to print contracts.

Profit on Cost once adjustment

We agree with the proposal to increase the threshold on group sub contracts to £250k and that this amount is consistent with other levels in the guidance. We do not support the concept of aggregating multiple contracts for the purpose of ascertaining whether the threshold as this would add complexity to an already complex area.

We support the broadening of the definition of 'Competitive process' to include GSC's & FGSC's which are priced in line with market price conditions even though not competed.

Defined Pricing Structure

We agree with the SSRO that it is too early to suggest radical change to the DPS and concur with the principles of 'Relevance, Consistency & Proportionality' outlined in table 2. Consistency of approach and reporting being fundamental to the achievement of MOD expectations.

Amendments and Variance

We support changes in the guidance to include examples of Amendments & Variances reporting in order to clarify definitions and achieve consistency of approach together with the changing of the DefCARS tool to facilitate the reporting and impact of Amendments separately from that of Variances. However, the existing requirement to analyse 90% of variances and record all contract amendments is already onerous and any additional reporting over and above this would be overly burdensome. We suggest that the level of variance analysis be lowered from the 90% level and reporting is standardised on categories which are in line with the DPS categories for consistency of approach.

Overheads

The proposal to shorten the due date for reporting overheads to less than 3 months from the contractors accounting period would put undue pressure on the contractor during what is already a busy period.

Other matters

We believe that SSRO's proposal on the viability of a blended profit rate would lead to inconsistency and much greater scope for variability in DPS data input into the DefCARS reporting tool as DefCARS requires separate inputs for each profit segment.

We agree with the proposal to amend the Regulations for the target pricing method to permit adjustments to be made to Allowable Costs estimated at the time of agreement due to changes in specified indices or rates, thereby bringing the approach in line with the fixed and volume driven pricing methods.

We support the definition change proposed to Regulation 17(2), (3) and (4) re profit rate adjustments for the final price adjustments to be in line with the intent clearly expressed in Regulations 17 (6) a) and b).

11. Respondent 4

Section	Consultation request	Company A feedback
5.8	*We invite stakeholders' views on whether and how Section 17(2) and Regulation 11(3) might usefully be amended to better state the intended purpose and therefore facilitate more appropriate application.*	Company A agrees that these sections should be amended to cover more than just actual vs estimated costs. Perhaps the terminology that the SSRO have used of considering "substantive financial risk" could be applied to consider the context when applying an adjustment to the BPR. As regards Regulation 11(3) (CRA), it would be helpful to amend this regulation to recognise that at the time the contract is bid it will, in some cases, be impossible for the contractor to have fully identified likely sources of risk to executing the contract within the proposed costs (including management reserve) as **a number of 'unknown unknowns' which by their nature cannot be defined will continue to exist**. As regards Regulation 17(2), Company A would request that reviews are made taking account of the following: - Whether it is reasonable to assess that the company providing the contract will not incur any cost following closure of the contract. - **Whether it is reasonable to limit recovery of costs to a maximum of 50% of increased costs per 17(5) taking into account that the contractor's margin throughout the contract is limited by the BPR (preventing them from having significant reserves to fund cost growth) and cost growth could be driven by 'unknown unknowns' which could not reasonably be estimated at contract initiation.** Perhaps an approach to allowing more than 50% of cost growth to be recovered could be to assess whether the risk was reasonably identifiable at contract outset so that risks causing cost growth that are true 'unknown unknowns' would be fully recoverable.
5.20	*We invite views on whether there should be additional direction in the SSRO's guidance and/or rules within the legislation to specify the CRA range for contracts with different pricing methods.*	Company A believes that the 6 step profit generally, and the CRA specifically, need to be re-characterised as guidelines, rather than rules. While the DFA and the SSCR define themselves as "principles based, not rules based", the CRA boxes the parties into a narrow range which does not permit the flexibility to address many factors that are not mentioned in the guidance, such as cited below. Contract type is not the only key factor. The current regulation imposes too strict of a constraint on the negotiation process. This is particularly unworkable for cutting edge, state of the art defence contracts. Absent further detail, the point system discussed in 5.23 (b) appears to be the most sound of the 3 options presented, but it should still be presented as guidelines rather than impose strict mandated mechanical calculations. As currently written, the CRA

Section	Consultation request	Company A feedback
		does not provide the flexibility to permit a corresponding adjustment in negotiated profit reflecting an informed review of a statement of work and the landscape in which it will be performed. Another option would be to define separate ranges for commercial goods and services versus defence goods and services, with defence goods and services, regardless of contract type, having a higher floor and significantly higher ceiling range. **Finally, Company A would recommend that a review be performed to assess the benefits of removing the CRA as a point of contention and replacing it with a significant range for negotiating adjustments to the BPR, based on whatever complexities and risk factors impact each particular requirement. Company A hypothesises that cost savings would be made across industry, the MOD and the SSRO as protracted CRA and BPR negotiations (including complex reviews as contract amendments are made) could be avoided. The MOD customer would in instance be required to document the supporting rationale for the negotiated profit rate adjustments.**
5.30	*(CRA RANGE) We welcome views from stakeholders on the development of such guidance.*	Company A considers that a points-based approach is likely to have too many variables to adopt a consistent approach and may not consider all elements of the substantive financial risk described above. Instead, perhaps greater granularity on (appropriate) benchmarking data would enable to MoD to make informed decisions about what is reasonable **on a case by case basis**. If the CRA range is to be reviewed, Company A believes that as a minimum the range needs to be broadened on the positive side. **However, the current maximum *negative* adjustment should not be increased.** Irrespective of the factors discussed below, a reasonable floor should be maintained for compensation on any contract. Assuming the CRA remains part of the BPR calculation, Company A believes that **the ceiling for positive adjustment to the BPR needs to be increased to accommodate the wide range of variation in risk,** complexity and required expertise, as well as contract type, among the MOD's contractor base. The current range is insufficient to address the difference between a contract for commercial of the shelf items or routine services, and a contract for production or maintenance of a

Section	Consultation request	Company A feedback
		complex weapon system, and every variation in between, as well as factors such as contract type and schedule.
5.64	*We welcome stakeholders' specific proposals for changes to the range of the CRA, with supporting evidence or information which explains the rationale for the proposals. We also welcome alternative proposals for achieving a wider range of available contract profit rates.*	The danger with using a wider range of BPR is this could become a self-fulfilling prophecy. Contract risk varies significantly even within the same contract type and segment and this approach could discriminate against high-risk but low BPR contracts, creating low market engagement for this type of activity (e.g. cost-plus construction contract with immature requirements, leading to a high risk labour profile). As highlighted in 5.20 above, the CRA range needs to be broadened and the criteria expanded, to allow for differentiation between commercial goods and services, and defence goods and services. Even mature defence programs inherently present higher risk and require more expertise and tighter controls than comparable commercial products and services. In addition, the range should be, as the SSCR describes itself, principles based rather than rules based, therefore the ranges should be a guideline rather than a mandate. In addition, any range adjustments should consider the fact that "firm priced" contracts under the SSCR regime no longer exist, and the profit rates under those contracts are not comparable to those of "firm priced" contracts elsewhere in the global landscape, where the contractor is free to benefit from efficiencies realized under a firm-priced contract. The intent of such contracts is to incentivize the contractor to control costs, in that the contractor assumes all the risk but also all the benefit if he achieves efficiencies and controls costs. Under the SSCR, the contractor assumes much of the risk, but is forced to share the benefit of any efficiencies. The best way to mitigate the negative impact of the current approach on the incentive to control costs is to: (1) Broaden the upper CRA range to ensure appropriate compensation for complex goods and services. In this way, the traditional incentive for a firm priced contract would remain as previous unless the contractor significantly underruns the contract. This would prevent unreasonable windfalls, but still offer a reasonable range within which the contractor can realize benefit from seeking and implementing efficiencies. These efficiencies would also be baked into negotiations for follow-on contracts and thus put downward pressure on follow on contracts; and (2) move to the "principles-based" approach held up as the standard for DRA, so that the range is a guideline and not a regulatory mandate.

Section	Consultation request	Company A feedback
		In addition, the current 6-step profit regime, and the CRA in particular, when combined with the end of contract adjustment, stifles the previously robust relationship between contractor and customer that provided sufficient flexibility to meet unexpected changes and customer requests within a broader interpretation of the statement of work. When the profit range is unacceptably low on a "firm priced" contract, the Contractor will have less flexibility to accommodate changes or unplanned requests as they occur, and be forced to require contract changes for any deviation from a strict interpretation of the scope of work.
6.2	*We welcome views on the various points raised in paragraphs 6.7 to 6.20 about the definition of GSCs and FGSCs, together with any specific proposals for related changes to the Regulations.*	6.10 Assuming the entities truly are operated independently and each incur legitimate costs (especially if the prime has legitimate cost in managing / integrating the deliverable from the other party) it seems reasonable that both should be permitted to earn margin. **Company A shares the views that a clear definition of the word "associated" would be beneficial in relation to section 10, for example 1161 of the Companies Act 2006? I.e. a group undertaking** 6.17 – we would concur that lifting the threshold to £250K / £1M would make sense as the cost of additional reporting / administration of reporting on complex group arrangements is likely to offset any benefit of lowering the current threshold. At this level, tracking would become more viable. 6.19 – demonstration of value for money – it may be possible to demonstrate from price lists / absence of viable competitors that placing a non-competed contract delivers best VFM so broadening the competition exclusion to consider these scenarios would be welcomed. **Overall, Company A agrees that when reviewing contracts for adherence to SSCR POCO restrictions, SSRO should consider: (1) the value of the subcontract; (2) whether the benefit obtained by policing POCO is outweighed by the administrative costs for smaller contracts; and (3) whether or not the associated contractor is a domestic UK company. Finally, Company A would advocate for a clear exclusion where it is evident that a company can be seen to have structured themselves deliberately to avoid the POCO restrictions.**

Section	Consultation request	Company A feedback
6.25	*(POCO) We welcome views from stakeholders on the potential benefits or impacts of changes to how the adjustment is determined, together with any specific proposals for related changes.*	Company A is aware of the accounting complexities associated with varying this calculation and believes that continued engagement between industry, MOD and SSRO is required. Company A would advocate that creating transparency and simplicity in the calculation should be the objective of any change to this calculation method.
6.28	*We welcome proposals from stakeholders on how greater transparency about POCO adjustments might be achieved in a way that is not unduly burdensome for contractors.*	**Would a starting point be to include within the ICR template a section detailing subcontracts with a Y/N identification of whether this is a GSC / FGSC? Again, the cost of compliance with reporting should be considered.**
7.17	*Stakeholder views are invited on whether the characteristics in Table 2 provide the right basis for future review of the DPS. Any further input on the proposed pace of change would be welcome.*	Company A believes that adding some examples of the nature of each DPS would help. Where have costs been categorised previously could be shared so there is greater consistency between contractors. Irrespective of any change, allowing variations on a case by case basis must be permitted to recognise that all businesses are structured differently and recover different costs directly / indirectly.
7.25	*Recognising that this is a complex area, the SSRO is seeking further input on its suggested proposals before making changes to its reporting guidance and the DPS templates in DefCARS.*	Company A agrees that this is a difficult area and agreeing at contract outset how to report ancillary services would avoid confusion as the contract progresses. In some occasions, the proposal in Table 3 would be feasible however, in complex systems where a service may touch components that underpin multiple DPS elements, showing this reporting at a more consolidated level will be necessary to avoid confusion.
7.33	*The SSRO proposes changing paragraph 5.30 in its current reporting guidance to that proposed in Table 4. We welcome stakeholder views on this proposal.*	In general Company A is supportive of the approach in Table 4 and agrees, if the DPS structure can be confirmed by all parties involved as early as possible and included within the pricing/cost model it would solve a lot of the teething problems further down the line. The clarification on exclusion of risk contingency is also helpful (as long as this is reported elsewhere)
7.36	*We are proposing a change to DefCARS to allow reporting against more than one template where this is appropriate in response to stakeholder feedback that the single-equipment type structure may be unsuitable for a small number of contracts. This might include, for example, framework agreements where more than one equipment type will be*	Company A views that the main challenge is how amendments / tasking contracts are handled within DEFCARS. We would welcome improvements to this process. In particular, • The current system makes it very difficult to reflect changes in costs that are not induced by the contractor. • Task based contracts or line items should not have to renegotiate profit, for each task or each program year, nor should that be needed for minor changes

Section	Consultation request	Company A feedback
	provided or supported under the contract (for example allowing the selection of fixed-wing aircraft alongside rotary wing aircraft). We acknowledge that reporting in this way will be the exception rather than the rule and a change to the reporting guidance and DefCARS will be required to accommodate this. Stakeholder views are sought on this proposal.	or additions to the SOW within the broad scope of effort. There should just be language prohibiting using the change order process to sidestep issuing a new contract. This would give the MoD program team the flexibility they need to perform effectively and saves unproductive time and expense needed to continuously negotiate profit rates for minor changes to the contract.
7.43	*The SSRO considers that it should proceed with its working paper proposal to make it easier for contractors to explain their mapping within DefCARS by adding an additional field within DefCARS to allow contractors to explain their approach. Stakeholders are asked to share any views on this.*	In line with the above, extra commentary would help the online submission provided this is optional where it makes sense to provide and not mandated.
7.47	*The SSRO has decided not to proceed with the proposals on additional categorisation within the DPS which was presented in the working paper, though this is something we may explore in future reporting guidance work on the contract description. Stakeholders are asked to share any views on this.*	Could a drop down list be implemented alongside the contractor's summary of the contract? The main obstacle to this applying universally is that some companies cover certain costs in their rates whereas others recover directly and so if categorisation were introduced there would have to be cautionary guidance around comparing contract to contract – **this would be more for analysing an individual supplier's performance across contracts (as opposed to comparing suppliers against each other).**
7.56	*Stakeholder views are welcome on these proposals or any other matters addressed in this section on DPS metrics*	Real consideration needs to be given before comparing reporting across different contracts for the reasons outlined above….**different companies' overhead structures will lead to huge fluctuation in how different costs are realised and reported**. The intent of the reporting through DEFCARS is fundamentally to ensure that profit being made on sole source contracts is reasonable. Company A believes that the huge fluctuations would also lead to mischaracterisation of the causes of those fluctuations due to lack of understanding of each contractor's accounting system. Both within the UK and the US, any contractors complying with the QMAC process to set rates / the USG's Cost Accounting Standards undergoes intensive, extensive review, auditing and approval processes, in accordance with US law and regulation. It would not be and it is not productive to duplicate that effort.
7.66	*At this stage the SSRO would like to seek further input on whether the current arrangements which allow the parties to agree the frequency of interim contract reports remain fit for purpose. It would be*	Company A agrees with ADS that for small contracts submission of an ICR at the beginning and end of the contracts works. Throughout the contract there will be other deliverables provided by the contractors to MoD to show how the contract is

Section	Consultation request	Company A feedback
	helpful to receive feedback on whether interim DPS reporting in the ICR remains appropriate or whether a different mechanism is required.	performing, Quarterly review meetings etc. Completing a further ICR duplicates this process in our view.
8.12	*The SSRO welcomes views on possible changes to the guidance to reflect definitions and examples.*	Company A would like to see a revised definition for 'variance' – perhaps one that explains the change in cost due to change in contract cost based on both performance and scope, as backed up by ADS. We would argue that the definition of 'difference between one cost and another' is too narrow and doesn't address the variance to cost that in a new context and is based on completely new assumptions when affected by a contract change. SSRO have stated in their pricing guidance that the baseline value of a contract is determined when the contract price is agreed at start, so we would welcome acknowledgement that any detriment on the original perceived value is based from variances driven by the MoD via scope increase/decrease and subsequent contract change. We believe that the guidance would be clearer if the relationship between baseline value, an amendment and a variance is explored further. **Some variances are not Contractor induced, i.e. increase in cost to resolve a customer dependency and maintain schedule – if this hasn't been considered as a cost risk it could still impact negatively on the contractor. As per our comments at 8.12 we consider that situations of this type are not easily reflected in DEFCARs and therefore often not acknowledged.**
8.24	*The SSRO invites input from stakeholders on its proposal to modify DefCARS and reporting guidance to collect details of material pricing amendments, using the requirement to report material events and circumstances and the facility for on-demand reporting.*	We have a fundamental question over the purpose of the reports within DefCARs – is the purpose in order to track the profit rate or realised cost over the period of the contract? If the latter then wouldn't the previous realised cost would need to be overwritten with each amendment, or at least the opportunity for the contractor to demonstrate a variable (contract type, terms, assumptions, profit rate) that might have changed? These could have an unforeseen impact on cost over the contract period regardless of the contract price change associated with an amendment. (This might reduce effort required for the ICR and CCR) **We would therefore welcome the opportunity to provide details of material events and can see value of ad-hoc reporting – this is caveated heavily that the**

Section	Consultation request	Company A feedback
		scope of these reports and the extent of detail requested by MoD would need to be agreed with industry, do not result in more effort for some contractors over others and are included within the reporting guidance. **We also would suggest a revision of rules of engagement to provide more ability for MOD customer teams to engage prior to reporting / provide subjective overview. This would align with the principles based approach.**
8.29	*The SSRO is interested to hear views on whether this would provide an effective materiality threshold for explaining variances.*	Company A agrees that a materiality threshold would be beneficial, but think that this should only apply to certain categories of cause of cost variance. i.e. we would not be expected to explain the cause of a cost variance that had an associated contractual concession, regardless of value. The categorisation is key – not just 'high level and low level', but broken down by causes would give MoD and Industry the opportunity to demonstrate trends in variance.
8.31	*The SSRO is interested in views on the above categorisation. The SSRO would also be interested in evidence on how easy or difficult it would be for contractors to use this categorisation when reporting variances.*	Currently we are being asked to show all variances as the lowest line level and this is driving high volumes of work that has already been explained to the customer in regular meetings. Being able to summarise into categories would be highly beneficial. We would therefore welcome a categorisation approach, however further examples based on explanations of contractor variance would support the guidance. These categories will become more credible with the natural growth in reports submitted.
8.43	*It seems premature to contemplate proposals for legislative change at this time, but the SSRO continues to welcome evidence of unnecessary duplication.*	We consider that one area where there is currently potential for duplication / opportunity to streamline the process would be to make sure that various groups (MOD project teams, CAAS, SSAT, SSRO) are all able to access the same data source at the appropriate time via a central repository. For example, data such as QMAC information may have been provided to ICPT but CAAS have no record of this information.
9.18	*We welcome stakeholder feedback on whether referrals to the SSRO for opinions and determinations about rates should be expressly provided for in the legislation and whether this may*	Setting of rates is very complicated and is dependent upon the nature of contract as well as the contractor and its financial operations (including other non-MOD customers) on the creation of those rates which is unique. SSRO involvement could

Section	Consultation request	Company A feedback
	facilitate agreement of rates. The SSRO would welcome further input on the typical timetable of agreeing the rates and the points at which delays occur.	mean getting involved at tactical level and maybe not best use of their time. SSRO opinion could set a precedent which maybe unworkable for other organisations.
9.19	*The SSRO would appreciate input from stakeholders about the merits of it being able to give advice or opinions, on request, on matters of general application to the operation of the regulatory framework. These requests would not need to be linked to a particular contract.*	General advice is helpful provided it is clear and timely. Being able to seek input without it becoming precedent setting would also be critical.
9.32	*We invite feedback on how arrangements can be modified so that overhead reports received in DefCARS best support the MOD to determine rates and price contracts and on how the overlap between the information provided in DefCARS and the information requests from the ICPT can be minimised.*	When do we expect the update of the CAAS Recovery Rates programme will be? If this can be updated and brought in line with both this process and the ICPT, it has potential to smooth the process and remove any duplication.
9.37	*These have not been the subject of our analysis but the SSRO would welcome feedback from the MOD and industry as to whether there may be rationale to require this data for the preceding years. The SSRO is also seeking feedback on any suggestions to address the issue.*	We would suggest that, given the scale of reporting today, only data directly impacting current and future contracts is prioritised (rather than seeking historical data which would require support / commentary to explain).
9.38	*The SSRO proposes to recommend to the Secretary of State that regulation 37(7) is amended by inserting the words "the accounting period immediately following" before the words "the relevant accounting period". We would welcome any further feedback on the proposed recommendation.*	Company A has prior experience or knowledge of the QBUECAR at this stage.
9.45	*The SSRO is prepared to recommend a legislative change to require reporting of agreed rates and costs. Before doing so would like to receive further information in relation to how the MOD is using the data or intends to use the data. The further information that the SSRO has called for in relation to the rates programme would assist with the further consideration of this issue. The SSRO would also*	Would this be linked to the QMAC and approving costs for each contract? If the two can be aligned then this would limit the incremental costs as the QMAC/agreed rates/costs can be agreed together. There could be possible incremental costs associated for renewing the QMAC and renewing the agreed rates year on year and the extra compliance/agreement needed.

Section	Consultation request	Company A feedback
	welcome feedback on the impact of capturing the agreed rates and costs information, including the associated costs.	
9.55	*We welcome any further feedback on the SSRO views on QBU compliance monitoring.*	Company A has prior experience or knowledge of QBU monitoring at this stage.
9.66	*We welcome any further feedback stakeholders may have on the SSRO views on benchmarking and standardisation.*	Company A has previously provided input on benchmarking via ADS. In general, whilst benchmarking should always be a factor / data point when making industry-wide policy, it is critical that the level of variables in each unique company means that there always needs to be an over-arching principle that the circumstances unique to any particular company are closely considered prior to agreeing rates, BPR etc.
10.4	*The SSRO is inviting feedback on the matters that have been raised on segmentation of profit rates in contracts. The SSRO is particularly interested in receiving input on the impact that segmented profit rates would have on contractors and the extent to which this should be reflected in reporting.*	We believe this would over-complicate an already difficult process for agreeing profit rates. Industry has to take a view on the mix of work within any contract when considering risk and therefore should have adequately assessed the different work types and uncertainties when negotiating the CRA. The current reporting regime does not handle tasking or phased contracts with amendments which already demand a separate CRA 6-step process to run. Where the work is task based and well understood it should be considered as part of the base contract; where it is a new development or significant change then a new 6 step CRA could be applied by agreement. We would recommend simplification of the agreement of the Contract Profit Rate – segmentation would not achieve this for a relative small window of change to the profit and in parallel would recommend better focus on clarity of requirements to enable more cost effective solutions to be provided.
10.9	*(Allowable costs)* *We invite comment from stakeholders on the need for any changes to the Regulations related to this matter and proposals for how any changes should be implemented.*	Company A notes that in any revision to allowable costs estimation, consideration might be useful in relation to the position impacting international companies position not fully e.g. where a company is subject to international accounting stds / group structures and may be subject to more than one national regulated pricing regime.

12. Respondent 5

Contractor Comments on SSCR 2020 Review
SSRO Question and Answer Sheet

Paragraph Ref No.	SSRO Question
5.6 - 5.8	*We invite stakeholders' views on whether and how Section 17(2) and Regulation 11(3) might usefully be amended to better state the intended purpose and therefore facilitate more appropriate application.*

Contractor response:

Ignoring the question of the appropriateness of the BPR, the BPR comparator group and assuming that for any given project the parties have agreed a level of contingency within the Allowable Cost Estimate based on the risks foreseen the following can be reasonably deduced:

i. For any pricing method based on an estimate of allowable cost, the incidence of risk and uncertainty which is included at a Cost Risk Analysis confidence less of than 100% (Monte Carlo or similar) or indeed any agreement of contingency derived from an alternate method has the potential to cost more than it was estimated whether foreseen or unforeseen / known or unknown. This assumes a confidence level of <100% is chosen and there are no unknown unknowns (Refer para v. below).

   We believe this represents the concept of risk inside of allowable cost as the estimate of allowable cost includes a sum for risk and uncertainty commonly referred to as contingency. The element of risk and uncertainty not included in the price being risk outside of the allowable cost estimate and not forming part of the cost, can then only be rewarded through the to the CRA.

ii. Equally where a cost plus pricing method is agreed (and there is no contingency for uncertainty and risk) then the potential of there being a variance, on face value, is nil or low. i.e.: Industry is not bound by a price, the profit amount varies with the actual allowable cost incurred and the actual cost is the Actual cost incurred subject to the AAR test.

   Here the incidence of risk is within the allowable cost incurred however we believe there are other factors which can be considered to effect the adjustment. (Refer paragraph vii. below). Hence we agree this is not just about cost risk but the wider exposure companies are expose to.

iii. It is evident that the provisions of *Section 17(2) and Regulation 11(3) were intended to cater for and in the process consider, similar to the previous Yellow Book principles, circumstances where the Contractor is carrying more or less cost risk as a result of the pricing method. E.g.:*

Cost Plus methodology.

iv. *It is therefore logical, fair and contemplated by the Act and the Regulations that a corresponding adjustment should be available where the incidence of risk is higher. In simple business terms the business case is the recompense, via a positive CRA adjustment. I.e. it is an adjustment that represents value for money and a fair return for industry when compared to the risk and uncertainty still remaining outside the estimate of allowable cost. We believed expressed in this manner there would be little ambiguity over the business case for adjustment.*

The risk and uncertainty remaining outside the estimate of allowable cost being an allowance for that proportion of known and identified risks that haven't made their way into the estimate of allowable cost due to negotiation or agreement of an a certain confidence level or unknown unknowns that haven't even been identified on the risk register.

It is notable that the larger and more complex the activity the more likely that the risk register will not have captured the specific risk. Statistics are available to support this premise.

v. The concept of unknown unknowns is difficult to quantify. Statistics show that it is often not the incidence of risks known, valued (in the estimate) and mitigated that occur but those that we had not thought about or considered, the unknown unknowns. We assess these unknown unknowns which cannot be valued inside an estimated of allowable cost as being a factor that contributes to whether there is a variance between the estimate of allowable cost and the actual cost. Large, novel, complicated one off projects by their nature don't have a history to value these unknown unknowns and this perhaps is the most compelling reason for widening the CRA band positively as well as adding guidance to the factors that give rise to positive CRA adjustments.

In this regard the guidance, in our opinion, is not clear how the factors at para vii below and the unknown unknowns are considered and their contribution to CRA.

This also creates a difficulty with the comparator group of companies the most notable feature was that many Comparator Group companies were performing work that was significantly less sophisticated or complex or both than what would be expected or required in typical QDCs/QSCs. Comparator Group company quality and reliability standards etc. were able to be lower because of the commercial nature of the end product and the demands of the market. Therefore using a 25% CRA adjustment from a baseline profit rate based on a non-comparable group of companies is, in our opinion, flawed.

vi. Turning to the drafting of the Regulation Step 2 (which follows the requirements of the Act) the baseline profit rate can be adjusted *"by an agreed amount which is within the range plus or minus 25% of the baseline profit rate so as to reflect the risk of the primary contractor's actual allowable costs under the contract differing from its estimated allowable costs".*

vii. We have previously commented to the SSRO in the 2017 Review on the factors that contribute to cause a variance between *actual allowable costs under the contract differing from its estimated allowable costs"*. Para 5.5 of "*The 2020 review of the procurement framework for single source defence contracts: Consultation states" for example makes a helpful reference for example to terms* and conditions (See underlined below)*:*

"The SSRO's working paper set out its view that the stated purpose meant considering how the variability between estimated and actual Allowable Costs imparts financial risk to either party to the contract, bearing in mind contract terms and conditions, the regulated pricing method used and the potential impact of any final price adjustment (for excessive profits and losses). Ensuring this risk is reflected in the contract profit rate contributes to the achievement of good value for money for the government and fair and reasonable prices for contractors."

The factors that influence and affect CRA were record as:

a. Wider business risks: e.g.: SQEP labour availability, capability, capacity, obsolescence, sharing, etc.
b. Market factors: e.g. Market or product withdrawal, commercial terms and prices, OEM's. etc.
c. Enterprise and site risks: e.g.: Employee liabilities / Union issues, Pension Shortfalls, Latent Defects, Business Continuity, Regulatory changes, Security, Transformation, Improvement, etc.
d. Disallowed contract costs: e.g. Selling and Marketing Cost, LD's, Rework, Acquired intangibles, etc.
e. The timing of risks and claims beyond completion especially with regard to claims, latent defects, subcontractor insolvency, security, regulation, etc.
f. Unknown unknowns or those items not identified in risk and uncertainty.
g. Effects of other project that are inflight possibly affecting the outcome of this project.

viii. Whilst we consider the Act and Regulation is fairly clear on the purpose for reduction under a cost pus methodology, we believe the drafting is too narrow, binary in application, is too simplistic and hence misleading for positive adjustments. We believe there is some evidence of possible pessimism bias in the application of positive CRA adjustments when compared to negative and would welcome the SSRO investigating this further in order to substantiate whether it is generating a fair return for industry. Negative adjustments seem to be binary whereas positive adjustment much more progressive and less likely.

Noting the foregoing observations we believe it would be worthwhile elaborating the drafting in the regulation to:

ix. Acknowledge the risk and uncertainty inside the estimate of allowable cost (being zero under cost plus arrangements).

x. Acknowledge that there could be risk and uncertainty still outside of the estimate of allowable cost which informs the adjustment of CRA.

xi. Add the factors that could adjust and effect the adjustment to guidance.

Proposed amendment:

(3) Adjust the baseline profit rate by an agreed amount which is within a range of plus or minus 25% of the baseline profit rate, so as to reflect the risk of the primary contractor's actual allowable costs under the contract differing from its estimated allowable costs to reflect:

i) the risk and uncertainty included in the estimate of allowable cost,
ii) the risk and uncertainty not included in the estimate of allowable cost considering those factors that could adjust the CRA positively and negatively including the timing of such factors that are outside of the estimate of allowable cost.
iii) the effect of terms and conditions
iv) the contract pricing method including share-line
v) the final pricing adjustment

xii. Whilst drafting this response and as evidence of what ambiguity and over simplification causes, we question why an estimate based fee pricing method automatically receives an expectation of -25% CRA adjustment?

The regulations state Estimate-based fee pricing method as:

(7) Under the estimate-based fee pricing method, the allowable costs by which the CPR is multiplied are the allowable costs as estimated at the time of agreement.

(8) The allowable costs which are added to the product of the CPR and the allowable costs determined in accordance with paragraph (7) are the actual allowable costs determined during the contract or after the contract completion date.

Under this method the simplification fails to recognise the potential for variance, the impact that it could have on CPR and whether it is a fair return. The key here are the factors that influence both the estimate and actual allowable costs. Who is responsible for load, scope growth, was risk and uncertainty allowable costs as estimated at the time of agreement, the terms and conditions and those other factors noted in para. vi etc. all have an influence on whether a -25% reduction is appropriate and fair.

For example whilst all costs under AAR will be paid imagine a situation where the costs double compared to that envisaged at the time of the agreement. This would have the effect of halving the CPR for the project. It seems inconceivable that a Contractor should receive the same profit for this arrangement as it would for a cost plus arrangement. Indeed why would any contractor agree to it? As the actual costs increase then the contractors return goes down possibly to lower single figure %ages, therefore the contractor must be taking a financial risk by having its return reduced.
We have a similar concern with regard to other concepts that provide pre conceived adjustments for each regulated pricing method. How this can procure a fair and reasonable return for industry when the factors are being ignored is not understood.

5.9 - 5.20	We invite views on whether there should be additional direction in the SSRO's guidance and/or rules within the legislation to

	specify the CRA range for contracts with different pricing methods.

Contractor response:

i. It is a concern that per paragraph 5.9 of the SSRO 2020 review the SSRO only regards "the contractor's actual profit will be affected by the contract's terms and conditions, the "contract pricing method, and any final price adjustment". Per our observations at paragraph 5.6 – 5. 8 above and specifically identified at our paragraph iv) to vii) this appears to be an over simplification and is contrary to the evidence and logic that there are items outside of the Estimate of Actual Cost that give rise to the variance.

ii. We therefore strongly believe further guidance and direction per our response above at 5.8 paragraph vi, vii and viii would greatly assist the understanding and application of the CRA to the BPR six step process.

iii. We are not supportive of a rules based system. Per the SSRO's current philosophy we support a principles based approach to guidance. A rules or process based system cannot hope to cope with the myriad of different scenarios for each contracting method. Nor would it increase the ability of parties to agree, perhaps also increasing the likelihood of referrals to the SSRO.

We see no reason, with adequate purpose defined under the regulation and suitable guidance, why a principles approach cannot work based around what is basically a judgement and business case. We are supportive of proposing the concepts to be considered and perhaps some examples but see no need for a rigid rules based framework. In this regard we are unsighted on the development of the Excel based framework system being tested by the SSAT.

If there is consideration of a more regimented rules based system we would ask whether there is also an intention to change the basis of the BPR calculation to align itself to the same principles as the CRA.

iv. We are not supportive of mandatory adjustments relative to each regulated pricing method. Such a concept we believe ignores the other factors and unique circumstances surrounding project contracting that are absent from the BPR group companies. We assess that such a mandated approach to specifying a range for each outcome does not support the concept of a fair return for industry as it would ignore the risk and uncertainty both inside an estimate of allowable cost and the factors that contribute to CRA adjustment described above.

An example of how specifying such a range can be misleading with regard to the risk and reward was provided at paragraph viii. to Question 8.5 above.

A further example of how basic assumptions to return and the CRA range drive illogical and inequitable outcomes to profit is already evident where a mandated -25% reduction from BPR applied on cost plus contracts ignores the factors outside of cost that cause potential erosion of profit. i.e.: the factors describe above including, long term effect of terms and conditions, warranty, indemnities, long statute of limitation, extensive access to data, project phasing, impact of one project on another etc. We also don't see how this would relate to the risks inherent in the comparator group of companies. I.e in order for the CRA to work , it assumes that the BPR derived from the comparator group of companies will be subject to the same level of risk as single source work at the BPR , i.e CRA +0% CRA. When we look at the comparator group of companies there are a signifigant number of component suppliers , retailers , leasing companies and operate in non relevant market sectors that cant possibily be subject to the same cost risks that are undertaken by single source suppliers. In addition the size of the comparator groups of companies indicate they are in general not perfroming work that is as sophistated or complex or carries the same level of prime contractor integration risk as is seen in the single source environment.

v. Additional guidance on how to price risk into the estimate on Estimated Based Fee regimes and how that works where current guidance states a -25% deduction would also be helpful.

5.21 - 5.30	*We welcome views from stakeholders on the <u>development of such guidance.</u>*

Contractor response:

i. We are supportive of further principles based guidance (and the widening of the purpose) to expand and contribute to the understanding and navigation of the CRA Range.

ii. We have limited knowledge of the current multi-criteria decision model proposed by MoD and has not been invited to scenario test the solution. It is aware of limited testing to date (2No) but do not know whether the issues highlighted at previous workshops have been addressed. e.g. Flexibility in the question sets and allocation of weightings, potential duplication of CRA criteria with risk and uncertainty included in the estimate of allowable cost, etc.

iii. We assess that better guidance would permit easier navigation of the CRA range and therefore reduce the disproportionate effect on lower-value contracts. A simpler approach seems fine on face value however the affect once aggregated might then highlight a new issue and also generate an unusual consequence.

iv. We are also concerned by the potential to adopt parts of other international schemes in a mix and match format.

v. We are not supportive of a highly structured approach for the CRA alone and such approach should be considered in the context of the BPR six step process in its' entirety.

5.59 - 5.64	*We welcome stakeholders' specific proposals for changes to the range of the CRA, with supporting evidence or information which explains the rationale for the proposals. We also welcome alternative proposals for achieving a wider range of available contract profit rates.*

Contractor response:

i. We are not convinced that a change to the range of the CRA is the best vehicle to achieve the objective of better incentivisation or alleviate industry concerns over the appropriateness of the comparator group composition or the method. We do not believe that we should burden an already a difficult area with further complication or process not relevant to the purpose.

Should the MoD wish to better incentivise industry to procure better outcomes and VFM then there is already a vehicle for incentivisation present in the Act and Regulation. Widening of the band relative to performance incentivisation and widening the definition of performance benefit (which is at present limited) would procure the same outcome more simply and aligned to MOD requirements. It would also provide due record of the business benefit and VFM.

ii. Should MOD wish to widen the band to permit and procure outcomes that better reflect the purpose to reward or recompense industry *so as to reflect the risk of the primary contractor's actual allowable costs under the contract differing from its estimated allowable costs"* then this might have some merit.

However it is not logical or proven that the reduction or increase should be in the same proportions or indeed why there should be a reduction at all. In this regard we provide the following observations:

a) Where there is a cost reimbursable contract there is also a reduction in the profit rate paid to reflect a corresponding reduction in risk noting the relationship between risk and reward.

b) However the starting point for the profit rate reduction would not necessarily be commenced using a median average profit based on potentially unrelated activities per the BPR method. I.e. High performing and hence higher profit earning companies with good SQEP, quality and delivery would be selected not the median.

c) Nor would the adjustment ignore matters such as terms and conditions, wider business risk, risk beyond completion, warranty, possible alternate use and those matters described above.

The question is therefore whether the parties should be free to commence at a rate higher than the BPR (median) or have the potential to make deductions and additions to the CRA to better reflect the factors that influence whether there is *risk of the primary contractor's actual allowable costs under the contract differing from its estimated allowable costs"*?

d) In addition the profit paid to a contractor commercially would consider quality, time and other factors that are important to generate VFM for the client and in our case the tax payer. This simple deduction method being so binary has in our opinion a disproportionate effect on procuring VFM. This is the whole argument surrounding financial risk rather than just a cost risk.

e) An interesting example might be where a programme requires valuable and "in demand" resources which could earn higher profit levels on another programme but are required on this cost plus contract. Business and economic logic would dictate that the company goes to the business or project with the greatest return so the MOD work would suffer. In these circumstances the regulations as written are heavily influencing the business and failing to recognise VFM.

f) In this regard we assess the guidance highlights in a quite binary manner the reduction to the CRA but not the additions or indeed the VFM or fair return for industry case.

g) With regard to range there again appears to be an adverse consequence potentially to agreeing a price when the limitation of recompense for taking the risk that *the risk of the primary contractor's actual allowable costs under the contract differing from its estimated allowable costs"* is capped to 25% of BPR or 1.91% as it stands today.
e.g.: Where the risk of actual allowable cost is deemed to be significantly higher than the recompense of the maximum CRA contractors will press for more recompense via cost, risk and uncertainty or press to select an alternate pricing method. This causes delay and difficulties to agreeing prices. In such circumstances a wider band might alleviate this pressure and procure better VFM.

iii. Whilst the SI NO. 02 clarified the position on profit and change / variation it has done little in our opinion to make the agreement of such change and variation practical or swift. In this regard we are supportive of change to the Act and Regulation to give power to MOD and Industry to agree the profit rates for lower value non material variations on a fair and reasonable basis consistent with the original contract. We do not assess that

the process needs to be considered in as much detail as the original agreement under the six step process and would suggest that the delay, disruption and administration caused by adopting even a simplified process doesn't represent VFM.

iv. In summary it seems the widening of the band only serves to prove the inadequacy of the BPR formula and an inability to navigate the existing range with limited bonus arrangements. At a BPR of around 8% the CRA is worth 2% , we find it difficult to understand why a 2% allowance could compensate the companies for the risk that is being taken on. I.e the risk between a P70 and a P100 price is likely to be vastly greater than 2% of the contract price . Our evidence from completed contract indicates this is of the order of 20% or 30%. (QEC)

6.7 - 6.20	*We welcome views on the various points raised in paragraphs 6.7 to 6.20 about the definition of GSCs and FGSCs, together with any specific proposals for related changes to the Regulations.*

Contractor response:

i. Para 6.12: Is amendment of Regulation 12(8) (b) required? It is noted that all the information is clear in Regulation 12 (7) (b) and 12 (8) (b). POCO should not apply to JV's where the primary contractor does not have a controlling interest.

ii. Para 6.17: There should be simplification of the POCO adjustment. Materiality would need to be considered when looking at contracts below the £1M reporting requirement. A figure of £250K may be more pragmatic compared to the current threshold of £100K. For contracts over £1M we may need to show a brief summary of the competition process where this has occurred to show transparency.

iii. Para 6.19: Where a subcontract is demonstrated to be competitive without the need for a competition, the POCO adjustment should be ignored as it will no longer be relevant.

iv. Para 6.20: This is a different quantum and could have wider market implications. QSC's would have to be reviewed on a case by case basis to assess value for money for MoD and reasonable price for the contractor.

6.21 - 6.25	*We welcome views from stakeholders on the potential benefits or impacts of changes to how the adjustment is determined, together with any specific proposals for related changes.*

Contractor response:

i. Para 6.24 seems a positive move towards simplifying the POCO adjustment.

ii. Regulation 12 could be amended to exclude attributable profit on GSCs and FGSCs. Whilst this would simplify the process it must be accepted that profit rates will vary by each subcontract. A level of pragmatism is required in these circumstances with regard to materiality. QSCs may present another challenge and require different treatment although the prime may have visibility of the profit.

The removal of complexity in the regulations is to be welcomed.

6.26 - 6.28	*We welcome proposals from stakeholders on how greater transparency about POCO adjustments might be achieved in a way that is not unduly burdensome for contractors.*

Contractor response:

i. Any approach should be consistent and easy to understand. We should restrict any changes to GSCs and not include FGSCs. The latter should not be that material, if so, the FGSC should be elevated to GSC status to simplify the process.

ii. We should be looking to simplify the POCO process not add layers of burden for Industry which is not value for money. A level of materiality is required as this could be quite insignificant for a lot of contracts.

iii. MoD already have access rights to data through DEFCON 802 and 812. The regulations do not need to be amended as this would create more duplication which everyone is trying to avoid.

7.17	*Stakeholder views are invited on whether the characteristics in Table 2 provide the right basis for future review of the DPS. Any further input on the proposed pace of change would be welcome.*

Contractor response:

i. We agree the principles on relevance and proportionality.

ii. Consistency requires further review as new DPS data needs to be developed for some categories. The pace of change should be set by the demand for each type of report. The SSAT have already stated that the current arrangements do not assist with future budget planning.

iii. As we are in a sole provider position for certain repair and disposal it should be able generate a new DPS that can be used as a standard template for future follow on contracts. This will assist the MoD with its long term planning and budgeting assumptions. Developments in this area will be subject to agreement with MoD before presentation to SSRO. This will allow consistent reporting of future projects.

iv. Other categories would require an Industry working party to develop more workable DPS structures.

v. There are no IFRS accounting policies to adhere to.

vi. Timeliness should be considered when these reports should be produced. Preparation of good quality data will always take time. This will lead to better value for money for MoD and Industry.

7.18 - 7.25	*Recognising that this is a complex area, the SSRO is seeking further input on its suggested proposals before making changes to its reporting guidance and the DPS templates in DefCARS.*

Contractor response:

i. Please refer to our response to 7.17 above.

ii. The DPS structure should be split according to the life-cycle of the equipment being procured. Generally it will consist of three stages; Design and Build, In Service Support (including major repair) and End of Life / Disposal. These would be discrete DPS's linked by a primary equipment title to precede each element.

iii. These elements can be linked offline for analysis purposes. Having a DPS that reflects the relevant stage of the life-cycle will reduce the number of lines in the current structures. Many contracts are let on this basis as there is often a different contractor for each stage of the product life cycle.

iv. As identified at the workshop, the DPS does not appear to be of real interest to the MoD delivery teams. It is more relevant to IPT budgets. We should consider reporting the DPS as a separate requirement and delete from the CIR, ICR and CCRs. This would simplify reporting to current business practices.

v. The DPS would then be subject to a separate reporting requirement with more leeway at the commencement of a project. This proposal would probably require legislation to effect. MoD should then be able to benefit by having a more structured report that is agreed in a timely manner with the contractor and assist with forward budget plans.

vi. MoD do not always specify which DPS is applicable, it is often neglected until after the contract has been agreed. This is not constructive when producing the initial contract reports within one calendar month of agreement.

7.26 - 7.33	*The SSRO proposes changing paragraph 5.30 in its current reporting guidance to that proposed in Table 4. We welcome stakeholder views on this proposal.*

Contractor response:

i. The revised guidance moves away from recommending rows according to contract size which is to be welcomed. The cost element should be to the nearest £100K. The reports request values by £M. £10K is not significant for the contracts Industry are reporting.

ii. The DPS is a complex requirement that cannot always be satisfied within one month of contract agreement. The contract negotiation process is such that the top level price is agreed before the rest of the build-up is amended. MoD contracting methodologies may require multiple DPS structures to be reported. It is recommended that a level of simplicity is maintained. We suggest that a DPS could be prepared within 6 months of contract agreement. This will allow for a fully inclusive process to be conducted by both MoD and the contractor.

7.36	*We are proposing a change to DefCARS to allow reporting against more than one template where this is appropriate in response to stakeholder feedback that the single-equipment type structure may be unsuitable for a small number of contracts. This might include, for example, framework agreements where more than one equipment type will be provided or supported under the contract (for example allowing the selection of fixed-wing aircraft alongside rotary wing aircraft). We acknowledge that reporting in this way will be the exception rather than the rule and a change to the reporting guidance and DefCARS will be required to accommodate this. Stakeholder views are sought on this proposal.*

Contractor response:

i. It is accepted that having more than one DPS will be the exception rather than the rule. This approach could become open to misuse and should be resisted.

ii. Framework agreements only add levels of complexity. This will largely depend on the nature of the contract in question. A contract within small tasking jobs may be fine but a contract with a number of larger tasks will be challenging. Some of these tasks could be QDCs in their own right but not treated as such. The drawback is that contract reporting will become of little benefit for the SSRO and ultimately MoD. MoD will be forced to rely upon their separate contract reporting requirements to receive detailed data. We are trying to remove duplication from the reporting process not have separate requirements. The MoD contracting strategy should be challenged where such events are identified as statutory reporting will be affected.

7.37 - 7.43	*The SSRO considers that it should proceed with its working paper proposal to make it easier for contractors to explain their mapping within DefCARS by adding an additional field within DefCARS to allow contractors to explain their approach. Stakeholders are asked to share any views on this.*

Contractor response:

i. The longer term issue is addressing the DPS structure itself to be more in tune with a contractors accounting system. This would make mapping easier for Industry contracts. We are working with MoD in an attempt to make a specific DPS relevant. This will benefit MoD when considering future workload.

ii. At previous workshops SSAT have stated that the DPS is not adequate for their purposes. We would welcome the opportunity to make the structures more relevant to industry with MoD input.

iii. As mentioned above, it would be easier to make the DPS a separate reporting requirement. Industry negotiates the prices of contracts first based upon scope. This scope then has to be configured into a DPS report which may only be considered post contract award. Larger contracts present a challenge to report within the current timescales.

iv. MoD and SSRO should be more receptive to suggestions made by Industry. We should try to assist one another. The reason we have the Regulations is that there is an insufficient number of suppliers in some areas along with security considerations.

7.44 - 7.47	*The SSRO has decided not to proceed with the proposals on additional categorisation within the DPS which was presented in the working paper, though this is something we may explore in future reporting guidance work on the contract description. Stakeholders are asked to share any views on this.*

Contractor response:

i. We welcome the decision not to proceed on this occasion.

ii. It should be noted that the contract description of works should provide enough information about the type of work being executed. If it is proposed to add more requirements to the DPS, the responses above should be considered. Moving towards a separate DPS reporting requirement would alleviate Industry's concerns.

iii. The DPS is required at the beginning of a contract. The CIR must be submitted within one calendar month. MoD are not always prompt in notifying SSRO about new contracts. The DPS is probably the least considered element of the reports at the current time. If MoD require data that is meaningful, the reporting requirement for the DPS should be reviewed and changed.

7.48 - 7.56	*Stakeholder views are welcome on these proposals or any other matters addressed in this section on DPS metrics.*

Contractor response:

i. We contend that metrics should be kept outside of DefCARS. These can be difficult to define and agree at commencement. This should form part of any reporting requirements under the contract.

7.57 - 7.66	*At this stage the SSRO would like to seek further input on whether the current arrangements which allow the parties to agree the frequency of interim contract reports remain fit for purpose. It would be helpful to receive feedback on whether interim DPS reporting in the ICR remains appropriate or whether a different mechanism is required.*

Contractor response:

i. This is an area that tends to get overlooked in contract negotiations.

ii. DefCARS now has the functionality to generate ICR dates so that puts the onus on Industry to agree them with MoD. Where ICR dates are agreed, the DPS should not form part of the report unless it is 'On Demand'. A couple of our contracts have annual reports to be produced which is fine when there is contract growth, but these contracts have not grown at all. We may have factored in the cost of completing these reports into the price but the reports basically stand still.

iii. MoD project teams have differing approaches. There is one team that does stand out in using the 'On Demand' reports in a sensible way to inform future contract negotiations. The DPS should be provided in such cases as this will contribute to an informed decision. As mentioned above, we contend that the DPS should be an independent report in its own right. This would remove a lot of complexity and frustration with the current requirements.

8.1 - 8.12	*The SSRO welcomes views on possible changes to the guidance to reflect definitions and examples.*

Contractor response:

i. There may be merit in changing the guidance to make the subject matter easier to understand. It should also address the quantum to be reported.

ii. A contract will change in value with an amendment. Industry is required to report the date of latest amendment and contract value. It will also report forecast costs against this revised contract. The difference between the two will constitute the variance.

iii. There will be occasions where the amendment does not change price and this will not be generally reported in DefCARS.

iv. Classification of variances should be seen as a welcome development. These will fall into a number of categories. The most obvious will the forecast of cost not yet agreed in price. Other variances will relate to programme and performance and be monitored accordingly.

v. The Amendments and Variance categories should be agreed with Industry prior to changing the guidance. MoD should also be clear about what they want to be reported without creating additional administrative activities. How is this data going to be used by both MoD and SSRO?

8.12 - 8.24	*The SSRO invites input from stakeholders on its proposal to modify DefCARS and reporting guidance to collect details of material pricing amendments, using the requirement to report material events and circumstances and the facility for on-demand reporting.*

Contractor response:

i. We have no issue with reporting material events as they occur.

ii. A lot of our Single Source contracts have amendments that are an aggregation of variations which can run into hundreds/thousands during the life of a contract. The MoD will already have this detailed data to analyse by work type. We oppose having to duplicate this task for the benefit of contract reporting in DefCARS. High level reporting of amendments should be sufficient.

iii. Major contracts will have regular price changes and it would be futile for MoD to make use of 'On Demand' reports. Contract reporting needs to be proportionate in these circumstances. MoD are more likely to require an updated CPS which could be an annual report. Industry will provide a CRP where contracted dates change.

iv. 'On Demand' reports bring into question DefCARS functionality. The CIR is an amalgam of three reports: CPS, CRP and CNR. The first two can also be 'On Demand'. To facilitate separate CPS and CRP reports the CIR functionality requires update so that a number of desired outcomes can be submitted. These will include separate CPS and CRP reports as well as a combined report that may be required.

v. Reporting of amendments and variance requires careful consideration as this could have unintended consequences for wider contract reports.

8.25 - 8.29	*The SSRO is interested to hear views on whether this would provide an effective materiality threshold for explaining variances.*

Contractor response:

i. Do we need a materiality threshold based upon the SSRO proposal in 8.29? £100K represents 1% of a £10M contract. It should be contended that the threshold be the higher of 1% or £100K. This would ease the burden when completing QCRs whose contract values are £50M plus. The SSRO should review its proposal.

8.30 - 8.31	*The SSRO is interested in views on the above categorisation. The SSRO would also be interested in evidence on how easy or difficult it would be for contractors to use this categorisation when reporting variances.*

Contractor response:

i. There is some benefit to reporting by some form of classification as defined by SSRO. The categories should be developed with Industry. We already distinguish between some variances in our QCRs. We already report using some form of categorisation. A more formalised approach is to be welcomed.

8.32 - 8.43	*It seems premature to contemplate proposals for legislative change at this time, but the SSRO continues to welcome evidence of unnecessary duplication.*

Contractor response:

i. The feedback we get at SSRO workshops and meetings is that MoD do not have enough information. This may be the case for SSAT but they may not be aware of the onerous reporting requirements the Commercial Teams put into contracts. The reason the commercial teams may not review DefCARS reports is that they already have the information, often at a more detailed level. It will become further duplication for Industry if the level of detail increases.

ii. The MoD project teams have total visibility of Industry costs for relevant contracts.

iii. SSAT are just a conduit for the MoD, not the end customer who processes our reports. We would welcome the opportunity to review the requirement for QCRs and ICRs into a single report.

iv. A lot of Events and Circumstances get reported locally so it will not be new when reported via DefCARS.

9.1 - 9.18	*We welcome stakeholder feedback on whether referrals to the SSRO for opinions and determinations about rates should be expressly provided for in the legislation and whether this may facilitate agreement of rates. The SSRO would welcome further input on the typical timetable of agreeing the rates and the points at which delays occur.*

Contractor response:

i. We do not feel there is a need for the legislation to be amended in this respect.

ii. Any determination process will add significant time to the rates agreement process. Opinions on allowable cost would be welcome if there is a quick turnaround time for this process.

iii. We already have arrangements in place for agreeing the rates. We are fully aware of CAAS resourcing challenges to complete such tasks. Consequently CAAS prioritise their work accordingly which may not always benefit some smaller value QDCs. These smaller value QDC's will then suffer delays to firming up prices which has unintended consequences with Regulation 14. Industry should not have to be inconvenienced as a result. MoD commercial teams should be empowered to agree prices where the rates are not a material element of the allowable cost for a

	contract. If ICPT are able to agree rates in a timely manner, this will assist smaller value contracts let by MoD.
9.19	*The SSRO would appreciate input from stakeholders about the merits of it being able to give advice or opinions, on request, on matters of general application to the operation of the regulatory framework. These requests would not need to be linked to a particular contract.*

Contractor response:

i. If we are able to de-link the process, this would be a welcome development.

ii. General advice on the application of the regulatory framework will enhance our understanding. A quick turnaround time would be required to make this a success.

iii. Opinions are more likely to have some tie to a contract in some form. Where this is the case it may be beneficial for Industry and MoD to submit a joint request.

iv. Development of this area is likely to give SSRO targeted feedback on which areas of the regulations require future attention and review.

9.20 - 9.32	*We invite feedback on how arrangements can be modified so that overhead reports received in DefCARS best support the MOD to determine rates and price contracts and on how the overlap between the information provided in DefCARS and the information requests from the ICPT can be minimised.*

Contractor response:

i. The overhead reports on DefCARS only satisfy the SSRO reporting requirement.

ii. Industry will represent the same information in a different manner in order to calculate a set of rates which are shown in the reports. The rates and the reports will always reconcile. The statutory reports in their current format do not really contribute to the rates programme. More detailed data is provided to CAAS during this process. The statutory reports can only assist benchmarking if data is consistent across Industry. We do not feel arrangements need to be modified.

iii. The overhead reports will need to be framed differently in order to assist with the rates programme. The ICPT will agree rates in many different formats and recovery methodologies. This process will always be conducted outside of DefCARS which only requires a high level submission.	
9.33 - 9.37	*These have not been the subject of our analysis but the SSRO would welcome feedback from the MOD and industry as to whether there may be rationale to require this data for the preceding years. The SSRO is also seeking feedback on any suggestions to address the issue.*
Contractor response: i. Our FY aligns to the MoD FY and we have no issue with the current reporting process. Some contractors have already been reporting overheads for a number of years so the data is already available.	
9.38	*The SSRO proposes to recommend to the Secretary of State that regulation 37(7) is amended by inserting the words "the accounting period immediately following" before the words "the relevant accounting period". We would welcome any further feedback on the proposed recommendation.*
Contractor response: i. We already report in line with the regulations so do not see the need for change.	
9.39 - 9.45	*The SSRO is prepared to recommend a legislative change to require reporting of agreed rates and costs. Before doing so would like to receive further information in relation to how the MOD is using the data or intends to use the data. The further information that the SSRO has called for in relation to the rates programme would assist with the further consideration of this issue. The SSRO would also welcome feedback on the impact of capturing the agreed rates and costs information, including the associated costs.*
Contractor response:	

i. If any legislation is to be recommended, it needs to be open-ended in terms of reporting requirements. This could only be on an 'On Demand' basis. Rates agreement timescales will vary by contractor. We would only be looking to upload any agreed promulgation document in this respect. Could submission of any reports be delayed to when rates are agreed? This will avoid duplication of effort and costs will be agreed.

9.40 - 9.55	*We welcome any further feedback on the SSRO views on QBU compliance monitoring.*

Contractor response:

ii. We maintain that SSRO should be able to conduct a simple analysis on whether a QBU meets the reporting requirements. This will be conducted by analysis of CIRs, ICRs and QCRs for relevant companies. Where a group company has a contract over £50M it is highly likely that is will be liable to produce overhead reports. There could be many instances where companies breach the £10M threshold but not breach the £50M threshold. The SSRO should take a more proactive role where contracts over £50M have been let. The only challenge is where there is more than one QBU feeding into a contract but this could be overcome by looking at the relevant rates tabs in some of these reports.

iii. The other area that SSRO conduct monitoring is through the SICR submission. This detail the profiles of live Qualifying contracts held by QBU's.

9.56 - 9.66	*We welcome any further feedback stakeholders may have on the SSRO views on benchmarking and standardisation.*

Contractor response:

i. Before standardisation and benchmarking can be achieved, there needs to be common ground between MoD and Industry on how costs are interpreted. Each company will have a different opinion about the make-up of the functions being reported as well as the grouping of cost categories. MoD have to review their requirement and share their vision with Industry. We can hold workshops on how this vision will be achieved. The only positive measure the current reports provide is to compare QBU costs from year to year. Each company will have differing capacity and capability issues so MoD will need to provide consistent guidelines for cost treatment.

ii. A universal agreed QMAC would be required to achieve such an outcome. We have differences in interpretation of functions which will vary. Some companies have differing capabilities according to specialism. Companies are seeking to continually improve their processes through transformation. This would only be relevant where companies are reliant on single source contracts for their revenue.

10.1 - 10.4	*The SSRO is inviting feedback on the matters that have been raised on segmentation of profit rates in contracts. The SSRO is particularly interested in receiving input on the impact that segmented profit rates would have on contractors and the extent to which this should be reflected in reporting.*

Contractor response:

i. We do not support the use of blended or multiple profit rates within a contract.

ii. We believe that the profit rate should be assessed and based on the primary purpose of the contract, the risk of output and not the segmentation of inputs. E.g. The cost of an Apple computer is not reduced because of the need to maintain the factory.

iii. It is of note that the comparator group companies do not suffer or utilise profit segmentation or multiple profit rates and in this regard the application would only serve to make the defence industry less comparable.

iv. Our experience thus far is that where proposed it is being misused as a means to reduce contract profit rates rather than incentivise outcomes or indeed follow a logical pricing method.

v. It appears odd that such a proposal is being proposed by MOD where all pricing methods as an early step requires agreement.

vi. It also appears inequitable to us that the components of cost would be broken down to the most basic of inputs to fundamentally ignore and distort the primary purpose of the contract at output. E.g. the simplest of tasks at input could look low risk but their reliance to and impact on the output code be demonstrable. E.g. the maintenance of a communications systems and the impact of failure on engineering works.

Such a process also seeks to distort the application of CRA and limit the application of risk to certain areas of cost.

vii. We do not see a case for changing legislation to permit segmentation as we believe it would encourage the wrong behaviour and not be equitable using the current BPR formula and adjustments. We have current experience of a contract being divided into Lots and Sub-lots priced under multiple and discrete segmented scope all fundamentally service one purpose (but divided). There is also evidence that what was once a single contract is now at re-award being broken into multiple contracts all with cross dependencies and reliance. Again this seeks to distort and confused not only the components of profit and the application of risk and CRA but also Actual Cost.

It is notable that in the June 2017 final recommendations MOD suggested that restricting contracts to a single profit might create incentives to

contract in an inappropriate way. However it appears to be happening in any case.

viii. Per the June 2017 SSRF review we see no need to change except for strengthening the message of artificial segregation and multiple profit rates is not permitted.

Segmented in Comp Group

ix. It should also be considered that the segmentation would only serve to complicate the reporting requirements and guidance might be helpful to limit the number of pricing methods in any one contract.

10.5 - 10.9	*We invite comment from stakeholders on the need for any changes to the Regulations related to this matter and proposals for how any changes should be implemented.*

Contractor response:

i. We interpret your proposal as providing for a TCIF being on fixed as well as firm basis and therefore permitting or clarifying that this type of adjustment may be made to the allowable cost estimate or target throughout the contract noting the difference between fixed priced contracts and a TCIF. I.e.: that the indices serves to amend the price in fixed price situation but the Target in TCIF pricing methods.

ii. We are therefore supportive of this proposal but would like a pragmatic approach to the impact on reporting.

10.10 – 10.14	*Final Pricing Adjustment – NOTE: Whilst no question was asked we have taken the opportunity to respond to the comments as 10.13 and 10.14.*

Contractor response:

i. We have no objection to the proposal to define the difference between the outturn profit rate and the contract profit rate as percentage points and not percentage differences.