



SSRO

Single Source
Regulations Office

Guidance on the Final Price Adjustment

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1. Introduction

SSRO guidance on the Final Price Adjustment

- 1.1 The final price adjustment (FPA) provided for under section 21 of the Defence Reform Act 2014 allows the price of a qualifying defence contract (QDC) or qualifying sub-contract (QSC) to be increased or decreased following contract or component completion where certain conditions are met. Through the application of an FPA, a contractor's excess profits or losses arising from variances between the estimated and actual Allowable Costs of a qualifying contract can be shared between the contractor and the Ministry of Defence (MOD) rather than being borne by only one or the other.
- 1.2 This document supplements the SSRO's existing pricing and reporting guidance on the topic of the final price adjustment. The SSRO issues the following statutory guidance which should be read in conjunction with this document:
- [Guidance on the baseline profit rate and its adjustment](#)
 - [Guidance on Allowable Costs](#)
 - [Guidance on preparation and submission of contract reports](#)
- 1.3 This guidance is to help the parties to QDCs and QSCs meet their legal obligations under the Defence Reform Act 2014 (the Act) and the Single Source Contract Regulations 2014 (the Regulations) in relation to sections 16 and 21 of the Act and aims to ensure that value for money is obtained on qualifying contracts and that contractors are paid a fair and reasonable price under those contracts. It is a legal requirement to have regard to the SSRO's statutory guidance when:
- Determining the Allowable Costs for a QDC or QSC under section 20 of the Act;
 - Determining the contract profit rate for a QDC or QSC in accordance with section 17(2) of the Act;
 - Preparing contract reports on QDCs and QSCs under section 24 of the Act; and
 - Preparing supplier reports under section 25 of the Act.

Structure of this guidance

- 1.4 The remainder of this guidance is structured as follows:
- Section 2 – Eligibility criteria: the requirements that contracts and any intended adjustments must meet to apply the FPA mechanism.
 - Section 3 – Procedural requirements: beginning and cut-off events for applying an FPA and other associated processes.
 - Section 4 – Calculating an FPA: the method set out in the Regulations on how to calculate the FPA.
 - Section 5 – Reporting requirements: an overview of the reporting that takes place during the life of a contract and at completion relating to a potential FPA.
 - Section 6 – Getting help and resolving issues: how the SSRO can support both the MOD and contractors to apply the FPA and resolve issues and disputes.
 - Section 7 – Key questions and answers: addresses commonly asked questions about the FPA.

FPA checklist

- 1.5 The table below provides a checklist that parties can follow to help establish if the contract is one to which an FPA may apply. If the answer to any of the questions is no, then an FPA will not apply to the contract or the component. This table is intended to provide a quick and easy reference to the basic aspects of the criteria for an FPA. The parties should always ensure they are aware of the full extent of the legal obligations which may apply to them which are explained in the remainder of this guidance.

Criteria	Assessment (Yes / No)	Guidance section
Pricing method	Does the contract or at least one component use the firm, fixed or volume-driven pricing method(s)?	2.3
Value	Is the contract value (excluding the value of any components using a pricing method to which the FPA cannot apply) at least: <ul style="list-style-type: none"> £5 million for a QDC? £50 million for a QSC? 	2.4 – 2.5
Amount of the FPA	Is the amount of the FPA at least £250,000?	2.10
Disapplication	If the contract is a QDC with a value below £50 million has it been established that the MOD has not directed that the FPA provisions are to be disapplied?	2.11 – 2.13
Excess profit or loss making	Has excess profit been earned? The contractor may earn 5 percentage points (pp) additional profit, over that agreed in the contract price, before an FPA can be applied. or Is the contract or component loss making? The contractor can share losses with the MOD where the outturn costs exceed the contract price. The proportion that is shared is determined by the loss level.	Excess profit: 4.7 – 4.8 Excess loss: 4.9 – 4.11

Key terms and definitions

<p>Contract or component value</p>	<p>For firm, fixed and volume-driven priced contracts the value is determined at the relevant date described in regulation 5(3), which is broadly:</p> <ul style="list-style-type: none"> • for QSCs, the date of the QSC assessment or any later date it is proposed to enter into the QSC; • for QDCs by amendment, the date of the amendment; and • in all other cases, the date the contract or component is entered into. <p>The price payable to complete the contract (or component) may change over the life of the contract but its value (for the purpose of meeting the thresholds) is fixed.</p>
<p>Contract completion date (CCD)</p>	<p>The date on which the contractor completes all obligations which entitle it to final payment under the contract or, if a contract is terminated before that date, the date the contract is terminated (Regulation 4(1)).</p>
<p>Component completion date (CoCD)</p>	<p>The date on which the contractor completes all obligations under that component which entitle it to final payment under that component or, if a component is terminated before that date (and any other part of the contract is not terminated) the date the component is terminated (Regulation 4(2)).</p>
<p>Outturn costs</p>	<p>The amount of the contractor's actual costs under the contract or component which meet the requirements of being appropriate, attributable to the contract and reasonable in the circumstances, which also underpin the determination of Allowable Costs.</p> <p>More detail on these requirements may be found in section 3 of the SSRO's Allowable Costs guidance.</p>
<p>Outturn profit</p>	<p>The difference between the contract price and the outturn costs.</p>
<p>Outturn profit rate</p>	<p>The outturn profit, expressed as a percentage of the outturn costs.</p>

2. Eligibility Criteria

- 2.1 There are a range of criteria, identified in this section, that must be met in order for an FPA to apply. These are in addition to the procedural requirements set out in Section 3.
- 2.2 If a party is considering an FPA it should seek to establish whether the criteria are met at the earliest possible stage. Some criteria should be straightforward to establish, such as the pricing method used. Others may take longer to establish, such as whether the minimum adjustment threshold is met in a borderline case. Information reported in DefCARS¹ can help establish at an early stage if an FPA may be made. If the criteria are not met, an FPA cannot be applied. In order to ensure the correct outcome, parties should be transparent with each other when seeking to establish if the criteria apply.

Pricing method

- 2.3 An FPA may only be made where the price payable under the contract or component has been determined using one or more of the following contract pricing methods:

Contract pricing method	Costs estimated at the time of agreement	Costs may be adjusted in accordance with rates and indices
Firm	✓	
Fixed	✓	✓
Volume-driven	✓	✓

Contract value – qualifying defence contracts

- 2.4 A QDC must have a value of at least £5 million for an FPA to apply (see below for QSCs) and use one or more of the firm, fixed or volume driven contract pricing methods. The value of any components of the contract which use a pricing method to which an FPA cannot be applied (see paragraph 2.3) must be disregarded for the purposes of this value assessment. Therefore, after any such exclusions, the total value of all remaining components to which the FPA can apply, must be at least £5 million. If this value criteria is not met an FPA cannot be applied at a contract level, or to any components of the contract.

Example 1 – contract value for the FPA

A QDC has two components and a total contract value of £60m. Component A uses the volume-driven pricing method and has a value of £40m. Component B has a value of £20m and is priced using the commercial pricing alternative pricing method. Components using the volume-driven method can have an FPA applied, whereas those using the commercial pricing method cannot. Excluding the value of component B gives a value of £40m. This is above the minimum value for a QDC of £5 million at which an FPA may be applied.

¹ The Defence Contract Analysis and Reporting System

Contract value - qualifying defence sub-contracts

- 2.5 A QSC must have a value of at least £50 million for an FPA to apply and use one or more of the firm, fixed or volume driven contract pricing methods. The value of any components of the contract which use a pricing method to which an FPA cannot be applied (i.e. which do not use the firm, fixed or volume driven pricing methods) must be disregarded for the purpose of this value assessment. Therefore, after any such exclusion, the total value of all remaining components to which the FPA can apply must be at least £50 million.
- 2.6 There are other matters relevant to the final price adjustment in respect of a QSC:
- The Secretary of State may not disapply the legal provision for an FPA to be made in the case of a QSC.
 - The FPA for a QSC is applied through a payment between the sub-contractor and the Secretary of State, rather than an adjustment to the price payable under the QSC to the contracting authority (the holder of the QDC under which the relevant QSC is a sub-contract) (see regulations 65(8) and 66).
 - Notifications of intent to make an FPA for a QSC must be made directly either by the MOD to the sub-contractor or by the sub-contractor to the MOD.

Minimum amount of the adjustment

- 2.7 For an FPA to be made, the amount of the adjustment must be at least £250,000. As the final amount of an FPA must be agreed between the parties, when considering notification of intent to make an FPA, parties should use an estimated value. Contractors are required to include in their contract reports an estimate of any FPA that they expect (see paragraph 5.1). Any such reported FPA estimates and other relevant contract data held by the parties may be used to establish if it is likely that the £250,000 threshold for an FPA to be made will be met. If having submitted a notice of intent the adjustment is subsequently calculated to be less than £250,000, an FPA will no longer apply.

Disapplication of the legal provisions of the FPA

- 2.8 The Secretary of State may direct that an FPA is not to be applied to a QDC whose value is £5 million or above but below £50 million, even though an FPA may otherwise have been permissible. Such a direction cannot be made for a QSC. The value of components of the contract which use pricing methods to which an FPA cannot be applied (see paragraph 2.3) must be excluded for this purpose.
- 2.9 Beyond the requirements above, the legislation does not constrain or direct the Secretary of State as to the reasons they may or may not direct that an FPA is to be disappplied, or the timing of when this direction can be made. It is beneficial for parties to be transparent with one another in respect of the application of the FPA and this guidance is intended to support this.
- 2.10 As explained in this guidance there are a number of criteria that must be met in order for an FPA to be applied. Contracting parties should be cautious in respect of any terms and conditions in their contracts that might intentionally, or unintentionally, seek to fetter their legal rights in respect of the application of an FPA. For example, a contractual commitment not to issue a notice of intent to make a final price adjustment. It should be noted, however, that any contractual provision that is inconsistent with the Act or Regulations will be overridden by the legislation.

Regulations relevant to this section

- FPA criteria: Regulations 16(1), 16(4) & 16(7)
- QSC modifications: Regulations 65(8) & 66
- Reporting requirements: Regulations 26(6)(g), 26(6C)(g), 27(5)(a), 27(6)(a), & 28(2)(k)
- Ability to disapply: Section 21(5) of the Act & Regulation 16(2)

3. Procedural requirements

- 3.1 There are timescales prescribed in the Regulations for certain procedural actions which must be met if an FPA is to be applied to a contract or a component of a contract. The MOD and contractors with QDCs or QSCs should familiarise themselves with these timescales as failure to meet them can prevent the application of an FPA where one may have been permissible.
- 3.2 Contractors and the MOD should pay particular attention to how the FPA timescales operate for contracts with multiple components where:
- the component completion date for one or more components falls before the contract completion date (for example, in a contract comprised of components related to sequential pricing periods); and
 - it is intended that an FPA be applied to one or more of these components prior to completion of the contract.

Example 2 - My contract contains components. Can an FPA be applied to a component of a contract rather than the whole contract?

Yes, the parties to a QDC or QSC may agree to apply an FPA to a component or a number of components of a contract or to the contract as a whole. They may also agree to aggregate two or more components for the purpose of calculating an FPA in relation to those components. Unless agreed, FPA calculations for components to a contract are made in relation to that component alone.

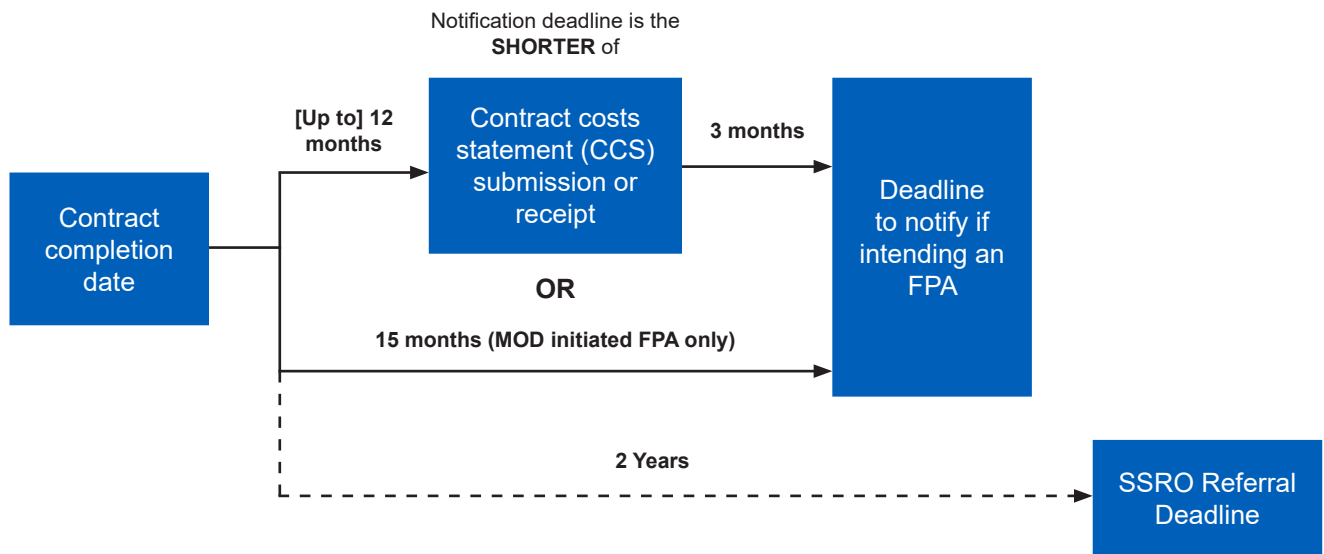
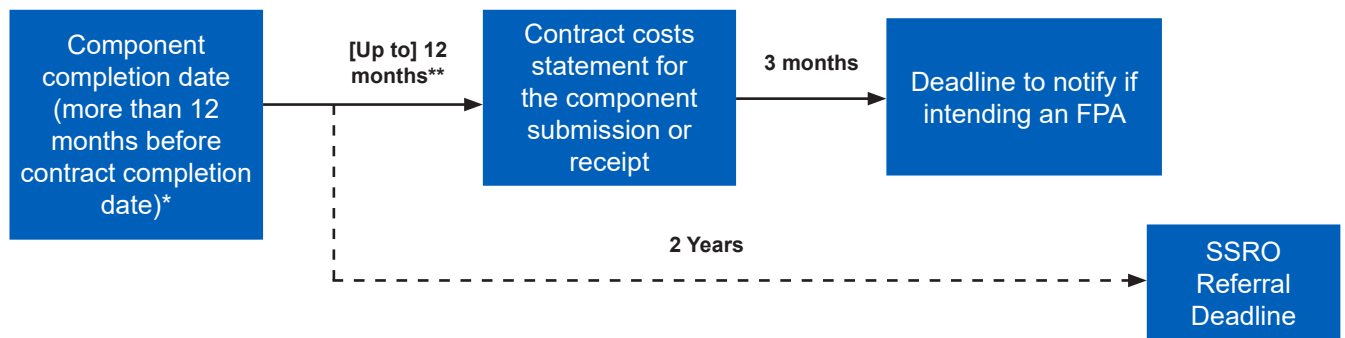
A notification of intent must be given for an FPA to be made to a component. This can be given following the completion of the component, or the contract in accordance with the relevant timelines (see Figures 1, 2 and para 3.10).

Contract completion

- 3.3 The contractor must submit a contract costs statement (CCS) within twelve months after the contract completion date (CCD). The CCD and the date of submission/receipt of the CCS are the dates against which the statutory timescales related to the FPA for a contract are set. **Readers should consult the SSRO's [guidance on preparation and submission of contract reports](#) for more detailed information on reporting requirements.**

Component completion

- 3.4 Following the component completion date (CoCD) for a component (unless the CoCD falls within the 12 months preceding the expected CCD of the contract) the contractor must provide a CCS for that component. This is due within 12 months after the CoCD of each component. The CoCD and the date of submission/receipt of the CCS for the component are the dates against which the statutory timescales related to the FPA for a component are set. **Readers should consult the SSRO's [guidance on preparation and submission of contract reports](#) for more detailed information on reporting requirements.**
- 3.5 Figures 1 and 2 show the timeline of milestones for MOD- and contractor-initiated FPAs. The timescales are explained in more detail below.

Figure 1 – Timeline for FPA on a contract**Figure 2 – Timeline for an FPA on a component**

*For components that have a component completion date less than 12 months before the completion date for the contract of which the component is a part, the process set out in figure 1 applies.

**Contractors should ensure that the contract costs statements for components are submitted within the required timescales.

Notification of intent to make an FPA

- 3.6 Once a contract or component has completed, the MOD or the contractor (in a QDC) or sub-contractor (in a QSC) may give notice of its intention to make an FPA. The timescales within which a notice of intent may be issued are set out in table 1. Failure to issue the relevant notice(s) in the required timescales may restrict on a temporary or permanent basis the ability to make an FPA.

Notification after contract completion

- 3.7 For a contract without components, or a contract whose components have completion dates which are the same as (or within the 12 months preceding) the contract completion date, a notice of intent to make an FPA can be issued after contract completion and within the relevant deadline in respect of either the contract as whole or one or more of the components as appropriate.

Table 1 – Milestones and time limits for the FPA.

Action that may be taken	Statutory time limits	
	For a contract	For a component
MOD to notify the contractor or sub-contractor of the Secretary of State's intention to make an FPA	Within the sooner of: <ul style="list-style-type: none"> • three months after receipt of the CCS in respect of the contract; or • 15 months after the contract completion date. 	Within three months after receipt of the CCS in respect of the component
Contractor (in a QDC) or sub-contractor (in a QSC) to notify the MOD of its intent to make an FPA	Within three months of the contractor or sub-contractor submitting a CCS to the MOD in relation to the relevant contract or component.	
Referral to the SSRO to determine the amount of the FPA	Within two years after the contract completion date	Within two years after the component completion date

Example 3 - What happens if the contract costs statement is submitted or received earlier than 12 months after the contract (or component) completion date or later than is required?

CCS submitted within 12 months after the CCD or CoCD

Where a CCS is submitted within 12 months after the completion date for a contract or component, the MOD or the contractor or sub-contractor must give notice within three months of the CCS being submitted if they wish to apply an FPA to the contract or component (see additional conditions for components below).

CCS submitted later than 12 months after the CCD or CoCD

For a contract FPA, the MOD has a maximum of 15 months after the CCD to give notice of its intention to apply an FPA. If the CCS for the contract is received late, this means the MOD will have less than three months after receiving the CCS to provide a notice of intent.

In the case of a component FPA, the MOD may give notice to a contractor or sub-contractor within three months of the date the CCS for the component is received even if this is received later than 12 months after the completion date of the relevant component.

A contractor or sub-contractor wishing to apply an FPA to a contract or component may give notice to the MOD up to three months after the date it submits a CCS even if this is submitted later than 12 months after the completion date of the relevant contract or component. *Contractors should note that late submission of a CCS may result in enforcement action being taken by the MOD.*

Notification after component completion

- 3.8 For a contract with multiple components, for example, one comprising sequential pricing periods which meet the requirements of components, the Regulations provide:
- for an FPA to be made to each component individually;
 - for two or more components to be aggregated for the purpose of calculating an FPA for those components; or
 - for an FPA to be made to the contract as a whole.
- 3.9 The MOD and the contractor (QDC) or sub-contractor (QSC) should decide the approach to be taken. If the parties do not agree to aggregate components, the FPA calculations for components to a contract are made in relation to that component alone. Any agreement to aggregate components should be recorded by the parties. There is no requirement, or function, in DefCARS for this to be recorded.
- 3.10 Where it is intended to apply an FPA to components before contract completion, whether individually or in aggregate, it will be necessary for one of the parties to give notice of the intention to make an FPA for each component within the statutory timescale. **Failure to provide timely notice of the intention to apply an FPA to a component will mean the next opportunity to issue a notice of intent to apply an FPA to that component will not arise until after the contract has completed.** Following contract completion, and subject to the relevant criteria being met, the FPA is to be applied to that component alone, or by agreement in aggregate with other components.

Example 4 - I have a contract with three pricing period components each ending 18 months apart. Can I wait until the end of the contract to apply a single FPA on all of them, or do I have to apply an FPA to each individually?

Either option is possible so long as the relevant criteria for an FPA are met. Whichever approach is to be taken, a notice of intent will need to be issued within the prescribed timescales for either the component(s) or the contract.

There is no prescribed method for deciding which approach to take. For contracts with concurrent components which end on or around (e.g. within 12 months of) the contract completion date, aggregating the components for the purpose of calculating an FPA is likely to be a more straightforward approach. Alternatively, if a contract contains components with significantly differing component completion dates (e.g., pricing periods ending more than 12 months apart), assessing FPAs on a component-by-component basis through the life of the contract might be preferable.

It should be noted that the amount of any FPA (including whether an FPA applies at all) may not be the same for each approach.

Content of the notification

- 3.11 A notification of intent to make an FPA should contain sufficient information to facilitate a discussion on the amount of the FPA, as it is a legal requirement following notification for the parties to attempt to reach agreement. Information that would facilitate this process may include, for example, the basis on which the party issuing the notice believes an FPA is applicable and how the amount of the proposed FPA has been calculated.

Agreeing the FPA

- 3.12 If a notice of intent to make an FPA is issued by the MOD, contractor or sub-contractor within the required timescales, the MOD and the contractor or sub-contractor must attempt to agree the amount of the FPA. While this should occur promptly, there is no statutory time limit within which agreement on the amount of the FPA must be reached or when any adjustment to the price of a QDC or payment in respect of a QSC must be made.
- 3.13 To determine the FPA the parties will need to have first agreed which, if any, components will be aggregated for the purpose of the calculation, otherwise they will be treated individually (see paragraphs 3.8 - 3.10 and examples 2 & 4). It would be reasonable for the parties to a QDC to agree the approach to aggregation in advance of the component completion dates for the components, although the timing of any such agreement is at the discretion of the parties.

Referral to the SSRO

- 3.14 If the parties are unable to reach an agreement, at any time within two years after the contract (or component) completion date, either the MOD or the contractor or the sub-contractor may ask the SSRO to determine the amount of the FPA. The parties may (and should) continue to seek to reach agreement on an FPA after a referral has been made to the SSRO.
- 3.15 More details on making a referral to the SSRO for a determination and other ways in which the SSRO can assist the MOD and contractors or sub-contractors to understand and apply the regulatory provisions for an FPA can be found in section 6 of this document.

Example 5 - I'm negotiating an FPA and it's approaching two years since the contract completion date. Will I run out of time to reach agreement?

No, the deadline of two years after the contract (or component) completion date only relates to your right to seek a determination from the SSRO on the amount of the FPA. While it would be preferable to have concluded your FPA negotiations with sufficient time to permit a referral to the SSRO if needed, the passing of the two-year referral deadline does not result in the loss of any right to agree an FPA. Indeed it may be that having referred the matter to the SSRO for a determination, further negotiation results in agreement between the relevant parties prior to any final determination by the SSRO on that referral.

Regulations relevant to this section:

- FPA notification deadlines: Regulations 16(5) & 16(6)
- CCS deadlines for components/contracts: Regulations 29(1)(a) & (b)
- Aggregation of components: Regulations 17(5A) & 17(5B)
- Referral to the SSRO and deadlines: Regulations 16(7) & 16(8)

4. Calculating the FPA

4.1 The FPA amount must be calculated using the methodology as set out in regulation 17, which is explained in this section. It is a legal requirement to follow the methodology set out in the Regulations. The calculation of the FPA amount must be:

- agreed by the MOD and the contractor or sub-contractor, or
- determined by the SSRO where a valid referral (by either party) has been made.

4.2 An Excel FPA calculator is available on the SSRO's website. The use of this calculator is not mandatory, and the contracting parties may use their own tools. However, any alternative calculation tool must generate a result which complies with the Regulations. The SSRO tool has been developed to be both compliant with the Regulations and accessible to all users.

Data inputs

4.3 To calculate the FPA you will need to know the following information for the contract or component(s) whose price you intend to adjust:

- The price of the contract or component(s) to be adjusted; this comprises:
 - i. The Allowable Costs of the contract or component(s) to be adjusted (this used when determining the contract price using the price formula)²; and;
 - ii. The contract profit rate (CPR) of the contract or component(s) to be adjusted, calculated by the four-step process (six steps for contracts or components entered into or amended before 1 April 2024);
- Any incentive adjustment included in the contract profit rate.
- The value of the contract or components where this is different from the price.
- The outturn costs of the contract.

4.4 A glossary of terms is included earlier in this document which provides additional information on each of these terms.

4.5 When calculating the FPA:

- The contract profit rate (CPR) and contract price must exclude any amount resulting from the step 3 incentive adjustment (step 5 for contracts entered into or amended before 1 April 2024). For example, if the contract profit rate is 11 per cent and includes an incentive adjustment of 2 percentage points, then the CPR for the FPA calculation is 9 per cent; and
- The actual costs (used to determine the outturn costs) and the contract price used in the calculation must exclude any liquidated damages or interest on overdue payments payable under the terms of the contract.

4.6 Any amounts of Allowable Costs used in the FPA calculation must be appropriate, attributable to the contract and reasonable in the circumstances. The SSRO publishes separate guidance³ on the determination of Allowable Costs to which the parties must have regard.

² Users who wish to enter the contract price directly into the FPA calculation must ensure that this price is in accordance with the pricing formula. To avoid errors, the SSRO's calculator allows users to enter the Allowable Costs and contract profit rate and will calculate the contract price from these inputs.

³ <https://www.gov.uk/government/publications/allowable-costs-guidance-version-71>

Excess profit

- 4.7 The contractor may earn 5 percentage points (pp) additional profit, over that agreed in the contract price, before an FPA can be applied. For example, if the CPR is 8 per cent, then the contract's outturn profit rate can be up to 13 per cent without adjustment.
- 4.8 The Regulations specify three levels of excess profit which act as thresholds for the purpose of calculating the FPA for a contract or component. Through the FPA calculation, the amount of outturn profit which exceeds each of these thresholds informs the amount of the adjustment that is to be made to the contract price. The way in which excess profit reduces the contract price is shown in the table below.

Table 2: Excess profit thresholds and effects

Excess level	Threshold (where the outturn profit rate is greater than the contract profit rate)	Amount by which the contract price must be reduced (Final Price Adjustment)
1	5pp greater than the CPR	25% of profit of the outturn profit which exceeds level 1
2	10pp greater than the CPR	50% of profit of the outturn profit which exceeds level 2 25% of profit of the outturn profit which exceeds level 1 (excluding that which is above level 2)
3	15pp and above	75% of profit of the outturn profit which exceeds level 3 50% of profit of the outturn profit which exceeds level 2 (excluding that which is above level 3) 25% of profit of the outturn profit which exceeds level 1 (excluding that which is above level 2)

Excess profit worked example

A firm price contract where the estimated Allowable Costs (AC) are £100M with a 10% contract profit rate (with no incentive adjustment)

- The contract price is set by the formula $(AC \times \text{profit rate}) + AC$, so the contract price is: $(£100M \times 10\%) + £100M = £110M$
- The outturn costs were £90M so the outturn profit was $(£110M - £90M) = £20M$
- $£20M \div £90M$ gives an outturn profit rate of 22.2% on the outturn costs
- The outturn profit exceeds Excess Levels 1 and 2 as below.
- Excess Level 1 is the profit the contractor would earn on the outturn costs (before an FPA) if the CPR were 5pp higher. The CPR in this example is 10% so Excess Level 1 is $(£90M \times (10 + 5)\%) = £13.5M$
 - **The amount of outturn profit exceeding Excess Level 1 is $(£20M - £13.5M) = £6.5M$**
- Excess Level 2 is the profit the contractor would earn on the outturn costs (before an FPA) if the CPR were 10pp higher. The CPR in this example is 10% so Excess Level 2 is $(£90M \times (10 + 10)\%) = £18M$
 - **The amount of outturn profit exceeding Excess Level 2 is $(£20M - £18M) = £2MM$**
- Excess Level 3 is the profit the contractor would earn on the outturn costs (before an FPA) if the CPR were 15pp higher. The CPR in this example is 10% so Excess Level 3 is $(£90M \times (10 + 15)\%) = £22.5M$
 - **The amount of outturn profit does not exceed Excess Level 3**
- Under the FPA, the MOD receives payment from the contractor for the excess profit as follows:
 - 50% of the amount exceeding Excess Level 2: $0.5 \times £2M = £1M$
 - 25% of the amount exceeding Excess Level 1 excluding any amount above Excess Level 2: $0.25 \times (£6.5M - £2M) = £1.125M$

The final price adjustment is therefore a decrease in the contract price of £2.125M

Excess loss

- 4.9 Where the outturn costs of the contract or component exceed the contract or component price, that contract or component is said to have made a loss. Where a loss is made the FPA acts to increase the contract or component price to reduce the amount of the loss borne by the contractor by sharing it with the MOD. The proportion of the loss that is shared depends on whether the amount of the loss is above or below the “loss level”.
- 4.10 The loss level is the loss which the primary contractor or sub-contractor would have made under the contract or component (before the application of the final price adjustment) had the outturn costs been 5 per cent higher than the contract or component price. For example, if the contract price is £110M as in the previous example above, the loss level is $(£110M - (£110M \times 1.05)) = -£5.5M$.
- 4.11 A contractor’s loss is shared with the MOD by increasing the price of the contract or components as follows:

Amount of loss	Amount by which the contract/component price must be increased (Final Price Adjustment)
Loss is below the loss level	25% of the amount of the loss up to the loss level
Loss is above the loss level	25% of the amount of the loss up to the loss level 50% of any loss above the loss level

Excess loss worked example

<p>A firm price contract where the estimated Allowable Costs (AC) are £90.91M with a 12% contract profit rate including a 2pp incentive adjustment (IA).</p> <ul style="list-style-type: none"> The contract price is set by the formula $(AC \times \text{profit rate}) + AC$. The incentive adjustment must be excluded so the contract price for the purpose of the FPA is $(£90.91 \times 10\%) + £90.91M = £100M$
<p>The actual outturn costs were £111M which meant the contractor made a loss of $(£100M - £111M) = -£11M$</p>
<p>Firstly, calculate the loss level. The loss level is the loss that would have been made had the outturn costs been 5% higher than the contract price. The contract price (excluding IA) is £100M so the loss level is $(£100M - (£100 \times 1.05)) = -£5M$</p> <p>The loss made by the contractor (£11M) exceeds the loss level by £6M</p>
<p>Where a loss has been made, the contract price is increased by:</p> <ul style="list-style-type: none"> 25% of the loss below the loss level: $0.25 \times 5 = £1.25M$ and 50% of the loss above the loss level: $0.5 \times 6 = £3M$
<p>The final price adjustment is therefore an increase in the contract price of £4.25M</p>

Qualifying Sub-Contracts (QSCs)

- 4.12 For a QSC an FPA does not adjust the price of the QSC to the QDC holder. Instead, a payment for the amount is made directly from either the sub-contractor to the MOD or from the MOD to the sub-contractor, whichever is appropriate. This applies whether the parties agree the FPA or it is determined by the SSRO following referral.

Components and contract amendments

- 4.13 As explained above, the FPA may be applied to the contract as a whole (excluding any components to which it cannot apply), or to components of the contract to which an FPA could apply (individually or in aggregate). Different approaches will be more suitable than others depending on the circumstances of the contract and the parties must decide which approach to take.
- 4.14 Aggregation is particularly useful if the contract contains multiple components with concurrent completion dates, for example, having undergone several pricing amendments using different contract profit rates, it allows the amended contract price to be adjusted as a whole. Alternatively, if the contract is formed of several sequential pricing periods which are components, each of which make up a substantial proportion of the contract price, it may be preferable to apply the FPA to each pricing period separately through the life of the contract.

- 4.15 The outcome of the FPA process for a contract (including if an FPA applies at all) may differ depending on whether the parties choose to take an individual component or aggregated approach to the FPA. It is not necessarily the case that the sum of individual FPAs for two components will be the same as the amount of a single FPA applied to those components when aggregated for the purpose of calculating the FPA. However, the parties to a QDC or QSC should note that they are prohibited from forming components for the purpose of avoiding an FPA (for example, splitting up a contract into components so as to ensure that no FPA on any component would exceed £250,000).
- 4.16 It should also be noted that if the FPA is calculated on the basis of the aggregate of several components it will be necessary to aggregate the relevant inputs from each component to perform the calculation. As an example:
- Original firm price contract: Estimated Allowable Costs £60M plus 10% profit (with no incentive adjustment/ any incentive adjustment excluded) = £66m contract price.
 - Pricing amendment: Estimated Allowable Costs £10m plus 8% profit (with no incentive adjustment/any incentive adjustment excluded) = £10.8m amendment price.
 - In this case the FPA calculation could be based on the total estimated costs of £70m and a total redetermined contract price of £76.8m.
 - The aggregate contract profit rate of £6.8m on £70m cost would therefore be 9.71%.
 - The contractor can earn up to 5pp additional profit, without triggering an FPA so in this case the contractor could earn up to 14.71% profit on its outturn costs or the outturn costs could fall by £3.05M before the FPA would be triggered.

Regulations relevant to this section

- FPA payable at different excess profit levels: Regulations 17(2), 17(3) & 17(4)
- FPA payable at excess loss: Regulation 17(5)
- FPA aggregation of components: Regulations 17(5A) & 17(5B)
- Definitions of calculation terms: Regulation 17(6)

5. Reporting requirements

Reporting requirements

- 5.1 Contractors with a firm, fixed or volume-driven priced contract must provide a forecast of any FPA which the contractor expects to be made in any update report.⁴ This report must include confirmation of whether they think an FPA will be made and the amount of the likely adjustment. The SSRO publishes [detailed guidance on completion of contract reports](#) in DefCARS.
- 5.2 In the Contract Costs Statement submitted within 12 months after the contract (or component) completion date, the contractor reports its total actual Allowable Costs. This report is used by the MOD to inform its calculation of the FPA. The contractor is not required to but may include in the CCS what it thinks the FPA will be, based on the most up-to-date information about its actual costs which meet the requirements of Allowable Costs.

Regulations relevant to this section

- Reporting requirements: Regulations 26(6)(g), 26(6C)(g), 27(5)(a), 27(6)(a), & 28(2)(k)

⁴ Quarterly Contract Reports, Interim Contract Reports (lower value only), Contract Completion Report and Component Completion Report.

6. Getting help and resolving issues

6.1 While it is envisaged in most situations that this guidance will be sufficient to allow the relevant parties to agree an FPA if one is due, there may be cases where further assistance is needed to reach agreement. There are several ways in which the SSRO can help in these circumstances:

- the SSRO helpdesk;
- non-referral advice service; and
- referral for an opinion or determination.

More information on these services is set out below and is also available on the [SSRO's website](#).

The SSRO helpdesk

6.2 Our helpdesk provides ongoing support to contractors and the MOD. It operates from 9am to 5pm Monday to Friday, excluding UK bank holidays. It can be contacted on 020 3771 4785 or by email at helpdesk@ssro.gov.uk. We can also arrange online video calls via Microsoft Teams. We answer most helpdesk queries within 1 or 2 working days and aim to respond to all queries within a maximum of 5 working days. The SSRO also publishes on a quarterly basis the [responses it provides to commonly asked questions](#).

6.3 MOD staff should follow internal routes for guidance and support in the first instance but can also (after that) contact the helpdesk for any additional support.

Non-referral advice service

6.4 We provide a non-referral advice service for contract-specific queries on applying the regulatory framework that are more complex in nature and cannot be dealt with by the SSRO helpdesk. This service offers independent and authoritative advice on a confidential basis on any matter related to the interpretation and application of the regulatory framework for qualifying defence contracts. Either party to a current or proposed qualifying contract may seek non-referral advice on the application of the regulatory framework to that contract. Further information on the SSRO's non-referral advice service can be found on our website.⁵

Referrals

6.5 The MOD or a contractor may, in certain circumstances, seek an expert opinion or determination from the SSRO on the application of the FPA. We have published guidance for the MOD and contractors on making a referral for an opinion or a determination.⁶ To discuss a potential referral, please email referrals@ssro.gov.uk or contact helpdesk@ssro.gov.uk and we will direct you to a member of staff.

6.6 Note that where the right to seek a determination in relation to the amount of an FPA for a component has expired, this does not necessarily prevent a determination being sought in relation to the amount of an FPA for the contract. Further explanation is provided at paragraphs 3.14 and 3.15.

⁵ <https://www.gov.uk/government/publications/the-ssros-non-referral-advice-service>

⁶ <https://www.gov.uk/government/publications/guidance-on-the-ssros-referrals-procedures-under-the-defence-reform-act-2014-and-single-source-contract-regulations-2014>

- 6.7 If a notification of intention to make an FPA is given, it is a legal requirement for the parties to attempt to reach agreement on the FPA. It is advisable, where possible, for such attempts to conclude before the right to seek a determination expires (within two years after the completion date of the contract or component). In cases where the right to seek a determination has expired, but negotiations on the FPA are ongoing, the SSRO may still be able to provide non-referral advice or (if permitted) an opinion if requested by one of the parties. These, however, would not be binding on either party.

7. Key questions and answers regarding the final price adjustment

7.1 This section addresses commonly asked questions about the FPA.

Question	Answer
<p>1. When should I be thinking about whether I want to make an FPA?</p>	<p>This should be considered before entering into, or during the life of, the contract and not left until contract completion. Contracting parties should be monitoring variances between the expected and actual costs under a QDC or QSC. This should give an indication of whether an FPA may be applicable. Contracting parties should also be considering the estimated FPA that contractors may have included in statutory reports. Being prepared ahead of the end of the contract completion will help ensure procedural deadlines are not missed. The FPA can only apply in the specified circumstances and cannot be used to remedy cost variances which do not give rise to excess profits or losses. Such variances should be managed through the normal contractual processes.</p>
<p>2. We are only halfway through the contract and I think an FPA is likely. Is there anything I should be doing now?</p>	<p>Continue to monitor variances to see whether and how the situation changes. You may also wish to discuss the matter with the other contracting party, as there may be actions that could be taken to avoid an FPA arising. An example of this can be found in question 14.</p>
<p>3. I want to notify the other party of my intent to make an FPA. How do I do this? Is there a specific process I need to follow?</p>	<p>There are specific timelines for notification of an FPA explained in section 2 of this guidance.</p> <p>There is no prescribed format for a notification, but we recommend that it be in writing and that it contains sufficient information to facilitate a discussion and agreement of the FPA amount.</p> <p>Such a notice might include: the contract reference number, the contract or component completion date, the basis on which an FPA is applicable, (if a component) reference to any prior agreement to aggregate components for the FPA, and (if known) the estimated quantum of the FPA amount to be sought.</p>
<p>4. I have notified the other party of our intention to make an FPA but later I decide it's not necessary - what should I do?</p>	<p>Notification is of intent only. It is acceptable to inform the other party, having previously given notification of intent, that you will not proceed to seek an FPA. The amount of an FPA is agreed by the parties (unless the matter is referred) and it is acceptable for the parties to agree an FPA of £nil is appropriate (e.g. if additional information was supplied or a reporting error was corrected).</p>

Question	Answer
5. The Regulations say I must notify the Secretary of State - how do I do that?	<p>Any reference to the Secretary of State includes an authorised person to whom the Secretary of State has delegated authority.</p> <p>We understand that there is a dedicated Final Price Adjustment team within the MOD. Your point of contact within the MOD should be able to direct you to an appropriate contact for the FPA notification.</p>
6. I am an MOD commercial officer. I think a contract has completed but I have not had the relevant reports from the contractor. Should I have received something? What can I do?	<p>Initially, we would suggest speaking with your contractor via your point of contact.</p> <p>You should also have some indication from the previous reports (available on DefCARS) or the contract as to the expected contract completion date.</p> <p>We understand that Chapter 6 of the MOD commercial toolkit contains information on MOD internal procedures for requesting on demand reports which may assist you in determining next steps.</p>
7. It is almost 2 years since the contract completion date, FPA negotiations are ongoing, but I think we may need to refer the matter to the SSRO. What should I do?	<p>A referral to the SSRO for a determination on the amount of an FPA can be made within two years after the contract completion date of the contract (or component) in respect of which the referral is made. If you think more time will be needed to agree an FPA, you can refer the matter before negotiations have concluded (provided the deadline has not lapsed). A referral should indicate the basis of any disagreement between the parties as to the amount of an FPA and confirm whether negotiations are ongoing. The SSRO will consider the likely benefit of allowing any ongoing negotiations between the parties to conclude before commencing any investigation of the matter. The SSRO referral process exists to help contracting parties resolve disputes, and if the parties are able to reach agreement on the FPA before the SSRO begins its investigation, the SSRO may close the referral without taking any further action. Indeed, knowing the matter has been referred may assist the parties in concluding their negotiations in a timely manner.</p>
8. The Regulations say the parties need to agree the FPA amount. How do we do that? Where should we start?	<p>The way in which the FPA is calculated is prescribed in law (regulation 17). Section 4 of this guidance and the SSRO's calculator will enable both parties to apply regulation 17. The parties should identify any disagreement on the inputs to the calculation and the basis for this as the starting point negotiation about reaching agreement.</p> <p>You can also contact the SSRO helpdesk for further assistance: helpdesk@ssro.gov.uk or by telephone on 020 3771 4785.</p>

Question	Answer
<p>9. We are attempting to agree an FPA amount with the other party. I think a referral to the SSRO may be necessary, but I'm concerned the result may be less favourable. Can I get any early indication from the SSRO on what it may determine?</p>	<p>Irrespective of whether it is determined by the parties or the SSRO, the FPA should always be calculated in accordance with the Regulations, resulting in the correct adjustment being made. The SSRO cannot comment on the amount of an FPA to be applied in relation to a matter that has not been referred to it, as it will not be in a position to verify the facts and circumstances of the case. However:</p> <ul style="list-style-type: none"> • the calculator issued alongside this guidance can be used to ensure that any calculation is error free; and • the SSRO may be asked to provide non-referral advice on any matter related to the application of the regulations which are relevant to determining the FPA; for example, on how the parties should determine the amount of the contractor's outturn costs for the purposes of the calculation.
<p>10. I have completed a contract with the MOD. I have just been informed that the Secretary of State has directed that the provision to make an FPA does not apply. What does that mean?</p>	<p>Under section 21(5) and regulation 16(2), if a QDC's value is between £5m and £50m the Secretary of State (or someone with appropriate delegated authority) may direct that no FPA will apply for either cost over- or underruns.</p> <p>No such direction may be given in respect of QSCs.</p>
<p>11. I've been told I can only earn an extra 5 per cent profit on my contract because of the FPA. Is that true?</p>	<p>No. Contracts can earn up to an additional 5 per cent profit before an FPA applies.</p> <p>In the case of profit which is higher than an additional 5 per cent an excess profit is deemed to have resulted, and an FPA takes a portion of any excess profit above that 5 per cent threshold. This still means that a contractor is earning additional profit.</p>
<p>12. We have a firm price contract which the MOD has not fully utilised, and it looks like we will have excessive profits on it. We don't feel this is our fault, is there anything we can do before the contract ends to avoid an FPA?</p>	<p>Discuss the matter with your contact at MOD. Assuming the under-utilisation is unlikely to be remedied, the parties could agree to reflect the under-utilisation in an amendment to the contract price. This could avoid an FPA, but the amendment itself would lower the amount of the profit on the contract. If the contract is between £5m and £50m the Secretary of State (or delegated person) may also direct that no FPA should apply.</p>

Question	Answer
<p>13. My contract with the MOD was likely to make excessive profits. I agreed to do some additional work to increase my Allowable Costs (and therefore reduce my excess profits). Do I need to report this extra work in DefCARS? How will this affect the value of my contract and any potential future FPA?</p>	<p>The excess profit would only be reduced if the contractor agreed to incur additional costs (that meet the requirements of Allowable Costs) which did not result in a commensurate increase in the contract price. Reducing excess profit reduces the amount of an FPA, possibly to the extent that no adjustment is required. The additional actual (outturn) costs incurred would be reflected in any relevant subsequent reports in DefCARS. There would be no effect on the contract value, which was determined when the contract was entered into and has not changed. If the contract is amended to include these additional costs as Allowable Costs under the contract, thereby increasing the contract price, the excess profit and an expected FPA is likely to endure.</p>
<p>14. The Regulations say that I must provide evidence to the SSRO in the event of a referral. What evidence do I need to keep?</p>	<p>The evidence required is not specified by the Regulations and will be individual to the specific contract and the nature of any dispute giving rise to a referral. Contractors have an obligation to keep relevant records, which include records for the purpose of verifying any matter relating to the price payable under the contract. This would include any records relevant to an FPA. Relevant evidence from these records would form the basis of an SSRO request for evidence in the case of a referral.</p>