



**SSRO**

Single Source  
Regulations Office

*Assuring value, building confidence*



## Review of the Single Source Regulatory Framework

Call for input - Transparency September 2016

# Glossary

<b>Act</b>	Defence Reform Act 2014
<b>Contract completion date</b>	The date described in the contract as the contract completion date, or if no such date is described in the contract, the date on which the contractor completes all obligations which entitle it to final payment under the contract. If the contract is terminated before either of these dates, the contract completion date is the date on which the contract is terminated.
<b>Cost recovery base</b>	The unit of measure for which a cost recovery rate is applied in order to calculate a cost under a contract.
<b>Cost recovery rate</b>	A rate calculated for a business unit that is used to determine the cost payable under a contract.
<b>CRB</b>	Cost recovery base
<b>CRR</b>	Cost recovery rate
<b>Defined pricing structure</b>	A basis on which costs must be split in a contract notification report, interim contract report or contract completion report. The SSRO has published 16 defined pricing structures for this purpose.
<b>Designated person</b>	The person required to submit supplier reports. If the contractor is associated with one or more other persons (i.e. the contractor is part of a group), then the designated person will be the contractor's ultimate parent undertaking. If the contractor is not part of a group, then the contractor will be the designated person.
<b>DP</b>	Designated person
<b>DPS</b>	Defined pricing structure
<b>FAS</b>	Financial accounting statement
<b>Initial reporting date</b>	The date from which the obligation to submit the initial contract reports is measured. The initial reporting date is usually the date of agreement, unless a contract becomes a QDC by amendment, in which case it is the date of amendment.
<b>MOD</b>	Ministry of Defence
<b>QBU</b>	Qualifying business unit
<b>QDC</b>	Qualifying defence contract
<b>QSC</b>	Qualifying sub-contract
<b>Regulations</b>	Single Source Contract Regulations 2014
<b>Relevant period</b>	A period used for determining whether overhead reports are required and the information to be provided in them. It is the business unit's accounting year ending in the financial year in question.
<b>TCIF</b>	Target cost incentive fee
<b>Undertaking</b>	A body corporate or partnership, or an unincorporated association carrying on a trade or business, with or without a view to profit.

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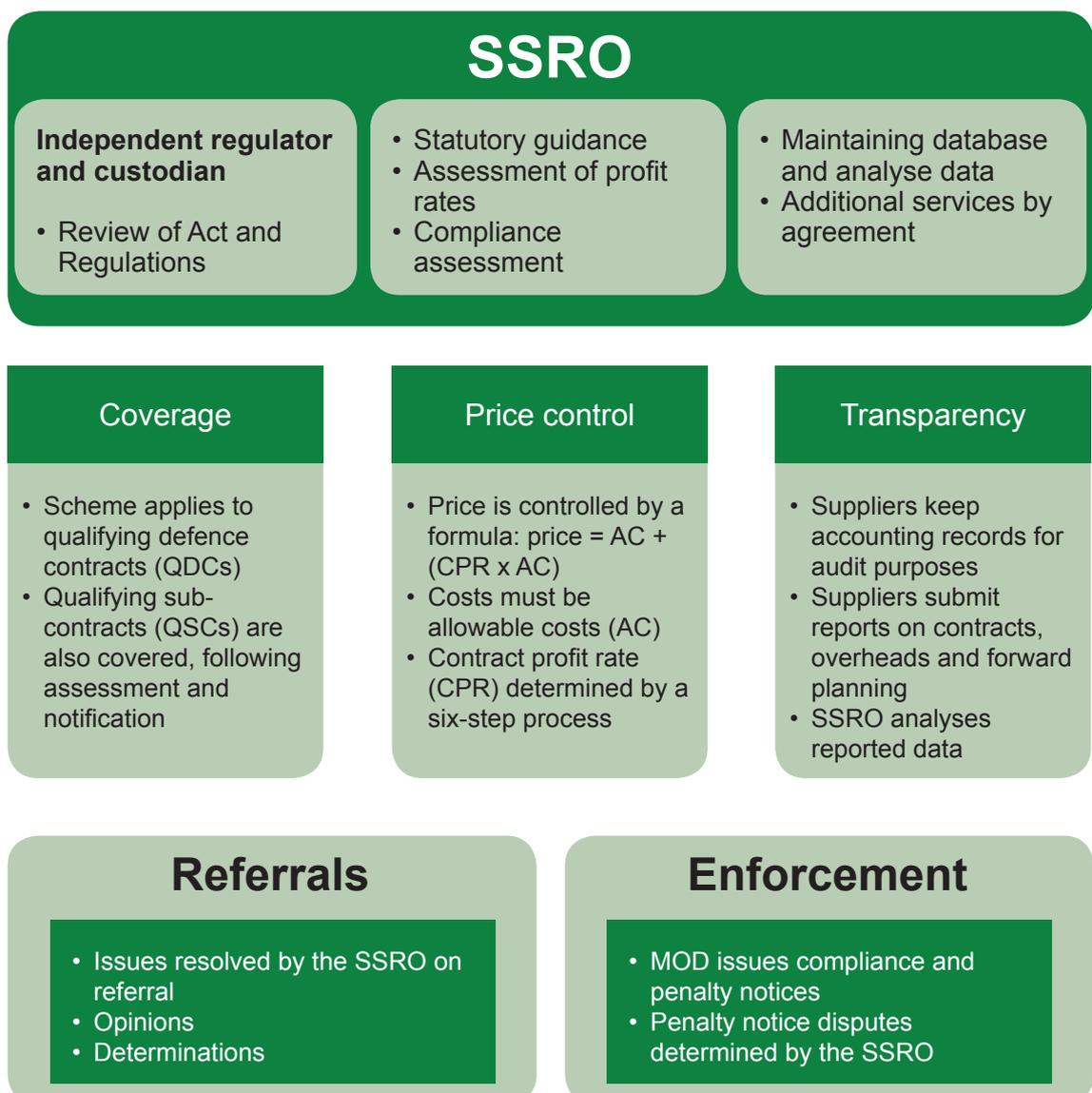
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# Introduction

## 1. Single source regulatory framework

- 1.1 The regulatory framework for single source defence contracts was introduced by Part 2 of the Defence Reform Act 2014 (the Act) and the Single Source Contract Regulations 2014 (the Regulations) and came fully into effect in December 2014. The scheme of regulation aims to strike a balance between value for money and fair prices by subjecting covered contracts to price control and requiring suppliers to report a suite of information designed to give greater transparency to these contracts. Figure 1 summarises the elements of the scheme.

**Figure 1: Summary scheme of regulation**



## 2. Review of the legislation

- 2.1 The SSRO was established to be the independent expert on single source defence procurement and the custodian of the regulatory framework. Its statutory functions include keeping Part 2 of the Act and the Regulations under review. The SSRO may recommend to the Secretary of State such changes to the regulatory framework as it considers appropriate.
- 2.2 The Secretary of State is required to complete periodic reviews of the framework, with the first review to be completed by December 2017. Subsequent reviews by the Secretary of State are to be carried out in five-year cycles. In carrying out a review, the Secretary of State must have regard to any recommendations made by the SSRO, provided these are submitted six months before the date on which the review is to be completed. This means that the latest the SSRO may make recommendations for the Secretary of State's first review of the legislation is Friday 16 June 2017.
- 2.3 The SSRO proposes to consult widely before making recommendations to the Secretary of State. This will include a public consultation, which is expected to take place over two months in early 2017. The SSRO is seeking the views of key stakeholders in advance of that public consultation to help it prepare its consultation proposals.
- 2.4 The SSRO called for input from stakeholders in the period 23 May 2016 to 15 July 2016. That call for input covered most elements of the framework, but left detailed consideration of the transparency provisions until later to give stakeholders more time to experience their operation. The SSRO is considering the submissions received in response to its first call for input and intends to address these as part of the public consultation in 2017.
- 2.5 This second call for input deals specifically with transparency. The particular issues presented for discussion have been selected following a detailed examination of the relevant statutory provisions. We have also taken into account the SSRO's strategic objectives, our learning from the operation of the scheme, relevant comparisons with other regulatory schemes and the recommendations in the Currie report which led to the new regime. Appendix 1 sets out a summary of matters considered by the SSRO but in respect of which it is not specifically calling for input.
- 2.6 The SSRO's call for input is intended to stimulate feedback in key areas. However, the SSRO welcomes representations from stakeholders on any matters they consider should form part of the review.
- 2.7 Stakeholders are requested to provide written responses to this paper by **4.00pm on 4 November 2016**. All communications in respect of the review should be directed as follows:

**Email:** [reviewofregulation@ssro.gov.uk](mailto:reviewofregulation@ssro.gov.uk)

**Telephone:** 020 3771 4767

# Transparency provisions

## 3. Outline of the provisions

- 3.1 A key feature of the regulatory framework is that contractors and suppliers are required to provide the SSRO and the Ministry of Defence (MOD) with information about their contracts, business unit costs and related activities. This transparency supports the SSRO to deliver its statutory functions, outlined in Figure 1, and the MOD to negotiate and manage single source defence contracts.
- 3.2 The measures used to deliver transparency are standard reporting requirements, supplemented by duties to notify and keep records, as outlined in Figure 2.

**Figure 2: Transparency measures**



Contract reporting	<ul style="list-style-type: none"> <li>Contractors provide standard reports to MOD and SSRO about each QDC and QSC</li> </ul>
Duty to notify	<ul style="list-style-type: none"> <li>Contractors must notify events and circumstances that may materially affect the contract and materially relevant information</li> </ul>
Supplier reporting	<ul style="list-style-type: none"> <li>Suppliers provide standard reports to MOD and SSRO about overheads, SMEs and industrial capacity</li> </ul>
Record keeping	<ul style="list-style-type: none"> <li>Duty to keep records</li> <li>Open book access by the MOD</li> </ul>

- 3.3 The transparency provided by the regulatory framework is limited to the SSRO and the MOD, in recognition of the commercial sensitivity of the information. The framework provides an additional safeguard by removing transparency obligations in cases where compliance would breach an enactment or a duty of confidentiality. It also makes individuals criminally liable in specified circumstances for disclosing the information that has been made available.
- 3.4 The transparency measures and associated safeguards are described in greater detail in the following sections of this call for input, to assist stakeholders to make representations.

### Call for input 1

The SSRO invites views regarding the transparency measures and associated safeguards and raises specific issues for consideration below.

# Record keeping

## 4. Obligation to keep records

- 4.1 The regulatory framework requires the following people to keep records and to make them available for inspection by the Secretary of State:
- the primary contractor in relation to a QDC;
  - the sub-contractor in relation to a QSC; and
  - a designated person required to submit supplier reports.
- 4.2 The records required to be kept are described as “relevant records”. These are accounting and other records which may reasonably be expected and which are sufficiently up-to-date and accurate for use by the Secretary of State for prescribed purposes.
- 4.3 One of the prescribed purposes for which records must be kept is to enable the Secretary of State to audit contract reports or supplier reports. In cases where a contractor keeps records in relation to a QDC or QSC, the prescribed purposes also include the following:
- verifying whether a cost is an Allowable Cost;
  - verifying the reason for any difference between an estimated and actual Allowable Cost;
  - verifying any other matter relating to the price payable under the QDC or QSC;
  - monitoring the performance of the primary contractor in relation to its obligations under a QDC, or the sub-contractor in relation to its obligations under a QSC; and
  - determining whether a contract between the record holder and another person is a QSC.
- 4.4 Records must be kept from the “recording date”, which differs depending on who has the reporting obligation and how it arose. The alternatives for the recording date are summarised in Figure 3.

**Figure 3: Initial recording date**

Person required to keep records	Recording date
a. Primary contractor (PC) in respect of a contract that became a QDC by amendment	The earliest of: (a) the date PC received written notice that amendment negotiations had commenced; (b) the date PC was invited to provide an offer to amend; (c) the date PC made an offer to amend; (d) the date of amendment (Regulation 20(2) and 20(3)).
b. PC in respect of a QDC resulting from a process in which a notice of intention to seek offers was published	The date of publication of the notice (Regulation 20(4)).
c. PC in respect of all other QDCs	The earliest of: (a) the date PC received written notice that contract negotiations had commenced; (b) the date a voluntary transparency notice was published; (c) the date PC was invited to provide an offer; (c) the date PC made an offer; (d) the date the QDC was entered into (Regulation 20(5)).
d. Sub-contractor in respect of a QSC	As in (c), with PC replaced by sub-contractor and QDC replaced by QSC (Section 30(1) of the Act).
e. Designated person (DP) in respect of a supplier report	The first day of the DP's accounting period in respect of the relevant financial year for which the report is provided (Regulation 20(6)).

- 4.5 The requirement to keep records does not continue indefinitely. The date on which it ends is determined differently depending on whether the records are being kept by the contractor in respect of a QDC or QSC or by a designated person. In each case the end date is the earlier of two possible dates, as shown in Figure 4.

**Figure 4: End date for the obligation to keep records**

Record-keeper	End date (earlier of the two dates)
Contractor in respect of QDC or QSC	<ul style="list-style-type: none"> <li>two years after the contract completion date</li> <li>six years after the end of the contractor's accounting period in which the duty first arose</li> </ul>
Designated person	<ul style="list-style-type: none"> <li>two years after the end of the designated person's accounting period relating to the last relevant financial year in relation to which the ongoing contract condition is met</li> <li>six years after the end of the designated person's accounting period in which the duty first arose</li> </ul>

## 5. Examination of relevant records

- 5.1 The Secretary of State is entitled to examine relevant records for one of the prescribed purposes, but must first give written notice to the record-keeper describing the purposes for which examination is required. The record-keeper is only obliged to permit examination on a working day between 9 am and 5 pm that is at least 20 working days after receipt of the written notice. The Secretary of State may require the record-keeper to make a copy of relevant records available for the purposes of enabling the records to be examined. The Secretary of State may request the record-keeper to provide further information or explanation relating to any relevant records.

## 6. Review and enforcement

- 6.1 The record keeper may apply to the SSRO to review the Secretary of State's exercise of the power to examine records and to require copies or further information or explanation. If the SSRO determines that the Secretary of State has acted unreasonably, it may make a declaration to that effect.
- 6.2 A failure to comply with a requirement to keep relevant records, to permit examination or to provide further information or explanation imposed is a ground on which the MOD may issue a compliance notice or penalty notice.

## 7. Call for input

- 7.1 In its first call for input the SSRO proposed that it might be given the power to examine relevant records, which the Secretary of State currently has. The SSRO is considering the responses received. The SSRO welcomes any other representations that stakeholders may wish to make about record keeping.

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# Material events, circumstances and information

## 8. Duty to notify

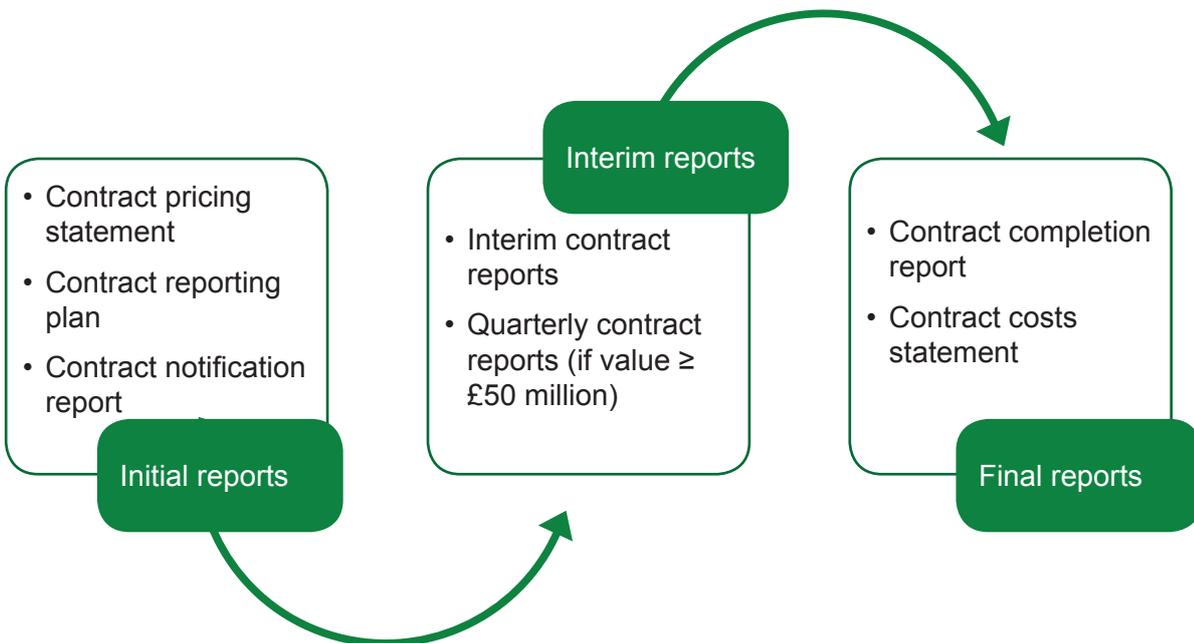
- 8.1 The Defence Reform Act supports the MOD's management of single source defence contracts by requiring contractors to notify matters that may impact on QDCs and QSCs. A primary contractor is required to notify the Secretary of State on becoming aware of:
- an event that has occurred or is likely to occur that is likely to have a material effect in relation to a QDC to which the contractor is a party;
  - circumstances likely to have a material effect in relation to the QDC; or
  - information likely to be materially relevant to the QDC.
- 8.2 A sub-contractor in relation to a QSC has the same obligation to notify the Secretary of State of events, circumstances and information.
- 8.3 The Act does not define when an event or circumstance may have a material effect or when information may be materially relevant. It does, however, indicate that there may be such an effect or such relevance where it relates to:
- the primary contractor's costs;
  - the price payable to the contractor; or
  - the primary contractor's ability to perform a material obligation to the contract.
- 8.4 A failure to comply with the duty to notify is a ground on which the MOD may issue a compliance notice or penalty notice.
- 8.5 The SSRO is not making any specific proposals in relation to the duty to notify in this call for input but welcomes any representations that stakeholders may wish to make.

# Contract reports

## 9. Outline of the reporting requirements

- 9.1 Part 5 of the Regulations details the reports that primary contractors are required to submit in relation to their QDCs. These requirements apply, with some modification, in relation to sub-contractors and QSCs.
- 9.2 A number of standard reports are required to be provided to the SSRO and the MOD at the initial, interim and final stages of a qualifying contract, as summarised in Figure 5 below. The Secretary of State may direct the provision of additional reports, referred to as on-demand contract reports.

**Figure 5: Reports required for qualifying contracts**



- 9.3 In preparing a report, the contractor or supplier must have regard to any relevant guidance issued by the SSRO. The SSRO has published a range of guidance, which takes the form of:
- report templates and associated user guides; and
  - defined pricing structures (DPS) for different types of military equipment, IT systems and ancillary services.
- 9.4 Every report submitted in respect of a QDC must contain a range of basic information. The same information is required for QSC reports, subject to two omissions reflecting the fact that there will likely neither be a MOD civil servant responsible for managing the QSC nor a unique MOD reference for the contract.

## 10. Initial reports

10.1 Three reports are required to be submitted within one month of the initial reporting date. Figure 6 provides a brief outline of the information required to be provided in each of the reports.

**Figure 6: Summary of initial reports**

Contract pricing statement (Regulation 23)	Contract reporting plan (Regulation 24)	Contract notification report (Regulation 25)
<ul style="list-style-type: none"> <li>• Allowable Costs</li> <li>• Contract profit rate</li> <li>• Facts, assumptions, calculations</li> </ul>	<ul style="list-style-type: none"> <li>• Contract value</li> <li>• Required reports</li> <li>• Report dates</li> <li>• DPS</li> <li>• Output metrics</li> <li>• Cost recovery bases</li> </ul>	<ul style="list-style-type: none"> <li>• Information on deliverables</li> <li>• Breakdowns of costs, profits and payments</li> <li>• Details of sub-contracts</li> </ul>

10.2 The reason for having three initial reports rather than one is not immediately clear, but there are consequences which may be summarised as follows:

- the same basic information required in all contract reports is repeated three times at the outset of the contract and the need for this may be questioned;
- the contract notification report contains data which is updated at the initial and final reporting stages but the information in the other initial reports is not updated, such as the description of Allowable Costs and the related facts, assumptions and calculations; and
- there is a degree of arbitrariness about the division of information, for example, it isn't clear why the contract value should appear in the contract reporting plan rather than in the contract pricing statement.

10.3 Having regard to these points, views are sought from stakeholders as to whether a single initial report should be introduced.

### Call for input 2

The SSRO invites views on whether a single initial report should be introduced.

## 11. Interim reports

11.1 There are two types of reports that may be required during the life of a QDC or QSC: quarterly contract reports; and interim contract reports. Figure 7 provides a brief outline of the information required to be provided in each of the reports.

**Figure 7: Quarterly and interim contract reports**

Quarterly contract reports (Regulation 26)	Interim contract reports (Regulation 27)
<ul style="list-style-type: none"> <li>• Information on deliverables</li> <li>• Breakdown of costs and profits (actuals and forecasts)</li> <li>• Annual cost profiles split by contractor reporting structure</li> <li>• Forecast TCIF or final price adjustment</li> <li>• Material events and circumstances</li> <li>• Sub-contract details</li> </ul>	<ul style="list-style-type: none"> <li>• Information on deliverables</li> <li>• Breakdown of costs and profits (actuals and forecasts)</li> <li>• Annual cost profiles split by defined pricing structure</li> <li>• Forecast TCIF or final price adjustment</li> <li>• Material events and circumstances</li> <li>• Payment details</li> <li>• Sub-contract details</li> <li>• Some information required only if contract value is &lt; £50 million</li> </ul>

11.2 The regulatory framework seeks to take a proportionate approach to the interim reporting requirements by:

- only requiring quarterly contract reports for contracts valued at £50 million or more; and
- varying the frequency and the content of interim contract reports depending on whether the contract value is below the £50 million threshold or not.

11.3 It is unclear, however, why there is a need for two different types of interim reports in order to achieve proportionate reporting requirements. The required frequency and content of a single type of interim report may still be determined by reference to a £50 million value threshold. A single report may simplify the reporting requirements and reduce to some extent the reporting burden on contractors.

### Call for input 3

The SSRO invites views on whether a single interim report should be introduced.

11.4 Quarterly contract reports are required to be submitted within one month of the end of each quarter. This obligation applies from the initial reporting date to the contract completion date, although no report is required for the quarters in which the initial reporting date and contract completion dates themselves fall. The first report is required to cover the period from the initial reporting date to the end of the next calendar quarter.

11.5 Whether there is a need for quarterly reporting may depend on the purpose the reports are intended to serve. The SSRO uses the information provided to discharge its statutory functions and is considering whether it is helpful to have the information updated four times a year for these purposes. We would welcome feedback on the usefulness of quarterly reports for contract management or other purpose at the current frequency.

### Call for input 4

The SSRO invites views on whether the required frequency of quarterly contract reports should be changed.

- 11.6 Interim contract reports are required to be submitted within two months after each reporting date. The reporting dates may be agreed between the primary contractor and the Secretary of State (or between the contracting authority and the sub-contractor for a QSC) within limits. Failing agreement the reporting dates are imposed by the Regulations. The approach to reporting dates gives rise to a degree of complexity as shown in Figure 8.

**Figure 8: Reporting dates for interim contract reports**

	< £50 million		≥ £50 million	
	1st report	Later reports	1st report	Later reports
Agreed date	≤ 5 years from time of agreement	≤ 5 years from previous reporting date	≤ 3 years from time of agreement	≤ 3 years from previous reporting date
Without agreement	3 years after last date of the quarter of the initial reporting date	Each third anniversary	12 months after last date of the quarter of the initial reporting date	Each anniversary

## 12. Final reports

- 12.1 There are two reports required at the end of a QDC or QSC:

- contract completion report, due within six months after the contract completion date; and
- contract costs statement, due within 12 months after the contract completion date.

- 12.2 Figure 9 provides a brief outline of the information required to be provided in each of the reports.

**Figure 9: Contract completion report and contract costs statement**

Contract completion report (Regulation 26)	Contract costs statement (Regulation 27)
<ul style="list-style-type: none"> <li>• Information on deliverables</li> <li>• Breakdown of costs and profits</li> <li>• Payment details</li> <li>• Sub-contract details</li> <li>• Forecast TCIF or final price adjustment</li> <li>• Material events and circumstances</li> </ul>	<ul style="list-style-type: none"> <li>• Contractor's accounting period</li> <li>• Cost allocation and apportionment methodology</li> <li>• Annual profile of Allowable Costs</li> <li>• Explanation of any variance between total actual Allowable Costs and the breakdown of purchases, other direct costs and indirect costs</li> <li>• Explanation of any variance between reported information and most recent on-demand report</li> </ul>

- 12.3 The final reports should provide the actual costs and profit earned under the contract. However, the regulations permit the contract costs statement to contain estimates in place of actual costs. The contractor must state the percentage of Allowable Costs which are still estimated. Up to two percent of the costs may be estimated without any explanation given. Two percent or more of the costs may be estimated provided an explanation is given as to why it is not possible to provide actual costs and when actual costs will be available.
- 12.4 There may be a variety of reasons for costs still to be estimated, such as an ongoing contractual dispute between the parties, a contract amendment or extension, or delays in delivery. The consequence is that the SSRO may not collect the actual costs of qualifying contracts and may be unclear as to the actual profits earned. This may present an obstacle to the SSRO understanding how the Act and the Regulations are being applied.
- 12.5 The Regulations permit the Secretary of State to direct the provision of an on-demand contract report containing the information described in the contract costs statement. Such a direction may be given at any time up until the contract completion date. If a date is agreed for providing the report, this could be up to 18 months after the direction is given. This may permit contract costs statement information to be provided up to six months later than otherwise, but will not necessarily mean that the SSRO receives actual costs.
- 12.6 The situation could be remedied by a final accounting report to be submitted. It could be a requirement that such a report contain audited, reconciled costs rather than estimates.
- 12.7 The contract notification report (one of the initial reports) requires a range of information about expected payments under the contract. Interim contract reports require the same categories of payment information, but updated to include actual as well as expected payments. At the final stage, the contract completion report takes the same approach as the interim contract reports, recognising that there may still be payments outstanding at the time the report is submitted.

- 12.8 An understanding of the actual payments made under a contract may provide a useful basis for analysing the effectiveness of the regulatory framework. For example, a comparison between the actual payments made and the contract price may indicate whether the pricing formula is being correctly applied. There may be a case for the actual payments made to be reported, particularly if the payments are materially different from those reported in the contract completion report. This may assist to understand the actual profits achieved.

#### Call for input 5

The SSRO invites views on whether a final accounting report should be required in cases where actual costs are not known at the time of the contract costs statement and whether this should include a requirement for actual payments.

- 12.9 The contract costs statement requires an annual profile of the actual Allowable Costs. The SSRO can see value in the facts, assumptions and calculations relevant to each element of those costs also being provided. This is information provided in the contract pricing statement in relation to estimated costs and provides insight into the application of price controls under the regulatory framework. Having this information at the end of the contract in relation to actual costs, to the extent that these differ from estimates, would support the SSRO to discharge its duty to keep the provision of Part 2 of the Act and the Regulations under review.

#### Call for input 6

The SSRO invites views on whether the contract costs statement should provide a description of the facts, assumptions and calculations relevant to each element of the Allowable Costs that represent variations from the original estimates.

- 12.10 The contract completion report is required to contain a forecast of any target cost incentive fee (TCIF) and of any final price adjustment expected by the contractor.
- 12.11 In contracts that apply the target pricing method, the TCIF is determined based on the difference between actual and estimated Allowable Costs. The requirement for a forecast in the contract completion report reflects the fact that actual costs may still not be known at the time the report is submitted.
- 12.12 The mechanism in the regulatory framework for final price adjustment applies to contracts priced according to the firm pricing, fixed pricing, or volume-driven pricing methods. It provides a means for sharing the pain and gain between the MOD and the contractor:
- where the outturn profit rate exceeds the contract profit rate, the final price adjustment is intended to claw back for the Secretary of State a part of the contract price. The amount of the contract price clawed back is determined on a sliding scale by reference to the amount by which outturn profit rate exceeds the contract profit rate;
  - where the outturn costs exceed the contract price, the final price adjustment is intended to increase the contract price to reduce the pain experienced by the contractor. The amount of the increase is determined by reference to the amount of the excess and whether it exceeds an arbitrarily defined "loss level".

- 12.13 The procedure for final price adjustment is such that the intention to make an adjustment need not have been notified by the time the contract costs statement has been submitted. In order to carry out its statutory functions, the SSRO needs to understand the prices actually paid to contractors. This is to enable the SSRO to keep under review the pricing provisions of the framework, provide statutory guidance and assess the baseline profit and capital servicing rates.

### Call for input 7

The SSRO invites views on whether there should be a means of the SSRO accessing final TCIFs and final price adjustments.

## 13. Datasets from contract reports

- 13.1 The contract reports generate a set of data that may be used by the SSRO in carrying out its statutory functions and by the MOD as a purchaser and contract manager. The data requirements are detailed and Figure 10 provides a high-level outline of the set of data generated.

**Figure 10: Outline of the dataset obtained by the SSRO and the MOD from contract reports**

Deliverables	<ul style="list-style-type: none"> <li>List of key deliverables and description</li> <li>Estimated and actual quantum of deliverables by metric</li> <li>Delivery milestones and dates</li> <li>Causes of variance between expected and actual delivery</li> </ul>
Payments	<ul style="list-style-type: none"> <li>Expected and actual payments exceeding the greater of £100,000 or one per cent of contract value</li> <li>Amount, due date, currency and annual profile of all such payments</li> </ul>
Price	<ul style="list-style-type: none"> <li>Contract value</li> <li>Allowable Costs, including annual profiles of estimated and actual costs and each cost recovery base</li> <li>Risk contingency in the Allowable Costs</li> <li>Contract profit rate</li> <li>Planned and actual profits, excluding step 5 adjustment</li> <li>Maximum and actual profit from step 5 adjustment</li> <li>Causes of variance between estimated and actual and forecast costs</li> <li>Forecast TCIF or final price adjustment</li> </ul>
Events and circumstances	<ul style="list-style-type: none"> <li>Description of any event or circumstance that has affected or is likely to materially affect the contract</li> <li>Whether covered by any contingency in the contract</li> <li>Effect or forecast effect on costs</li> </ul>
Sub-contracts	<ul style="list-style-type: none"> <li>Description of actual or intended sub-contracts</li> <li>Proportion of contract value intended to be sub-contracted.</li> <li>Details of top 20 sub-contracts valued at £1 million or more</li> </ul>

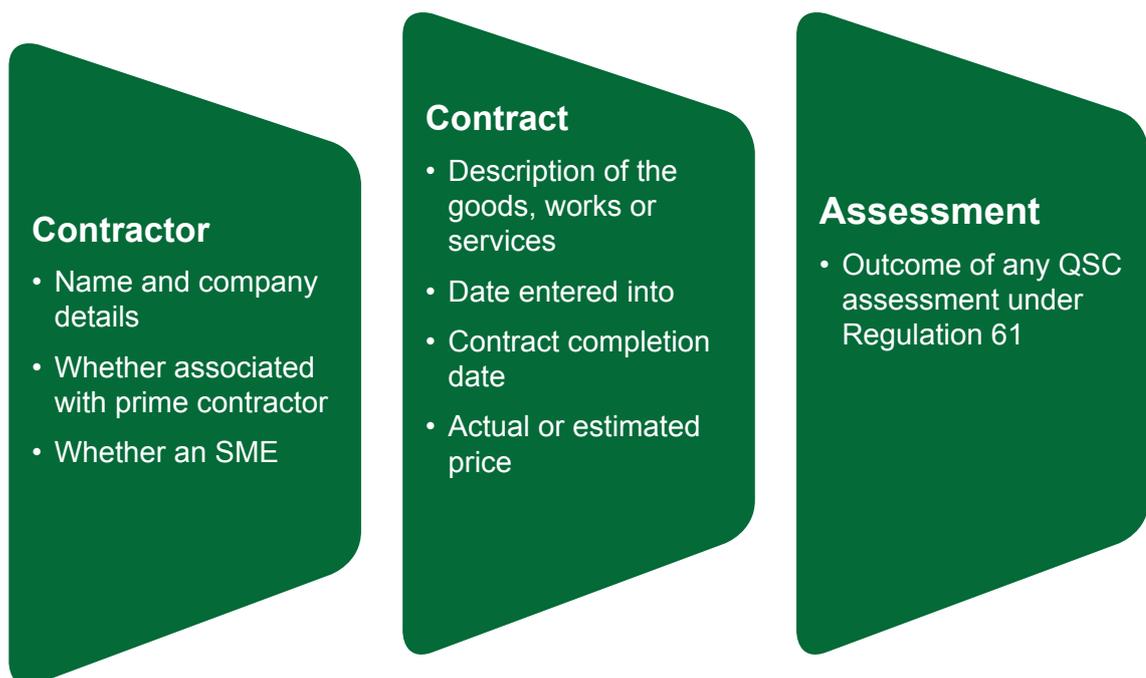
- 13.2 The SSRO uses the reported data for the purposes of its statutory functions, including keeping the provision of Part 2 of the Act and the Regulations under review. The SSRO continues to assess the extent to which the data supports delivery of its functions and, in doing so, is mindful of its aims to ensure good value for money is obtained in government expenditure on QDCs and that contractors receive a fair and reasonable return.

#### Call for input 8

The SSRO invites views on the dataset generated from the contract reports.

- 13.3 Information is required to be provided about sub-contracts in the contract notification report, quarterly contract and interim contract reports, and in the contract completion report. At the initial and interim stages a description is provided of the sub-contracts, together with a statement of the proportion of contract value intended to be sub-contracted. All of the reports provide details about sub-contracts as summarised in Figure 11.

**Figure 11: Information required about sub-contracts**



- 13.4 The details in Figure 11 are not required for every sub-contract, but only those valued at £1 million or more and only in respect of the 20 sub-contracts with the highest value. In July 2016, the SSRO published a short analysis of information reported about sub-contracts in 2015/16, which showed that:
- reported sub-contracts comprise 17 per cent (£1.8 billion) of the total value of QDCs/QSCs (£10.6 billion) in 2015/16;
  - 19 QDCs/QSCs (out of 33 analysed) reported having at least one sub-contract worth over £1 million;
  - suppliers reported a total of 112 sub-contracts, with an average of six per QDC/QSC (excluding those who reported no sub-contracts);

- four per cent of reported subcontracts were with small and medium enterprises (SMEs) but reporting requirements prevented determination of the actual number of SME sub-contracts, which are likely to be smaller in value; and
  - two QDCs reported 20 sub-contracts, the maximum number that is required for reporting purposes, and these contracts could potentially have additional sub-contracts worth more than £1 million.
- 13.5 The SSRO previously called for input on the definition and assessment of QSCs and whether the QSC threshold should be lowered. Those matters may impact the degree of transparency of the supply chains of QDCs and the SSRO is considering the responses received.
- 13.6 The question of how many sub-contracts are reported in the standard reports is also related to the transparency of supply chains and, to that extent, there may be a relationship between the questions. The SSRO is concerned that it should have sufficient information to analyse fair pricing and value for money for the purposes of its statutory functions.
- 13.7 The SSRO is considering whether more information can reasonably be provided about sub-contracts by:
- requiring the contract completion report to describe the sub-contracts and state the proportion of contract value that was sub-contracted (as is required at the initial and interim stages of reporting but which is based partly on intention);
  - adjusting the threshold value or number of sub-contracts about which details are required to be provided. In this context, analysis of 2015/2016 data shows that removal of the 20 sub-contract limit would have affected two of 33 contracts.
- 13.8 It would be helpful to have input from stakeholders regarding the impacts and

### Call for input 9

The SSRO invites views on the impacts and benefits of:

- requiring the contract completion report to describe the sub-contracts and state the proportion of contract value that was sub-contracted;
- adjusting the threshold value or number of sub-contracts about which details are required to be provided.

# Supplier reports

benefits of requiring more sub-contracts to be described.

## 14. Outline of the reporting requirements

14.1 Part 6 of the Regulations sets out a scheme for suppliers to report details of their businesses that are relevant to single source defence contracting. If reports are required, then they provide detailed information about the supplier’s calculation of overheads, engagement with SMEs and industrial capacity. There are seven

**Figure 12: Supplier reports**



“standard” reports as summarised in Figure 12.

14.2 The Secretary of State may require an additional report on overheads to be provided (the rates comparison report) by giving written notice to the supplier. The rates comparison report is not included in Figure 12 as it is only required on demand.

14.3 The overhead reports (see Figure 12 above) provide detailed information concerning the costs of QBUs. In each case the report relates to the business unit’s accounting period, although two of the reports are concerned with actual costs in the relevant period and three deal with estimated costs in the

**Figure 13: Overhead reports**

Actual rates claim report	Provide the actual and estimated cost recovery rates and cost recovery bases for the QBU with supporting information and analysis.
Estimated rates claim report	
Estimated rates agreement pricing statement	Provides descriptions, facts and assumptions used in the estimated rates claim report.
QBU actual cost analysis report	Provide actual and estimated operating costs, staffing costs (including contractors) and revenue for the business unit, together with associated analysis. The cost recovery rates and cost recovery bases are also stated.
QBU estimated cost analysis report	

immediately following accounting period. Figure 13 describes the content of the reports.

## 15. Determining whether reports are required

- 15.1 Not every single source defence supplier is required to submit supplier reports. It is a complicated process to determine whether a reporting obligation arises, who holds the reporting obligation and what reports need to be submitted.

### The ongoing contract condition

- 15.2 The requirement to submit supplier reports only applies for a financial year in which the “ongoing contract condition” is met in relation to a contract. The ongoing contract condition requires that both of the following are satisfied:
- the contractor or someone in the contractor’s group is party to at least one QDC or QSC with a value above £20 million (rising to £50 million in 2017/18); and
  - there are obligations outstanding for the supply of goods, works or services under one or more such contracts at any time in the financial year.
- 15.3 The raising of the value threshold in the ongoing contract condition to £50 million will place a significant limit on the number of suppliers required to submit reports. In 2015/16, 12 of 34 QDCs had values over £50 million and these contracts were held by nine suppliers (out of a total of 17). There is potential for the £50 million threshold to result in a limited number of supplier reporting obligations, adhering to large, prime contractors.
- 15.4 The SSRO is concerned that there should be sufficient reporting to enable analysis of value for money and fair pricing for the purposes of its statutory functions. With this in mind the SSRO will continue to review the supplier reporting obligations against the numbers and values of qualifying contracts.

### Call for input 10

The SSRO invites views on the appropriateness of the threshold at which supplier reports are required.

- 15.5 The Secretary of State may direct that a particular contract is not to be taken into account in determining whether the ongoing contract condition is met in relation to a financial year. The Act provides no guidance as to the circumstances in which such a direction should or may be made, leaving the Secretary of State to determine whether or not a contractor or group should comply with the supplier reporting regime.
- 15.6 To the SSRO’s knowledge there has been limited application of the power of exemption to date. There may be merit in providing some transparency as to the number and basis of such exemptions so that the SSRO is in a position to discharge its duty of keeping the provision of Part 2 of the Act and the Regulations under review. It would support fairness and consistency and oversight of the effectiveness of supplier reporting requirements.

### Call for input 11

The SSRO invites views on whether there should be greater transparency regarding the exemption of contracts from the ongoing contract condition.

## Designated person

- 15.7 If the ongoing contract condition is met in relation to a contract, then the obligation to submit supplier reports falls on the “designated person”. If the contractor is associated with one or more other persons (i.e. the contractor is part of a group), then the designated person will be the contractor’s ultimate parent undertaking. If the contractor is not part of a group, then the contractor will be the designated person.

## Overhead reports and the QBU threshold

- 15.8 A designated person is required to provide reports on overheads in relation to qualifying business units (QBUs). A QBU may be a group of undertakings, a single undertaking, or a business unit within an undertaking. The conditions for a unit, undertaking or group to be a QBU in a relevant period are summarised in Figure 14 below. A “relevant period” means the business unit’s accounting year ending in the financial year in question.

**Figure 14: Conditions for being a QBU in a relevant period**

	Unit	Undertaking	Group
Basic requirement	N/A	No unit is a QBU in respect of the period by virtue of carrying on activities for the purposes of the undertaking	In respect of the period, no unit is a QBU by virtue of carrying on activities for the purposes of the undertaking and none of the group undertakings is a QBU
Relationship to the designated person (DP)	Carries out activities for the purposes of the DP or an associated undertaking	Undertaking is the DP or is associated with the DP	Each of the group undertakings either is the DP or is associated with the DP
Financial accounting statements (FASs)	Separate FASs produced for the unit for the period	FASs produced for the undertaking for the period	A single set of FASs is produced in respect of the group
Production	Provides something in the period for a QDC or QSC to which the DP or anyone associated with the DP is a party		
Value	The total value of what the unit provides for the QDC or QSC in the period is at least £10 million		

- 15.9 It may be the case that a designated person is required to submit supplier reports in a relevant financial year, but that the application of the conditions for being a QBU mean that no overhead reports are required. There is, however, a degree of complexity in determining whether there is a QBU in a relevant financial year, as indicated in Figure 14. For example, questions may arise regarding the application of the conditions in a case where there are units carrying out activities for a designated person and the contribution made by individual units does not exceed £10 million but the contribution by the undertaking or group does.
- 15.10 The imposition of the £10 million threshold may be intended to ensure that reporting requirements are proportionate, but a question reasonably arises as to whether the effect is indeed proportionate, particularly when a value threshold already needs to be met before supplier reports are required at all (a single contract valued at £20 million, soon to rise to £50 million).

#### **Call for input 12**

The SSRO invites views on the application of the QBU conditions and the impact of the £10 million QBU threshold.

## 16. Datasets from supplier reports

### Overheads

16.1 Figure 15 outlines the set of data generated by the overhead reports listed in Figure 12 above.

**Figure 15: Outline of the dataset from overhead reports**

Rates	<ul style="list-style-type: none"> <li>• actual and estimated cost recovery rates (CRR)</li> <li>• cost recovery bases (CRB) used to calculate the rates</li> <li>• calculation of each CRR and CRB</li> </ul>
Costs	<ul style="list-style-type: none"> <li>• total actual and estimated operating costs incurred by the QBU</li> <li>• FASs and supporting schedules for the relevant period</li> </ul>
Quantified analyses	<ul style="list-style-type: none"> <li>• costs allocated to each CRB</li> <li>• adjustments between FASs and costs claimed</li> <li>• adjustments for costs incurred in the relevant period but claimed in another period</li> <li>• QBU costs recovered as direct costs</li> <li>• total actual and estimated QBU revenue</li> <li>• actual and estimated staffing costs for the QBU</li> </ul>
Descriptions, facts and assumptions	<ul style="list-style-type: none"> <li>• any deviation from the statutory guidance</li> <li>• explanation of differences between previous estimated costs analysis information and actuals</li> <li>• material future initiatives</li> <li>• facts and assumptions used in calculating each CRB used to calculate estimated CRRs</li> <li>• whether the manner of estimating each CRB has changed and a description of any change</li> <li>• facts and assumptions used in the quantified analyses and FASs</li> <li>• indices and rates used in calculating estimated costs and why these are appropriate</li> <li>• material assumptions regarding changes to employment costs</li> <li>• material assumptions used to derive any estimated head count</li> <li>• material assumptions used in calculating costs relating to decreasing over capacity</li> <li>• material assumptions regarding significant novel or unusual costs</li> </ul>

- 16.2 In order to be effective the data should permit benchmarking and analysis of whether costs are being apportioned to contracts in compliance with the legislative test for Allowable Costs. The SSRO continues to review the effectiveness of the dataset, particularly for the purposes of its value for money and fair pricing studies. It would be helpful to receive the views of stakeholders in this regard.

### **Call for input 13**

The SSRO invites views on the effectiveness of the dataset generated from the overhead reports.

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# Disapplication of transparency requirements

## 17. Restrictions imposed by enactment or confidentiality obligation

17.1 The following transparency requirements do not apply if compliance with them would require contravention of a “relevant restriction”:

- Secretary of State’s entitlement to examine relevant records and to require copies;
- the obligation to submit contract and supplier reports; and
- the duty to notify material events, circumstances and information.

17.2 A relevant restriction is one of the following:

- a prohibition or restriction imposed by an enactment; or
- a duty of confidentiality owed by the person to someone else, provided that the other person is not an associated person and not including cases where the person to whom the duty is owed gives consent to the requirement in question being complied with.

17.3 If a person intends not to comply with a transparency requirement due to a relevant restriction, the person must notify the Secretary of State in writing. The Secretary of State may refer matters to the SSRO for investigation of whether a duty of confidentiality has been entered into otherwise than for genuine commercial reasons.

17.4 The SSRO is not making any specific proposals in relation to disapplication of the transparency requirements in this call for input but welcomes any representations that stakeholders may wish to make.

# Restrictions on use of information provided by contractors

## 18. Schedule 5 to the Act

- 18.1 Schedule 5 to the Act limits the extent to which any person may disclose information provided under the regulatory framework. This recognises the commercially sensitive nature of information that contractors are required to disclose to the SSRO and the MOD and provides an added layer of protection.
- 18.2 It is an offence to disclose information to which Schedule 5 applies, unless the disclosure is in accordance with one of the specified exceptions. The offence attracts serious penalties, with the maximum being as follows:
- six months' imprisonment or an unlimited fine (for offences committed on or after 12 March 2015), or both, if dealt with summarily in a Magistrates' Court; or
  - two years' imprisonment, or an unlimited fine, or both, if dealt with on indictment.
- 18.3 There are five broad categories of information to which Schedule 5 applies, which are set out in the Regulations and summarised in Figure 16 below.

**Figure 16: Information to which Schedule 5 applies**

Relevant records	Information obtained by examining relevant records, if its disclosure would be likely to substantially prejudice the commercial interests of any person.
Reported information	Specified categories of information submitted in contract and supplier reports.
Reportable events	Information reported to the Secretary of State in accordance with the duty to report specified events, circumstances or information, or in a notice given stating that the person will not comply with a requirement to report, allow examination of relevant records or notify events etc.
Referrals	Information provided to the SSRO for the purposes of any application, reference or appeal, if its disclosure would be likely to substantially prejudice the commercial interests of any person.
Analysis and services	Information provided to the SSRO for the purposes of analysis required by the Secretary of State or in accordance with arrangements made with the Secretary of State for the SSRO to provide assistance or services, if its disclosure would be likely to substantially prejudice the commercial interests of any person.

- 18.4 The criminal offence of disclosure does not apply in some circumstances which are set out in Schedule 5 to the Act, even if the information disclosed is information to which the Schedule applies. It is not proposed to repeat all the exceptions here, but they include disclosure with consent, disclosure of information already in the public domain and disclosure required under the Freedom of Information Act 2000.
- 18.5 The Secretary of State may make an order imposing additional prohibitions on the disclosure of information to which Schedule 5 applies. It is an offence to contravene a prohibition imposed by such an order, with the same maximum penalty as applies to the Schedule 5 offence. The order is required to be made by statutory instrument, and must be approved by both Houses of Parliament.
- 18.6 The SSRO is not making any specific proposals in relation to the provisions of Schedule 5 in this call for input but welcomes any representations that stakeholders may wish to make.

# Appendix 1 – Matters considered by the SSRO on which it is not specifically calling for input

- Whether a proposal should be developed to expand the definition of relevant records.
- Whether the recording dates are sufficiently broad to support the prescribed purposes for which relevant records must be kept.
- Whether the limitations imposed on the requirements to keep records are reasonable.
- Whether the procedural requirements for the Secretary of State's power to examine records are reasonable.
- Whether the provision for review by the SSRO of the exercise of open book rights should remain in its current form.
- Whether the duty to notify has been sufficiently provided for in the regulatory framework.
- Whether the purposes of the standardised reporting regimes are sufficiently articulated.
- Whether it is sufficient for selection of the DPS to be left to guidance.
- Whether the definition of contract completion date should be amended to provide greater clarity in the case of contract delays.
- Whether a proposal should be developed for the contract reporting plan to describe each step taken to determine the contract value.
- Whether the legislation should be amended to better define the frequency of interim contract reports, particularly in relation to shorter contracts, or whether this is a matter the SSRO should address in its guidance.
- Whether the contract reports provide sufficient information about deliverables to support analyses of value for money and fair pricing.
- Whether greater clarity is required as to the costs information required across the contract reports.
- Whether a proposal should be developed for the final reports to provide more comprehensive data in relation to the profit achieved.
- Whether information materially relevant to a contract should be reported.
- Whether the obligation to forecast an effect on costs should also apply to the contract completion report.

- Whether the ODCR requirements should remain in the legislation without amendment.
- Whether a proposal should be developed to modify the threshold at which supplier reports are required.
- Whether the definition of defence contract is sufficiently clear for the purposes of the supplier reporting regime.
- Whether the definition of direct cost is sufficiently clear for the functioning of the supplier reporting regime.
- Whether a proposal should be developed for expanding the contents of the SME report.
- Whether it is appropriate for transparency requirements to be dis-applied as currently provided in the Regulations.
- Whether the provision for the Secretary of State to refer obligations of confidence to the SSRO for investigation provides sufficient safeguard over transparency requirements.
- Whether it is appropriate for a criminal offence to continue to apply to information to which Schedule 5 applies.
- Whether revisions should be considered to the information to which Schedule 5 may apply.
- Whether the interaction between Schedule 5 and the FOI Act is sufficiently clear.
- Whether the exceptions to the Schedule 5 offence are sufficiently broad and well-defined.
- Whether the power to impose additional prohibitions on disclosure of information is sufficiently articulated and controlled.

