
**Single Source Regulations Office
Minutes of the 13th Board Meeting
Board Room, Finlaison House,
15-17 Furnival Street, London EC4A 1AB**

**Monday 23rd January 2017
2:00pm to 5:00pm**

Board members present:

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

Others present:

Malcolm Botting (Head of Governance)
David Galpin (Head of Legal)
Simon Mahony (Chief Analyst) (items 4 and 5)
Ben Johnson (Senior Analyst) (item 4)
Anton Hume (BDO) (item 4)
Duncan Nott (BDO) (item 4)
Andrew Stewart (BDO) (item 4)
David Pottruff (VFM Manager) (item 5)
Colin Sharples (Head of Regulatory Policy) (item 8)

1. Welcome, apologies, announcements and declarations of interest

- 1.1. The Chairman welcomed members to the 13th meeting of the Board.
- 1.2. No apologies had been received.
- 1.3. The Chairman formally noted that he had been appointed as Chairman of the SSRO by the Secretary of State.
- 1.4. The Chairman introduced Terence Jagger, who was attending his first Board meeting as a newly appointed non-executive member. The Chair noted that Terence brought with him a wealth of experience from several senior positions at the MOD and from a range of non-executive positions in the private, public and third sectors.
- 1.5. The Chairman reported on the first of a series of scheduled monthly meetings with the Minister for Defence Procurement, which had taken place on 18 January 2017. At the meeting it had been agreed that Terence Jagger should be appointed as a non-executive Board member. The Minister had also agreed to a recruitment process for appointing further non-executive members, up to the previously agreed full complement of members.
- 1.6. The Chairman announced the appointments he had made to the Board's sub-committees. The Audit Committee would continue to be chaired by Marta Phillips, and the members would be Jane Attwood, David Johnston and Terence Jagger. The Regulatory Review Committee would continue to be chaired by Jane Attwood. The members of the Committee would be Marta Phillips and Marcine Waterman. Terence Jagger would Chair the Referrals Committee, with David Johnston appointed as the other permanent member. The Board noted the appointments to its sub-committees.

<p>There were no declarations of interest.</p>

2. Minutes of 12th meeting of the Board

- 2.1. The Chairman introduced the minutes of the Board meeting held on 8 December 2016 and asked the Board members who attended the meeting whether they were a correct record.
- 2.2. The minutes of the 12th meeting of the Board were approved as a correct record.

3. Chief Executive's report

- 3.1. Marcine Waterman, Chief Executive, presented her report to the Board, which provided an update on items not included elsewhere on the agenda.
- 3.2. The Chief Executive provided an update on the SSRO's stakeholder engagement since the last meeting, including meetings with the MOD and ADS, site visits and meetings with industry and other external stakeholders.
- 3.3. The SSRO's budget request for 2017/18 would be considered according to the MOD's DG Head Office and Community Services' processes, and a response was expected in February.
- 3.4. Invitations had been sent for the 8 March meeting of the SSRO's Senior Stakeholder Forum. The agenda was being developed and would include an opportunity to have a full discussion on issues of mutual interest.
- 3.5. The Executive Committee had recently reviewed the forward programme of studies that had been published, following consultation, in February 2016. The Chief Executive sought, and received, the Board's approval to amend the order of the programme.
- 3.6. The Chief Executive's report to the Board stated that the SSRO's stakeholder engagement strategy was scheduled to be considered by the Board at its June 2017 meeting, and Board members asked whether it was possible for the date to be brought forward to March 2017. The Chief Executive agreed to consider whether the resources were in place to allow this amendment to the work programme. **Action:** Chief Executive to consider bringing forward the stakeholder engagement strategy.
- 3.7. The Chairman had been asked to address the 'D Group' on 31 January 2017, in a Chatham House discussion on 'understanding the role of the SSRO in defence procurement'. The discussion would focus on the SSRO's objectives and priorities, and its impact on the defence industry.
- 3.8. The Board discussed the NAO's ongoing study into 'securing VFM from non-competitive procurement in defence'. The NAO had started its fieldwork and had discussed the work with SSRO officials.

The Board:

- a) approved the revised order of the studies programme; and
- b) noted the information provided in other sections of the report, regarding stakeholder engagement, publications and events, the minutes of the Audit Committee and the Regulatory Futures Review.

4. Baseline profit rate 2017/18

- 4.1. Matthew Rees, Director of Analysis and Reporting, introduced the report on the assessment of the appropriate baseline profit rate, SSRO funding adjustment and capital servicing rates. He provided a presentation setting out detailed analysis to allow the Board to consider the rates. Provisional analysis had been presented at the Board's 8 December 2016 meeting, and this had now been finalised following further quality assurance, including from BDO.
- 4.2. The proposal from the report was that the SSRO should recommend a composite rate in 2017/18, using the same methodology to calculate that rate as in the previous year.
- 4.3. The Board was provided with an external quality assurance assessment by BDO of whether the analysis undertaken aligned with the intended purpose for which it was developed, and whether it had been conducted accurately. BDO had worked alongside the SSRO throughout its review of methodology, and had considered the process overall and whether the results could be replicated satisfactorily. Its findings were that:
- a) The analysis undertaken aligned with the intended purpose for which it was developed. BDO had supported the SSRO throughout its policy setting and strategy process, the execution stage, and its reviews of initial outputs. It considered that transfer pricing remained an appropriate method to assess levels of profitability, and that targeting a broad pool of comparables remained the most effective way to minimise volatility.
 - b) The analysis undertaken had been conducted accurately. BDO had reviewed the entity characterisation in detail, and reviewed search strategies for consistency, including a review of a sample of companies from each search.
 - c) The analysis could be replicated using the published SSRO methodology. BDO had considered the full process at each step, had reviewed and discussed all methodology documents and stated that the results were consistent with the expectation that all search steps could be explained in the documentation.
- 4.4. BDO's conclusion was that the SSRO's process, and the execution of it, remained robust. The approach taken by the SSRO was reasonable and well documented, and the final samples were considered to be appropriate and supportable.

- 4.5. The Board was then asked to decide the recommended baseline profit rate, along with the capital servicing rate and the SSRO funding adjustment for 2017/18, in order to submit it to the Secretary of State in advance of the statutory deadline of 31 January 2017. The Board considered a range of issues relating to the methodology, including:
- The composition of the list of companies used in the calculations.
 - The turnover threshold. It was noted that the SSRO had found no relationship between turnover and profit'; reducing the basket size by raising the threshold would also have a negative impact on data quality.
 - The SSRO had reviewed the company search criteria, including NACE codes, and made some minor changes to these as a result.
 - Loss-making companies, which had been excluded from the methodology. If loss-making companies had been included, it would have reduced the profit rate in each of the comparator groups.
 - The application of the median as the choice of average in the methodology. The Board agreed that it continued to be the most robust option.
 - That the SSRO had written to 12 of the MOD's prime contractors to explain how the numbers in the Orbis database could be reconciled to their accounts. The SSRO's position remained that there was no need for the SSRO to over-ride the Orbis data.
- 4.6. The Board continued to support the methodology. Board members indicated that they understood the approach, including how the numbers had been derived and had changed. They were comfortable with the outcome, the logic and the attention to detail in the process to calculate the rates. It thanked the Director of Analysis and Reporting and his team for their work.
- 4.7. The Board considered issues relating to transparency, including the timing of release to stakeholders. Alongside the rates the SSRO would publish all activity type factsheets to increase transparency and inform the MOD's modelling work.

The Board:

- a) agreed that the SSRO should recommend a composite rate for 2017/18, applying the same methodology as last year to calculate that rate, and publish the activity type factsheets for information alongside this recommendation;**
- b) agreed the final recommendations to make to the Secretary of State by 31 January 2017 on the BPR, CSRs and the SSRO funding adjustment for 2017/18;**
- c) agreed to the proposed approach to transparency and timing of release, that is, providing information to the MOD and later publishing information in March;**

- d) considered the assessment provided by BDO and noted responses from industry on quality assurance of company data;**
- e) approved the 'Recommendation fact sheets', the 'Activity type fact sheets', the 'Supporting analytical slide pack' the 'Single source baseline profit rate, capital servicing rates and funding adjustment profit rate methodology for 2017/18' document, and the 'Question and answer' document;**
- f) delegated to the Chairman and Chief Executive authority to approve the final documents for provision to the Secretary of State on 30 January 2017 and for publication in March 2017 at the time of the Secretary of State's announcement; and**
- g) agreed that the 'Statutory guidance on the rates, including adjustments' should be published in March following the announcement of the Secretary of State's decision.**

5. Calibrating profit rates

- 5.1. Matthew Rees, Director of Analysis and Reporting, introduced a report setting out the SSRO's work to examine defence industry health as a means of calibrating the profit rates for single source contracts. Calibration would support the SSRO's role in recommending profit rates to the Secretary of State each year, and would be included in the planned publication of the 2016/17 regime monitoring report in June 2017.
- 5.2. The draft report presented to the Board discussed a series of strategic topics that were relevant to the potential longer term development of the profit rate methodology. It described how the SSRO planned to calibrate profit rates and develop the profit rate methodology accordingly, and provided a link between the data being reported by contractors in statutory reports and the SSRO's monitoring of the profits being earned in QDCs and QSCs.
- 5.3. During the autumn of 2016, the SSRO had engaged with the government and industry on this topic. The Board agreed that the SSRO should further engage stakeholders with a discussion draft, and seek their views in a collaborative way. It agreed to provide a discussion draft to stakeholders, which would give them an opportunity to comment and better allow the SSRO to take account of their views on the long term issues the report sought to address.
- 5.4. The Board discussed the discussion draft, which it agreed was helpful in demonstrating the SSRO's understanding of a fair and reasonable return for industry, its second statutory aim. There was a detailed discussion about the analysis and the level of detail provided in the draft, and the necessary information needed to begin the discussion. The Board considered the sensitivity of material, which had been drawn from publicly available sources, and was informed that other regulators had undertaken and published work of a similar nature.

- 5.5. The Board agreed the general direction of the discussion draft, and that the paper should be considered by the Board after views had been received from stakeholders. Having received feedback, a final report for publication would be brought to the Board for approval at a later date.

The Board:

- a) noted the engagement undertaken so far on calibration;**
- b) agreed that the SSRO should now engage stakeholders with a discussion draft of the report, and plan to publish the report after further consideration by the Board in March; and**
- c) approved the general direction of travel of the work and delegated to the Chairman and Chief Executive authority to approve the document for circulation to stakeholders.**

6. Review of legislation

- 6.1. David Galpin, Head of Legal, presented a report regarding the SSRO's review of Part 2 of the Defence Reform Act 2014 and the Single Source Contract Regulations 2014. The Board had responsibility for agreeing the consultation document and any recommendations that were made to the Secretary of State.
- 6.2. Since the Board considered the report at its December 2016 meeting, the SSRO's proposed consultation was delayed at the request of the Permanent Secretary at the MOD to enable Ministerial consideration. The report outlined representations made by the Minister for Defence Procurement regarding the SSRO's proposed consultation. In light of the representations made, the Board was asked to further consider the consultation document and the timeframe for consultation.
- 6.3. The Minister's letter of 17 January 2017 had included representations regarding the SSRO's proposed recommendations on contract amendments; exclusions; access to information; enforcing price controls; and compliance and penalty notices. It was agreed that the SSRO would seek further evidence on two matters, government-to-government contracts and enforcing price control, so as to enable recommendations to be developed if appropriate. The Minister's letter had drawn attention to three matters that the MOD wished to be reflected in the consultation document. Two of these matters (price re-determination and multiple contract profit rates) were already referred to in the consultation document. The third matter (multiple baseline profit rates) would be added.
- 6.4. As the start of the consultation had been deferred, it was proposed that the consultation should be reduced to a period of eight weeks, beginning on 30 January 2017. A period of eight weeks was consistent with the minimum commitment made by the SSRO in its Framework Document with the MOD. It was shorter than the 12 week period contemplated by the government's Code of Practice on Consultation, but was considered necessary to accommodate further

work in advance of the deadline for making representations to the Secretary of State in June.

- 6.5. The Board agreed to the changes to the consultation document, and thanked staff for their work on the review of the legislation.

The Board:

- a) agreed changes to the consultation document and the extent to which they should be referenced in the SSRO's publications;**
- b) agreed that the document should be consulted on for a period of 8 weeks from 30 January 2017;**
- c) agreed that the summary of call for input responses (amended to reflect the Minister's representations) should be published on 30 January 2017; and**
- d) delegated final approval of the consultation document to the Chairman and Chief Executive.**

7. Final compliance and review methodology

- 7.1. Ian McPherson, Director of Compliance and Investigations, introduced a report on the SSRO's compliance and review methodology. The Board had approved the publication of the SSRO's updated compliance and review methodology at its December 2016 meeting. This methodology had been subject to an open consultation with stakeholders. Subsequent to the Board meeting, the publication of the methodology had been delayed in order to clarify in full what the MOD's views were, and SSRO officials had met with the MOD in order to gain further understanding. The MOD requested amendments across seven paragraphs and the appendix showing the format of publication.
- 7.2. The report set out the issues raised by the MOD and presented for approval an updated version of the methodology.

The Board:

- a) noted the amendments to the methodology requested by the MOD after 8 December, along with the SSRO's response to each of the points raised; and**
- b) approved the final methodology for publication on the SSRO website.**

8. Corporate Plan 2017-2020

- 8.1. Marcine Waterman, Chief Executive, presented a series of slides, inviting discussion and seeking the Board's direction on the future strategy of the SSRO. Under the Corporate Governance Framework, the Board had responsibility for considering and approving the SSRO's Corporate Plan. The discussion would be used to inform the drafting of the Corporate Plan 2017-2020, which the SSRO was required to submit to the MOD and publish at the end of the financial year.
- 8.2. The MOD had provided initial views on the SSRO's future workplan, which were provided to the Board during the presentation. In discussion, the Board agreed the SSRO's mission statement and values, and the structure of the document. The Board considered and set five objectives for the SSRO, and modified the key performance indicators that had been used in previous years.
- 8.3. Following the Board's discussion, the SSRO would undertake an informal consultation with the MOD and ADS on the issues to be addressed in the Corporate Plan, and would ask the Board to consider the proposed final document at its March 2017 meeting.

The Board:

- a) **approved the approach to the production, content and tone of the 2017-2020 Corporate Plan, as set out in the presentation that was given to the Board; and**
- b) **delegated approval of the draft Corporate Plan for consultation to the Chairman and Chief Executive.**

9. Corporate Performance Report

- 9.1. Neil Swift, Director of Corporate Resources, presented the regular Corporate Performance Report to the Board. The report described how the organisation was delivering against its corporate priorities. The report set out all relevant matters relating to the SSRO's performance, including progress against key performance indicators, budgetary updates and the delivery of corporate priorities with associated objectives and tasks.

The Board:

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

10. Any other business

- 10.1. The Board agreed to change the date of its next meeting to 21 March 2017.

10.2. Non-executive Board members were asked to undertake a skills survey, which would assist with the recruitment process for further Board member appointments.

11. Date of the next meeting

11.1. The next meeting of the Board would take place on 21 March 2017 at 2:00pm in Finlaison House.