

# SSRO

Single Source  
Regulations Office

## **The baseline profit rate and capital servicing rates assurance services Specification**

## 1. Introduction

- 1.1 The UK spends over £8 billion a year on single source (non-competitive) Ministry of Defence (**MOD**) contracts. The Defence Reform Act 2014 and the Single Source Contract Regulations 2014 establish a regulatory framework which includes the following key features in regard to the rate of profit payable on qualifying defence contracts (**QDC**) and qualifying sub-contracts (**QSC**).
- 1.2 The contract price of a qualifying contract is determined by the formula: price = (CPR x AC) + AC, where CPR is the contract profit rate and AC means the Allowable Costs determined in accordance with one of the six regulated pricing methods. The contract profit rate is determined in each case by beginning with a baseline profit rate and making adjustments as part of a six-step process. This adjustment process applies rates for capital servicing and a funding adjustment. The Allowable Costs are those related to the delivery of the contract which the parties agree satisfy the test of being Appropriate, Attributable to the contract and Reasonable in the circumstances (the 'AAR test').
- 1.3 The SSRO makes an annual assessment of the baseline profit rate, capital servicing rates and funding adjustment (the "rates"). The rates are recommended to the Secretary of State no later than the 31st of January in the financial year prior to that in which they will apply. The Secretary of State determines the rates to be used not later than the 15th of March in the financial year prior to that in which they will apply.
- 1.4 The SSRO's recommended baseline profit rate for 2018/19 on qualifying defence contracts of 6.81 per cent took effect on 1 April 2018. The SSRO also recommended a fixed capital servicing rate of 4.38 per cent, a positive working capital servicing rate of 1.21 per cent and a negative working capital servicing rate of 0.53 per cent. These rates were accepted by the Secretary of State and took effect on 1 April 2018.
- 1.5 The SSRO has a dedicated in-house team that calculates the rates and has access to the data systems relevant for calculating the rates.
- 1.6 The methodology used to calculate the 2018/19 rates can be found at the following link; the methodology is updated each year and will be approved by our Board in early autumn. We do not anticipate a substantial change to our methodology over the term of this contract:

[https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/687507/Baseline\\_profit\\_rate\\_\\_capital\\_servicing\\_rates\\_and\\_funding\\_adjustment\\_methodology\\_2018-9.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/687507/Baseline_profit_rate__capital_servicing_rates_and_funding_adjustment_methodology_2018-9.pdf)

- 1.7 Note that the section of the methodology titled 'The SSRO funding adjustment' is not a consideration for the services we are seeking.

## 2. The Services

- 2.1 The SSRO is seeking an independent assurance service for three consecutive years (with an option to extend for an additional one year) in relation to the baseline profit rate and capital servicing rates that it will respectively recommend to the Secretary of State in January 2019, January 2020 and January 2021. This service will take the form of independent assurance on the execution of the methodology to calculate the rates. This does not include the 'The SSRO funding adjustment' element of the methodology. The objective will be to provide the SSRO Regulatory Committee with an independent professional assurance that the underlying models are internally consistent and calculate the result correctly.
- 2.2 To achieve this the SSRO will require the assurance to be undertaken from November to January of each of the financial years 2018/19, 2019/20 and 2020/21. The SSRO will require

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written reports of the findings for the 2018/19 assurance to be submitted for two SSRO Regulatory Committee meetings of 26 November 2018 and 23 January 2019. Attendance at those meetings is not required. The dates for the written reports of the findings for the 2019/20 and 2020/21 assurances will be communicated at an appropriate date in the year when the assurance will be undertaken.

- 2.3 The assurance services (hereafter referred to as ‘the Assurance’) the SSRO requires are:
- a) Scrutiny of the records of the SSRO’s decision process to assess comparator companies in each of the four activity types (‘develop and make’, ‘provide and maintain’, ‘ancillary services’ and ‘construction’) to ensure they are consistent with the published methodology. This will require an understanding of transfer pricing principles upon which the methodology is based<sup>1</sup>
  - b) Verification of whether the SSRO’s Microsoft Excel based model calculates the baseline profit rate and capital servicing rates in accordance with paragraph 3.8 and Sections 9 to 11 of the methodology.
  - c) Verification that graphs, charts, and summary tables are linked correctly to the model outputs.
  - d) Submission of the findings for the assurance activities 2.3 a), b) and c) in the form of written reports to the Regulatory Committee. The first report will cover preliminary assessment of 2.3 (a). The final report will cover the final assessment of 2.3 a), b) and c).
- 2.4 The methodology involves the selection of a number of benchmark comparator companies and we expect these selections to be scrutinised as part of the 2.3 a). This may include the supplier determining an appropriate sampling approach in order to undertake this scrutiny.
- 2.5 We expect the number of comparator companies scrutinised under assurance activity 2.3 a) to be in the region of 1000 for years one and three of the contract, and to be of the magnitude comparable to that specified in Sections 1 to 4 of Appendix B, of the methodology for the second year of the contract.
- 2.6 The SSRO will need to correspond at working level with the contractor in a way that enables it to respond to the findings arising from the above stated review of the methodology used and its application to calculate the 2019/20 baseline profit rate and capital servicing rates in good time before the Regulatory Committee meetings.
- 2.7 The deadline for the preliminary written report for the Regulatory Committee will be 19 November 2018, and that for the final written assurance will be 4 January 2019. The dates for the written reports of the findings for the 2019/20 and 2020/21 assurances will be communicated at an appropriate date in the year when the assurance will be undertaken.
- 2.8 The SSRO will make available any relevant documentation, data and models related to the methodology and its execution in calculating the rates.
- 2.9 The SSRO may also request that the Contractor provide additional services of an analytical nature in relation to the profit rate methodology but outside the scope of the Specification. This additional work may be undertaken through an agreed variation to the price, and if undertaken on a time charge basis will be calculated on the hourly rates included in the Contractor’s tender.
- 2.10 The SSRO expects the contractor or a member of the contracting team to work at its office based at 15–17 Furnival Street, London, EC4A 1AB, and will make available a desk, a

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<sup>1</sup> OECD (2017) *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*

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computer, a telephone and any other relevant necessities including stationary and printing facilities.

- 2.11 The timeliness of services is a particular requirement, as the SSRO expects to deliver its functions to exacting timescales and may frequently require rapid responses at short notice.

### **3. Relationship**

- 3.1 The SSRO considers the relationship between the Contractor and the SSRO to be key to delivery of services which economically, effectively and efficiently support delivery of the SSRO's functions.
- 3.2 The Contractor must nominate a relationship partner whose role it will be to –
- (a) manage the relationship between the contractor and the SSRO on a day to day basis;
  - (b) be the primary point of contact for the SSRO;
  - (c) propose whichever of the Contractor's staff is most suitable for a particular matter, having regard to the requirements of economy, effectiveness and efficiency, and remain a point of contact throughout the engagement;
  - (d) actively monitor and advise on conflicts of interest as they arise and be the author of any conflict waiver requests to the SSRO;
  - (e) understand the SSRO as an organisation and help translate that to the firm's quality assurance staff working on a particular matter;
  - (f) ensure compliance with security requirements;
  - (g) remain consistently informed about the Contractor's performance on a matter and be a point of escalation;
  - (h) be available to address issues in a timely manner and meet the SSRO's urgency requirements;
  - (i) ensure that the agreed fee structure is followed and that costs are communicated to the SSRO on a routine basis throughout an engagement; and
  - (j) be a point of contact for the SSRO's auditors if necessary.

### **4. Conflicts of interest**

- 4.1 The SSRO recognises that Contractors with relevant experience and expertise may encounter conflicts of interest due to working with, or having worked with, stakeholders who are subject to regulation by the SSRO. Bidders should consider whether they are likely to experience conflicts and whether that will present a significant barrier to accepting engagements under the Agreement. Bidders should demonstrate that they have an effective and efficient mechanism for assessing and managing conflicts of interest, which will enable the SSRO's expectations of timeliness to be met.
- 4.2 Contractors will be required to check for actual or potential conflicts of interest that exist or may arise as a result of their status as an approved provider in accordance with their professional codes of conduct and the nature of the SSRO's activities and the identity of its stakeholders. If the Contractor accepts an engagement without disclosure of a conflict of

interest then the SSRO will take that as a representation that a conflicts check has been conducted and no conflict exists.

- 4.3 The obligation to make conflicts known to the SSRO will continue throughout the Agreement. Contractors will be required to raise conflicts of interest with the SSRO on an ongoing basis as they arise and the SSRO shall make the final decision in each case as to whether the conflict of interest can be mitigated and waived or prevents the firm from acting.
- 4.4 Any conflicts will be raised by the Contractor's relationship partner with the Director of Economics and Regulation. Any requests to waive conflicts must be made in writing to the Director of Economics and Regulation and must include all relevant facts, including: (a) the identity of the other client; (b) the nature of work; (c) whether the other client has consented to waiving the conflict; and (d) the identity of the individuals working for the other client and details of how they propose to mitigate the impact of the conflict.

## 5. Information Security

- 5.1 In carrying out its statutory functions, the SSRO will process information of the following kinds –
- (a) Information to which Schedule 5 of the Defence Reform Act 2014 applies, which may make it a criminal offence to disclose the information.
  - (b) Official information, which may be marked OFFICIAL-SENSITIVE or higher in accordance with the Government Security Classifications. The disclosure of such information may constitute an offence under the Official Secrets Act 1989.
  - (c) Confidential or commercially sensitive information, which the SSRO would not disclose under the Freedom of Information Act 2000 by reason of the application of one of the exemptions in that Act.
  - (d) Personal data or special category data within the meaning of the General Data Protection Regulation and the Data Protection Act 2018 must be processed in accordance with applicable data protection law.
- 5.2 The SSRO takes the security of the information it holds seriously, as demonstrated in its statement on handling commercially sensitive information, which may be viewed here –
- [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/711223/SSRO\\_Commercially\\_Sensitive\\_Information\\_Handling.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/711223/SSRO_Commercially_Sensitive_Information_Handling.pdf)**
- 5.3 Included in the Terms and Conditions provided with the ITT are Security Measures the Contractor would have to meet in the event of being presented with a Secret Matter (i.e. material classified SECRET or TOP SECRET) and Security Conditions which the SSRO requires the Contractor to meet in relation to Schedule 5 information and OFFICIAL-SENSITIVE information. The SSRO makes no warranty but does not expect that the Contractor would be required to deal with a Secret Matter, but it will be common for it to be required to deal with OFFICIAL-SENSITIVE Information.
- 5.4 If the Contractor received a Secret Matter, it would need to be accredited for List X. It is proposed, however, that should any access to Secret Matter be required, then that access to Secret Matter would take place at the SSRO's premises, rather than any Secret Matter ever being held by the Contractor.

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- 5.5 The Terms and Conditions provided with the ITT refer to the Government's Security Policy Framework, which may be viewed here –

**<https://www.gov.uk/government/publications/security-policy-framework>**

- 5.6 The National Security Vetting (NSV) scheme gives an assurance of an individual's suitability for access to sensitive government information or other valuable assets. Details of the scheme may be viewed here –

**<https://www.gov.uk/guidance/security-vetting-and-clearance>**

- 5.7 The SSRO does not require that the Contractor's staff have been subject to NSV, although all staff dealing with Sensitive Information are expected to have undergone Baseline Personal Security Standard (BPSS) clearance, details of which may be viewed here –

**[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/365602/HMG\\_Baseline\\_Personnel\\_Security\\_Standard.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/365602/HMG_Baseline_Personnel_Security_Standard.pdf)**

- 5.8 The SSRO uses Information Rights Management to protect electronic Sensitive Information, both at rest and in transit Contractors will need to demonstrate that they will be able to receive or return electronic Sensitive Information, or suggest equivalent alternative methods, to avoid delays in delivery of the Services.