

SSRO

Single Source
Regulations Office

The baseline profit rate and capital servicing rates assurance services

Appendix 1: 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 relation to the rate of profit payable on qualifying defence contracts (QDC) and qualifying sub-contracts (QSC):
- 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').
 - 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 31 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 15 of March in the financial year prior to that in which they will apply.
 - For 2022/23, the baseline profit rate is 8.31 per cent, the fixed capital servicing rate is 3.27 per cent, the positive working capital servicing rate is 1.33 per cent and the negative working capital servicing rate is 0.65 per cent. These rates were determined by the Secretary of State and took effect on 1 April 2022.
- 1.2 The SSRO has a dedicated in-house team that calculates the rates and has access to the data systems used for calculating the rates.
- 1.3 The methodology used to calculate the 2022/23 recommended rates can be found at the following link:
- https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1060640/Single_source_baseline_profit_rate_capital_servicing_rates_and_funding_adjustment_methodology_March_2022A.pdf
- 1.4 The methodology is updated each year and is approved by the SSRO Board in early autumn. The SSRO does not anticipate any substantial change to its methodology over the term of this contract.

2. The service requirement

The Core Services

- 2.1 The SSRO requires independent assurance services to be provided in relation to the baseline profit rate and capital servicing rates that it will recommend to the Secretary of State in January 2023, 2024 and 2025 (and, subject to the SSRO exercising the options to extend the contract, January 2026 and January 2027). The services will take the form of independent assurance on the execution of the methodology to calculate the rates. 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 requires the assurance services to be undertaken from November to January of each of the financial years 2022/23, 2023/24 and 2024/25. The SSRO requires written reports of the findings for the assurance for each financial year to be submitted for two SSRO Regulatory Committee meetings. For 2022/23, these meetings are scheduled for 31 November 2022 and 18 January 2023. Attendance at those meetings is not required. The dates for the written reports of the findings for the 2023/24 and 2024/25 assurances will be communicated at an appropriate date in the relevant year.
- 2.3 In carrying out the assurance services, the contractor will be required to:
- a) Scrutinise 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 based¹
 - b) Verify whether the SSRO's Microsoft Excel based model calculates the baseline profit rate and capital servicing rates in accordance with paragraph 4.9 and Sections 12 to 14 of the methodology.
 - c) Verify that graphs, charts, and summary tables are linked correctly to the model outputs.
 - d) Submit the findings for the assurance activities 2.3 a), b) and c) in the form of written reports for the SSRO's 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 the SSRO expect these selections to be scrutinised as part of 2.3 a). This may include the supplier determining an appropriate sampling approach from the overall data set in order to undertake this scrutiny. The number of comparator companies from which a sample could be drawn is expected to be in the region of 1500 for year one of the contract, and to be in the region of 700 and 500 in the second and third years of the contract respectively. However the precise number of companies is not known until the analysis is undertaken.
- 2.5 Paragraph 4.5 of the methodology anticipates a comparator group will have a lifespan of three years and requires a full refresh in Year 1, with only annual validation of the existing group in Year 2 and Year 3. A new set of comparators is identified during a full refresh. In Year 2, validation is undertaken on the set of Year 1 comparators, and in Year 3 validation is undertaken on the set of Year 2 comparators.
- 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 2023/24 baseline profit rate and capital servicing rates in good time before the Regulatory Committee meetings.
- 2.7 The deadline for receipt of the preliminary written report for the Regulatory Committee will be 21 November 2022, and that for the final written assurance will be 9 January 2023. The dates for the written reports of the findings for the 2023/24 and 2024/25 assurances will be communicated at an appropriate point in the year when the assurance will be undertaken.
- 2.8 The SSRO will make available the relevant documentation, data and models related to the methodology and its execution in calculating the rates.

¹ OECD (2017) *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*

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- 2.9 The SSRO does not anticipate the contractor, or a member of the contracting team will need to work from or attend its office based at 15–17 Furnival Street, London, EC4A 1AB. If such a need arises, the SSRO will make all the necessary arrangements to accommodate attendance.
- 2.10 The timeliness of the performance of the services and delivery of the outputs is essential, as the SSRO expects to deliver its functions to exacting timescales and may frequently require rapid responses at short notice. The Contractor will be required to deliver the services accordingly.

The Optional Services

- 2.11 The SSRO may from time-to-time request that the Contractor provide services of an analytical nature in relation to the profit rate methodology. The SSRO does not guarantee any minimum volume or level of these services and any requirement for the Contractor to deliver them shall be at the SSRO's sole discretion. Any agreement as to the requirement for, and delivery of, these optional services shall only become binding when an order is executed in accordance with the process set out in the contract.
- 2.12 The price of any optional services will be calculated on a time charge basis using the relevant hourly rates contained in the Pricing Schedule. The SSRO does not expect to utilise more than 45 additional days over the period of the contract.

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 who will:
- (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-of-interest waiver requests to the SSRO;
 - (e) understand the SSRO as an organisation and help translate that to the firm's 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 avoidance of conflicts of interest is critical to the SSRO. Its minimum requirements are set out in clause 30 of the Contract.

5. Information Security

- 5.1 In carrying out its statutory functions, the SSRO processes 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 UK General Data Protection Regulation and the Data Protection Act 2018, which must be processed in accordance with that legislation.
- 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**
- 5.3 The Contractor must handle all materials and communication in connection with the services securely and in a confidential manner. Confidentiality will attach to all information given to the Contractor by the SSRO or a third party, or materials or communication generated by the Contractor, in connection with delivery of the Services. The Contractor's attention is drawn to Schedules 1 and 2 of the Contract, which sets out the Contractor's obligations in respect of security and confidentiality.
- 5.4 The Contractor must ensure that all personnel assigned to the contract have undergone personnel security checks equivalent to the HMG baseline personnel security standard, the latest details of which are available here:
- https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/365602/HMG_Baseline_Personnel_Security_Standard.pdf**
- 5.5 The SSRO shares electronic Sensitive Information on minimum TLS 1.2 connections and information may be AES-256 encrypted and password protected. Contractors must send/receive electronic Sensitive Information in this manner (or equivalent alternative methods as agreed with the SSRO), to avoid delays in delivery of the Services.
- 5.6 The SSRO maintains Cyber Essentials Plus certification and the Contractor shall be Cyber Essentials PLUS certified throughout the Contract Period.