

Title: Public Procurement – The Single Source Contract (Amendment) Regulations 2024 IA No: MOD2024/001 RPC Reference No: N/A Lead department or agency: MOD Other departments or agencies: N/A	Impact Assessment (IA)			
	Date: 22/01/2024			
	Stage: Implementation			
	Source of intervention: Domestic			
	Type of measure: Secondary legislation			
Contact for enquiries: steve.davies262@mod.gov.uk				
Summary: Intervention and Options			RPC Opinion: Not applicable	

Cost of Preferred (or more likely) Option (in 2024/25 prices)			
Total Net Present Social Value (£m)	Business Net Present Value (£m)	Net cost to business per year (£m)	Business Impact Target Status
-£0.20	-£0.20	£0.02	N/A

What is the problem under consideration? Why is government action or intervention necessary?

Part 2 of the Defence Reform Act 2014 introduced the Single Source Contract Regulations (SSCRs) to address long-standing issues with the £9.2bn per year that the MOD spends on non-competitive defence procurement. The SSCRs were expressly designed to provide value for money in public expenditure while ensuring fair prices are paid to industry. The last statutory review of the SSCRs found that while the regime worked well for pricing in traditional single source defence contracts, reforms were needed to continue delivering the full benefits under the changing defence procurement landscape delivered by the Defence and Security Industrial Strategy (DSIS). For example, having to use the pricing formula based on assessing allowable costs and adding a profit rate in a specified range means that single source defence contract in sectors such as software are often exempted from the regime meaning the MOD does not get the assurance on value for money that the SSCRs provide.

What are the policy objectives of the action or intervention and the intended effects?

These amendment regulations are intended to both increase the flexibility of the single source regime and make it simpler and quicker to use. Doing so will support the policy objective to increase assurance on value for money by enabling contracts that currently have to be exempted from the regime to be brought under the SSCRs. It will also support for better value for money through better tailoring of the profit rate to different parts of a contract. Reducing exemptions will save officials' and Ministers' time currently spent on administering the exemption approval process. This will support the MOD's policy of speeding up the procurement process by removing delays to contract award caused by awaiting exemption approvals. These changes also aim to increase legal clarity in the SSCRs, by regularising what is common practice and removing scope for disagreement between MOD and industry.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

Do nothing: To continue with the existing regulations and not implement the reforms that have already been publicised through in a Command Paper and with first stage of implementation taken through the Procurement Act 2023.

Option 1 (preferred option): Update SSCRs through amending existing secondary legislation, including changes to:

- Allow alternative ways to demonstrate value for money in pricing single source contracts other than using the pricing formula;
- Allow contracts to be split in to multiple components allowing for better tailoring of profit rates to different parts of a contract;
- Clarification of the circumstances under which a single source contract should be treated as a Qualifying Defence Contract;
- Ensuring that the provisions which ensure profit is only paid on costs once (POCO) sit in a more appropriate stage of the procurement process ensuring disagreements on their application do not delay contract award.

Will the policy be reviewed? It will be reviewed. If applicable, set review date: 2027					
Is this measure likely to impact on international trade and investment?			No		
Are any of these organisations in scope?		Micro Yes	Small Yes	Medium Yes	Large Yes
What is the CO ₂ equivalent change in greenhouse gas emissions? (Million tonnes CO ₂ equivalent)			Traded: N/A		Non-traded: N/A

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible MOD CHIEF
ECONOMIST

..... John Ogilvie Date: 20/12/2023

Summary: Analysis & Evidence

Policy Option 1

Description: Option 1: Update SSCRs through amending existing secondary legislation

FULL ECONOMIC ASSESSMENT

Price Base Year 2024/25	PV Base Year 2024/25	Time Period Years 10	Net Benefit (Present Value (PV)) (£m)		
			Low: -£0.14	High: -£0.25	Best Estimate: -£0.20

COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	£0.02	3	£0.02	£0.17
High	£0.04		£0.04	£0.29
Best Estimate	£0.03		£0.03	£0.23

Description and scale of key monetised costs by 'main affected groups'

This option allows the use of alternative pricing formula, which will result in a cost to businesses in instances where contracts that are currently exempt from the SSCRs will fall in to scope. It is estimated that this could lead to 10 additional contracts per year requiring additional reporting, which results in a staff time cost of around £28,700 per annum.

Other key non-monetised costs by 'main affected groups'

It is assumed that clarifying the definition of Qualifying Defence Contracts will result in a small number of contracts coming under the scope of the regulations, potentially 1-3 additional contracts over the 10 year appraisal period. This cost has not been monetised due to the low volumes.

Allowing components within contracts will require existing report to be submitted in a new format, so it is assumed the costs of this will be minimal.

The POCO changes are assumed to result in a negligible cost to businesses, as these measures move the provisions to a more appropriate stage of the process.

BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Not quantified	N/A	Not quantified	Not quantified
High	Not quantified		Not quantified	Not quantified
Best Estimate	Not quantified		Not quantified	Not quantified

Description and scale of key monetised benefits by 'main affected groups'

It has not been possible to monetise the benefits of this option.

Other key non-monetised benefits by 'main affected groups'

The main benefit of this option is that additional contracts will be within scope of the SSCRs and therefore receive additional levels of assurance to ensure value for money. The benefits of this have not been monetised.

Allowing components in contracts will increase flexibility and allow profit rates to be better tailored to each aspect of the contract, the benefit of which has not been monetised.

The POCO changes simplify the existing process and reduce the reporting required, although the benefits of this have not been monetised.

This option gives the SSRO the power to take referrals on new issues, the benefit of which has not been monetised.

Key assumptions/sensitivities/risks

Discount rate (%) 3.5

The potential volume of future contracts that could be affected by this option has been estimated based on historic volumes and therefore no significant change has been accounted for.

It is assumed that these reforms will be in place from April 2024.

BUSINESS ASSESSMENT (Option 1)

Direct impact on business (Equivalent Annual) £m:			Score for Business Impact Target (qualifying provisions only) £m:
Costs: £0.02	Benefits: £0	Net: -£0.02	
			N/A

Evidence Base

1. Problem under consideration and rationale for intervention

The MOD introduced the Single Source Contract Regulations in 2014 to address long standing issues with the £9.2bn per annum spent on non-competed defence contracts. The Regulations are expressly designed to provide value for money in public expenditure while ensuring fair prices are paid to industry. There is a statutory requirement to review these regulations on a regular basis. The most recent review was timed to ensure the Regulations would support the delivery of the Defence and Industrial Strategy (DSIS). It identified a series of necessary reforms which were set out in a Command Paper published on 4 April 2022. These will ensure that the Regulations are flexible enough to the full range of sectors and contract types that will be used in future single source defence spending while speeding up and simplifying their application in line with the Procurement Reform programme.

Published data shows that between 2016/17 and 2022/23 there were on average around 60 qualifying defence contracts (QDCs) per year and around 10 qualifying sub-contracts (QSCs) per year¹.

Table 1 - Historic data on QDCs and SDCs per financial year

	16/17	17/18	18/19	19/20	20/21	21/22	22/23
QDCs	51	44	50	74	65	79	64
QSCs	13	10	8	13	7	13	9
Total value of contracts	£21.8bn	£3.7bn	£7.8bn	£11.4bn	£7.2bn	£11.1bn	£3.2bn
Average contract length (years)	4.3	4.4	4.4	4.4	4.4	4.4	4.8

Source: SSRO qualifying defence contract statistics

2. Rationale and evidence to justify the level of analysis used in the IA (proportionality approach)

The proposed secondary legislation will require businesses to undertaking additional reporting, as a result of previously exempt contracts becoming within the scope of the regulations. This additional cost to businesses has been estimated and monetised in the IA however is under the +/-£5m threshold for Regulatory Policy Committee clearance, so this analysis has been cleared internally within the MOD.

3. Description of options considered

Do nothing – Continue with the current regulations.

Under this option, the necessary reforms identified from the last statutory review of the SSCRs as set out in a Command Paper published in 2022 would not be implemented. Continuing with the SSCRs in unamended form would mean that single source defence contracts in non-traditional sectors such as software will continue to require exemptions from the regulations. It would continue to be difficult/not possible to benefit from tailoring profit rates to different parts of a contract where it makes sense to do so. Contract negotiations would also continue to be delayed due to lack of legal clarity on when a single source contract should fall under the SSCRs and having to resolve disagreements on the application on Profit of Costs Once (POCO) provision as part of the pre-contract profit setting process.

¹ SSRO Annual qualifying defence contract statistics: 2022/23 (<https://www.gov.uk/government/collections/ssro-qualifying-defence-contract-statistics>)

Option 1 – Update SSCRs through secondary legislation.

This option assumes amendment regulations deliver changes to the SSCRs to implement the key reforms identified in the Command Paper published in April 2022 following the most recent statutory review of the regime. This option aims to ensure that the regulations more effectively deliver against their objectives and will support the Defence and Security Industrial Strategy and the MOD's wider Procurement Reform programme.

These reforms fall into four areas which will:

- Allow alternative ways to demonstrate value for money in pricing single source contracts other than using the pricing formula;
- Allow contracts to be split in to multiple components allowing for better tailoring of profit rates to different parts of a contract;
- Clarification of the circumstances under which a single source contract should be treated as a Qualifying Defence Contract;
- Ensuring that the provisions which ensure profit is only paid on costs once (POCO) sit in a more appropriate stage of the procurement process ensuring disagreements on their application do not delay contract award.

4. Policy objective

The overall objectives of these reforms are to:

- improve choice and flexibility in the contracting approach by ensuring the regime can be used in a wider range of sectors and contract types;
- allow the regime to be used to help speed up and simplify the acquisition process; and
- adapt the regulations to cater for new contracting types to ensure they support innovation and exploitation of technology.

The overall objective of the SSCRs is to assure value for money for the taxpayer and a fair price for industry. These amendment regulations will ensure that the SSCRs can achieve these objectives across the full range of sectors and contract types when contracts are single source that the MOD needs to use.

5. Summary and preferred option with description of implementation plan

These amendment regulations will enable implementation of the key reforms to the SSCRs identified in the 2022 Command Paper using some of the powers taken in Schedule 10 of the Procurement Act 2023. It is intended that these reforms will be available to parties to single source defence contracts from April 2024. Implementation will be supported through Statutory Guidance produced by the Single Source Regulations Office (the SSRO plans to consult on draft statutory guidance in parallel with these amendment regulations clearing the Parliamentary process). There will also be changes to MOD commercial policy and practice and a programme of training to ensure that the changes are properly understood and new options can be used when there is reason to do so.

6. Monetised and non-monetised costs and benefits of each option (including administrative burden)

The key assumptions included in the analysis are:

- Appraisal has been conducted in line with HMT Green Book guidance.
- Monetised costs and benefits have been estimated in 2024/25 prices.
- The HMT Green book discount rate of 3.5% has been applied to the monetised costs and benefits.

- Monetised costs and benefits have been discounted relative to 2024/25.
- An appraisal period of 10 years has been used.
- Costs and benefits have been estimated relative to the do nothing option.

Option 1 – Update SSCRs through secondary legislation.

Monetised costs

The monetised costs from this option are driven by the changes being made to allow exceptions to the pricing formula. These changes will allow alternative pricing methods and as a result a number of contracts previously exempt from the regulations will no longer require exemptions. This will result in additional reporting being required in order to comply with the regulations.

It has been assumed that an additional 10 contracts, lasting an average duration of 4 years, per year could fall under the regulations. These contracts will be required to undertake the standard reporting, which can be split in to:

- Contract initiation (32 hours per year, in first year of contract)
- Contract management (12 hours per year, every year of contract)
- Contract completion (66.6 hours per year, in final year of contract)

It is assumed that the reporting will be completed by a buyer and procurement officer (£17.87/hr); salary data has been based on SIC code 3551 in ONS published data. To obtain values in real terms, this hourly salary has been inflated in line with the OBR’s Nov-23 Average Weekly Earnings forecast to £19.60/hr to represent 24/25 salaries. These reporting estimates and volumes are based on anecdotal evidence.

Over the 10-year cost estimate, there is an initial transition period of 3 years. These transitional costs are calculated by adding the staff hours of the 10 new contracts initiated in that financial year to the hours needed for annual contract management reporting of the contracts that are already up and running. As the average contract length spans 4 years, over the 3-year transition period the costs increase as the number of existing contracts increase from 10 in year 1 to 20 in year 2, then to 30 in year 3. The total number of reporting hours per year is then multiplied by the average hourly salary to generate a total labour cost. From year 4, the costs remain constant at around £28,700 per annum. This is calculated by adding the same contract initiation labour costs to the annual contract management reporting costs of the, now 40, ongoing contracts, along with the labour costs associated with contract completion reports for the 10 contracts ending that financial year.

The yearly costs are then translated into NPSV terms, using a discount rate of 3.5%. At the end of the 10-year period, the total net present social cost of this option is £195,700 in 24/25 prices.

Table 2 - Additional reporting costs of Option 1

	24/25	25/26	26/27	27/28	28/29	29/30	30/31	31/32	32/33	33/34
Additional FTE hours of reporting per year	440	560	680	1470	1470	1470	1470	1470	1470	1470
Staff cost (24/25 prices, not discounted)	£8,600	£11,000	£13,300	£28,700	£28,700	£28,700	£28,700	£28,700	£28,700	£28,700

Table 3 - Discounted costs of Option 1

	24/25	25/26	26/27	27/28	28/29	29/30	30/31	31/32	32/33	33/34
Discount factor (Discount rate 3.5%)	1	0.9662	0.9335	0.9019	0.8714	0.8420	0.8135	0.7860	0.7594	0.7337
Total costs (24/25 prices, discounted)	£8,600	£10,600	£12,400	£25,900	£25,000	£24,200	£23,400	£22,600	£21,800	£21,100

Non-monetised costs

There are a small number of contracts currently regulated by other laws which could come within scope of the SSCRs under this option, however it is estimated that this could affect less than 5 contracts over the 10-year appraisal period. In addition to this, the updated definition of Qualifying Defence Contracts could result in an additional 1-3 contracts over the 10 year period becoming in scope of the updated regulations. The combined additional cost of these changes is therefore assumed to be negligible and has not been monetised.

There could also be a cost in terms of the senior executive time that will be required in the early years of these changes, to resolve any queries around the application of the new pricing methods. However once precedents have been set, this cost will no longer occur. It is assumed that this cost will be negligible and therefore it has not been monetised.

The POCO changes are a simplification of the current process, there could be some negligible impact on the calculation of allowable costs for the small number of contracts where POCO is a factor, however it is assumed that this will be a minor adjustment and therefore this impact has not been monetised.

Under this option the Single Source Regulations Office (SSRO) will have the power to take on additional referrals relating to the reforms being delivered, for example whether use of an alternative pricing method has resulted in value for money and a fair price. It is not possible to estimate whether and if so how many referrals may come forward as a result of these reforms. Historically, SSRO has taken on an average of just over one referral per year, although frequency varies significantly from year to year. SSRO is also currently consulting on whether changes can be made to make its referral process faster and easier to use.

There could be a familiarisation cost while contractors transition to adopting these new regulations. This has not been monetised.

Monetised benefits

It has not been possible to monetise any of the benefits of this option, due to the nature of the benefits.

Non-monetised benefits

The MOD believes that the SSCRs have improved assurance on value for money on single source defence contracts, leading to significant savings. The reforms being delivered through these amendment regulations will ensure more single source defence contracts can fall under the SSCRs bringing additional assurance on value for money.

This option will ensure that a wider range of sectors and contract types can fall under the SSCRs with respective benefits relating to assurance on value for money (see above). By providing new options in both pricing types and the ability to break contract down into components, significantly fewer contracts will have to be exempted from the regime than at present.

The process for exempting otherwise eligible contracts takes a significant amount of time and resource on the part of officials and Ministers. The process also delays contract signature while the exemption process is cleared, delaying delivery of goods, works and services. Not exempting these contracts will speed this process.

Speeding up and simplifying the acquisition process will also be supported by the other amendments in these regulations, for example clarification of the circumstances under which a single source contract should be treated as a Qualifying Defence Contract and ensuring that the provisions which ensure profit is only paid on costs once (POCO) sit in a more appropriate stage of the procurement process.

Allowing contracts to be split into multiple components will have minimal impact on reporting requirements as in general the same information will be required but in a different format. MOD will work with SSRO to ensure that where there is a risk of some increase in reporting requirements, this is dealt with in a pragmatic fashion.

Both the ability to split contracts into components and the clarification of the Qualifying Defence Contract definition are legal regularisations of what is often already common practice. Providing regulations and Statutory Guidance to underpin this practice will reduce the amount of time currently taken discussing how for example amended contracts, or contracts that only have a defence element should or shouldn't come under the SSCRs, however any potential time saving benefits as a result of this have not been quantified.

7. Direct costs and benefits to business calculations

The monetised costs estimated above are a direct cost to businesses and therefore are used for the Equivalent Annual Net Direct Cost to Business (EANDCB) calculation. As outlined above, all of the direct benefits to business are non-monetised and so have not been included in the EANDCB calculation. As a result, it has been estimated that this policy has an EANDCB of -£22,700.

8. Risks and assumptions

Volumes have largely been based on historic volumes, which assumes no significant change in the number of future contracts that could be in scope of the regulations. An average number of 10 contracts per year have been used in the analysis. This figure is based on an internal assessment of the number of single source defence contracts that have had to be exempted as they were commercially priced and an estimate of the likely increase in commercially priced contracts in future Defence procurement where there will be an increasing focus on sectors such as software. These contracts have an average duration of 4 years, similar to the average QDC/QSC durations captured in the 2016-23 annual defence contract statistics (see table 1).

Costs captured in the model are dependant on the staff required to undertake the additional hours of reporting. It is assumed that the reporting will be completed by a buyer and procurement officer (£17.87/hr, inflated to £19.60 in 24/25 prices); salary data has been based on SIC code 3551 in ONS published data (ASHE table 14).

It has been assumed that these reforms will be in place from April 2024, therefore the 10-year cost model captures costs beginning in FY24/25 to FY34/35. The additional report requirements have been estimated based on assumptions around how long the reporting currently takes. These previously exempt contracts will be required to undertake the standard reporting, which can be split in to three types of report categories. In the first year on a contract, it is assumed that 32 hours' worth of contract initiation takes place. Throughout the 4-year duration of the contract, an annual contract management report will be produced to track progress, which takes

12 hours. At the end of the contract, a contract completion report will take 66.6 hours. These assumptions are largely based on anecdotal evidence, so sensitivity analysis is shown below to demonstrate the impact of changing these assumptions:

Table 4 - Sensitivity Analysis

Assumption	Description of change	Sensitivity analysis – Updated NPSV	Difference compared to original NPSV
Number of contracts per year	Increase by 20% (12 contracts per year), resulting in additional time spent on reporting	-£234,900	-£39,100
Time taken to complete reports	Increase time taken to complete each report to top end of range provided by project team	-£246,600	-£50,900
Salary of reporting officers	Increase by 20% (£23.50 per hour), resulting in a higher cost of hourly labour	-£234,800	-£39,100
Worst case scenario	All of the above	-£355,100	-£159,300

9. Impact on small and micro businesses

The SSRCs are only applied to contracts over the value of £5m, which will limit the impact of these reforms on lower value contracts and potentially therefore smaller businesses. In addition to this, published SSRO statistics show the proportion of contracts awarded to small and medium sized enterprises as being around 6% per year. A number of these will be medium sized enterprises, which suggests that the number of contracts awarded to small businesses is relatively low.

Table 5 - Contracts awarded to SMEs

	16/17	17/18	18/19	19/20	20/21	21/22	22/23
Proportion of contracts awarded to Small or Medium sized enterprises (%)	8	4	4	7	7	6	7

Source: SSRO qualifying defence contract statistics

The SSRO provides training and on-boarding assistance to any companies using the SSCRs and associated reporting requirements for the first time. This includes both on-line and person to person assistance. This assistance is available to businesses of all sizes and therefore is one mitigation in place that small and micro businesses could seek assistance from if needed.

10. Wider impacts (consider the impacts of your proposals)

The aim of these proposals is ultimately to assure value for money in a wider range of single source contracts, where a lack of competition could otherwise result in an unfavourable outcome. Bringing the regulations up to date to capture sectors such as software will result in the benefits of the regulations being achieved more widely.

11. A summary of the potential trade implications of measure

These measures are not expected to have significant trade implications. Government to government contracts will not be affected by these proposals and therefore international trading will not significantly be impacted.

12. Monitoring and evaluation

MOD will monitor the impact of these reforms to inform the next statutory review due in 2027. By that stage there should be sufficient Qualifying Defence Contracts signed under the amended Regulations and that use the alternative pricing methods and/or componentisation options to fully evaluate how successfully these approaches have met their policy objectives. This monitoring will inform whether further adjustments are needed to the Regulations to address changing circumstances or rectify any technical issues that arise. As with the most recent review, this evaluation will be carried out by drawing on the direct experience of all the key players including MOD commercial officers, industry and the Single Source Regulations Office.