

<b>Title:</b> Single Source Contract Regulations 2014 (SI) <b>IA No:</b> MOD0002 Part 2  <b>Lead department or agency:</b>  <b>Other departments or agencies:</b> n/a	<b>Impact Assessment (IA)</b>		
	<b>Date:</b> 13/08/2014		
	<b>Stage:</b> Final		
	<b>Source of intervention:</b> Domestic		
	<b>Type of measure:</b> Secondary legislation		
<b>Contact for enquiries:</b> Single Source Procurement Team DES-SSPR-TL 02072183769			
<b>Summary: Intervention and Options</b>			<b>RPC Opinion:</b> Not Applicable

Cost of Preferred (or more likely) Option				
Total Net Present Value	Business Net Present Value	Net cost to business per year (EANCB on 2009 prices)	In scope of One-In, Measure qualifies as One-Out?	
£1,696m	Not estimated	Approx £m	No	Zero Net Cost

**What is the problem under consideration? Why is government intervention necessary?**

Single source procurement accounts for around 45% of MOD's total procurement budget over recent years (amounting to £5-6bn per year). The nature of the defence market means that some large non-competitive contracts will always be placed with a limited number of suppliers where we need to protect our operational advantage or freedom of action. Under current arrangements, the UK taxpayer does not always get best value for money and there is little incentive for industry to reduce its cost base. To improve this, government intervention is necessary as industrial suppliers are unlikely to comply with recommendations that are not statutory. Part 2 of the Defence Reform Act 2014 makes provision for contracts entered into by the Secretary of State of Defence for procuring goods, works or services for defence purposes. Part 2 is largely enabling and so requires those provisions to be made in regulations.

**What are the policy objectives and the intended effects?**

The main objective is have a more transparent, balanced and fair relationship between the MOD and its suppliers that provides better VFM protection for taxpayers than is currently achieved. The intended effect is to allow MOD to become a better informed and intelligent customer, improving its ability to negotiate prices effectively, identify and challenge problems earlier and more robustly, and to close loopholes in the current system that allow additional profits to be earned in ways that do not require cost efficiencies. The changes will also assist in meeting the wider department objective of reducing the cuts and delays to defence programmes and decrease the waste that results.

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

**Option 1 – “Do nothing”.** The existing Review Board for Government Contracts would continue to set the annual profit rate, publish the allowable cost categories and rule on “Equality of Information” disputes but this approach is increasingly unfit for purpose and will not meet the recommendations of Lord Currie's review (2011).

**Option 2 – “Non Legislated Negotiated Improvements”** The MOD would attempt to gain industry consensus for as many of the new Single Source Procurement Regulations (SSPR) as possible.

**Option 3 – “Legislation for SSRO and SSPRs”** The SSPRs define new pricing principles, standard reporting and transparency requirements. The Single Source Regulations Office (SSRO) will be set up as an Executive Non Departmental Public Body (ENDPB) to manage, monitor and update the SSPRs.

Option 3 is recommended. It allows all required changes to be implemented quickly and effectively and will ensure the highest possible levels of supplier adherence and application, and hence the greatest possible benefit

<b>Will the policy be reviewed? It will be reviewed. If applicable, set review date: 04/2019</b>						
Does implementation go beyond minimum EU requirements?				N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.		Micro No	< 20 No	Small Yes	Medium Yes	Large Yes
What is the CO <sub>2</sub> equivalent change in greenhouse gas emissions? (Million tonnes CO <sub>2</sub> equivalent)				Traded: Nil		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 Minister: \_\_\_\_\_ Philip Dunne \_\_\_\_\_ Date: 04/12/2014

**Summary: Analysis & Evidence**
**Option 2 – Non Legislated Negotiated Improvements**
**FULL ECONOMIC ASSESSMENT**

Price Base Year 13/14	PV Base Year 13/14	Time Period Years 20	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	High: Optional	Best Est: £373m

COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional	N/A	Optional	Optional
High	Optional		Optional	Optional
Best Estimate	£8.5m over 2 years		£10m	£134m

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

Additional costs initially incurred by industry in completing reports – then reclaimed from MOD, £3.2m / yr (based upon 50% of option 3)

Cost of enlarged Review Board staff by consultants, £6m / yr

Additional resources within MOD, £0.9m /yr.

Total transition includes £2.5m for ANDPB, £2.8m for industry (passed back to MOD) and £3.2m for MOD.

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

Staffing an Advisory NDPB with consultants rather than employing permanent staff in an ENDPB would be likely to lead to higher staff turnover and an associated slower growth in the accumulation of SSPR knowledge and expertise. If resourced this way there might also be greater difficulty in managing and mitigating the confidentiality issues arising from the volume and highly sensitive nature of supplier data held centrally.

BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional	N/A	Optional	Optional
High	Optional		Optional	Optional
Best Estimate	Nil		In long term, average £64m pa	£507m

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

Negotiation of better future contract prices as a result of better understanding of outturn costs on past projects (through development of benchmarks and parametrics, and through the development of a better understanding of the pricing of risk).

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

Nothing material identified.

**Key assumptions/sensitivities/risks**

Contract volumes and single source expenditure levels  
MOD ability to extract value from the information flowing from the new reports  
MOD ability to negotiate changes into contracts / compliance rate

**Discount rate (%)**

3.5%

**BUSINESS ASSESSMENT (Option 2)**

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: Nil	Benefits: not estimated	Net: Nil	No	Zero Net Cost

**Summary: Analysis & Evidence**
**Option 3 – Legislation for SSRO and SSPRs**
**FULL ECONOMIC ASSESSMENT**

Price Base Year 14/15	PV Base Year 14/15	Time Period Years 20	Net Benefit (Present Value (PV)) (£m)		
			Low: Optional	High: Optional	Best Estimate: £1.696m

COSTS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Cost (Present Value)
Low	Optional	N/A	Optional	Optional
High	Optional		Optional	Optional
Best Estimate	£12.8m over 2 yrs		£7m	£129m

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

Additional costs initially incurred by industry in completing reports – then reclaimed from MOD, £6.1m / yr  
Initial cost of SSRO, £5.8m / yr but 50% reclaimed from industry via profits "levy", so net £2.5m/year  
Additional resources within MOD, £0.9m /yr.  
Total transition includes £1.85m for ENDPB, £5.6m ofr industry (passed back to MOD) and £3.5m for MOD.

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

Nothing material identified.

BENEFITS (£m)	Total Transition (Constant Price) Years		Average Annual (excl. Transition) (Constant Price)	Total Benefit (Present Value)
Low	Optional	N/A	Optional	Optional
High	Optional		Optional	Optional
Best Estimate	nil		In long run, average £213m pa	£1,837m

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

Negotiation of lower future contract prices as a result of improved understanding of outturn costs on past projects (though development of benchmarks and parametrics, and through the development of a better understanding of the pricing of risk), closure of loopholes in current regulations, and better alignment of supply and demand when planning the required capacity at key industrial facilities.

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

Nothing material identified.

**Key assumptions/sensitivities/risks**

Contract volumes and single source expenditure levels  
MOD ability to extract value from the information flowing from the new reports

**Discount rate (%)**

3.5%

**BUSINESS ASSESSMENT (Option 3)**

Direct impact on business (Equivalent Annual) £m:			In scope of OIOO?	Measure qualifies as
Costs: £2.5m	Benefits: not estimated	Net: £2.5m	No	Zero net cost

## EVIDENCE BASE

### Problem under consideration

#### ***Background - MOD use of single source procurement***

1. The MOD's approach to procurement was set out in the 'National Security Through Technology' White Paper (February 2012). Single source procurement of equipment and support occurs where the MOD is unable to source its requirements through open competition. This is most common where only a single supplier has the ability or rights to perform the work, or where, for national security purposes, a single supplier is chosen so as to protect the UK's freedom of action and operational advantage. In these cases we use single source procurement.

*Figure 1 – Examples of single source procurement*

#### **Single Source procurement examples**

- A maintenance contract for a fast jet engine, where only the original manufacturer has the design rights and experience.
- A manufacturing contract for an additional nuclear submarine, to add to the existing fleet, where it would be impractical to either have a different type of submarine or to pay for another supplier to replicate the same design.
- A contract to test the operational limits of a tank's armour, where only one UK supplier has the right facilities, and we do not want anyone outside the UK to know what the limits are.

2. Over the last five years the proportion of contracts placed on a single source basis has been around 45%<sup>1</sup> (by value), and is likely to remain significant in the future. Single source procurement is concentrated in a relatively limited number of high value contracts with a small number of suppliers. There are around 100 existing single source contracts above £50m in value, which account for over 90% of the value, and most of these are with our top ten single source suppliers.
3. In the absence of an alternative supplier, VFM is at risk. Suppliers can price without fear of being undercut by their competitors, so they are not subject to normal market pricing pressures. Furthermore, because we require the military capability they provide, suppliers can be confident of follow-on work even if costs are high or performance is poor. The volume of single source procurement, together with the risk to VFM inherent in this approach, means assuring VFM in single source procurement is of great importance to both the MOD and the taxpayer.

#### ***The current single source framework***

4. The MOD currently uses a framework to price single source procurement known as the Yellow Book<sup>2</sup>. The aim of the Yellow Book is to give industry a fair and reasonable price, based on an annually published profit rate to be used in price setting. In exchange, and in order to help us to ensure VFM, MOD are granted limited protections such as:
  - a) a commitment to Equality of Information at the point of pricing (and the right to challenge this post contract);

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<sup>1</sup> The average is based on data from the 2007/8, 2008/9, 2009/10, 2010/11 and 2011/12 Financial Years.

<sup>2</sup> The Yellow Book's formal title is 'The Government Profit Formula and its Associated Arrangements'.

- b) the ability to recover “unconscionable profits”; and
  - c) a definition of the types of overhead cost suppliers can recover.
5. The Yellow Book was established in 1968 following instances where suppliers made high profits by effectively double-charging their overhead costs to the MOD<sup>3</sup>. It is underpinned by a non-legally binding Memorandum of Understanding<sup>4</sup>, and it is published by an Advisory Non-Departmental Public Body (ANDPB) called ‘The Review Board for Government Contracts’ (the “Review Board”).
  6. The Yellow Book framework is typically reviewed every three years and may be updated, but only if agreement can be reached between MOD and industry. This requirement for consensus means it is hard to make any change where one party feels disadvantaged. As such it has remained largely unchanged since 1968, despite many significant changes to the industrial landscape and MOD procurement practices over the years.

*Figure 2 – How defence procurement has changed since 1968*

1968	2013
<b>Industrial Cost Base</b>	
<ul style="list-style-type: none"> <li>• Government owned factories and dockyards</li> <li>• Industry overheads are minor relative to direct labour and materials</li> </ul>	<ul style="list-style-type: none"> <li>• Facilities owned by industry</li> <li>• Overhead costs similar to direct labour, typically 30% of total cost</li> </ul>
<b>Industrial landscape</b>	
<ul style="list-style-type: none"> <li>• Large number of smaller companies</li> <li>• Extensive state ownership of defence suppliers</li> </ul>	<ul style="list-style-type: none"> <li>• Small number of global companies</li> <li>• Predominantly private sector</li> </ul>
<b>Government expertise</b>	
<ul style="list-style-type: none"> <li>• Substantial Government resources directly involved in equipment design and support</li> </ul>	<ul style="list-style-type: none"> <li>• Government role is primarily to set capability requirements and manage industry delivery</li> </ul>
<b>Technology</b>	
<ul style="list-style-type: none"> <li>• Larger number of simpler assets with shorter development times</li> </ul>	<ul style="list-style-type: none"> <li>• Smaller number of ever more complex assets with development cycles up to twenty five years</li> </ul>
<b>Nature of contracts</b>	
<ul style="list-style-type: none"> <li>• Shorter, simpler contracts</li> <li>• Price set by applying a fixed profit rate to costs that a supplier had already incurred (cost plus)</li> <li>• Little sub-contracting</li> </ul>	<ul style="list-style-type: none"> <li>• Contracts for ten or more years</li> <li>• Predominately fixed price, with suppliers accepting and pricing in risk</li> <li>• Significant use of sub-contractors</li> </ul>

<sup>3</sup> Report of the Committee of Inquiry into Certain Contracts made with Bristol Siddeley Engines Ltd., 21 Feb 1968.

<sup>4</sup> The Memorandum of Understanding was between Her Majesty’s Treasury and the Confederation of British Industry; although originally set up as a potential cross-Government regime, MOD and the defence industry are now the sole users of the Yellow Book.

## ***Rationale for Intervention – the shortcomings of the current arrangements***

7. Following the 2010 Strategic Defence and Security Review, the Minister for Defence Equipment, Support and Technology (Min(DEST)) commissioned Lord Currie of Marylebone to chair an independent review of single source pricing regulations. The objective of the review was to propose a fit-for-purpose framework that could be applied to equipment and support contracts between MOD and its single source suppliers. Lord Currie met with senior executives of UK-based defence suppliers, senior MOD and Government officials, trade bodies and the Review Board. He also sought views from other Ministries of Defence undertaking substantial single source procurement.
8. Lord Currie's report, published in October 2011, recommended a fundamental recasting of the current Yellow Book. He identified the following serious shortcomings:
  - a) **Poor focus.** The Yellow Book focuses on profit and overhead costs but does not adequately cover direct costs, subcontracted work, or risk. This means the bulk of the price is not closely considered.
  - b) **Inadequate incentives for efficiency.** The Yellow Book does little to provide suppliers with ongoing incentives to reduce their costs once on contract, or to support the MOD to replicate the missing competitive pricing pressure.
  - c) **Inadequate protections for MOD.** Equality of Information protections do not work and under current provisions MOD has to wait until the end of a contract, which may be ten years or more, before it can challenge whether the pricing assumptions provided to the Department by a supplier were reasonable or appropriate.
  - d) **Insufficient challenge to overhead costs.** The current framework allows suppliers to charge the MOD for millions of pounds of overhead costs (including rationalisation and redundancy costs even if not on contract) without any need for prior approval or consultation. This is clearly inappropriate when the MOD accounts for the majority of the output of a supplier's business unit. The Yellow Book also puts an onus of proof onto the MOD to prove that overhead costs are "unreasonable, extravagant or wasteful".
  - e) **Weak governance of the regime.** The Review Board, through no fault of its own, is very constrained in its resources and remit<sup>5</sup>. They have no visibility of how or whether the Yellow Book is applied to specific contracts, and little understanding of its MOD single source procurement.
  - f) **Lack of transparency.** There is no standard reporting requirement which leads to poor visibility of supplier or contract performance.
  - g) **Gaming opportunities.** There is scope under the current overhead absorption methodology to over recover costs. Also, suppliers are able to charge profit on profit for work subcontracted within same group.
9. In summary, the Yellow Book was designed to deal with the issues that industry and Government faced over forty-five years ago. It has been kept in the past by a process that has made revision very difficult, and change is now long overdue.

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<sup>5</sup> The Review Board has five non-executive directors and is supported by a part-time secretariat under a contract with Deloitte LLP.

## Policy – Principles, Objectives, Design & Benefits

### *Lord Currie's Proposals*

10. In order to address the shortcomings mentioned above, Lord Currie made several recommendations:
  - a) **Better focus** - mandatory standard cost reporting and increased transparency (open book) to support the MOD in assuring VFM across all of the elements of the price including direct costs, subcontracted work, and risk. These reports would allow the MOD to understand the true costs related to single source contracts in a much more timely fashion.
  - b) **Stronger supplier efficiency incentives.** Standard pricing and actual cost reports would enable benchmarking across projects and suppliers, which should be used by the MOD to challenge supplier prices more effectively. Greater transparency and audit rights should be used by the MOD to ensure suppliers were looking for continuous improvements once on contract. Lord Currie noted that profit is a supplier's strongest incentive for efficiency. He recommended that the link between a supplier's costs and profit should not be unduly undermined by contractual sharing arrangements, and that projects where a supplier carries higher risk should attract a higher profit rate (and the converse should apply with lower risk).
  - c) **Stronger protections for the MOD.** The MOD should be able to investigate whether a supplier's pricing assumptions were reasonable and appropriate at any point during a contract, rather than just at the end. The standard reports should allow the MOD to target these investigations appropriately (e.g. where costs were much higher or lower than anticipated).
  - d) **Improved visibility and challenge of overhead costs.** New mandatory overhead reports from suppliers would support a pre-approval process for significant overhead costs, and would require suppliers to be more transparent with MOD about industrial over- or under-capacity. The supplier would have to demonstrate that overhead costs are reasonable and appropriate, rather than the MOD having to argue that they are "unreasonable, extravagant or wasteful".
  - e) **A stronger Single Source Regulations Office (SSRO) replacing the current Review Board.** The new arms-length-body would keep the new framework under review and would publicly recommend changes to the Secretary of State. It should lead the debate rather than requiring consensus between the MOD and single source suppliers. It would also monitor the application of the regulations, and provide analysis that would aid the MOD to better forecast future costs. It should be supported by full time staff.
11. The MOD have consulted extensively since Lord Currie published his report including a formal public consultation and detailed discussions with our largest single source suppliers. Although there have been areas of difference, defence suppliers have accepted the need for change.

### *The New Framework - Overview*

12. As a result of Lord Currie's recommendations, the MOD decided to introduce new legislation (Part 2 of the Defence Reform Act 2014) to introduce a new framework designed to address the current challenges in single source pricing, supported by a process that ensures it is kept current.
13. Our new approach to managing defence single source procurement has two principal characteristics:
  - a) New statutory regulations – the **Single Source Pricing Regulations (SSPR)**
  - b) A new regulatory body – **the Single Source Regulations Office (SSRO)**

14. At the heart of the new pricing framework is the principle that industry gets a fair and reasonable price in exchange for providing the MOD with the protections we need to assure VFM. We will retain the current profit formula for defence single source procurement, which provides the defence industry with a profit rate comparable to the rest of UK industry, in exchange for greater transparency.
15. In designing the new approach the key guiding principles have been to:
  - a) **Address issues that arise from single source procurement** – for example, supporting the MOD’s ability to replicate the missing competitive pressure;
  - b) **Focus on areas where standardisation is of value** – the framework proposed benefits from wide application and stability over time;
  - c) **Be proportionate** – higher value contracts carry a greater risk to VFM, so there should be greater protections. We also do not want to discourage the greater involvement of Small and Medium Sized Enterprises (SMEs) in defence by a framework that is too burdensome.
  - d) **Provide VFM** – we have taken a balanced approach between asking for information we would ideally like, and asking for information that is readily available using current industry systems and processes. We have ensured that the framework is practical by engaging with industry on these proposals.

### ***The New Framework – Key features***

16. The new framework can be described in terms of four key features:
  - a) Transparency rights;
  - b) Pricing principles;
  - c) Standard Reporting; and
  - d) its Compliance Regime.
17. **Transparency** will be increased through:
  - a) A wide ranging open book provision will allow MOD to request access to and explanation of any information pertinent to the price and outturn performance of a contract throughout the duration of the work.
  - b) The current requirement for “Equality of Information” at the point of contract pricing will be extended to the overhead rates agreement process.
  - c) MOD will have the right to conduct a post award review shortly after the start of a contract if it feels there is any doubt around Equality of Information at the point of pricing. The right to conduct a “supplier performance review” will address broader efficiency and performance issues.
18. Improvements to the **pricing principles** include:
  - a) Shifting the “onus of proof” – currently MOD must show that there are extravagant, wasteful or unreasonable costs in an overhead claim, but in future the supplier will have to show that all elements of their claim are appropriate and reasonable.
  - b) a simple points based risk assessment will be applied to every contract and the outcome used to determine a risk driven adjustment to the standard baseline profit rate.
  - c) the mechanism currently used to correct for “profit on profit” when subcontracts are let within the prime owning group will be made specific to each contract, improving accuracy, transparency and ease of application.



- d) the current unconscionable profits & losses mechanism (DefCon 648A) will be modified, in favour of suppliers, in order to improve their incentive to find efficiency savings and retain more of the resulting additional profit.
19. Suppliers will be required to produce with comprehensive set of **standard format reports**:
- Contract reports will provide a detailed breakdown of the price and associated deliverables, track the actual cost performance of the contract, explain variances and demonstrate the extent to which allowances for risk events were drawn upon; whilst
  - Supplier reports will provide a standard analysis across business units and through time of all overhead costs by type and function, track overheads incurred against those charged to contracts, give earlier insight into the content of future years rates claims and support earlier and better information senior management dialogue around aligning long term capacity with anticipated demand.
20. **Compliance / Enforcement issues** - To help achieve good levels of **compliance**, the SSPRs will be backed by a comprehensive compliance framework, including, as a last resort, financial civil penalties. The MoD will operate the compliance regime through a combined input from both existing employees and a small number of new recruits. Appeals by suppliers against penalties levied by the MoD can be made to the SSRO. The impact and staffing to support the compliance regime both in the MoD and the SSRO has been addressed in the business case.

*Figure 3 – Summary of the new single source contract regulations*

Area	Element	Purpose
Transparency	Open Book	To provide a general 'back-stop' right to help assure VFM in single source procurement and to check the new framework is working
	Audit rights and referral rights to an independent expert	To put a duty on suppliers to use reasonable and appropriate pricing assumptions
Pricing	Standard profit	To provide industry with an independently assessed fair return, equal to the average of UK industry
	Incentivisation of efficiency	To allow additional profit where it is earned by performance
	Variation of profit with risk	To give a profit that is fair to both parties, given the risk profile of the contract
	Protection from excessive profits and losses	To provide the MOD with protection in the event of excessive supplier profit, and suppliers protection against excessive losses
	No profit on profit	To ensure suppliers get a fair profit, and not an unwarranted profit achieved simply by clever deal structuring
	Standard list of allowable costs	To ensure both parties negotiate fair prices within a clear and coherent approach and on a level playing field
	Onus of proof	To put a duty on suppliers to demonstrate the overhead costs they claim are reasonable and appropriate for MOD to pay
Standard contract reports	Benchmark reports at start/end/amendments	To improve price negotiation (and capability planning) by building up a database of defence benchmarks from comparable projects

Area	Element	Purpose
	Quarterly contract reports	To get timely checks on project health that can be used to support a stronger financial and performance management regime; and so that MOD can negotiate follow-on prices with a good understanding of historic costs.
	Annual contract reports	To maintain an audit trail of the cost baseline that is directly comparable to the original price
Standard overhead and supplier-level reports	Annual overhead benchmark reports	To improve overhead negotiation by building up a database of overhead benchmarks
	Overhead comparison report	To check the effectiveness of the range of overhead recovery methods we have available
	Long term overhead report	To optimise the industrial capacity we pay for with our long-term military capability requirements
	SME report	To support SMEs down the supply chain
Compliance regime	Publically naming the supplier	To increase the timeliness and likelihood of adherence to the new regulations
	Financial penalty	

### ***The New Framework - Benefits***

21. The following sections make clear how the changes described above will lead to improvements in single source procurement, and are described in terms of:
  1. Better price negotiation
  2. Stronger efficiency incentives
  3. Better joint planning of key facilities.
  4. Stronger financial and performance management regime
  5. Encouraging SMEs
  6. Better Compliance

### ***Benefit 1 - Better Price negotiation***

22. In single source procurement, the MOD must take the place of the missing competitive pricing pressure by challenging a supplier's price. The new single source framework will support the MOD's ability to negotiate prices that are fair and reasonable to both suppliers and taxpayers by providing an underpinning reference framework that defines how those prices should be calculated.
23. To do this, the MOD needs better quality and more standardised historic outturn data. The regulations will introduce standard reports, at the beginning and end of each single source contract (and substantial contract amendments) that will allow us to build up a database of defence benchmarks. We will use these benchmarks to find pricing assumptions that are at odds with other comparable projects and to embed tough, but achievable, efficiency targets into the price.
24. Defence benchmarks can also be used to support capability planning and to improve the accuracy of early budgets. By allowing capability planners to make high-level trade-offs for a given level of cost, for example between a ship's range and its maximum speed, the MOD will be better placed to optimise equipment specifications and make more robust long-term cost forecasts in the early acquisition phases.

## ***Benefit 2 - Stronger Efficiency Incentives***

25. In a competitive environment, suppliers must continuously improve or risk being overtaken by their competitors whereas, in single source procurement, a lack of an alternative means that follow-on work is less dependent upon any improvement. The single source framework must help provide a proxy for the missing on-going efficiency incentive.
26. We accept Lord Currie's view that the strongest motive for supplier efficiency is higher profit; however, profit should be the reward for good performance and a continuous drive to improve. To ensure this we need to get the price right in the first place, so high profits cannot simply be incorporated into the price, and we must also ensure that the only way to higher profits is through greater efficiency.
27. As suppliers will always know more about their costs than we will, the new regulations must put an onus on single source suppliers to use reasonable and appropriate pricing assumptions. If supplier costs turn out to be lower than expected, we will have the right to investigate if the price was genuinely based on a supplier's best estimates at the time. We will then be able to refer any such concerns to the SSRO, as an independent expert body, which if it believes reasonable and appropriate pricing assumptions were not used, have the power to require the supplier to compensate us accordingly<sup>6</sup>.
28. Ensuring the only way to higher profits is through greater efficiency means we have to be confident that there are no weaknesses in the system that could be used to achieve higher profits without cost reduction. To achieve this we will address three known weaknesses in the current framework:
  - a) **No profit on profit.** Suppliers often subcontract work to their own subsidiaries, who in turn can subcontract to other business units in the same corporate group. At each stage it is possible to add a layer of profit. The current framework addresses this poorly and we are therefore introducing a clearer system where 'profit on profit' is adjusted for at the contract level, at the time the contract price is agreed.
  - b) **The current overhead recovery methodology can result in over-recovery of overheads.** Overhead allocation and recovery is a complex activity, and our current approaches can result in systematic over-recovery or under-recovery. We will require suppliers to provide a report that compares overhead recovered with overhead spending to ensure we are not paying twice for the same capabilities.
  - c) **Onus of proof.** Under the current arrangements the onus of proof is on the MOD to demonstrate that costs are unnecessary, extravagant or wasteful. Given that we did not incur the costs in the first place, and were not involved in any investment decisions, this is very hard to do. The new framework will place the onus on suppliers to demonstrate that costs they claim are reasonable and appropriate for MOD to pay.
29. No framework can offer complete protection, and we will therefore have a general audit right to investigate how our money is being spent and how the supplier is performing. This will allow us to continuously monitor performance to both evaluate the framework, and where appropriate, further encourage ongoing efficiency improvement. We will also put a duty on suppliers to let us know in a timely fashion of any cost, performance, or schedule risks or changes. This over-arching obligation on single source suppliers provides an important back-stop protection that means the MOD can accept a lighter-touch framework as opposed to one that attempts to address all potential issues with explicit measures.
30. Our concern for supplier efficiency is based on a desire for VFM. Greater efficiency will result in lower supplier costs, which in turn will result in lower follow-on prices and better VFM. However this is not always true, as not all contracts lead to follow-on work. We accept Lord Currie's view that there can be a trade-off between strong supplier efficiency incentives and VFM. Suppliers must benefit from cost reduction or they will not do it, however if we do not

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<sup>6</sup> We also accept that we have a duty to provide supplier with any information we have that is relevant to pricing, and that if this information is not shared or if misleading information is provided, suppliers will also be able to refer the matter to the independent body.

share this benefit then VFM has not been improved. If actual profits are substantially greater than expected, we will include provisions that allow us to share the increased profit, and our share will increase as the profits become ever greater. We accept that it would not be fair to share potential gains without also taking a share of potential losses, so the provisions will also provide for some share of any such losses. It is not in our long-term interests to force suppliers to provide capability while they suffer from on-going and potentially crippling losses.

### ***Benefit 3 - Better joint planning of key facilities.***

31. Where only one supplier can provide aspects of the capability we require, the sustainment of industrial capability can be a matter of national security. There is also a risk to VFM as this capability sustainment is paid for through the overheads that suppliers charge to us via single source contracts. To help ensure that we optimise industrial capacity with our long-term military requirements (building, sustaining and rationalising as appropriate), we need a single source framework that allows us to be appropriately involved in the long-term planning of facilities where MOD makes a significant financial contribution.
32. The current methodology for overhead recovery does not require suppliers to provide the MOD with any transparency of current and future over-capacity, or any rationalisation and redundancy plans they may have. The new regulations will require suppliers to submit annually a long-term plan for the key facilities where substantial overhead is (or is planned to be) recovered through MOD single source work. This will show current and forecast activity and plans for closure, enhancements, or significant changes. This plan will be used as the basis for joint long-term planning, to ensure we can address potential national security or VFM issues.

### ***Benefit 4 - Stronger financial and performance management regime***

33. Given their complexity, size, and long duration, single source projects have historically been at the highest risk of cost growth, programme changes, and delay. The single source framework should allow these risks to be highlighted to MOD in a timely fashion.
34. Cost reporting on our current large contracts is ad-hoc and sporadic. Reporting requirements and adherence to these requirements is highly variable, and what reports we do receive come into multiple points across the Department and in multiple formats. This makes it labour intensive for MOD to collate such information.
35. In recent years most of our single source suppliers have introduced, for their own internal purposes, standardised project reporting, including cost reporting. The additional overhead cost in producing standardised reports is justified by their improved ability to understand their portfolio of projects. Standardisation allows for aggregation at different levels (e.g. project, programme, portfolio), and for systems and process to be easily introduced to convert lower-level information into useful information for our suppliers' senior management. Given that we are paying through our single source work for much of this information to be generated, MOD senior and project management should be entitled to similar information, for similar purposes.
36. The regulations will require standard quarterly reports for all single source contracts above £50m. That will allow MOD senior and project management to be given assurance and confidence concerning project health, and to be better enabled to identify cost, performance, and schedule risks and opportunities. These contract reports will be included in standard MOD processes, helping to support a stronger financial and performance management regime and helping the MOD to become a more intelligent customer.

### ***Benefit 5 - Encouraging SMEs***

37. The MOD set out in the *National Security Through Technology* White Paper its approach to providing greater defence opportunities for SMEs, and we have made good progress implementing these reforms. We wish to encourage the use of SMEs in single source

contracts, even though we expect that large suppliers will continue to account for the majority of the value of single source procurement. We are therefore introducing simplified single source procurement processes for smaller contracts and suppliers.

38. We would also like to encourage the use of SMEs in our larger suppliers' supply chains and will require our larger single source suppliers to generate an annual SME report describing their sub-contractor procurement processes and outlining how they have encouraged the greater involvement of SMEs in their supply-chains.

### ***Benefit 6 - Better Compliance***

39. The lack of commercial leverage in the single buyer/single provider environment makes it more difficult to ensure compliance with contract conditions; the ultimate sanction of contract termination due to non-performance is of little value when there is no alternative supplier.
40. Current reporting requirements are usually not linked to any direct financial consequence. We will move to a stronger compliance regime where failure to provide transparency and reports results in the name of the supplier being made public and a fine under a civil penalty regime. This will ensure a fast and straightforward means of addressing breaches. The SSRO, given that it is arms-length from MOD and industry, will act as the appeal body for the compliance regime.

### ***Single Source Regulations Office (SSRO)***

41. Any set of regulations as involved and far reaching as these needs some form of "owning body" to oversee their application and manage their maintenance and update. A key component of Lord Currie's recommendations was therefore the replacement of the current Review Board with a stronger SSRO.
42. The SSRO will:
  - a) keep the new regulations under review, periodically recommending changes to the Secretary of State for Defence;
  - b) monitor their application;
  - c) provide an expert determination role between MOD and single source suppliers; and
  - d) analyse standard reports to understand better single source procurement issues, extract benchmarks, and highlight where greater efficiency might be achieved.

These roles are described in more detail below.

43. The SSRO will be an arms-length body and is expected to have up to five non-executive board members (and two executive members) and a full-time staff of around 40 people once it achieves its steady state (in year 6). It is anticipated it will cost approximately £5.8m per annum, with the costs to be shared equally between the MOD and single source suppliers.
44. The creation of an independent, arms-length body is central to the effectiveness of the new framework. If MOD were to unilaterally set the pricing framework, including the profit rate, there would be a risk over time that the framework would tend to favour Government and become overly burdensome on suppliers. However, if any change or agreement to the pricing framework was based on gaining consensus between the MOD and industry, it would suffer from the same limitations as the existing framework.
45. The overriding duty of the SSRO will be to maintain a single source procurement framework that assures value for money to UK taxpayers and a fair and reasonable price for suppliers.
46. To enable the SSRO to be as independent, impartial and cost effective as possible, it should be created as an Executive Non Departmental Public Body (ENDPB) which requires legislation. A key factor in arriving at this conclusion is the ability of an ENDPB to recruit its own staff. Many of the other organisational models considered do not have this right and are

staffed by civil servants on secondment (which would very definitely undermine its independence and impartiality), or by consultants, which would cost considerably more.

47. As briefly outline above the SSRO terms of reference would allow it to:

- a) *Manage the regulations* – set the rules, and where it deems necessary, following consultation with all affected parties, recommend changes to the Secretary of State without the need to seek a full consensus. If the statutory framework created is owned and managed by MOD it will clearly be seen as biased by industry who, in the extreme, might choose to exit the market for single source work.
- b) *Monitor the use of and compliance with the regulations* - to be best able to recommend improvements to the regulations, the owning body must understand how they are complied with and applied, so it should also perform a monitoring role, covering the use of audit rights and pricing principles, and provision of reports. The MOD believes that independent compliance monitoring coupled with a “name-and-shame” approach will significantly reduce the risk of non-compliance.
- c) *Perform an adjudication role* - the lack of commercial leverage in single source contracting means disagreements over interpretation of rules can lead to long delays and additional cost for both parties. Fulfilling the roles above will quickly make the SSRO an independent expert in the rules such that it is well placed to have an adjudication (or more accurately an ‘expert determination’) role and resolve disagreements more quickly.
- d) *Perform and share data analysis* - data from the new reports will allow benchmarks and parametrics to be created for use in negotiations, “should costing” and comparative supplier analysis.

## Analysis of options

### ***Rationale for level of analysis used in impact assessment***

- 48. Given the far reaching and complex nature of the proposed changes, and that there will be some industry resistance to them, it was deemed necessary to develop a robust financial business case for changes based upon thorough analysis of the incremental costs and benefits to all affected parties.
- 49. The costs and benefits presented below have been summarised from a detailed financial model built to support the development of the Outline Business Case (OBC) for the SSPRs / SSRO. The OBC was prepared as part of gaining collective policy approval and so was shared with and approved by the Treasury and Cabinet Office. Prior to sharing it outside of the MOD, it was independently reviewed and endorsed (as “compelling”) by MOD’s Head of Appraisal and Evaluation in DASA<sup>7</sup>.
- 50. The analysis included in the financial model also enabled sensitivity testing to demonstrate that the business case was robust to significant over-estimation of benefits, or a possible under-estimation of costs.
- 51. Three options were considered in the development of the OBC:
  - a) **Option 1 - "Do Nothing"**
  - b) **Option 2 - "Non Legislated Negotiated Improvements"**
  - c) **Option 3 - "Legislation for SSRO and the SSPRs"**

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<sup>7</sup> Defence Analytical Services and Advice

## 1.1 Analysis of Option 1 – “Do Nothing”

	Option 1 – Do Nothing
<b>Description</b>	The Review Board continue to set the annual Baseline Profit Rate (BPR), set the allowable cost categories and rule on “Equality of Information” disputes.
<b>Advantages</b>	None identified
<b>Disadvantages</b>	Cost reporting would continue to be very ad-hoc, and in some cases non-existent. Due to the multiplicity of formats in use there will be little or no consolidation and central analysis of data for the purposes of contract monitoring, benchmarking and development of parametrics. MOD transparency over supplier records once on contract would remain poor, and “loopholes” such as the one allowing double charging of profit where contracts are sublet within the same owning group would continue.
<b>Monetary / Non Monetary Costs &amp; Benefits</b>	Not applicable – none assessed as this is the baseline option against which the other two were assessed.

## 1.2 Analysis of Option 2 - "Non Legislated Negotiated Improvements"

	Option 2 - "Non Legislated Negotiated Improvements"
<b>Description</b>	Without legislation the only option would be to attempt to gain industry consensus for as many of the new single source procurement regulations as possible and have them negotiated into contracts. Creating the SSRO as an ENDPB requires legislation so this is not possible under Option 2. In time, it might have proved possible to negotiate (with industry) extensions to the scope of the terms of reference of the current Review Board (an ANDPB), to include, for example, a wider role in data analysis or dispute resolution. However, this would only really have been of value if there was sufficient change in and uptake of the regulations.
<b>Advantages</b>	Relative to doing nothing (option 1), undertaking option 2 would probably help MOD to secure some of the required changes and also to make a small proportion of the savings on future contracts expected under option 3
<b>Disadvantages</b>	Since 1968 when the current Yellow Book was introduced, single source procurement arrangements between MOD and its suppliers have, due to the need for consensus, been very slow to change, and there is no reason to believe that this rate of change would quicken now without legislation. A contractually negotiated approach would therefore most likely require MOD to negotiate terms on a case by case basis with suppliers. This is likely to limit the application of, and adherence to, the new framework. In time, with sufficient senior pressure and focus, and possibly in return for other concessions, it might have proved possible to negotiate that some of the SSPRs be adopted as standard contractual terms and conditions, but there would remain the risk that these would normally get modified, watered down or omitted altogether on a case-by-case basis. MOD commercial officers would invariably have little real leverage over suppliers where they were reluctant to comply with the proposed changes, so uptake would most likely be slow, and adoption would only ever reach a small proportion of the total contract base.

	<b>Option 2 - "Non Legislated Negotiated Improvements"</b>
	As an ANDPB the Review Board would not be able to employ its own staff. In order to be seen as independent and impartial it also could not take MOD civil servants on secondment, leaving potentially expensive external consultants as the only viable resources option.
<b>Costs associated with regulatory body</b>	<ul style="list-style-type: none"> <li>• The initial setup costs associated with making the necessary changes were estimated to be around £2.5m.</li> <li>• The ongoing annual cost of procuring external consultancy support comparable to the resources assumed in option 3 was estimated to be around £5.2m.</li> <li>• Once other miscellaneous operating costs are included, the annual expenditure would be around £6.3m.</li> <li>• Without legislation, and sceptical that it would be of any value to them, it seems highly unlikely that industry would agree to contribute any of this, so MOD would pick up the whole bill.</li> </ul>
<b>Costs to MOD &amp; Industry arising from regulations</b>	<ul style="list-style-type: none"> <li>• As explained more fully below under option 3, the costs are primarily associated with report production. These are initially incurred by industry but all are passed back to MOD. For option 3, which assumes full compliance with the law, initial setup costs have been estimated to be around £5.5m and ongoing annual costs £6.4m. Where compliance is voluntary it seems likely that both costs would be around half of these amounts, i.e. £2.8m set-up and £3.2m per annum in ongoing costs.</li> <li>• As explained below under option 3, a small amount of additional MOD resource will be required, but this is not likely to amount to any more than £0.9m of expenditure per annum.</li> </ul>
<b>Benefits</b>	<ul style="list-style-type: none"> <li>• Benefits profiles developed for option 3 were built from a series of assumptions and calculations around the scope to negotiate slightly lower future contract prices. The assumptions were based on the expected impact of the proposed rules changes, and the anticipated value of the additional information provided and the analysis derived from it. Option 2 profiles have been factored down from Option 3 values.</li> <li>• Estimates showed a fairly flat long run level of saving versus Option 1 "Do Nothing", but it takes time to get to this level due to the volume of legacy contracts (not priced under the SSPRs) which continue to spend significant money long into the future. Also, although new data and reports will start to be accumulated in the early years, some of the benefits calculations require large volumes of data to be collected and analysed before its full value can be leveraged on future contracts.</li> <li>• In option 2, benefits are eventually expected to reach around £64m per annum. This reflects low levels of uptake and compliance, and that some of the changes included in option 3 could not be made to happen at all without legislation.</li> </ul>
<b>Non monetary considerations</b>	<p>Staffing an ANDPB with consultants rather than employing permanent staff in an ENDPB could lead to:</p> <ul style="list-style-type: none"> <li>• higher staff turnover and an associated slower growth in the accumulation of SSPR knowledge and expertise;</li> <li>• Greater difficulty in managing and mitigating the confidentiality issues arising from the volume and the highly sensitive nature of supplier data held centrally.</li> </ul>



### 1.3 Analysis of Option 3 - "Legislation for SSRO and the SSPRs"

	Option 3 - "Legislation for SSRO and the SSPRs"
<b>Description</b>	<p>The legislation has two main parts:</p> <ul style="list-style-type: none"> <li>• The Single Source Pricing Regulations (SSPRs) define new standard reporting and transparency requirements, as well as defining more precisely how contract prices must be set and then adjusted in response to emerging actual costs.</li> <li>• The SSRO will be created as an ENDPB to own, manage monitor and update the new regulations. It would also perform analysis on the data submitted in the new mandatory contract and supplier reports, and provide expert determinations on matters referred to it by one or other of the parties to a dispute over a single source contract or related matter.</li> </ul>
<b>Advantages</b>	<p>There are three main advantages to legislating the changes:</p> <ul style="list-style-type: none"> <li>• The statutory approach ensures wide, consistent and fair application across defence single source suppliers. Very high levels of compliance would be achieved because the new rules become the law, so there would be no need to negotiate and make concessions</li> <li>• The changes can be supported by a much more effective compliance regime underpinned by civil penalties. It is difficult to attach any financial remedy to non-provision of information using contractual terms.</li> <li>• Wider application down the supply chain as single source contracts frequently involve subcontracts which are also single source and which MOD pay for in the prime contract price. The same risk to taxpayer VFM exists in these subcontracts, yet the prime contractor currently lacks the commercial leverage to flow down the obligations; if the sub-contractor refuses there is little the prime can do. Statutory underpinning will allow the new pricing framework to be applied more effectively down the single source supply chain ensuring wide adherence to the new regime.</li> </ul>
<b>Disadvantages</b>	<ul style="list-style-type: none"> <li>• Nothing material identified. (the process of preparing for and successfully securing legislation is time consuming and costly, but when set against the degree and speed of change that could be negotiated through contracts, this is not a significant concern.)</li> </ul>
<b>Costs associated with regulatory body</b>	<ul style="list-style-type: none"> <li>• The initial and setup costs associated with designing, creating and staffing the ENDPB SSRO, as a successor body to the Review Board, have been estimated to be around £1.85m.</li> <li>• The ongoing annual staff cost for the organisation chart currently envisaged is around £3.5m.</li> <li>• Once other miscellaneous operating costs are included, the annual expenditure would be around £5.8m.</li> <li>• Under the legislated option, industry would be required to pay approximately half of this amount, which would be recovered via a levy applied to the contract profit rate. Hence in steady state the basic annual net operating cost to MOD would be around £2.5m.</li> </ul>
<b>Costs to MOD &amp; Industry arising from regulations</b>	<ul style="list-style-type: none"> <li>• MOD has accepted that industry will incur new costs in producing all of the standard reports required under the SSPRs and has agreed that, subject to audit of their expense claims, suppliers can recover these costs, which fall into two main categories, from MOD: <ul style="list-style-type: none"> <li>○ Initial set-up costs associated with making changes to systems, setting up new tools and processes, and providing training to</li> </ul> </li> </ul>

	Option 3 - "Legislation for SSRO and the SSPRs"
	<p>affected users, has been estimated to cost approximately £7.1m over the first two years of the new regime; and</p> <ul style="list-style-type: none"> <li>○ The ongoing costs of completing reports, getting them approved, and dealing with questions arising from them, has been estimated to cost around £6.4m p.a. based upon the anticipated volume of contracts.</li> <li>• Although it is expected that most of the proposed changes will quickly become part of "business as usual", realistically a small amount of additional MOD resource will be required in order to accommodate the incremental workload around administering new processes, managing the compliance regime, reviewing the framework, performing data analysis and managing the SSRO as an MOD sponsored ENDPB. This is expected to cost no more than £0.9m.</li> </ul>
<b>Benefits</b>	<ul style="list-style-type: none"> <li>• The benefit profiles for options 2 and 3 were both built from a series of assumptions and calculations around the scope to negotiate slightly lower future contract prices. The assumptions were based on the expected impact on the proposed rules changes, and the anticipated value of the information provided and analysis derived from it.</li> <li>• Both benefits profile show a long run flat level of saving versus option 1; however, it takes time to get to this level due to the volume of legacy contracts (not priced under the SSPRs) which continue to spend significant money long into the future. Also, although new data and reports will start to be accumulated in the early years, some of the benefits calculations require large volumes of data to be collected and analysed before its full value can be leveraged on future contracts.</li> <li>• Option 3 benefits are eventually expected to reach around £213m p.a.</li> </ul>
<b>Non monetary considerations</b>	As a permanently staffed independent and impartial body, the SSRO could quickly accumulate knowledge and experience in all matters relating to single source pricing, and establish for itself a reputation as a fair minded expert in this field.

## Assumptions and Risks

### Assumptions

52. The advantages and disadvantages in the analysis above are given from the point of view of the government. The only net cost to industry is its 50% share of the SSRO cost in Option 3, which it will experience through a very small reduction in the profit rate earned on contracts.
53. All of the financial costs and benefits (and supporting assumptions) referred to above are aligned with the Full Business Case which was developed and approved by the Cabinet Office and HM Treasury in July 2014.

### Risks

54. Risks and mitigations around the confidentiality of sensitive information provided by suppliers is dealt with in the next section. Other risks to the successful implementation that have been identified include:
  - a) **SSRO Recruitment** – *probability Medium, impact High*. There is a risk that the specialist technical resources required to staff the SSRO will not be secured and trained within the challenging implementation timeframe resulting in delays, staggered launch, and/or a skills gap.

- b) **SSRO Duplication** – *probability Low, impact Medium*. The creation of the SSRO could be perceived to cause duplication with CAAS, NAO or Parliamentary Oversight.
- c) **SSRO Scope** – *probability Low, impact Medium*. There is a real or perceived risk that the SSRO will grow in scope to undertake procedures outside of its agreed remit; and
- d) **Loss of Confidential Supplier Information** – *probability Low, impact High*. Unauthorised release of confidential supplier information would cause substantial damage to the credibility of the new framework and hence affect suppliers' willingness to co-operate.

55. Mitigation of Risks.

- a) **SSRO Recruitment** Early development of a People Strategy including structured roles and responsibilities, targeted recruitment campaign, competitive salary benchmarking and leveraging the advice of external experts will all help mitigate risks in this area;
- b) **SSRO Duplication** Early engagement and close working with CAAS will help to resolve any potential areas of overlap. We will make clear wherever necessary that no unauthorised part of MOD should undertake their own supplier portfolio analysis or attempts to maintain a library of industry cost parametric or benchmarks. The MOD will assure all stakeholders that the SSRO has no "MOD assurance role" (to remain in accordance with what Lord Currie recommended) which should reduce significantly any perception of duplication, and the associated complications, with OGDs and bodies;
- c) **SSRO Scope** The Terms of Reference for the SSRO will be documented tightly and ring-fenced in statute as well as being set out in a framework agreed with the MOD;
- d) **Confidential Supplier Information** A new criminal offence on unauthorised disclosure of specific information obtained under the new framework will be created; and
- e) **Quality of regulations** - The SSRO will keep the operation of the new framework under very close scrutiny and will have the right, initially after 3 years and then after every 5, to conduct an extensive review (consulting all stakeholders) and recommend changes to the Secretary of State;

## Wider Impact

### ***Markets, business and competition***

56. These options do not regulate competition and markets in any way. The proposed new regulations only come into effect once a decision has been made to procure and contract on a single source basis rather than to attempt to compete the requirement.

### ***Equality Impact Assessment***

57. Recognising the importance of demonstrating that the changes described above do not have any disproportionately positive or negative effects on any protected groups of individuals, we have conducted an Equality Impact Assessment in line with Cabinet Office guidance.
58. The assessment covered all nine protected groups (age, race, gender, disability, religion or belief, sexual orientation, gender reassignment, pregnancy and maternity, marriage and civil partnership) and concluded that there will be no equality or discriminatory impacts for them.
59. In reaching this conclusion, the assessment took into account:
- a) All SSRO 'People Policies and Practices' (recruitment, employment terms and conditions and the complaints procedures) will be in line with the Code of Practice issued by the Commissioner for Public Appointments;

- b) The SSRO will comply with the statutory obligations (including the Equality Act 2010) on race, disability and gender equality and promote equal opportunity for other equality groups e.g. sexual orientation, age, religion;
- c) The Commissioner for Public Appointments will oversee and audit the appointment of the SSRO Chair and ensure that in discharging this responsibility Ministers and their officials observe three key guiding principles: merit, fairness and openness; and
- d) Adherence to these same three principles across all other SSRO recruitment and promotion will ensure that there are no discriminatory barriers to involvement/inclusion in its activities.

### ***Social and Environmental Issues***

60. There options do not have any social or environmental implications.

### **Implementation Plans**

61. A number of change work streams will support the successful rollout and implementation of the Single Source Pricing Regulations (SSPRs) and these are outlined below:

#### ***Transition***

- 62. We have recently reviewed the expected profile of future contracts (across all MOD operating centres) and have already identified several that are due to be signed between now and the expected 'Commencement Date' for the legislation. We intend to write to the relevant suppliers to propose voluntary adoption of the SSPRs on these contracts.
- 63. Initially, we will not attempt to negotiate all aspects of the SSPRs into these early contracts, preferring a more targeted approach, but the scope of this pilot work is intended to increase to full coverage as the Commencement Date approaches.
- 64. Where aspects of the SSPRs can be included during the transition phase, we will create new supplier and contract 'regulatory codes' to shadow the legislation and be included as contract clauses where the agreement of the relevant suppliers can be secured.
- 65. These contracts will also act as pilots for MOD and supplier SSPR training as outlined below.

#### ***Training***

- 66. A detailed training plan has been developed and to map out all affected stakeholders will be introduced to the new regime. We will commission an external training provider to ensure that when legislation is introduced, all parties are properly informed. Specific groups requiring training include:
  - a) **Commercial teams:** this will form the bulk of the training requirement;
  - b) **CAAS:** expected to be largely self-sufficient in terms of providing wider briefing on the new reporting requirements, but this will need to be centrally co-ordinated;
  - c) **Industry.** our suppliers will need to be thoroughly trained on the new regime, its new requirements and procedures. It is intended that each will nominate an 'SSPR Champion' to receive in-depth training and then act as a focal point for issues and queries arising during further wider training and implementation;
  - d) **SSRO and other MOD stakeholders** (e.g. DASA, project teams. etc.) All parties who have an interest in single source procurement throughout the MOD will need to be made aware and receive appropriately tailored training where necessary.

## ***Communications***

67. Closely linked to the activities outlined above is the need for a comprehensive communications plan. This will promote awareness of the SSPRs prior to their introduction and will need to be carefully timed to ensure we are synchronised with legislation and other significant changes within the department (such as the Materiel Strategy of other Defence Reform work). We will communicate at various different levels across the MOD, other government stakeholders, industry and other interested parties. Example channels include:
- a) MOD in-house publications (such as Commercial Break, DESIDER, Defence People);
  - b) External defence publications (such as Janes and other related publications);
  - c) Tri-folds and leaflets;
  - d) Intranet announcements;
  - e) Atrium displays;
  - f) Road shows to industry and business units (which are already underway); and
  - g) Other marketing literature. e.g. DRA 2014, white papers, etc.

## ***Building the Single Source Regulations Office (SSRO)***

68. This is already well underway and a detailed programme of work has been developed for the next 12 to 18 months which includes the following:
- a) Recruiting the Chair, the Board and, subsequently, around 40 permanent staff;
  - b) Location – fitting out the SSRO offices at Finlaison House in London; and
  - c) Organisation and process design – this will need careful consideration and will need to be closely aligned with the training activity identified above.

## ***MOD Single Source Advisory Team (SSAT)***

69. To ensure the MOD meets its requirements under the DRA and to enable the MOD be best placed to realise the benefits anticipated from the new SSPF, the SSAT will be established to deliver the following key functions:
- a) Framework development, advice and referrals – including reviewing and maintaining the single source procurement framework (SSPF), developing statutory guidance for the Secretary of State (SofS) and providing advice to SofS, overseeing MOD's contribution to the rate setting process, providing SSPF advice and expertise and, lastly, managing referrals to the SSRO for opinions and determinations;
  - b) Single source procurement framework data management and compliance – providing a single point of contact for the receipt of contract and supplier reports, managing the compliance regime and storing, maintaining and distributing all SSPF information appropriately;
  - c) Analysis – conducting analysis of SSPR information to provide insight and advice which supports better contract negotiation and management and contributes to delivering the benefits anticipated by the new framework;
  - d) Engagement and communication – to manage the relationship with the SSRO, to engage with industry and MOD colleagues regarding the SSPF and to raise awareness of the framework such that its profile and use is extended as appropriate; and
  - e) Managing the SSRO as an MOD ENDPB – to provide governance and oversight to the SSRO ensuring that it complies with relevant MOD policy and approaches, to ensure that it fulfils its obligations under the agreed framework document (including financial management) and delivers all organisational reporting and management requirements stipulated by HMT and the Cabinet Office.

### ***New Operating Processes***

70. Implementation of the SSPRs will require the design and rollout of a new set of operating processes in addition to modifications to existing tools, processes and systems. These processes will form part of the training delivery and provide users with the tools and guidance they require to understand and adopt the new framework successfully.

## **Post Implementation Review**

### ***Periodic Review of Regulations***

71. The SSRO must keep the SSPRs under constant review and may recommend changes that it considers necessary to the Secretary of State.
72. Within three years of the new regulations coming into force, and then every five years thereafter, the Secretary of State must carry out a review of the SSPRs taking into account the recommendations made by the SSRO. Any required changes to the regulations would be put before committee for approval before taking effect.

### ***SSRO Annual Reporting***

73. As an Executive NDPB with its own founding legislation, the SSRO will have an obligation to inform Parliament of its activities through an annual report and audited accounts that are either formally laid before Parliament or placed in the Library of the House of Commons.
74. This documentation must be prepared in accordance with directions issued by the Secretary of State with the approval of the Treasury.