

**Report by the
Comptroller and Auditor General**

Ministry of Defence

The Risk of Fraud in Property Management

Ordered by the
House of Commons
to be printed 15 May 2000

Executive summary

Introduction

1 The Ministry of Defence (the Department) have spent an average of some £900 million annually over the last five years on property management on the defence estate in the United Kingdom. The estate is diverse and includes a built estate with more than 45,000 buildings on over 2,500 sites. Expenditure is managed by over 200 Property Managers, supported by Establishment Works Consultants who provide technical support and advice, and by Works Services Managers who engage and monitor sub-contractors to carry out necessary works. The risk of fraud and corruption (fraud) in property management is intrinsically high. The Department have made broad estimates suggesting that property management expenditure of up to £180 million a year – 20 per cent of the total – may be at risk of fraud, although there is no evidence of actual losses on this scale.

2 This Report examines the Department's management of the risk of fraud in property management on their United Kingdom estate, excluding the parts run by agencies with Trading Fund status. The report is in three parts addressing: the Department's policy, strategy and organisation on fraud; an assessment of controls and risk; and fraud investigation and lessons learned.

3 The Department are considering possible changes to their arrangements for property management, along the lines of 'prime contracting'. This would involve passing to a single contractor financial responsibility for delivering works services including major construction work in one geographical region. And, as part of the introduction of resource accounting and budgeting, the Department are considering removing the current internal expenditure limit of £240,000 (plus VAT and fees) on each individual property management job, above which work is currently managed under different project arrangements. The Department are developing systems and checks to ensure that the risk of fraud is controlled in this new environment. Our report has been designed with these potential changes in mind. Although some may need to be adapted to the new structures, all of our recommendations will be as relevant to the new regime as they are to the current one.

Policy, strategy and organisation

4 The Department expect high ethical standards in their staff and their contractors. They have a clear policy that fraud will not be tolerated, that all suspected cases will be investigated, and that prosecutions will result in all cases where evidence of fraud is sufficiently strong to merit court action. We found that this policy was understood by Departmental staff, although it had not been communicated formally to the Department's contractors: the Department are now preparing to circulate appropriate guidance to contractors. The Department do not, however, have a coherent strategy for implementing their policy, and have not carried out an assessment of the risks of fraud across the Department on which such a strategy could be based. Complicated organisation responsibilities for fraud reporting and investigation have made it difficult to discern the roles of the various fraud units, and to network experience in this specialised area. This problem is now being addressed by the Department.

5 Despite the absence of a coherent Department-wide strategy, the Department have in place a number of practices – such as separation of duties between those authorising and paying for works, open competition for staff recruitment and a rotation of serving staff, and well-defined accounting and audit arrangements – designed to minimise the likelihood of fraud. These practices have not, however, been reviewed in the light of increased contractorisation and improvements in information technology and the streamlining of organisations – which lead to both threats to, and opportunities for, fraud risk management.

6 For the defence estate, the Department have produced a business strategy which amongst other things sets out their plans to move towards prime contracting with the construction industry and recognises that, in so doing, they will need to place a high priority on deterring and preventing fraud. The Department also recognise, however, that property management expenditure is an area already at high risk from fraud. Small teams in the Department, including staff in the Defence Estates agency and Defence Fraud Analysis Unit, have attempted to highlight the importance of fraud risks in this area and to counter fraud. The Department acknowledge that in the past a fragmented approach has not achieved a high degree of success. As a response to this lack of success, the Defence Estates agency, Defence Fraud Analysis Unit and Ministry of Defence Police have improved their collaborative working. This culminated in the Defence Estates agency setting up a high level Fraud Prevention Steering Group – chaired by the Chief Executive of the Defence Estates agency with representatives from budget holders, the Defence Fraud Analysis Unit, Ministry of Defence Police and the Defence Estates agency. The primary functions of the Group are:

- to co-ordinate the efforts of the different units in the Department who are combating fraud in the property management area;
- to develop and implement a strategy for fraud deterrence and detection; and
- to promote greater awareness of potentially fraudulent activities.

7 On property management expenditure, where contractors carry out, manage and monitor the majority of the work, we found that the Defence Estates agency's contractual arrangements do not make clear the responsibilities of contractors to protect the Department from fraud. And there was no effective incentive or encouragement for commercial Works Services Managers or Establishment Works Consultants to prevent, detect or report fraudulent practices. In line with wider Departmental and Government initiatives on "smart" procurement and improving interfaces with the construction industry, the Department are looking to develop a partnership with a small number of "prime contractors" who will procure and manage maintenance work and new works for them on a regional basis. The Department recognise the need to consider fraud prevention and detection when implementing these changes, including encouraging contractors to work with them to combat fraud, but have yet to develop fully their proposals.

8 In order to take full advantage of an internal environment which is generally hostile to fraud, and to build on their current initiatives to further combat fraud, we recommend that the Department:

*Summary
recommendations*

- make sure their policy on fraud is well understood by property management contractors (paragraphs 2.2 to 2.6);
- undertake a broad-based fraud risk assessment to inform a Department-wide fraud strategy (paragraphs 2.7 to 2.12); and then
- locate more detailed risk assessments, for areas such as property management, within the broader framework (paragraphs 2.7 to 2.12 and 3.1 to 3.7);
- set targets and monitor outcomes against key facets of the strategies (paragraphs 2.7 to 2.12);

- further simplify and clarify fraud reporting and networking responsibilities (paragraphs 2.13 to 2.22);
- further simplify investigation arrangements for fraud, making best use of those branches with appropriate skills and resources to perform important initial investigations (paragraphs 2.23 to 2.25); and
- examine ways of incentivising contractors, particularly in property management, to prevent and detect fraud (paragraphs 2.26 to 2.34).

Risk assessment and controls

9 In the absence of an up-to-date fraud risk assessment – a key element of any good practice fraud management model – we created a model of the property management transaction control regime to help define those risks, and how to mitigate them. We validated and refined the model in workshops with a group of the Department’s staff and tested some of the assumptions generated against actual processes and transactions at three sites. The model permits the quantification of the value of property management transactions exposed to a variety of fraud risks. The results show that at an average establishment some £580,000 (15 per cent) annually of property management expenditure could be lost to fraud, given the current level of control. This points to a figure of around £135 million expenditure on property management being potentially at risk from fraud, a figure of a similar order of magnitude to the Department’s own estimate. We found that the control regime for property management is not designed to counter a specific set of fraud risks, and local variations in the operation of controls, as to level and frequency, are not based on any objective analysis. Lower value transactions (below £1,000) are particularly vulnerable, both in the design of the controls and their operation. And more generally, the Department have not provided guidance in the way important controls – such as inspections of work required or carried out – should be operated. The Department intend to build on our risk assessment and risk model to improve the design of property management control over fraud risks.

10 The combination of our modelling work and our site visits also show that property management staff have a perception that expenditure is better controlled than it is in fact. Sample-based checks are applied less frequently than required. We observed other standard checks which are not being applied – such as checking work invoiced under term contracts to the standard rates. And we found check results which are not followed up – as, for example, where there are significant differences between Establishment Works Consultants’ estimates for jobs and the

values actually tendered. These findings suggest that not all property management staff fully understand the purpose of various controls, or how controls must be operated to provide the necessary assurance.

11 We recommend that the Department should:

*Summary
recommendations*

- build on our risk assessment and risk model to improve the design of property management control over fraud risks (paragraphs 3.1 to 3.7);
- ensure that controls are operated to the depth and frequency necessary to provide the assurance the Department need, in particular:
 - that all requests for work have an adequate statement of requirement and are adequately specified by the Works Services Manager. And that requests are authorised and cost estimates are reliable, to control what work is done and how much is paid for it (paragraphs 3.14 to 3.26);
 - that Works Services Managers, property management staff, Establishment Works Consultants or building occupants, as appropriate, inspect work and that the nature and outcome of inspections is properly recorded (paragraphs 3.11 to 3.13, 3.23 and 3.41 to 3.50);
 - that Property Managers more actively review approved tender lists, the distribution of work between sub-contractors, and the operation of tender board controls (paragraphs 3.27 to 3.40);
 - that basic financial checks on over-billing are conducted to prevent simple over-charging or duplicate payments (paragraphs 3.51 to 3.60); and
 - that sample checks conducted by Establishment Works Consultants are completed and written up on time, and that Property Managers act on the results (paragraphs 3.61 to 3.63).