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Fighting Construction fraud in the UK

In this report, Grant Thornton UK's forensic and investigation experts analyse Construction fraud in the UK. They give insights into the scale and types of fraud that organisations are likely to encounter in this country and highlight the main investigative issues involved. This is a supplement to the global insights provided in Grant Thornton's 'Fighting fraud in Construction' report.



“Estimates have placed the cost of fraud at up to 10% of revenue in the Construction industry or £40,000 per company. Targeted action on fraud can drive down these costs and drive up profitability.”

Sterl Greenhalgh
Grant Thornton UK

Scale

Fraud and corruption is commonplace and multi-faceted in the Construction industry in the UK. A recent Chartered Institute of Building (CIOB) study found that 49% of respondents believe corruption is common and that 50% believe companies are not doing enough to prevent corruption. Much fraud goes undetected and so the real cost to the sector is impossible to estimate accurately. The Chartered Institute of Loss Adjusters produced a report in

2011 stating that fraud in construction in the UK was rife, estimating it at 10% of the £6.5 billion of revenues, or £40,000 per company.¹ The National Fraud Office's Annual Fraud Indicator (AFI) reported losses to private construction companies resulting from fraud in 2012 at £3 billion, with £1 billion taken on by larger businesses, and £2 billion absorbed by SMEs.²

1. Chartered Institute of Loss Adjusters. Construction Fraud 2011. Access on 22 August 2013 at [http://www.cila.co.uk/files/Construction/Construction%20Fraud%20by%20Neil%20Miller%20\(EDITED\).pdf](http://www.cila.co.uk/files/Construction/Construction%20Fraud%20by%20Neil%20Miller%20(EDITED).pdf)

2. National Fraud Authority. Annual Fraud Indicator 2012. Accessed on 22 August 2013 at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/118530/annual-fraud-indicator-2012.pdf

Types of fraud

The Office of Fair Trading and the Office of National Statistics in one of its largest ever Competition Act investigations found widespread evidence of bid rigging on procurement projects in the UK.

The investigation uncovered issues such as so-called ‘breakfast-clubs’ (a form of illegal cartel where contractors meet up to decide who will win the latest contract). This relates to behaviour in earlier years. But in a 2012 survey of procurement professionals for the AFI, 40% of respondents said that spend on construction is at greatest risk from procurement fraud and the recent CIOB study indicated that only 20% of respondents, even now, do not consider cover pricing to be corrupt.³

One example of fraud is manipulation of percentage completion schedules, releasing payments early. Another area where fraud can occur is post-tender award change orders, add-ons and budget overruns. A 2009 Chartered Institute of Building report on Crime in the Construction Industry found that a third of companies had experienced fraud. When asked who was most likely to commit fraud, the top responses were contract staff and trade staff.⁴

Another area of fraud and corruption risk is funding of overseas projects by International Financial Institutions (IFIs) where the preference now is to provide grant and/or loan payments direct to the project as opposed to the government itself.

“Bid rigging on tenders has been found to be widespread previously in the UK. That is hopefully behind us, but spend on construction is still seen as the area at greatest risk from procurement fraud.”

Colin Johnson
Grant Thornton UK

Prevalence of different types of fraud in the UK

Type	Prevalence
Billing fraud	Med
Bid/contract rigging – market collusion	High
Bribery/corruption	Low
Fictitious vendors – falsifying payment applications	Med
Change order manipulation	High
Theft or substitution of materials	Med
False representation	High
Money laundering	Low



3. National Fraud Authority. Annual Fraud Indicator 2012. Accessed on 22 August 2013 at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/118530/annual-fraud-indicator-2012.pdf

4. Chartered Institute of Building (2009). Crime in the Construction Industry. Accessed 20 July 2013 at <http://www.ciob.org.uk/sites/ciob.org.uk/files/Crime%20in%20the%20Construction%20Industry.pdf>

Trends

There is debate about whether fraud is greater in boom times or in a crisis. In boom times, fraud may be less likely to be detected. However, a crisis such as the recent economic downturn can lead to greater pressure on individuals who wish to maintain their lifestyle or corporate performance, so turn to fraud or corruption to achieve results.

Either way, as the downturn led to increased focus on costs and more scrutiny of suspicious transactions, more fraud has come to light. Perhaps this has led to Transparency International's Global Corruption Barometer 2013 showing 65% of respondents considering that levels of corruption have increased in the UK over the last two years.

The internet is sometimes being used to assist frauds. One example is the

easy use of fake emails to commit identity fraud and divert payments. Colombian domain names, which end in ".co" have sometimes been used to provide legitimacy to the instruction; so "creditcontrol@constructionclient.com" becomes "creditcontrol@constructionclient.co" and the subtle difference is not always noted.

But technology is also being used to identify and track frauds. A data dump of employee and contractor addresses and bank accounts can be analysed to highlight suspicious links. Reverse online auctions can also be used to drive down prices, provide audit trails and foil rigged bids.

The government has recently tightened up in this area. It is moving towards centralised procurement procedures and frequently uses

e-auctions. It is also learning its lessons. Some twenty or so different types of fraud were investigated in relation to the Millennium Dome construction project in the early 2000s, but there was only one known case related to the 2012 Olympics, due in part no doubt to the heightened fraud risk assessments undertaken.

"Information technology and the internet offer both threats and opportunities. There are many data analytics tools that can help to identify and thereby prevent fraud."

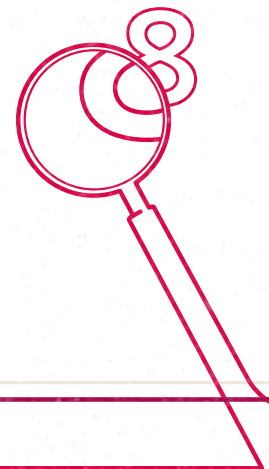
Sterl Greenhalgh
Grant Thornton UK

Investigation

Local police forces are responsible for investigating most cases of fraud, but they understandably prioritise investigation of other offences such as violence against the person. The Serious Fraud Office and City of London Police Economic Crime Department are specialised units who get involved in the more complex and larger cases. Professional advisers can conduct investigations themselves and then hand over a prepared case brief to police to consider asking the Crown Prosecution Service to launch a prosecution.

"There is often a reluctance to refer cases for prosecution because of reputational risk, and some companies decide to take the loss and just move on. This places an unacceptable cost on legitimate business and can enable fraudsters to commit further fraud."

Colin Johnson
Grant Thornton UK



Fighting fraud in action

A diversion of stage payments (usually final payments) were made to a falsified recipient company rather than the actual contractor, leading to a £680,000 fraud.

This occurred through an all too familiar fraud, whereby the victim company accepts a fraudulent letter (usually sent via email) as an instruction to change the contractor's bank account details resulting in payments being misdirected. The money was quickly transferred overseas and has not been recovered. The company still had to pay the contractor.

Call for action

- Further resources dedicated specifically to fraud, such as the National Crime Agency would help enable more cases to be investigated and prosecuted, and create a more effective deterrent.
- UK companies and the public sector should embrace technology to fight fraud and corruption. Systems are available and progress is being made – for example the government's use of e-auctions – but there is much more to be done.
- Companies must familiarise themselves with the impact of the Bribery Act 2010. This increases focus on issues around gifts, hospitality and corruption. So far there have been limited prosecutions using the Act, but the potential for high profile cases against major corporations is very much still there.

“Though some types of fraud are likely to be less prevalent, new types have appeared and the construction industry overall remains a high risk area for fraud and corruption. There is a need to maintain vigilance and review controls to combat these.”

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