CONSTRUCTION FRAUD

DETECTING

CONTROLLING

AUDITING
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- Construction Cost Recovery Auditing
- Project Controls Review & Analysis
- Project Cost Systems Development
- Seminars – Construction Auditing

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AGENDA

- Status of Fraud in the U.S.
- Who Commits Fraud
- Bidding Fraud Schemes
  - Symptoms
  - Controls
- Typical of Construction Contracts
  - Risks and Potential Fraud/Overcharges
- Change Orders
- Other Controls
- Audit
STATUS OF FRAUD IN U.S.

- 2011 – $816 Billion in U. S. construction activity
  - Private $529 – Public $287
- Current statistics suggest fraud accounts for 10% of construction costs
WHO COMMITS FRAUD

- Contractor Management
- Contractor Personnel/Subcontractors
- Owner Personnel:
  - Site Supervision
  - Procurement/Contract Administration
    - Kickbacks
    - Cash Payments
    - Gifts
- Organized Crime
- Minority Business Enterprises (MBE)
2010 FRAUD STATISTICS

Detection of Occupational Frauds

- **TIPS**: 50% of Cases
- **BY ACCIDENT**: 20% of Cases
- **INTERNAL AUDIT**: 10% of Cases
- **INTERNAL CONTROLS**: 10% of Cases
- **EXTERNAL AUDIT**: 0% of Cases

% of Cases
BI DDING FRAUD SCHEMES

- Complementary Bidding
- Bid Rotation
- Bid Suppression
- Market Allocation

Bidding Risks
BID RIGGING SYMPTOMS

- Same Contractor Consistent Winner
- Losing Contractor(s) Submit Unusually Higher Bid
- Suppliers Withdrawal
- Contractor(s) Bid But Never Win
- Losing Contractor Subcontracts To Winning Bidder
- Change Order(s) Issued Upon Commencement of Contract
- Socializing By Purchasing Personnel
CONTROLLING THE BIDDING PROCESS

- Detailed Contractor Qualification
- Team Approach to Qualifications Review/ Bid Opening
- Sealed Bids
  - Date Stamped
  - Locked in Secure Location
  - Adhere to Bid Cut Off Date
- Policies & Procedures
TYPICAL CONSTRUCTION CONTRACTS

- Lump Sum
- Unit Price
  - Purchase of Material Utilized on Project
  - Performance of Construction Contract
- Cost Reimbursable
- Time & Material
  - Cost-Based Contracts
- Guaranteed Maximum
LUMP-SUM CONTRACT RISKS

- Certificate of Insurance/ Bonds
- Sales Tax on Tax Exempt Improvements
- Specified Quantity/ Quality Materials not Used
- Quality of Work Installed does not Meet Specifications
- Lump-Sum Charged to T&M
UNIT-PRICE CONTRACT RISKS

- Quantities Billed Exceed Quantities Performed
- Measurement Methods do not Properly Reflect the Basis for Unit
- Improper Increases to Unit Prices on Billings
COST-BASED CONTRACT RISKS

- Base Labor Rates/ Prevailing Wages
  - Taxes, Insurance, and Fringe Benefits
  - Apprentice Billed as Journeyman
- Excess Overhead Rates Applied
- Non-Reimbursable Salaries/ Bonuses & Overhead
- Non-Reimbursable Premium Premium Overtime
COST-BASED CONTRACT RISKS, cont. . .

- Contractor Owned Equipment Rental
- Materials not Used or Diverted
  - Reuse of Materials
- Fraudulent Vendor Invoices
- Cash or Trade Discounts/ Deposits
- Weight Tickets & Quantities
COST-BASED CONTRACT RISKS, cont. . .

- Small Tools
- Consumable Supplies
- Office Equipment/Office Furniture/Computers
- Surplus (scrap) Materials
- Performance Bond Premiums
CHANGE ORDERS

- Change Orders for Work in Base Contract
- Change Order Price Proposals Improperly Inflated
- Change Order Fees/Mark-ups Incorrectly Billed
- Owner Provided Items not Credited
- Work Order Chaos
- Backcharge Administration
OTHER CONTROLS

CONSTRUCTION CONTRACT

- Clearly Defined Project Scope & Specifications
- Billings & Documentation Requirements
- Strong Audit Clause
- Termination for Cause
- Termination for Convenience
OTHER CONTROLS, cont. . .

- Clear Delegations of Authority
- Release of Liens
- Site Security
- Frequent Project Status Reporting
- Detailed Cost System
AUDIT

- When to Conduct A Compliance Audit
  - Beginning - During - End - ANYTIME
  - Audit by Exception
- Test Contractors Internal Controls
- Test Your Own Internal Controls
- Tie Contractors WIP to Payment Applications
THANK YOU QUESTIONS?
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