

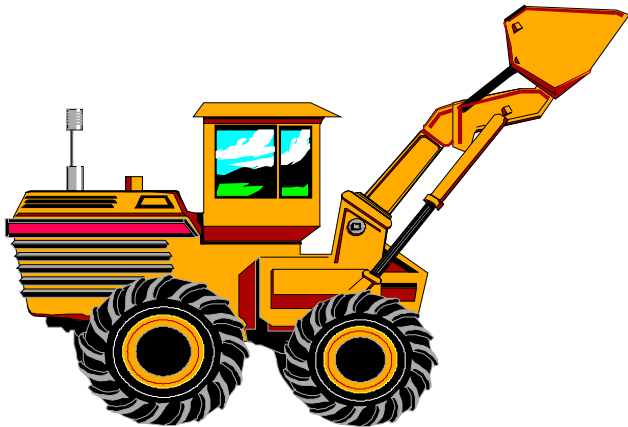
# **CONSTRUCTION FRAUD**

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**DETECTING**

**CONTROLLING**

**AUDITING**





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- **Construction Cost Recovery Auditing**
- **Project Controls Review & Analysis**
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# AGENDA

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- 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.

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



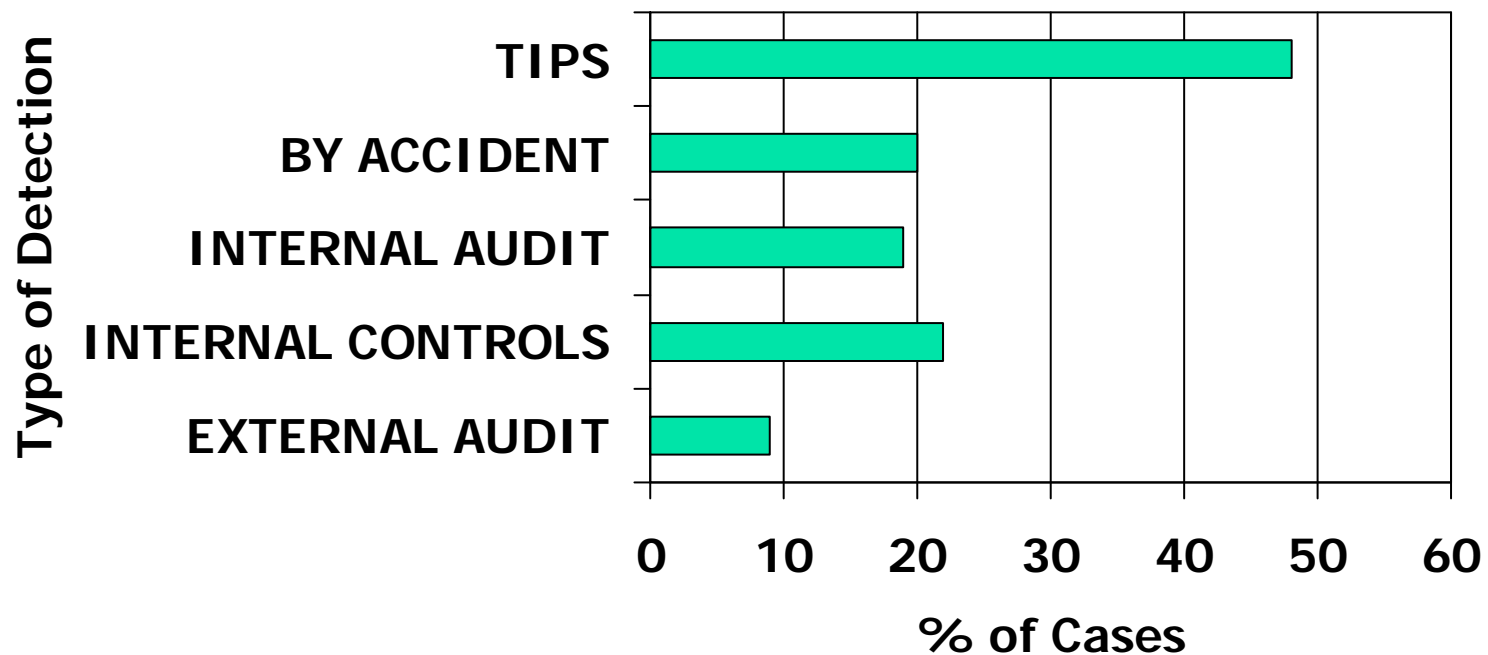
# WHO COMMITS FRAUD

- 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



# BIDDING FRAUD SCHEMES

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





# **BID RIGGING SYMPTOMS**

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- **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**

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- **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



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



# **LUMP-SUM CONTRACT RISKS**

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- **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**

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- **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**

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- **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 Overtime**



# **COST-BASED CONTRACT RISKS, cont. . .**

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- **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. . .**

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



# CHANGE ORDERS

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- **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

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- **CONSTRUCTION CONTRACT**
  - **Clearly Defined Project Scope & Specifications**
  - **Billings & Documentation Requirements**
  - **Strong Audit Clause**
  - **Termination for Cause**
  - **Termination for Convenience**



## **OTHER CONTROLS, cont. . .**

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



# AUDIT

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- **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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