

# Is Your Construction Project a Victim of Fraud?

---

Jeff Matthews, CPA, CFE  
Partner-in-Charge, Forensics and Litigation Services

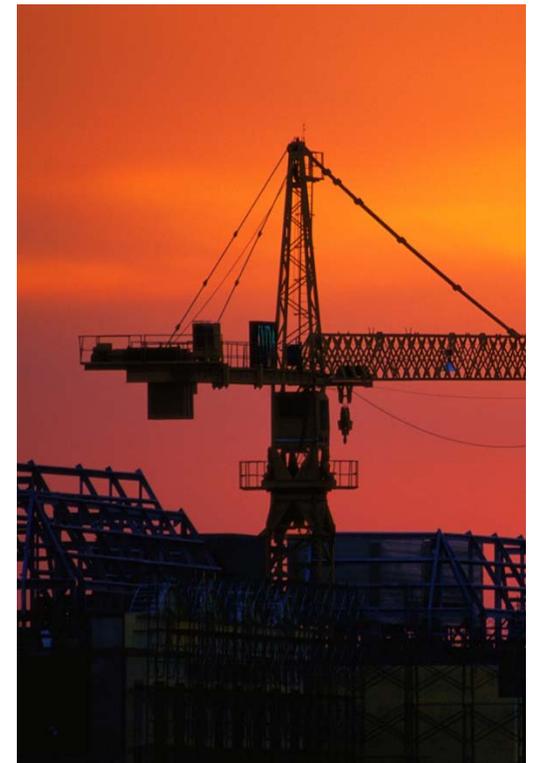


# Agenda

---

## Is Your Construction Project a Victim of Fraud?

1. Today's Culture and Environment
2. Case Study
3. Initiatives to Combat Construction Fraud
4. Considerations in Launching the Audit
5. Targeting the Appropriate Areas of Risk
6. Interpreting results



# Today's Culture and Environment

---



- ▶ According to the Office of Management and Budget (OMB), the federal government awarded the state governments federal grants totaling more than **\$710 billion** in 2017.
- ▶ In 2017, the Government Accountability Office announced it found **\$141 billion** in improper payments, of which **\$233 million** was estimated to be related to construction projects.
- ▶ Although the Federal Government generally provides funding, the States and local governments actually award contracts which makes the States and local authorities critically important, as they are the first line of defense.

# The Truth About Fraud Today

---



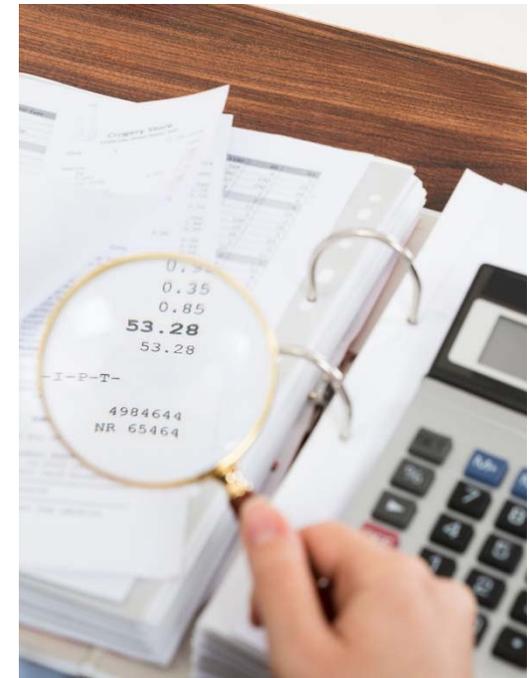
When it comes to fraud in the public sector, the following issues have become common:

- ▶ Persons convicted of fraud were generally trusted employees
- ▶ Perpetrated fraud in the U.S. is virtually equal between men and women (54% men – 46% women) **BUT** median loss by men is almost **225% more**
- ▶ Median duration – amount of time from when fraud commenced until it was detected was **18 months**
- ▶ Often cash given “under the table”

# Consequences of Construction Fraud

The consequences of the fraud can be staggering, with millions potentially siphoned from government agencies and its budget. Such frauds result in:

- ▶ Project delays
- ▶ Increased cost and project shortfalls
- ▶ Inferior developments and structures
- ▶ High turnover amongst vendors and employees
- ▶ Opportunity cost
- ▶ Lost in public trust



## CASE STUDY



City engaged contractor to complete three large P3 construction projects:

1. A park and recreation field - \$1.5m; completed
2. A parks and recreation center - \$9.7m; completed
3. A professional sports arena - \$60m; in progress

After a new mayor and city council were elected, the City determined prior leadership had not adequately monitored the projects, and requested we exercised the right to audit clauses.

The first two projects were fixed-fee arrangements, and the contractor refused to provide access to books and records without specific allegations.

## CASE STUDY



**The \$60 million arena** was set to open in November 2016. A provision in the contract stated that it would be terminated if not opened by November 2017. Our analysis began in January 2018.

Our initial observations:

- The original contract was for approximately \$60m and required a \$4m contribution from the city.
- Multiple change orders for “upgrades” increased project costs to \$83m and required an additional \$8m in from the city.
- The city received no additional rent or projected income, despite the significant increase in funds.

## CASE STUDY



---

### Findings and Results

By entering into a contract with the management company and not the subcontractor directly, the city essentially forfeited its right to audit the general contractor.

Potential overcharges totaling **\$3.2M** were identified due to inaccurate labor rates, duplicate billings for materials, and improper payments.

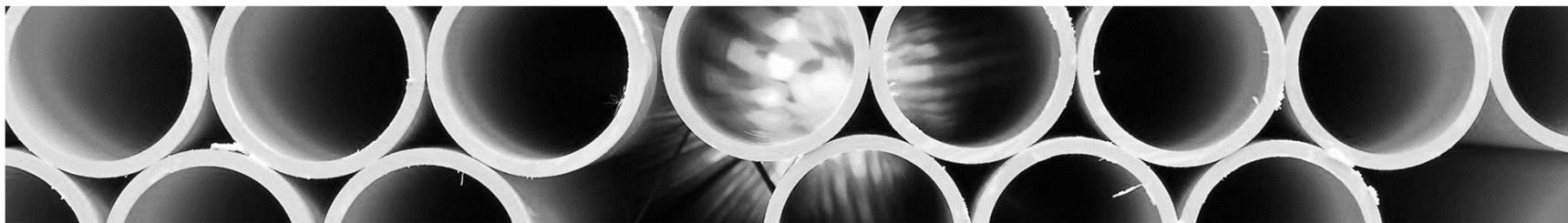
The delay in the Arena project had a significant impact on the local tax payers. The City has made three Bond payments to cover its Debt Service Requirements for a total amount of \$5,583,125, with no income to offset the expense.

# Initiatives to Combat Construction Fraud



## It starts with on-boarding

1. What is the vendor's history with providing goods and services?
2. Is there a history of litigation involved with the vendor, or of projects of this sort?
3. What items/elements within the statement of work will be outsourced or sub-contracted?
4. What performance metrics are in place to ensure contract compliance?
5. And the remedies for not?
6. What are your responsibilities?



## Let's talk about your end – what can you control?

### Assess Internal Controls

1. Bid process
2. Project scope and change orders
3. Jobsite management
4. Hotline or anonymous reporting mechanism
5. Right to audit



# Initiatives to Combat Construction Fraud



## 1. Bid Process – vetting!

- ▶ Understand conflicts of interest; affirm all bidders do too!
- ▶ Multiple business operating out of the same office
- ▶ Difficulty in finding background information on company or its operators
  - Lack of references
  - Online anonymity



# Initiatives to Combat Construction Fraud



## 1. Bid Process – vetting!

- ▶ Does the last bidder always win?
  - cheapest?
  - same?
- ▶ Do other bidders frequently appear as subcontractors on projects?
- ▶ What change orders are anticipated? Guaranteed?



# Initiatives to Combat Construction Fraud



## 2. Project scope and change orders

- ▶ Changes for scope of work with no defined necessity
- ▶ Excessive charges with no support
- ▶ Assignment of work to new subcontractors
- ▶ Material changes in specifications
- ▶ Lack of responsible party
  - Who ordered?
  - Caused?
  - Required?



# Initiatives to Combat Construction Fraud



## 3. Job Site Management

Do you have the capacity to engage in:

- ▶ Field visits
- ▶ Process and procedure reviews
- ▶ Vendor surveillance
- ▶ Interviews with vendor employees and subcontractors



# Initiatives to Combat Construction Fraud



## 4. Hotline and Reporting Mechanisms

FIG. 9 How is occupational fraud initially detected?

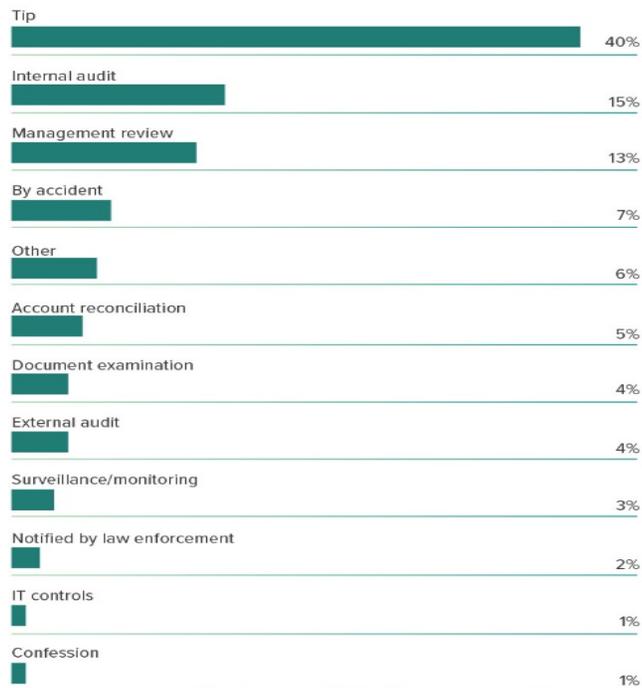
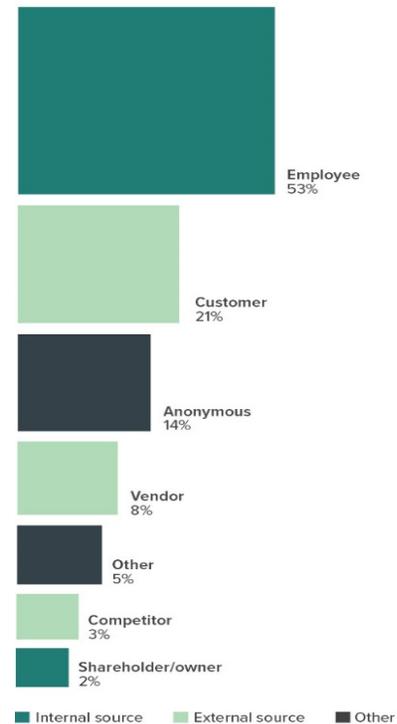


FIG. 10 Who reports occupational fraud?



# Initiatives to Combat Construction Fraud



## 4. Hotline and Reporting Mechanisms

- ▶ Awareness
  - Employees
  - Vendors (current and former)
  - Customers
  - Competitors
- ▶ Confidence
  - Resolutions
  - Surveys
- ▶ Training
  - Annually
  - Tracked certification



## 5. Right to Audit Clauses

- ▶ Rights to access and analyze books and accounts and confirm performance and accuracy of the licensees records. Provides:
  - Access by a third party or group of investors
  - Remedies, such as payment of the legal and audit expenses of the offended party.
  - Process to resolve disputes to avoid unnecessary litigation that may harm the future of the agreement between the parties.



## 5. Right to Audit Clauses (cont'd)

- ▶ The following issues should be considered for inclusion:
  - Is notice of an audit required? If so, how much time is appropriate?
  - Who bears the costs of the audit? Will there be a cost-shifting scheme based on findings?
  - What is the scope of the audit?
  - How will the data (and other) privacy concerns be addressed?
  - How frequently can audit occur?
  - Will employees be made available for interviews?
  - What accounting files will be made available electronically or in hard – copy master payee files, general ledger, internal audit materials, cash controls, travel expenses?

## 5. Right to Audit Clauses (cont'd)

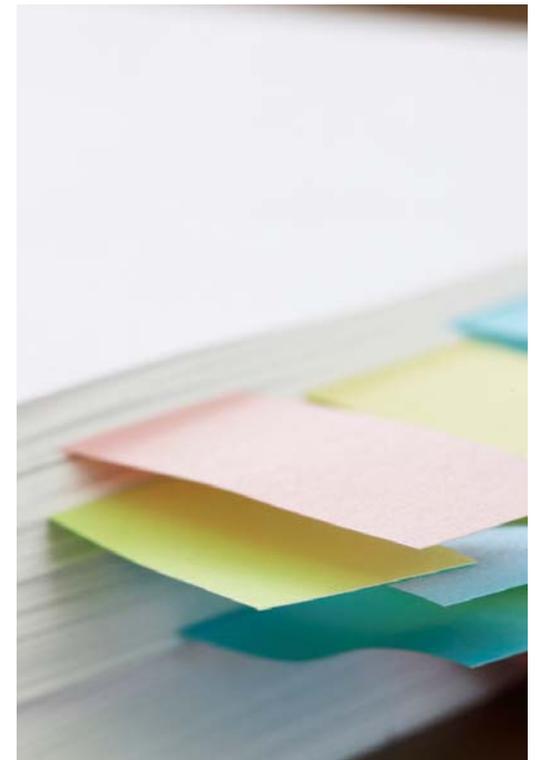
- Will electronically stored information be made available for review during audit?
- Can the auditor make site visits?
- Who chooses the auditors?
- Is there a time limit on the amount of time an audit can take?
- How long must the relevant records be retained?
- What can trigger an audit?
- How and when should materials provided pursuant to the audit be returned once the audit is complete?
- Will the audited company be notified of communications with DOJ and SEC by the auditor? If so, can the audited company review the materials that will be shared with the Government?

# Considerations in Launching the Audit



## Before launching a third-party audit, determine whether:

- ▶ you anticipate litigation
- ▶ you have sufficient and qualified resources to undertake the audit.
- ▶ there have been previous audits and/or unresolved issues
- ▶ you have requested, or they can provide sufficient documentation to compile a work plan
- ▶ Local/International concerns exist, such as:
  - Holidays
  - Employee rights
  - Legal rights
  - Language/Cultural
  - Health concerns



# Considerations in Launching the Audit



## Document requests should be extensive:

- ▶ Audited financial statements
- ▶ Significant issues, complaints, lawsuits
- ▶ Qualifications and experience of those significant to the vendor's operations and yours
- ▶ Their use of third parties, contractors or others
- ▶ Evidence of regulatory compliance
- ▶ With careful consideration to those areas of specific concern



# Targeting The Appropriate Areas of Risk



## Most common risks:

### ▶ Labor

- Lack of detail – omission of worker level and/or department
- Pre-printed time sheets that omits non-work time
- False invoices or inflated rates that do not tie to contracts or work orders
- Erroneous totals or line items, and roll forward errors
- Use of undocumented workers

### ▶ Employee Travel

- Hourly wages paid for travel time
- Mileage
- Excessive meals, entertainment, training or benefits
- Overhead/administrative duplication



# Targeting The Appropriate Areas of Risk

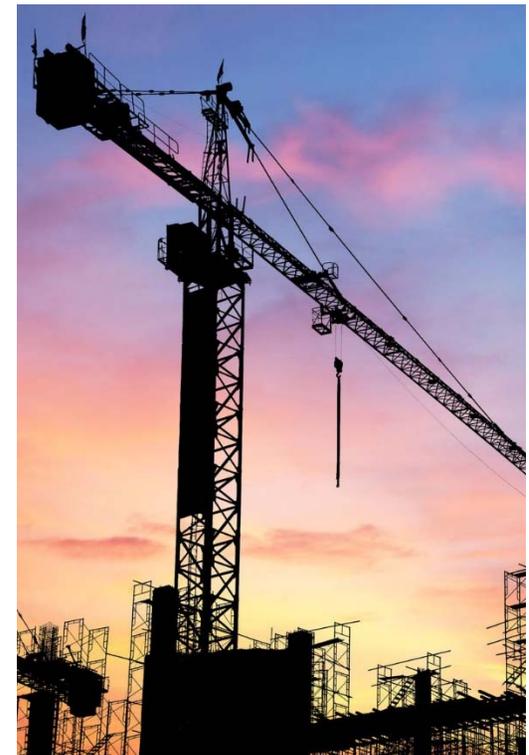


## ▶ Materials

- No supporting documentation or photocopies of certifications or deliveries
- Irregularities in signatures, dates or quantities on documentation
- Sequential or inconsistent numbering

## ▶ Equipment

- Delivered early or while under repair
- Held after use, but continued to incur charges
- Rentals in addition to actuals
- Small tools



# Targeting The Appropriate Areas of Risk



## ▶ Compliance

- Contractors misrepresent its standing as DBE (minority owned) to win contract awards
- Prime contractor always uses the same minority-owned entity
- Noncompliance with federal regulations and misrepresentation of business status
- False Claims Act violations



# Interpreting Results



## Always be on alert to potential conflicts of interests and bribes/kickbacks

- ▶ Unreasonable support on behalf of project owners
- ▶ Constant quality and quantity issues
- ▶ Unusual delays in providing documentation
- ▶ Incomplete responses to due diligence questionnaires
- ▶ Refusal to provide certifications or agree to policies
- ▶ Close relationship between third party and government official or entity
- ▶ Attorneys taking a “management” role

# Parting Shots - Tips



## Be Careful

- Identify “reporting” risks, both internal and external
- Acknowledge the dependency on the vendor
- Establish a “plan b”

## Be Responsive

- Monitor internal complaints and react **swiftly** as they come in
- Get the right people involved

## Be Disciplined

- Develop an audit **plan that is repeatable and defensible**
- Adhere to your investigative protocols
- Do not lose sight of issues related to **business implications**, privilege and potential self-reporting obligations

## Be Committed

- It is not enough to implement the framework of a system
- Companies must devote **appropriate resources to compliance** programs and obtain buy-in of key stakeholders

# Discussion and Additional Q&A



## **Jeff Matthews, CPA, CFE**

Partner-in-Charge, Forensics and Litigation Services

Jeff.Matthews@weaver.com | 972.448.9280

