Construction Industry
Fraud Awareness & Prevention Program

Presented by
James L McGovern, CPA, CFF, CVA
McGovern & Greene LLP
Construction Industry Fraud Awareness, Detection and Prevention
The Construction Industry suffers from fraud and corruption
Fraud Examiners must be aware and ready to prevent the schemes
The industry is susceptible to a myriad of frauds.
Training and education will help detect and prevent fraud
Economic Crime is a major problem in the construction industry.
Construction related cases keep the U.S. Justice Department busy.
Construction industry generates the most corruption cases
If they all get along, they can make more money
Odd-man out blows whistle
Amnesty program provides “Get out of Jail Free Card”
1/3rd of construction companies were victims of significant fraud

- Yes: 33%
- No: 67%
Construction Industry Fraud reporting lags behind others
Construction Companies approach fraud differently.
Misappropriation and Corruption & Bribery are most common offenses
Types of Economic Crime affecting the industry:

Types of Economic Crimes Affecting the Construction Industry

- Asset Missappropriation
- Corruption & Bribery
- Industrial Espionage
- Financial Misrepresentation
- Product Piracy/Counterfeiting
- Cybercrime
- Money Laundering

% of Respondents
Contractors often overvalue contingent assets
Owners often undervalue Contingent liabilities
Fraud creates collateral damage
Audits are best source of detection
Commons means of detection include:

- Tip-off
- Changes in Management
- Internal or External Audit
- Risk Management Systems
- Accidentally

![Graph showing how economic crime is detected in the construction sector.](image-url)
Companies may be overconfident
Audits do not assume “best practices” are being followed
“Tip-offs” are also fruitful sources of intelligence.
Elements of fraud and corruption in the industry are familiar
Bribery, Illegal Gratuities and Extortion are common
Bribery = Giving or receiving to influence an official act
Illegal Gratuity = Giving or receiving for or because of an official act
Ways to prove intent include:

- Alteration of documents
- Concealment/Destruction of evidence
- “False exculpatories” (Lies)
- Personal gain
- Obstruction of justice
- Pattern of conduct — repetition
- Testimony of co-conspirator
- Admissions/Confessions
Thing of Value can be almost anything
Cash
Gifts
Trips/Travel
Loans
Meals and Entertainment
Use of Credit Cards
Extortion requires use of actual or threatened force or fear
Many construction industry frauds occur before a contract is awarded.
Contractors and Buyers often collude
Tailoring Specifications creates an unfair advantage
Recognizing non-existent or dubious needs is another fraud
Purposefully vague specifications create an opportunity for fraud
Red Flags of specification related frauds include:

- Restrictions that limit competition or Sole Source procurements
- Contractor consults on specs and bids work
- Design consultants show up as sub
- Specs inconsistent with prior projects
Buyer assisted bid rigging requires inside help
Collusion can include anyone with the ability to influence the decision.
Common schemes include:

Abusing the sealed bid process

Submission of bids by non-existent or “dummy” companies

Unbalanced Bidding
Red Flags of contractor/buyer collusion include:

- Acceptance of late bids
- Falsification of documents or receipts to get a late bid accepted
- Change in a bid after other bidders’ prices are revealed.
- Allowing the low bidder to withdraw and become a subcontractor
Public projects are more vulnerable to Contractor bid rigging.
Types of Contractor Bid Rigging schemes include:

*Rotational Bidding*
Types of Contractor Bid Rigging schemes include:

Complimentary Bidding
Types of Contractor Bid Rigging schemes include:

Bid Suppression
Types of Contractor Bid Rigging schemes include:

**Territorial Bidding**
Types of Contractor Bid Rigging schemes include:

Predatory Bidding
Most schemes require a cartel of willing contractors
Corrupt union officials establish building trade cartels
Red Flags of Contractor Bid

Rigging include:

- Rotational/territorial pattern to winning bids
- Qualified bidders do not submit bids
- Successful bidder subcontracts to losers
- Firms that could bid alone form JV’s
- The same math or spelling errors in bids
MBE Misrepresentation attempts to take advantage of set aside goals
Some agencies require contracting $’s be placed with qualified MBE’s.
“Set asides” and “price allowances” create incentive and opportunity
False certification is a common fraud
Establishing a minority “front” is also common
Opportunities for fraud continue after a contract is awarded
Theft is still the most common offense
The size and traffic flow make most sites difficult to secure.
A lucrative black market provides ample motive
Ways to deter theft include:

Discouraging on-site storage

Requiring central storage of materials

Requiring workers to wear ID tags

Installing video cameras

Employing adequate security staff

Consistently pressing charges
Materials Substitution can create significant risks
Common excuse is “the substituted goods are just as good”
Common schemes include:

Delivery of materials lacking required tests or falsification of test results

Delivery of counterfeit/look-alike products

Passing off of specially created samples

Surreptitious movement of inspection tags
False claims seek payment for work not performed
Time & Materials contracts are especially vulnerable
Change Orders also present ample opportunity for fraud.
False claims for impact costs are also common.
Ways to deter false claims include:

Start with a well defined scope and specs
Maintaining a timely CO review process
Including right to audit clauses
Conducting periodic random audits
Negotiating predetermined unit prices
Require certified payrolls
Fraudulent Performance Bonds can have severe consequences
Fraudulent Performance Bonds can have severe consequences
A myriad of frauds harm the construction industry
Awareness and Detection = Prevention and Profit
Contact information:

Jim McGovern
McGovern & Greene LLP
105 W. Madison Street
Suite 406
Chicago, Illinois 60602
Telephone: (312) 419-1961
Fax: (312) 419-1962

Email: jim.mcgovern@mcgoverngreene.com
Web Site: www.mcgoverngreene.com