Fraud in Construction

Construction auditors are known to say:

There is no fraud in construction, only billing errors.

Then they laugh. Billing errors commonly run 1 to 2% construction costs. If there is corruption, pay to play, bid rigging or poor project control, fraud of 30 to 45% is not unheard of. Examples of fraud include:

- Intentional billing errors
- Billing for work not done
- Inflated change orders
- False claims
- Substandard or counterfeit materials
- Price fixing
- Kickbacks
- Theft of scrap
- Inflated labor costs

Unlike management of ongoing activities, construction projects may be a one time or occasional activity. As a result the owner may not be familiar with fraud risks related to the project work or billing. Transaction details are often in the records of others.

Owners overly rely on the contractor or subcontractor for their expertise. Construction work is complicated. Construction contracts and billings are complex.

Effective management of construction requires an understanding of both performance and administration. That person should work for the owner. Recent comments heard from experienced auditors embarking on construction auditing for first time:

> *I was surprised that our organization was spending hundreds of millions of dollars and we had no way of knowing that we got what we paid for, that it was billed properly.*
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> *I was overwhelmed by the complexity of the billing and what was needed to understand a pay request and tie it to the contract.*
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> *I was amazed at the audacity of some contractors in billing improperly. I was even more amazed that project managers did not seem to care.*

The following **Model for Addressing Fraud Challenges** can be used to develop or assess your own organization's approach. The highlighted areas are most often related to construction fraud.

A Model for Addressing Fraud Challenges

The Top	Environment	Codes & Policies	Detection	Investigation
Top executives set a personal example of ethics and honesty. *Top executives are involved in detail.* *Management has zero tolerance for dishonest and fraudulent activity.* *Management acts right in the moment of truth.* *Decisions are driven by logic and reasoning, facts and evidence.* *Decisions are based upon what is best for the organization, not bribes, relationships, or what is politically expedient or good for the executives.* *The interests of the organization are served before the interests of management.*	*Fraud-related expectations are well defined and communicated to staff, executives, and managers.* *Executives, managers, and staff are trained in fraud-related matters.* *There is thorough screening of new hires, contractors and temporary employees.* *Employees are treated consistently, without regard to who they are, position or performance.* *Management reviews, inspects, visits, asks and thus shows their interest and involvement.* *Executives and other members of management encourage uncovering problems and learning lessons from them.*	*Expectations regarding ethics and integrity are well defined and communicated.* *Responsibility for detection and investigation is well defined in written policy.* *This responsibility is communicated and acknowledged annually.* *Codes and policies are applied consistently without regard to who the person is, position, performance, or length of service.*	*Management understands their responsibility for detection.* *Management puts in place processes to detect fraud.* *Management detects fraud through their routine activity.* *Internal audit builds fraud detection into routine audits. Auditors detect fraud.* *Internal audit or others use data analysis to bring fraud to the surface.* *There is a hotline or another mechanism in place to encourage concerned employees to come forward without fear of retaliation.* *Third party auditing detects fraud - 1) contractors, 2) tenants, 3) taxpayers, 4) franchisees, 5) agents, 6) vendors, 7) customers, 8) distributors.*	*There is internal investigative capability.* *Investigators conduct complete investigations.* *Immediately upon discovery, suspected wrongdoing is referred to those responsible for investigations.* *Investigative methods avoid false accusations and minimize risks of civil litigation and other risks associated with mishandling* *Wrongdoing is consistently reported to law enforcement and the appropriate regulatory authorities.* *Recovery is sought.* *Investigative activity is reported to board.* *Lessons learned yield improvements for the future.*