



NWCCC and AGC
Business Ethics and Project Delivery

Top Ten Construction Project Fraud Schemes
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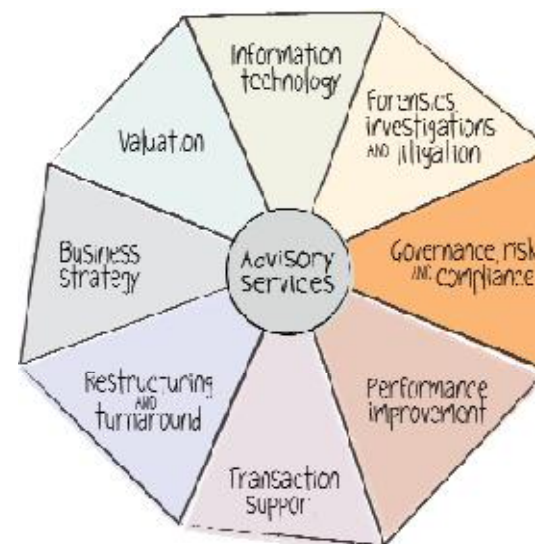
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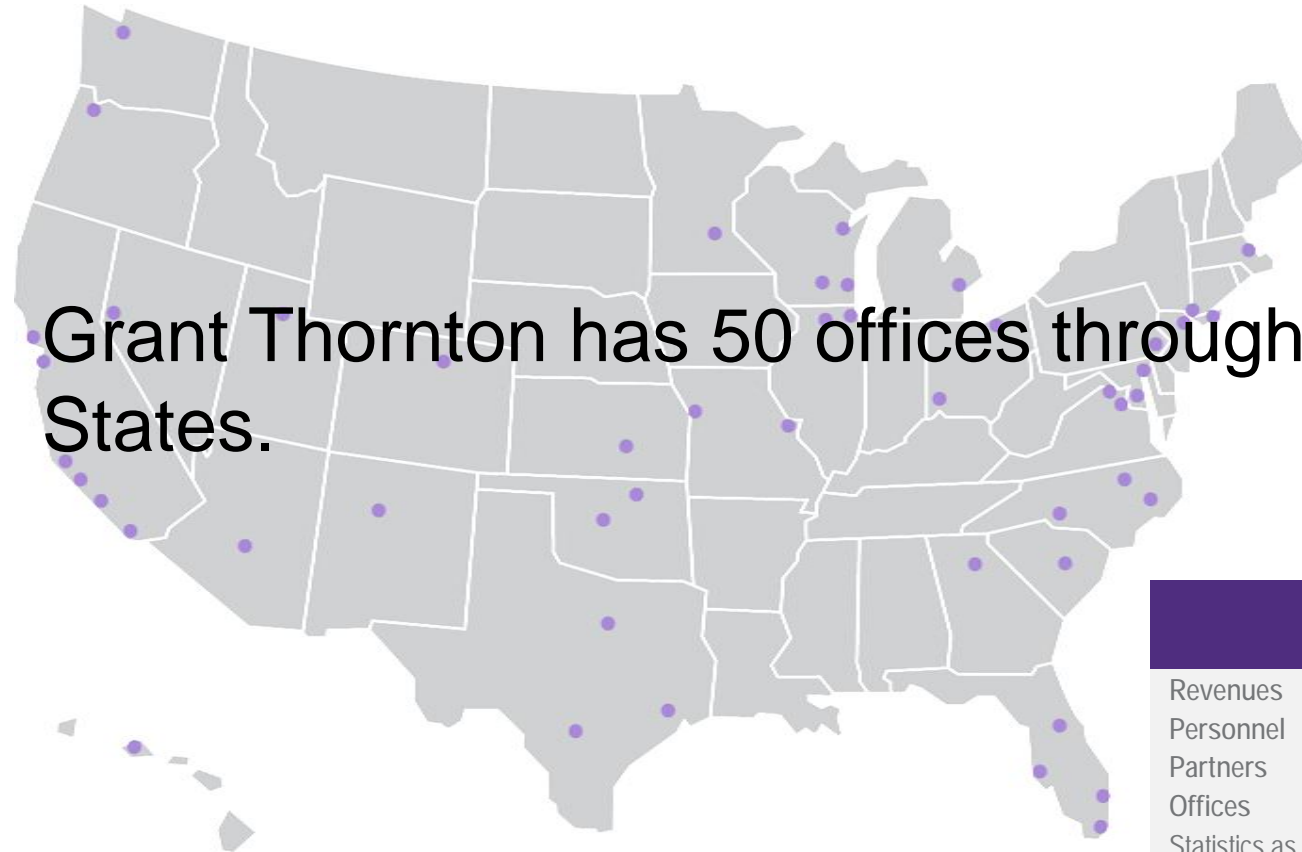
- comply with changing legislation
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- contain costs
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- identify strategic transaction opportunities

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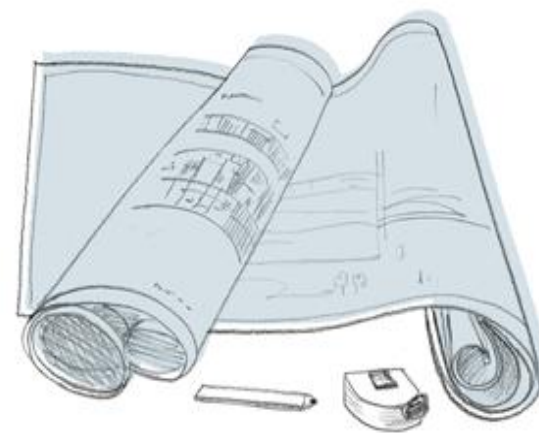
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	Grant Thornton International Ltd*	Grant Thornton LLP**
Revenues	US \$3.5 billion	\$1.2 billion
Personnel	27,277	5,970
Partners	2,423	522
Offices	481	50
Statistics as of:	Dec. 31, 2007	July 31, 2008
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Current state of construction fraud

Introduction

- Current state of construction fraud...
- Today's presentation will focus on construction project fraud.



Underlying causes for the increase in construction fraud:

- Economic Pressure
 - Risk of customer or supplier bankruptcy
 - Price volatility
 - Low profit
 - Tight bank credit
- Cost based contracting approaches
- Contracts where the scope is not defined until after the price is set
- Construction joint ventures



Who commits fraud?

- People who commit fraud do not fit the typical criminal profile
- Fraud can be committed by
 - Contractor employees
 - Owner employees
 - Contractors, subcontractors and consultants
 - Participants in successful and unsuccessful projects



Construction fraud schemes

- 1) False application for payment (“Pay App”)
- 2) Billing for work not performed
- 3) Collusion, related parties and conflicts of interest
- 4) Change order manipulation
- 5) Manipulation of the schedule of values and contingency accounts
- 6) Substituting or removing material
- 7) Diverting lump sum charges to time & material cost
- 8) Diverting purchases and theft of equipment/tools
- 9) Non-payment of subcontractors and material suppliers
- 10) False representations



1) False applications for payment (“Pay App”)

- Erroneous totals
- Erroneous line items
- Roll forward errors
- False invoices as support
- Inflated rates in the supporting invoices that do not reflect actual cost
 - Wage rates (includes hourly rate plus fringe)
 - Journeyman v. apprentice
 - Overhead rates
 - Equipment rates
 - Profit/markup formulas and fee calculations



2) Billing for work not performed

- Front end loading
- Claimed self performed work
- Overstating:
 - Units consumed
 - Equipment usage
 - Labor usage



3) Collusion, related parties and conflicts of interest

- Bid rigging and price fixing
 - Bid rotation
 - Collusion
 - Bribes and kickbacks
- False or inflated change orders
- Under valued deductive change orders
- Phantom subcontractors consuming buyout savings



4) Change order manipulation

- Change orders for base contract work scope
- Change orders with missing scope descriptions
- Change orders with excess charges
- Deliberate omission of design specifications in original scope of work
- Improper price reduction for work substitution
- Change order chaos



5) Manipulation of the schedule of values and contingency accounts

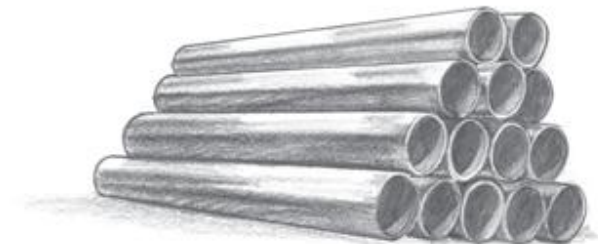
- Failing to update line items as buyouts or changes are made
- Not associating subcontractors/vendors with specific schedule of values line items
- Concealing buyout savings to fund:
 - Design errors
 - Excess charges
- Hiding cost overruns during the course of the project
- Use of contingency to cover non-reimbursable cost



The image shows an open ledger with two pages, numbered 53 and 54. The pages contain handwritten entries in columns, likely representing a schedule of values or account book. The entries are dense and difficult to read due to the handwriting and the small size of the text. The columns appear to be organized into several sections, possibly representing different categories of costs or items.

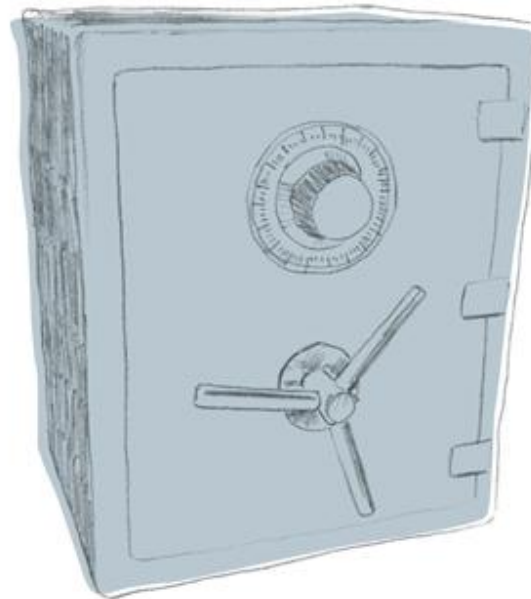
6) Substituting or removing material

- Using a lower grade material that requires subsequent change orders to repair/replace
- Using a lower grade material that leads to failure of a structure or system
- Ordering additional material for other projects or personal use
- Use of residual inventory



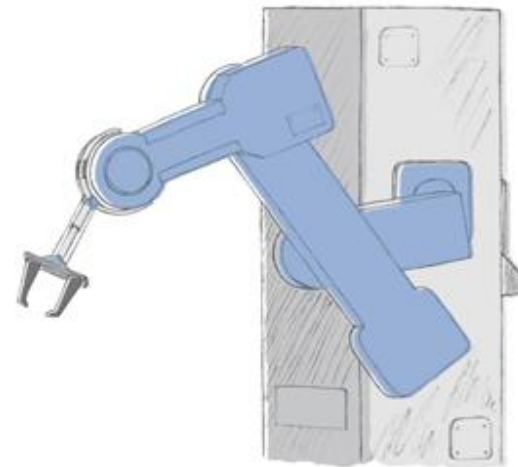
7) Diverting lump sum cost to time & material cost

- Charging cost records related to lump sum work to T&M change orders
 - Labor
 - Equipment
 - Material consumption



8) Diverting purchases and theft of equipment/tools

- Project purchases in excess of project specifications
- Purchase ship-to addresses to:
 - Other project sites
 - Will call
- Ordering additional equipment/tools for other projects



9) Non-payment of subcontractors and material suppliers

- Delay of subcontractor lien waivers
- Falsification of subcontractor lien waivers
- Using project cash receipts to pay bills of other projects



10) False representations

- Use of undocumented workers
- Falsifying minority content reports
- False insurance certificates
- Environmental non-compliance
- Violating “Buy American” requirements
- Falsifying test results
- Misrepresenting small business status



Examples of fraud red flags

- Atypical application for payment form
- Missing or disorganized billing back-up
- Use of contingency funds without adequate/timely explanation
- Changes in the schedule of values without adequate/timely explanation
- Subcontractor complaints regarding delayed payment
- Missing subcontractor lien waivers
- Unusual bid patterns
- Unsuccessful bidders hired as subcontractors
- Unauthorized changes in time records or missing time records
- Missing weight tickets
- Related parties and common ownership



If you suspect fraud...

- Contact your attorney
- Fully and discretely debrief any whistleblowers and/or complaints
- Secure the project's documents and electronic files, including email
- Conduct background checks
- Develop an understanding of the contract's key parameters
 - Determine the scope of work and when the scope was established
 - Determine the contract definition for chargeable work (the cost of work)
 - Determine the contract definition for reimbursable costs
 - Determine your audit rights
- Conduct some basic tests



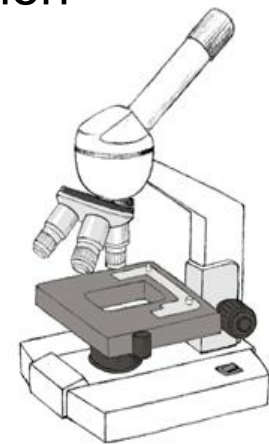
Conduct some basic tests

- Schedule out the pay applications
- Compare actual to budget on a line item basis
- Reconcile the payments to the pay applications
- Reconcile the pay applications to the job cost report
- Track changes in the schedule of values
- Track changes in the contingency account
- Compare change order signature dates to when the work was completed



Conduct some basic tests (cont.)

- Inventory the lien waivers
- List purchased equipment and inventory what is left
- Conduct supplier confirmations
- Prove reimbursable charges
- Tie subcontractor bills to the applications for payment
- Compare drawing/spec material volumes to claimed actual volumes
- Review the subcontractor bid selection process and selection documentation



Controls that should be in place

- Attitude at the top
- Compliance and ethics program
- Whistleblower hotline
- Define and monitor conflicts of interest
- Scope definition
- Receiving controls
- Right to audit clause and conduct surprise audits
- Screen suppliers and subcontractors
- Maintain a pay application check list



Thank you!



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