



Grant Thornton

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GLOBAL FRAUD COMMENTARY 2013

# Time for a new direction

*Fighting fraud in Construction*



# Introduction

**The presence of fraud and corruption in Construction can take many forms; from falsely representing the numbers of hours a contractor works, through to collusion when bidding for contracts or paying bribes to secure a contract. These inevitably increase costs and, in the case of bribes, inflate the contract price.**

*“More companies need to wake up and recognise that fraud and corruption costs, in terms of profits and a company’s reputation. It’s a real threat to growth.”*

**Clare Hartnell**

Global leader Real Estate and Construction  
Grant Thornton

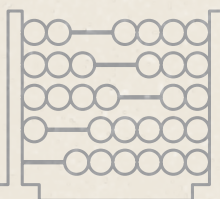
A fraud investigation can have a profoundly negative impact on a company’s reputation. This can threaten growth prospects, company share price and profitability. In certain cases a company convicted of corruption can be barred from tendering on public sector projects. Despite this, to many Construction companies doing business around the world, fraud and corruption are prevalent to the extent that they are now an ‘accepted cost of doing business’.

‘Time for a new direction: fighting fraud in Construction’ contains insight from Grant Thornton’s forensic and investigation teams in Australia, Canada, India, the UK and the US.

Drawing on insights from the five countries, it explores why, when crime figures are falling around the world, fraud occurs so frequently in the Construction sector. By highlighting the scale, trends and types of fraud and corruption that affect Construction companies and the public sector, this report provides practical guidance for organisations that want to identify fraud and mitigate their risk.

Responsibility must start with business leaders and their boards. This report makes a range of recommendations to the Construction industry to help it avoid being a weak link in the fight against fraud and corruption, including a phased, five-step protection process; and a robust programme of tests, responsibilities and corrective measures.

**\$300,000**



**average loss from fraud cases**

# The scale of fraud

## *Highly prevalent and high profile*

**According to the Association of Certified Fraud Examiners (ACFE) 3.4% of all reported fraud cases, over a two year period up to December 2011, were attributable to the Construction industry. This inflicted a median average loss of US\$300,000<sup>1</sup>. In a separate report, the UK's Chartered Institute of Loss Adjusters states that fraud in Construction is rife and estimates the impact at 10% of the industry's revenues. Recent estimates show that the global Construction industry is worth US\$8.6 trillion, rising to US\$15 trillion by 2025. This means that the global cost of fraud and corruption could be US\$860 billion, rising to US\$1.5 trillion by 2025<sup>2</sup>.**

Although the numbers are a useful guide on the scale of fraud, volumes are difficult to estimate. Clare Hartnell, global leader of Real Estate and Construction at Grant Thornton, says: "Most fraud is undetected so the quantum is impossible to accurately estimate. Businesses that have suffered from fraud are very reticent to let people know they have been a victim. Fraud happens, but it's another thing to report it – mainly for reputational reasons."

Across Australia, Canada, India, the UK and the US it is evident that fraud in Construction is commonplace and in some cases we could describe as endemic. Behind closed doors companies accept that fraud is a cost factor in the work they do.

Dealings with governments continue to attract more than their fair share of fraudulent activity. Construction fraud is front page news in Canada. The Charbonneau Commission has been investigating fraud and corruption in the awarding of public construction contracts across Quebec. Fraud has gone to the heart of local government with one mayor being charged with 'gangsterism'. Renata Eva Milczarek, Raymond Chabot Grant Thornton Quebec, says: "The investigation is shining a light on the issue of fraud and is creating a lot of public scrutiny." Fraud is also widespread in India. The most common type is bribery related to the need to clear projects through multiple official channels.

However, in a number of regions significant progress is being made in implementing controls. For example, the construction of the Olympic Park for London's 2012 Olympic Games incurred only one serious instance of fraud, compared to the 19 that occurred in the building of the city's Millennium Dome 12 years before.

*"Fraud is commonplace and often seen as the cost of doing business. This does not have to be the case."*

**Alvin Wade**

National leader Real Estate and Construction  
Grant Thornton US

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1. Association of Certified Fraud Examiners. Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study. Accessed on 22 August 2013 at <http://www.acfe.com/rtnn.aspx>

2. Global Construction Perspectives and Oxford Economics. Global Construction 2025. Accessed on 10 October 2013 at <http://www.globalconstruction2025.com>

# Spotting fraud

## *Knowing where to look*

**There are eight main types of fraud encountered in the Construction industry. Some are less obvious than others and often much harder to track.**

### **Billing fraud**

Purposely overstating the amount of labour, materials and other equipment required to complete a project.

### **Bid/contract rigging**

When suppliers in the market collude to fix prices or direct customers to use certain contractors. This can include bribery or kickbacks (see below).

### **Bribery/corruption**

Often collusion by two parties entering into a secret agreement whereby a financial incentive is made for securing a particular outcome. Examples include the awarding of a public or private contract or purchasing property on 'favourable' terms.

### **Fictitious vendors**

These are created by falsifying payment applications, covering up the purchase of personal items or diverting money to a phantom company. Activity is often controlled by an employee but can also be done by external entities through falsified company documentation or email addresses.

### **Change order manipulation**

Diverting lump-sum cost to time and material cost by initially budgeting expenses as a lump-sum then billing for time and materials related to change orders.

### **Theft or substitution of materials**

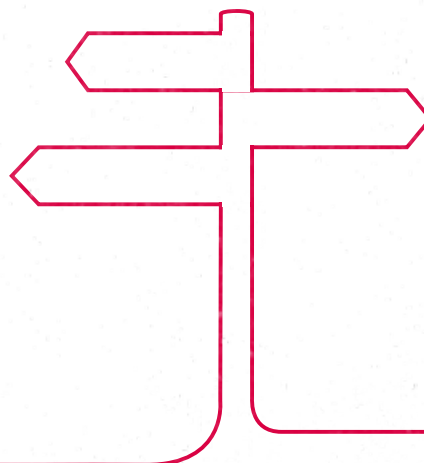
Taking material from the work site for personal use or using lower-grade material than quoted which might result in subsequent repairing or replacement.

### **False representation**

This might involve using undocumented workers; falsifying minority content reports, test results or insurance certificates; non-compliance with environmental regulations; and misrepresentation of small business status.

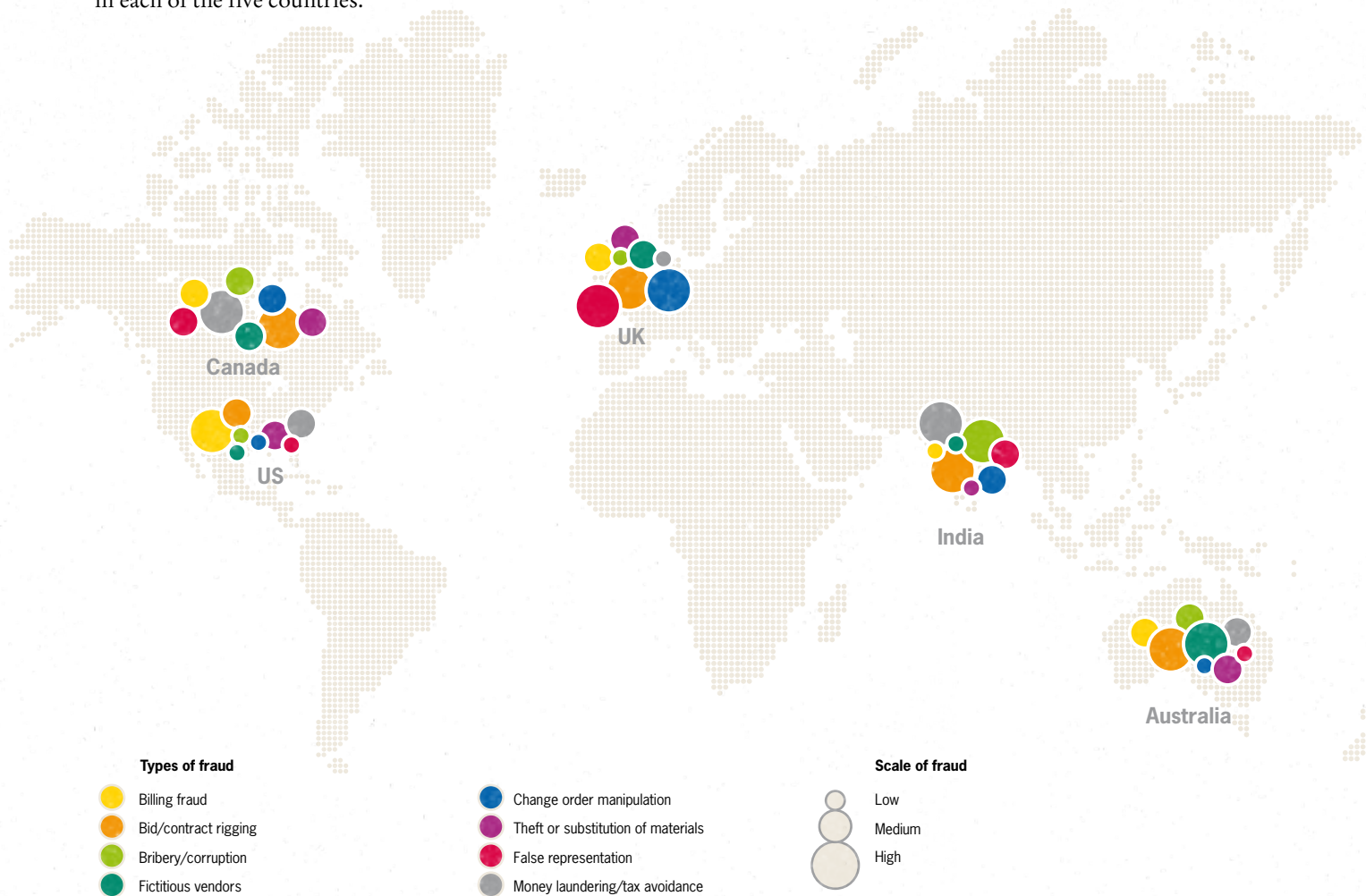
### **Money laundering/tax avoidance**

This is activity to legitimise money gained illegally. In real estate it could include making down payments on property and selling at a later date to give the money a legitimate origin. Tax avoidance can involve commonplace activity such as paying cash-in-hand for labour.



## Fraud hot spots

To spot fraud, Construction companies should be aware which types are most common. Based on the experience of Grant Thornton teams, the table below demonstrates the likelihood of encountering the types of fraud identified above in each of the five countries.



# Perpetration

## *Who commits fraud?*

**Controls to identify fraud are insufficient in many Construction companies. Fraud is often low on the agenda. As a consequence companies open themselves up to the risk of perpetration from a number of internal and external sources.**

The larger the number of stakeholders involved in a project, the more opportunities there are for fraud. However, the greatest threat of fraud comes from within – from employees and senior management. The ACFE, in its 2012 Report to the Nations, found that perpetrators who have high levels of authority often cause larger losses. This is an important consideration when companies address their own risks of fraud and develop mitigating policies<sup>3</sup>.

In addition to perpetration from inside the company, suppliers such as contractors, sub-contractors and even lending organisations must be considered risks to be addressed as part of a company's fraud exposure management policy.

There is evidence that organised groups of criminals are exploiting opportunities for fraud in the industry. In Canada, testimony at the Charbonneau Commission stated that elements of the construction industry

in Quebec were controlled by a small group of contractors who took turns 'winning' bids, and paid a percentage on the value of every public contract to organised crime and to public officials<sup>4</sup>. Organised crime expert, Jeffrey Robinson estimates that the five major Mafia families in New York take a 5% share of all construction projects in the city<sup>5</sup>.

*“The greatest threat of fraud comes from within - from employees and senior management.”*

**David Malamed**  
Fraud specialist  
Grant Thornton Canada



3. Association of Certified Fraud Examiners. Report to the Nations on Occupational Fraud and Abuse: 2012 Global Fraud Study. Accessed on 22 August 2013 at <http://www.acfe.com/rtnn.aspx>

4. Charbonneau Commission: Inquiry casualties mount. Montreal Gazette – 15 August 2013. <http://www.montrealgazette.com/news/Charbonneau+Commission+Inquiry+casualties+mount/8562536/story.html>

5. Slain mobster exported construction fraud. Montreal Gazette – 28 November 2011. <http://www.montrealgazette.com/news/Slain+mobster+exported+construction+fraud/5762200/story.html>

# Trends

## Three issues for companies to consider

### Technology

*“The Construction industry in Australia is 10 to 15 years behind the curve in the use of technology. Investing in technology can be the key to battling fraud.”*

**Chris Watson**  
Fraud specialist  
Grant Thornton Australia

Since the early and mid-1990s, crime against property and people has significantly fallen around the world, especially in the developed economies. In the G7 group of countries, for example, between 1995 and 2010 robbery fell approximately 20%, murder by over 30% and vehicle theft has halved<sup>6</sup>. The causes of these reductions are varied, but an often cited reason is the adoption of technology in detection and prevention.

Although perpetrators of fraud use technology to help them falsify payment applications by creating fictitious vendors, on the whole technology advances favour those investigating fraud. There are software and systems available that will create red flags to help companies identify possible fraud. These systems, coupled with the power available in today's microprocessors, have made it possible for many companies to combine large amounts of data to identify threats or possible weaknesses in controls.

However, the Construction industry has been a relatively low-level adopter of these technologies. Whilst financial institutions have reacted to cybercrime and money laundering threats by using technology, Construction companies have revealed little appetite to do the same.

### Recovery

*“With the construction market coming out of recession – fraud will be hot on its heels.”*

**Erik Lioy**  
Fraud specialist  
Grant Thornton US

As the global economy recovers, activity across the Construction industry will increase. This will bring more opportunities for fraud. Over the past four years, low levels of activity have meant that scrutiny on projects and transactions has been tight – there has simply been less activity so it has been easier to track – therefore companies have been stringent on cost and controls to ensure that the work they have delivered on profitability.

### Bid rigging

*“Contractors meet at so-called breakfast clubs to decide who will win the latest contract. This is a normalisation of an illegal act.”*

**Sterl Greenhalgh**  
Fraud specialist  
Grant Thornton UK

Bid rigging is an extensive issue and flagged as high risk in three of the economies covered in this report. In countries such as the UK, Canada and Australia, the propensity of bid rigging has been normalised to the extent that it might be perceived as legal. However, despite being perceived as institutionalised the activity is highly illegal as demonstrated by the fines levied by the UK's Office of Fair Trading.

# Mitigating fraud

## *How to protect your business*



**Grant Thornton suggests that private and public sector organisations in Construction apply a phased, five-step programme to protect against the risk of fraud.**

The programme's scope should be proportionate to the organisation's size and structure and to the nature, scale and location of its activities. The fuller the understanding of the fraud risks an organisation faces, the more effective its efforts to prevent fraud are likely to be.

### *First phase*

#### **Strategy**

Set 'tone at the top' and instill fraud avoidance as a corporate governance policy



Allocate a senior manager with overall responsibility and accountability



Make the board - including non-executives - aware of the key fraud risks via a monitoring programme

### *Second phase*

#### **Fraud risk assessment**

Conduct a fraud risk assessment



Put in place mitigating, preventative and detective controls



Capture risks in a fraud risk register



Segregate duties as appropriate





*Third phase*

**Policies and procedures**

Develop policies to mitigate identified risks



Create a whistleblower policy to allow concerns around fraudulent behaviour to be raised in confidence



Test procedures to ensure they remain effective



Consider using technology for data intensive procedures

*Fourth phase*

**Communication**

Create a communications programme to raise awareness of fraud policies



Make sure the message from middle management echoes the 'tone at the top'



Train the knowledge and skills needed to implement procedures and deal with any fraud related problems

*Fifth phase*

**Monitoring**

Monitor and evaluate the effectiveness of fraud prevention procedures and adapt where necessary



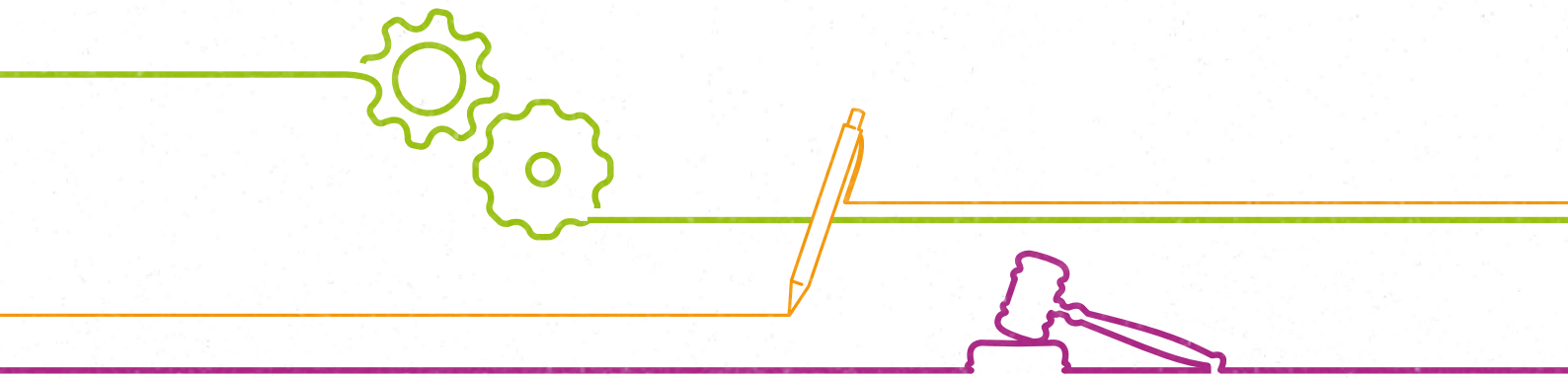
Review processes in response to events, including: incident of fraud, press reports or trend analysis



Task an individual with monitoring for fraud issues and information

**Once effective fraud controls are in place, Grant Thornton suggests these basic tests and responsibilities to detect and investigate irregularities:**

Tests	Responsibility		
	Operations	Reporting	Governance
Schedule out pay applications	■		■
Compare actual costs to budget on a line item basis	■	■	
Reconcile payments to pay applications	■	■	
Reconcile pay applications to underlying cost reports	■		
Track changes in the schedule of values		■	
Track changes in the contingency account	■		
Compare change order signature dates to the actual time in which the work was completed	■		
Implement inventory lien waivers	■		
Make a list of purchased equipment and inventory the remainder	■		■
Conduct supplier confirmations			■
Prove reimbursable charges			■
Tie subcontractor bill to payment applications		■	
Compare drawing/spec material volumes to claimed actual volumes			■
Review the subcontractor bid selection process and selection documentation			■



## Police enforcement

Police support and enforcement on issues of fraud vary by country. However, the need for companies to take responsibility for their own processes and investigations is consistent. The primary role of police forces is understandably to protect people and property. Although there are skills to help fight fraud, companies should look to work with the police rather than defer responsibility.

In the majority of cases responsibility for prevention and investigation of fraud starts with the company itself – where necessary working with advisers to build a case that can be passed on to law enforcement agencies. However, help is at hand in the form of technology and whistleblowers:

## Whistleblowing

Whistleblowing unearths nearly 50% of investigated fraud cases, in Grant Thornton's experience, although more whistleblowing occurs on public contracts than private ones. US legislation in the form of the Dodd Frank Act and Qui Tam laws aim to incentivise people to help expose fraudulent activity.

Communicating a clear and simple policy to employees and third party suppliers can allow them to raise concerns with confidence and impunity. A policy should cover the following:

- Simple and anonymous ways to speak up, including secure websites, anonymous email, confidential telephone line and secure post box
- Communication to make employees, suppliers and other third parties aware of the process
- The coding of complaints to maintain anonymity for the whistleblower
- A reporting and escalation process, including making the audit committee aware
- Senior management ownership of the complaint and procedures for further investigation

## Technology

Technology can be a powerful tool in preventing and investigating fraud. Once policies are in place, technology can take much of the work out of implementation. "It used to be that due diligence on vendors would mean someone driving by an address to make sure the company existed. Now you can use tools as simple as Google to search public records and even Google maps to check if vendors are real," says Scott Shaffer, Grant Thornton US.

Given the prevalence of bid-rigging in Construction, companies should develop appropriate policies to prevent collusion from contractors tendering for work. A well thought out procurement process is crucial to this. Again companies can make use of technology through the use of e-auctions, which can be effective in preventing supplier collusion or instances of corruption. In Quebec, technology is also being used by the public sector to increase 'open government' transparency, where all tendering information is available on the internet for everybody to see.

*"Construction companies need to get better at activities such as data mining. A data dump of employee and contractor addresses and bank accounts can be used to highlight suspicious links"*

**Colin Johnson**  
Fraud specialist  
Grant Thornton UK

# Corrective measures

## *Working to beat fraud*

**Grant Thornton makes six recommendations that will help the Construction sector avoid becoming the weak link for fraud.**

### 1 **Put fraud on the board's agenda**

Responsibility must start within the company. The board or senior management equivalent need to adopt a zero tolerance policy and give full support to those tasked with developing and implementing the correct policies and controls. Fraud is a governance issue and needs to be owned by the board.

### 2 **Be vigilant**

Since 2008 Construction companies have been more diligent in scrutinising their organisations to ensure efficiency and maximise profits. This focus, and the reduced number of opportunities, made fraud more difficult. As economic recovery takes hold opportunities will grow and companies will become busier – it is important that they keep a watchful eye for fraud.

### 3 **Be prepared to prosecute**

Companies should put aside reputational issues and speak more openly about fraud. This will foster a greater willingness by companies to prosecute the perpetrators.



## 4 **Look at Big Data**

The Construction industry can learn from effective developments in policing through the gathering and sifting of large volumes of data. This has made certain types of crimes, and where they might be committed, easier to predict and therefore led to more efficient deployment of resource for their prevention. With government facilitation, these predictive techniques could be made available to Construction companies by pooling data and experiences to help each other better identify and predict what fraud is most prevalent and where.

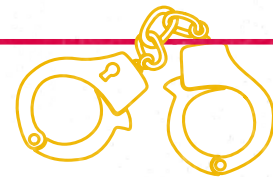


## 5 **Encourage whistleblowing**

Whistleblowers are critical to detection and governments should provide increased protection for whistleblowers, especially in the private sector, and explore ways to encourage whistleblowing.

## 6 **Access government support**

Education and support from governments and their business departments is vital. Interestingly, big sporting events such as India's 2010 Commonwealth Games and South Africa's Football World Cup the same year, can be the catalyst for governments to drive the issue. However, outside of these events, governments need to be part of the drive to instill awareness among companies. The urgency and inventiveness they used to fight crime must also be applied to fraud.



# Making a stand against fraud

## *Ready, armed and waiting*

**Fraud needn't be the 'cost of doing business' in Construction. However, if unaddressed fraud in the industry is likely to increase as businesses start to grow.**

As technology makes mainstream crimes such as theft increasingly risky and difficult, fraud risks becoming a weak link – one that professional criminals and opportunists will exploit. For the Construction industry the situation is, however, avoidable.

The action must come from the top of companies, including management teams and non-executives. Boards should lead the drive to prevent fraud and adopt the right tools, approaches and technology to do so.

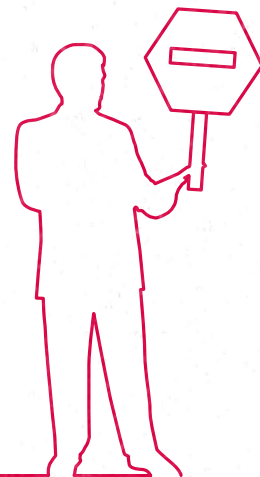
Companies are not alone. In many economies there is legal support, but business leaders must take responsibility and do it now to get ahead of any recovery in the Construction sector. If companies do not take action they increase the risk of becoming victims – a situation that will escalate costs, reduce margins and dampen growth.

As criminals search for their next victims, Construction companies must ensure they are not the weakest link.

*“Boards should lead the drive to prevent fraud and adopt the right tools, approaches and technology to do so.”*

**Clare Hartnell**

Global leader Real Estate and Construction  
Grant Thornton



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