

An Ounce of Prevention: A Guide for Combating Fraud in Construction

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The term *fraud* can evoke images of clever schemes, exciting investigations, and going to battle against evil corporate interests. Fraud is often glorified in Hollywood TV shows and movies like *The Sting*, *Dirty Rotten Scoundrels*, *The*

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Sopranos, *American Hustle*, and *Ocean's Eleven*. Many such plots end with the lovable fraudster duping the evil corporate empire, outsmarting the law, and disappearing to a tropical paradise with the ill-gotten gains.

But the fraud of the silver screen should not distract us from the fraud that happens every day. As we know from the nightly news and scandals such as those involving Bernie Madoff and Enron, fraud is nothing more than a theft, a criminal act with real victims. Fraud hurts corporations and real people and is rampant in all industries, including, and maybe especially, construction.

With this in mind, this article is intended to provide:

1. An understanding of who commits fraud and, more specifically, occupational fraud and how it manifests itself in organizations within the construction industry;
2. An account of some of the unique legal exposures that construction companies face, especially where many projects receive some government funding; and
3. A discussion of proactive and remedial measures to prevent fraudulent behavior, detect problems early, and minimize the impact of fraud within a project or organization.

Most fraud is performed not by clever evil geniuses, but by normal people who see a weakness in a control system and decide to take advantage of it for their own gain. It is the scale operator at the scrap metal plant who discovers he can write a check to himself or a fictitious subcontractor without anyone noticing. It is the bookkeeper for the small subcontractor who colludes with vendors to pay invoices for fictitious work while taking kickbacks. It is the contracts manager who provides winning bid information to his friends and then arranges change orders to make up for losses.

Some fraud may be viewed as harmless or understandable, such as the bookkeeper who borrows money from the firm without asking but then pays it back. But often, seemingly innocuous events are the tip of the iceberg or evidence of early efforts to test control systems to see if anyone notices. After all, many fraud schemes start with someone doing something small that they perceive as harmless, or at least justifiable.

We often hear of fraud on Wall Street or in the health care system, but what about the construction industry? In our industry, fraud can take on many forms, affecting owners, contractors, subcontractors, and sureties. The following are examples of fraud in the construction industry that have recently hit the headlines:

