



Fundamentals of a Construction Audit

August 7, 2014



Assurance ■ Tax ■ Consulting

Agenda

- Definitions
- Risk Based Approach
- What Determines Risk
- Fraud
- Construction Risks
- What to Audit
- Red Flags
- Why Audit
- Prevention
- Wrap-up

Definitions

- AIA
- Allowances
- Architect
- As-builts
- Change order
- Contractor
- Consumables, expendables and small tools
- Contingency
- Design Builder
- Fast Track
- General Conditions
- Labor
- Owner

- Owner representation
- Retainage
- Project Site
- Self Performed Work
- Shared savings
- Stored Materials
- Subcontractors
- Tiered subcontractors
- Trades
- Value Engineering

Risk Based Approach

- Size (\$ value and physical size)
- Type of contract
 - Cost Plus and T&M versus Lump Sum
 - Shared Savings Features (to calculate and make sure it's done right)
- High profile or high risk projects
- Experience of Owner's PM, Rep, GC, or CM
- Mandate from senior management or audit committee

- Risk – Based on contract type!

What Determines Risk

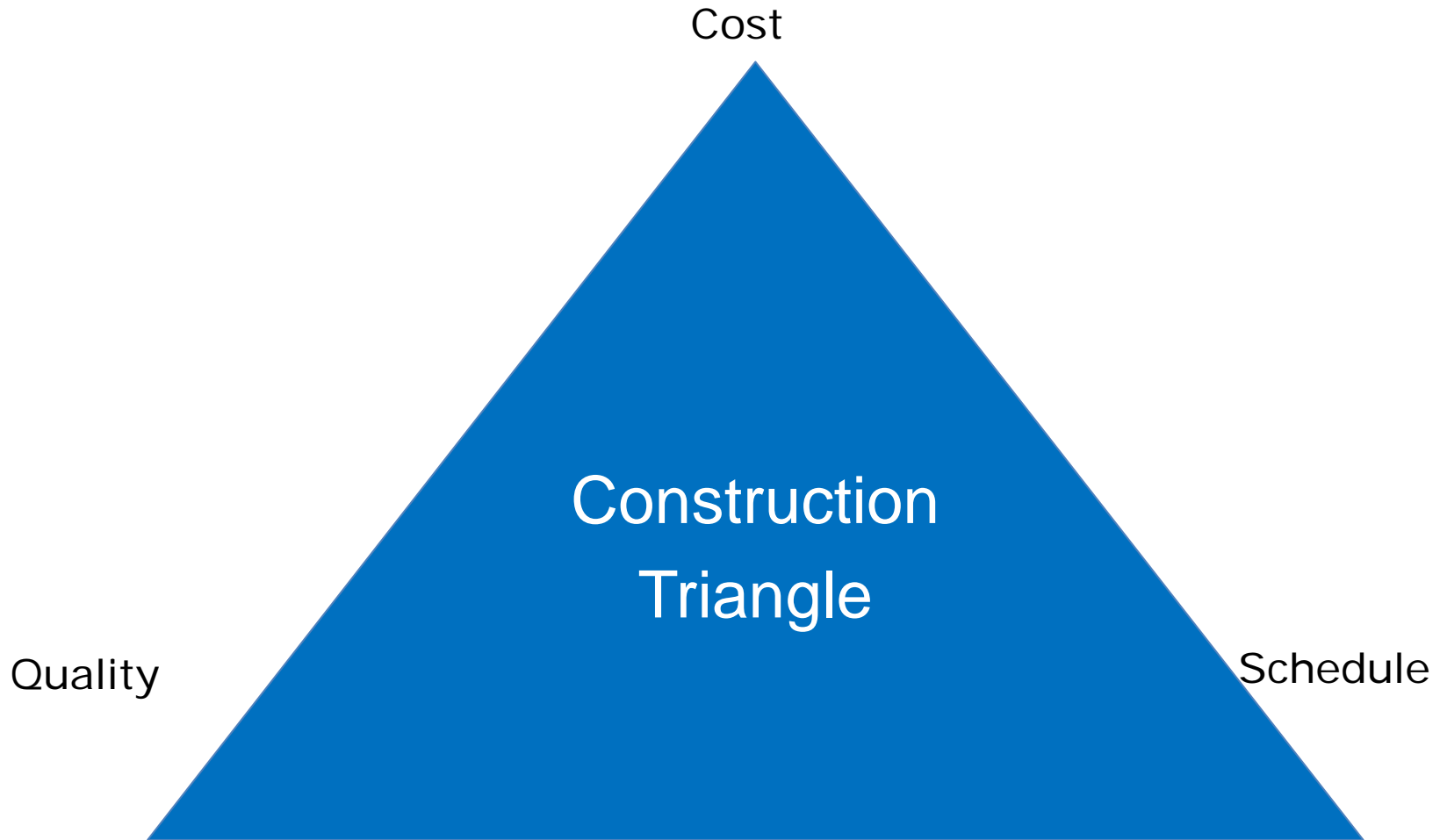
- Lump Sum, Fixed Price, Stipulated Sum
 - Competitively Bid
 - Negotiated (TINA)

- Cost Reimbursable or Cost Plus
 - Cost Plus with Fixed or Percentage Fee
 - Guaranteed Maximum Price
 - Time and Material
 - False Claims Act

What Determines the Contract Type

- Design
- Schedule
- Price Competition
- Location
- Regulations

Construction Risk



Organizations

- Owner
- Project Manager (Owner's Representative)
- Architect and Engineer
- Contractor
- Subcontractor (trades)

Fraud Statistics

- ACFE Statistics:
 - Median fraud loss in construction is \$245,000*
 - Seventh highest fraud loss amount by industry*
- ACFE Common Construction Fraud Schemes (two or more):
 - Corruption - 57%*
 - Billings – 22%*
- Construction Cost recovery Potential:
 - Easy way for IA to quantify value add
 - 2% of total contract value is potential overpayment amount
 - Average ROI ratio of 10
- Internal Fraud, Waste and Abuse
 - Procurement

* Per The ACFE's 2014 Report To The Nations On Occupational Fraud and Abuse

Behavioral Red Flags

- Close Association with Vendors
- Wheeler Dealer Attitude
- Excessive Pressure
- Control Issues

* Per The ACFE's 2014 Report To The Nations On Occupational Fraud and Abuse

Stipulated Sum - Risks

- Procurement process
 - Bid rigging
- Specifications
 - Outside specifications
 - Quantities not installed
- Change orders
 - Incremental cost – not including in contract value
 - In accordance with the contract
- “Front-end” or “top-loading”
- Allowances
- Prevailing Wage Rates
- Stored Materials

Stipulated Sum – Red Flags

- Less than 3 bidders
- More than 8-10 bidders
- Money left on the table
- Unsuccessful bidders doing subcontract work
- Subcontractor complaints
- Contingencies or allowances
- Excessive change orders

Change Orders



Specifications

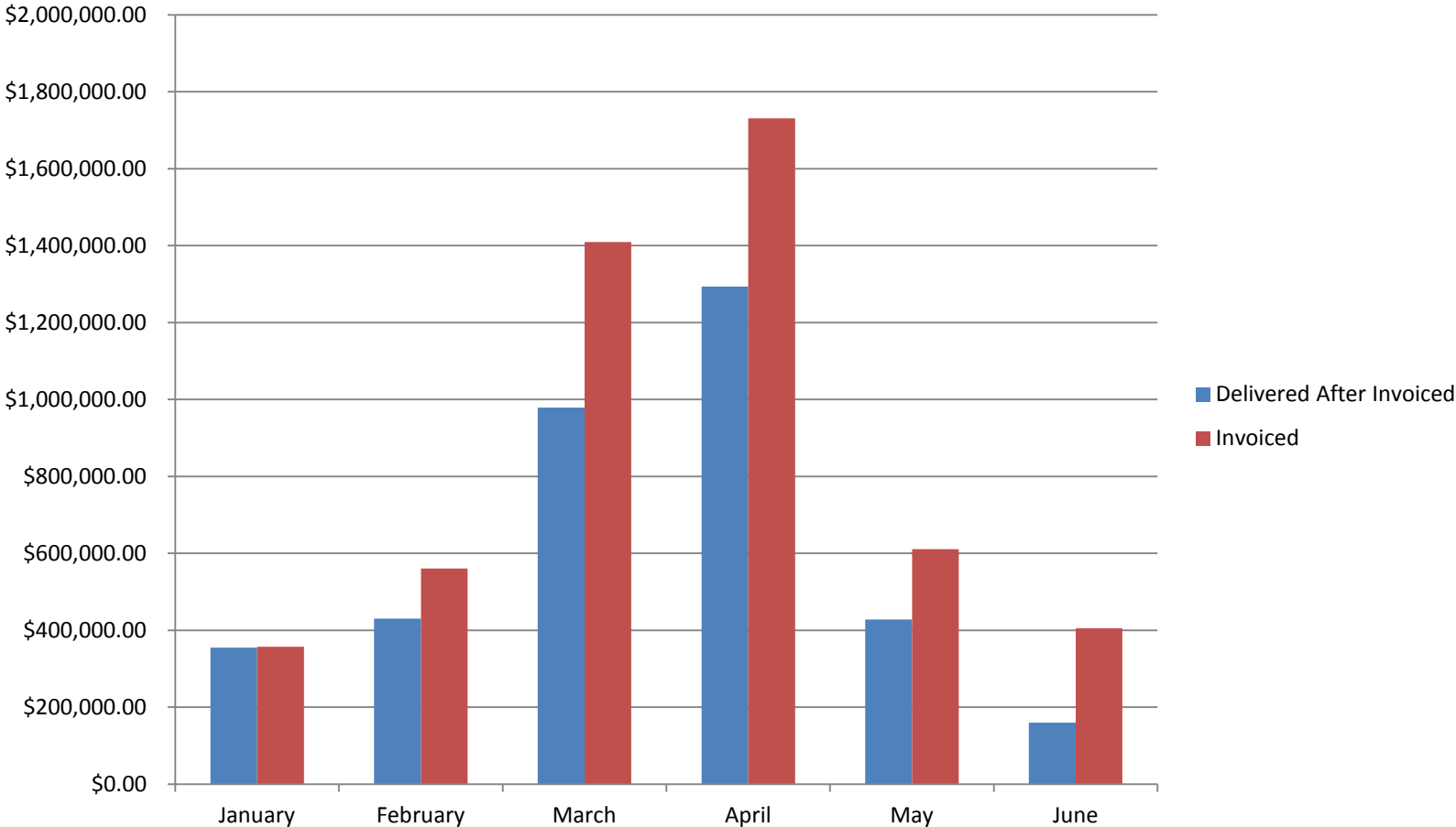


Specifications



Stored Materials

Stored Materials Invoiced



Stipulated Sum – Front End Loading

Contract value	\$754,168
Previous work in place	\$527,440
Previous stored material	\$162,493
Current work in place	\$ 40,162
Current stored material	\$ 24,073
Total completed and stored	\$754,168
Percent complete	100 %
Balance to finish	\$0

Cost Reimbursable - Risks

- Billings in excess of cost
- Labor – Fringe Benefits
- Insurance
- Materials
- Equipment
- Subcontractor
 - Self Performed Work
- Fee

Billings in Excess of Cost

- Allowed to bill the lesser of percent complete or actual cost.
- Job cost report
- Payment application
- Job cost should equal amount completed and stored to date less fee

Labor Cost

- Labor distribution report – integrates with job cost system
- Home office labor
- Excessive fringe benefit costs (25% to 40%)
- Unallowable cost in fringe benefits
- Duplication of compensated personal absence
- Time not worked
- Excessive overtime
- Negotiated rates

Insurance Cost

- Traditional Insurance
- Owner Controlled Insurance (OCIP)
- Contractor Controlled Insurance (CCIP)
- Subcontractor Default Insurance (Subguard)
- Issues
 - Insurance not required
 - Agreed upon rates
 - Rates to be applied on cost
 - Increase profits by at least 1%

Materials

- Excess materials
 - Trace to specifications
 - Delivered to different address
- Taxes

Equipment

- Equipment
 - In use – compare to labor
 - Insurance
 - Source: internal or third party
- Autos – Trucks
 - Equipment pool – audit pool
 - Allowance – included in compensation
 - Third party rental

Subcontract

- Self performed work
- Lien waivers
- Trace change orders with owner to subcontractors
- Cost reimbursable – high risk
- Clean-up
- Backcharges
- 90% of cost
- Check licenses
- Terminated subcontractors

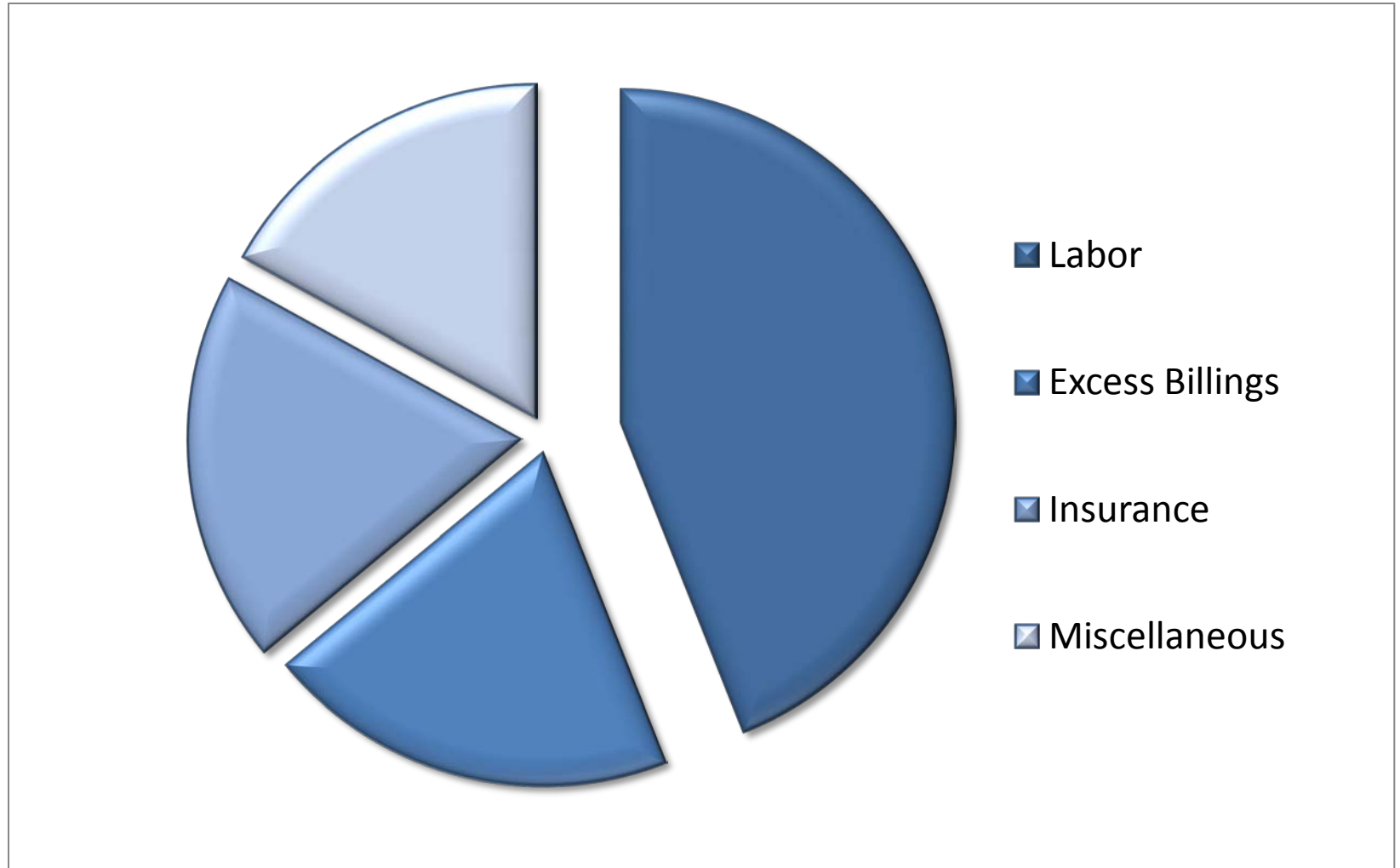
Fee

- Recalculate fee
- Fee percent complete should equal overall job percent complete

Cost Reimbursable - Red Flags

- Staffing
- Low Fee
- Fixed rates
- More than one subcontractor on a trade
- Different shipping address
- Self Performed Work

Over Charges



Time and Material - Risk

- Improper classification
- Improper rates
- Billing for costs in the rates

Architect Engineer

- Labor classifications
- Reliance on work
- Review change orders for entitlement
- Prototype design

Why Audit?

- Potential over billings
- Ensure owner receives deliverables
- Protect against irregularities
- Built in accordance with specifications
- “Low hanging fruit”

Preventative Measures

- Verification of the contractor qualifications
 - Financial statement review
 - References
 - Track record with this company
- Contract terms and conditions
- Review licenses
- Audit – construction life cycle

QUESTIONS?

Contact Information

John M. Croy
National Leader
Risk Advisory Services Construction

john.croy@mcgladrey.com

(C) 208 724-7804