The Path Paved With Good Intentions – Recent Issues in Fraud and Compliance

Speakers:

SAURA J. SAHU
SONI H. MITHANI
DOUGLAS L. MAIBACH, P.E.
MICHAEL A. HOSTETTLER
WAYNE KALAYJIAN, P.E., S.E., C.F.E.
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Learning Objectives

By attending this session participants will be able to:

- Identify the most common construction fraud schemes
- Identify probable amounts of loss due to fraud
- Identify possible related criminal exposure, including RICO and the Foreign Corrupt Practices Act
- Identify key risks in relation to the federal False Claims Act
- Learn how an active compliance program can add value and avoid risk
- Learn the key elements of an effective compliance program
FRAUD WEAKENS THE BUSINESS - LIKE BUILDING A HOUSE ON WATER

- False Financial Statements
- Overstating Assets or Revenue
- Undervaluing Assets or Revenue

- "Redirected" Assets
  - Costs - Skimming, Payroll Fraud, etc.
  - Equipment & Materials

- Corruption
  - Bribery, Gratuities
  - Conflicts of Interest
  - Economic Extortion
• False Financial Statements
  • Overstating Assets or Revenue
  • Understating Assets or Revenue

• “Redirected” Assets
  • Cash – Skimming, Payroll Fraud, etc.
  • Equipment & Materials

• Corruption
  • Bribery, Gratuities
  • Conflicts of Interest
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SPECIAL CHALLENGES IN CONSTRUCTION - BUILDING A STRONG BUSINESS

- You can't control everyone and everything
  - Subcontractors, consultants and joint ventures
  - 90% of reported FCPA cases involve outside agents

- You meet lots of interesting characters
  - Bidding, permitting and license processes
  - Negotiating additions and cost overruns
  - Organized crime
  - International projects/govts.
    - Europe: Intermediaries and entertainment
    - Middle East: “Gifts”, conflicts of interest, facilitation payments
    - India: Bribes, financial manipulation, weak records
    - Africa: Intermediaries, informal payments, weak records
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Common Construction Fraud Schemes
- **Corruption** – Bid-rigging, bribery, fiduciary violations (execs, sales) AND aiding and abetting others when structuring transactions**
- **Billing** – Fake vendors and employees (accounting)*
- **Skimming** (receivable clerk, deposit clerk)*
- **Stealing inventory** and equipment (anyone)*
- **Checks to employees**, while falsifying entries to vendors in the books (accounting, anyone)
- **Kickbacks** when over-purchasing (project managers)
- **Payroll tax fraud** (payroll)
- **Padding wages** (payroll)
- **Expense reimbursement**, company assets & credit (execs, project managers, accounting)

* Fraudulent billing, skimming and asset theft are also the most common misappropriation schemes in general

** In the US (25%) and the world (36-50%), corruption is one of the top 2 kinds of fraud cases. By one estimate, corruption accounted for 34% of the construction fraud cases. Corruption is usually the most common scheme in any department except accounting, where fraudulent billing and check tampering prevail.
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Who Does This Affect?

- **Everyone**: This is not just a problem for large, global, public companies
- **Private companies**: Fraud hits them harder and more often than public companies or govts.
- **Small businesses**: Fraud hits them more often, and for just as much money as mega-businesses
- **Innocent businesses**: Even when nothing is actually wrong, a culture of compliance avoids the appearance of impropriety and expensive, misguided investigations
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How Much Does Fraud Cost You?

**Association of Certified Fraud Examiners, 2012 Report to the Nations**
- Organizations usually lose about 5% of revenues to occupational fraud
- Median loss for a corruption scheme: $250,000 per case
- Median loss for a *construction* scheme: $300,000 per case
- “Corruption and billing schemes pose the greatest risks” - they are on the rise
- Top 10 FCPA settlements total over $3.5 Billion, all since 2008

**Bottom Line**
- Prevention is the key – after the money’s gone, only about 50% of victims actually recover anything
- Compliance programs work
  - “considerably lower losses and time-to-detection”
  - improve practices, efficiency, and morale across company
  - reduce employee replacement: costs 1/5 annual pay, plus litigation
  - more opportunity for mergers, growth, etc. (compare tanking of Olympus-Gyrus merger)
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What Are the Bigger Costs of Corruption?

Partners in Business

- International Chamber of Commerce - "Clean Business is Good Business," www.unglobalcompact.org


- Diverts health, education & infrastructure money
- Weakens public respect for law
- Facilitates criminal and terrorist activity - human, drug and weapons trafficking
- Distorts pricing and free, honest competition
- Undermines certainty and enforcement in transactions

"Corruption is the single greatest obstacle to economic and social development, and the fight against it is imperative. With our considerable resources, practical experience and front line position, international business must take a stand, for it is no longer enough to simply be against corruption or other unethical business practices. Global business leaders must be fully engaged in eradicating them and levelling the competitive playing field for all."

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What Happens To Those Who Don't Listen?
Criminal Charges

- Mail & Wire Fraud - 20 years
- RICO - 20 years
- Foreign Corrupt Practices Act - 5 years, 100K/$2M
- Conspiracy - RICO (20 years); general (5 years)
- Aiding and Abetting - Same as crime - 18 USC 2
- Accessory - 1/2 the crime - 18 USC 3
- Fines - 2x Ill-Gotten Gains or $250K/$500K - 18 USC 3571
Big-Money Civil Claims

False Claims Act
- Treble or double damages and fees
- Trends: DBE Fraud, Implied Certification

Civil RICO
- Treble damages and fees
- Lessons Learned
- Bid-Rigging
Global Exposure - FCPA

Anti-Bribery

- Who?
  - U.S. people and companies anywhere
  - Any company publicly traded on US Exchange or issuing penny stocks
  - Non-US people and businesses while in US

- What?
  - Pay, offer or authorize
  - Anything of value
  - To foreign official
  - To influence decision or secure improper advantage
  - To get or keep business

Accounting

- Publicly traded companies
  - Must maintain books and records [create paper trail]
  - Must have internal accounting controls

- People/companies
  - Cannot falsify records
  - Cannot fail to have controls
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Emerging issues:
  • Intermediaries
  • State-run businesses
  • Payments to get generally favorable treatment
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Are There Benefits for Those Who Listen?
Criminal Charges


When deciding whether to charge the company at all, prosecutors specifically consider:

- the company's willingness to report misconduct
- "the existence and adequacy of the corporation's pre-existing compliance program"
Sentencing

Under the U.S. Sentencing Guidelines, which advise Courts about the sentence to impose:

- Immediate 3-point reduction, plus potential to support other reductions

- Must be "reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct"
15 Elements of an Effective Compliance Program - Climbing the Ladder of Success
1. Establish Standards
2. Educate Corporate Governance
3. Assign Responsibility
4. Establish Reporting Chain
5. Devote Adequate Resources
6. Train Everyone
7. Incentivize
8. Establish Misconduct-Reporting Avenue
9. Deal With Misconduct
10. Beware Dicey Staff
11. Report Misconduct to Authorities
12. Audit the Program
13. Establish Periodic Updates
14. Evaluate the Program
15. Evaluate Company's Ongoing Risks and Adjust Accordingly
TOP 5's

- Ways to Reduce Median Loss
- Ways to Reduce Duration
- Suggestions for Small Bus.
- Riskiest Weaknesses
- Most Likely Controls Already in Place When Fraud Occurs
Q&A

PRESENTERS:

Saura J. Sahu  
Principal  
Miller Canfield Paddock & Stone PLC  
sahu@millercanfield.com  
313-496-7646 -or- 313-409-7590 (c)

Michael A. Hostettler  
- and -  
Wayne Kalayjian, P.E., S.E., C.F.E.  
Financial Advisory Servs., Capital Projects  
Deloitte Transactions & Business Analytics, LLP  
mhostettler@deloitte.com, 714-436-7768  
wkalayjian@deloitte.com, 213-593-4548

Soni H. Mithani  
Senior Principal & Deputy Group Leader  
Miller Canfield Paddock & Stone PLC  
mithani@millercanfield.com  
734-668-7786

Douglas L. Maibach, P.E.  
Vice Chairman  
Barton Malow Company  
doug.maibach@bartonmalow.com