



On Guard

When governments pump money into stimulus programs, fraud inevitably follows. Here is how to fight it.



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Summary

With large amounts of stimulus money sloshing around national, regional and local authorities, fraud attempts are siphoning off a significant percentage of contract value. FTI expert Dan Castleman says that by dedicating a tiny proportion of stimulus funds to fraud prevention, including the use of private-sector expertise, organizations can reduce fraud and ensure that the bulk of spending ends up where it can do the most good.

Around the world, governments are spending huge sums on stimulus plans in hopes of creating jobs, shoring up banks and boosting economic growth. Some of these programs are working better than others, but one thing is for certain: where there are government handouts, fraud, waste and abuse are rarely far behind.

As the head of investigations at the Manhattan District Attorney's office for 15 years, my office brought case after case against companies and individuals seeking kickbacks, rigging bids, issuing false invoices and engaging in outright theft. This took place across a wide scope of industries and all manner of public projects. The theft routinely amounted to a tenth of the value of contracts. In fact, one group of insurance fraudsters went as far as to brand themselves the "Ten Percenters."

With the equivalent of hundreds of billions of dollars being pumped into economies via a tangle of national, regional and local authorities, only the least ambitious thieves are not actively engaged in gaming stimulus systems. Take the U.S. bank bailout package, or Troubled Asset Relief Program (TARP). In its latest report to Congress, delivered in late January, the auditor of the \$700 billion program noted that its confidential fraud hotline received nearly 10,000 tips in its first year of operation. The suspected frauds run the gamut, including "accounting fraud, securities fraud, insider trading, bank fraud, mortgage fraud, mortgage servicer misconduct, fraudulent advance-fee schemes, public corruption, false statements, obstruction of justice, money laundering, and tax-related investigations," according to the audit report.

The auditor describes its fraud-fighting arm as a "sophisticated white-collar investigative agency." This group contributes to a special task force created to fight financial fraud related to stimulus programs, with other members drawn from

On the Upswing

Cumulative Civil and Criminal Investigations Initiated by the U.S. Government's Bank Bailout Program Watchdog

| | Investigations Opened | Investigations Ongoing |
|---------------|-----------------------|------------------------|
| March 31 2009 | 20 | 20 |
| June 30 2009 | 35 | 35 |
| Sep. 30 2009 | 61 | 54 |
| Dec. 31 2009 | 86 | 77 |

Source: Office of the Special Inspector General for the Troubled Asset Relief Program

a variety of criminal and civil law enforcement agencies and regulatory bodies. This approach is not ideal. Government agencies have a tendency to take too long to staff up – for example, the financial fraud task force held its first meeting in December 2009.

A Little Goes a Long Way

The problem is not confined to the world of high finance. Significant shares of stimulus funds are being devoted to construction and infrastructure projects, areas highly susceptible to fraud (see table overleaf). Late last year, the U.S. Department of Energy's inspector general published a report, *Management Challenges at the Department of Energy*, that lamented staffing shortages and other internal weaknesses. Similar agencies around the world face major challenges in keeping track of the flood of stimulus money meant to subsidize everything from large public works

projects to small home-improvement measures. The influx of funds is putting already understaffed offices under great strain, providing opportunists with an easy route to ill-gotten gains.

The solution is to devote a small share of stimulus funds to fraud prevention and detection programs. This way, the authorities can protect projects without struggling to stretch already thin resources.

When it comes to fighting fraud, a little goes a long way. Meaningful prevention, detection and investigation can be funded with no more than 2% of the stimulus money dispensed. Thus, a local authority receiving \$50 million for an infrastructure project should set aside \$1 million to fund anti-fraud efforts. If, in the end, the fraud-fighting initiative costs less than this, the remainder can be returned to the project's budget.

In addition to funding adequate prevention budgets, the effectiveness

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Fraud prevention can be funded with just 2% of the stimulus money dispensed.

and efficiency of spending can be enhanced further by engaging private-sector players. Former government prosecutors, regulators and detectives with experience in investigations abound in private practices. If these resources are tapped, watchdog programs become both more agile and less costly, as greater competition among bidders drives down the overall price of prevention.

Some might object to a perceived windfall to private companies. But these concerns are easily addressed, as it should be seen as spending 2% in order to save 8% in forgone fraudulent waste.

The alternative, however well intentioned, involves shuffling resources among law enforcement agencies that are already swamped with corruption cases growing as fast as governments can approve bills to boost stimulus spending.

The appetite of fraudsters to siphon off money from public projects is insatiable. Whatever the intentions or circumstances that surround a particular stimulus plan, by its nature these funds represent a pay day no criminal can ignore, particularly when times are tough. As a result, a precondition of putting honest people to work is putting fraudsters out of business. ■



Where Has the Money Gone?

| Country | Total Stimulus (\$ billion) | Construction Stimulus (\$ billion) | Breakdown (approx.) |
|-----------|-----------------------------|------------------------------------|---|
| U.S. | 800.0 | 135.0 | 67% infrastructure, 33% energy and housing repair |
| Germany | 81.0 | 32.4 | 55% road/rail, 20% education construction, 13% energy |
| Canada | 33.0 | 26.5 | 71% infrastructure, 29% housing |
| Australia | 38.0 | 16.2 | 67% education construction, 29% housing renovation |
| Spain | 14.4 | 10.5 | 80% infrastructure, 15% housing |
| France | 34.5 | 6.3 | 80% rail and energy infrastructure, 10% housing |
| Italy | 114.0 | 5.0 | 100% infrastructure |
| UK | 31.0 | 4.6 | 27% education construction, 26% housing, 24% roads |
| Total | 1,145.9 | 236.5 | |

Source: Global Insight Construction Outlook