

SOURCE: *IOMA's Report on Preventing Business Fraud*

DATE: *Issue 98-11*

TITLE: *Do You Perform Adequate Background Checks on Your Top Executives?*

The higher up the corporate pyramid, the greater the potential loss from a dishonest employee. According to the ACFE's Report to the Nation on Occupational Fraud, losses from fraud caused by managers and executives are 16 times greater than those caused by non-managerial employees (see the figure on following page). That being the case, candidates for management positions – directors of internal audit, controllers, CFOs, and the like – warrant extra scrutiny before they're given keys to the corporate dining room.

PBF put this topic and other questions about pre-employment screening to several top execs at Research Associates, Inc., a Cleveland-based investigative firm specializing in pre-employment background checks. Here's what Kevin Prendergast and Dean Kutz, vice presidents with RAI, had to say:

Question: **Isn't it now standard procedure for companies to run background checks on applicants?**

Kutz: Indeed, many companies do conduct pre-employment background investigations as a matter of policy. However, most do not realize that these investigations can be tailored to the importance of the position involved. I think it's important to note that one background investigation does not fit all employees. Not all employees have equal job responsibilities, so why should they all be screened in the same way?

Prendergast: Let me just add that while basic searches are adequate for many types of positions, serious scrutiny is advised for management-level personnel – and for good reason.

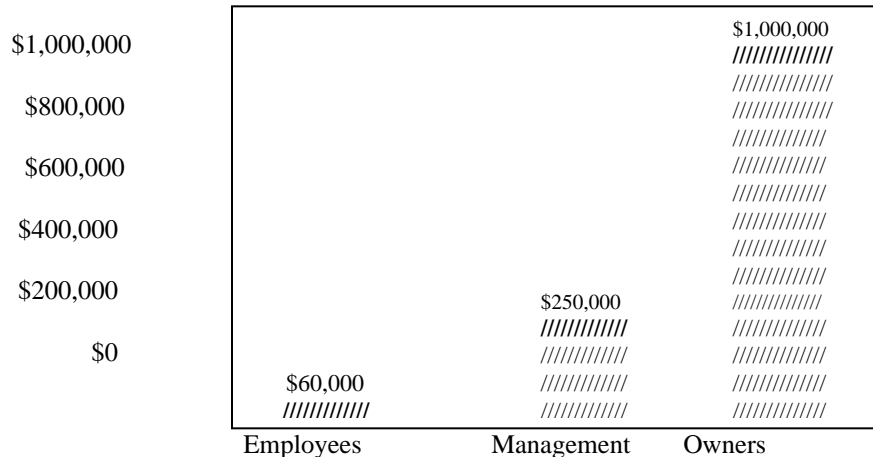
Question: **Those reasons include?**

Kutz: High-level employees are best positioned to steal from a company – and not just money. Executives and managers are privy to proprietary information. They are entrusted with corporate secrets, research data, new product developments, customer lists, corporate funds, and other sensitive information. Accountants have access to corporate funds and financial records. And systems personnel can reach into your corporate networks and personal computers.

The stakes are higher. The incidence and severity of fraud, embezzlement, theft, and sabotage rises sharply among managers, especially among those involved in financial and systems work. For example, even though embezzling is often associated with lower-level employees such as bank tellers, the amount of money executives embezzle from corporate coffers each year dwarfs ordinary employee theft (see the sidebar below), according to *Trusted Criminals*, a book by David Friedrichs. He says in addition to "routine" high-level crimes, we are on a "new frontier" of "techno-crimes."

Prendergast: Exactly. There's a whole new world of cyberfraud, for example sabotage or the deliberate destruction of the company's computer systems and records when an employee is terminated. This, as we all know, can be done from remote locations with a computer and a password. Still another executive crime is the theft of ideas, designs, and formulas – the stealing of trade secrets. The theft of a unique design or formula – if it reaches a competitor – can be far more costly than the theft of money or material property.

Median Loss by Position



(Source: ACFE's Report to the Nation on Occupational Fraud)

“Trusted” Employees Wouldn’t Do This...

- **In a recent celebrated case, two high-level employees of the Wells Fargo Bank cooperated with a group of sports promoters to defraud the bank of more than \$21 million by taking advantage of a flaw in the computerized system of recording deposits and withdrawals.**
- **In a 1989 case, an accountant employed by New York City used a loophole in the city’s computerized accounting system to divert \$1 million into his own bank account.**
- **In a 1988 case, an \$18,000-a-year clerk at First National Bank of Chicago almost succeeded in embezzling \$68.7 million. The clerk had access to codes used by major corporations to wire transfers, which banks used to transfer one trillion dollars per week.**

In point of fact, trusted employees are the *only* ones who could get away with such frauds.

Question: Are the risks greater for smaller companies?

Kutz: In small companies, the wrong individual can poison the entire company and threaten its very existence; in larger firms, an entire operation. In either case, the tarnish to a company's reputation can be irrevocable. Thus, more and more companies now invest in preventive maintenance by prescreening all applicants for employment.

Question: What's different about the top exec background search?

Kutz: The scope. Management-level investigations should be conducted with due consideration of the scope and responsibilities of the position. Often companies perform what is known as a records check or criminal investigation on potential new hires. But what if an applicant was investigated for crimes but never prosecuted? A "record" will not exist. The only way to uncover such a finding is with a comprehensive investigation that includes intensive interviews with former employers and a thorough search of all newspaper reports. If the crime was committed in another state, the incident also may go unrevealed unless the search includes all former addresses.

Prendergast: Those are just a few of the procedures in a management pre-employment investigation. The inquiry also is likely to include a chronological review, identification, education, license, and employment verification, credit review, court research, driver's license review, and newspaper indices (see below).

Components of a Comprehensive Executive Pre-Employment Background Check

Chronological review. A history review that determines the candidate's activities from high school to the present. It is important to ensure that all months and years are accounted for on the application or resume. All "gaps" are reported and attempts are made to determine activities during these time frames. These gaps often suggest unreported employment information or even periods of incarceration.

Identification. The applicant is properly identified throughout the entire investigation using sources such as credit bureaus, schools, licensing agencies, employers, Social Security number traces, and driver's license records. This also ensures and verifies the accuracy of information provided by the applicant.

Education/license verification. All claimed educational degrees, professional licenses, certifications, and memberships are confirmed and all discrepancies are thoroughly researched. This is an area of the application which is often falsified.

Employment verification. All previous employments are confirmed through the personnel office of the company. The verification includes hire and termination dates, professional title, salary confirmation, and reason for leaving.

Credit review. A financial history is conducted. With proper interpretation, this can yield vital information. Red flags such as excessively high credit balances and overdue accounts can infer poor financial management or the possibility of a drug or gambling problem.

Court research. A thorough search of public records in the appropriate counties and federal jurisdictions based on addresses reported by the applicant or developed from other sources. These searches reveal any civil, criminal or bankruptcy matters identified with the applicant.

Driver's license review. The applicant's driving status and history is reviewed. This will reveal suspensions, restrictions and violations that could shed light on the applicant's responsibility, judgment and character.

Newspaper indices. A review of newspaper articles will be conducted and will reveal any mention of the applicant's name. These articles may be positive or negative in tone, but will offer further insight into the applicant's character and reputation.

When all is said and done, cross-checked and cross-referenced, in-depth interviews with former employers and character references provide the best insight into the character of the candidate. These should be conducted by experienced professionals with specialized interview skills. Former employers can be masters at evasiveness. Professional investigators know what to ask, how to ask it, and how to develop relationships that yield vital information about potential new executives.

***Question:* Doesn't it get fairly expensive to conduct executive background checks?**

Prendergast: Costs should not be a driving factor for key positions within the company. There is simply too much at risk in treating an executive-level candidate on an equal plane with entry-level positions.

Kutz: Companies must consider all possibilities when hiring top executives. When you place an individual in a position of trust, every precaution must be taken to ensure the integrity of the individual – and that means going beyond a “standard” background check. It means delving into the past in a unique and comprehensive way.