

KLINK & CO., INC.

A Global Leader in Risk Consulting

Communiqué

INVESTIGATING THE BACKGROUND OF CORPORATE EXECUTIVES BEFORE HIRING

The following is a Klink & Co., Inc. Communiqué discussing issues facing attorneys and corporate counsel.

In the past year, the private lives of corporate executives have gone from being the subject of idle water cooler chatter to being plastered on the front page of every newspaper in the country.

Due to scandals rocking Enron, Tyco, MCI Worldcom and other corporate giants, stockholders, investors and employees alike are demanding accountability from the top down. As a result, increased focus is beginning to be placed on the screening of high-level corporate executives before they are hired.

Despite the high-profile scandals that have occurred, today many executive searches are conducted in a manner akin to joining a country club: A couple of collegial phone calls to old acquaintances are made and a series of interviews in front of board members are conducted. This process focuses not on the applicant's personal background, but on the perceived successes of previous stops.

As accusations and indictments of corporate fraud continue to mount, shareholders are starting to demand that boards act more inquisitively when handing over the keys to a multi-million dollar corporation. The result: a keener interest in discovering

the entire background of a proposed candidate—not just a perfunctory review.

CASE STUDY: **POST-HIRE** **INVESTIGATIONS**

After months of subpar performance by the president of a subsidiary, the board of directors sought a background investigation of its president. For a one-year period this executive had earned over \$1 million dollars in salary and bonuses, but had performed poorly.

Klink & Co. thoroughly analyzed the resume of the president. Our investigation revealed that the president had committed serious resume fraud. He had deceived the board and company about former positions, employment and education.

When faced with these facts, the president was terminated, but the company had lost significant money, and had, perhaps more importantly, lost important momentum in the marketplace.

Resume fraud is a common practice for many employees, from executives to hourly employees. The costs of a “bad” hire can sap a company of momentum, moral and money.

One of the most glaring examples of corporate malfeasance occurred in 1998 with Al Dunlap, a.k.a. Chainsaw Al. Dunlap, former CEO of Sunbeam Corporation, was accused and subsequently indicted over charges of accounting fraud while at the helm of Sunbeam. Dunlap, who received his nickname because of his slash and burn style of management, was fired twice before joining Sunbeam because

of charges similar to those he now faces. As a result of Sunbeam's failure to conduct a thorough background check, which would have certainly revealed the previous charges against Dunlap, it is now facing billions of dollars in lost stock value.

By no means are cases like this uncommon. In recent months, we have seen numerous high - profile cases of resume fraud.

RECENT PROBLEMS

On October 18, 2002 it was revealed that Ronald Zarella, the CEO of Bausch & Lomb, had falsely claimed an MBA from NYU. On October 4, 2002 it was revealed that Kenneth Lonchor, CFO of Veritas Software, falsified his resume by claiming degrees from Arizona State University and Stanford. Lonchor holds a single degree from Idaho State.

Some companies have the mistaken opinion that recruiting firms are investigating and verifying resume assertions. Executive search firms do not perform comprehensive investigations of their candidates, and actually, may not be responsible for doing so.

Recently, the U.S. District Court in Washington and a circuit court in Cook County found that executive recruiters were in the “talent business and not the criminal investigations business.” As such, recruiters have been dismissed from legal actions seeking damages for breach of contract and negligence.

CASE STUDY: **PREEMPTIVE** **INVESTIGATIONS**

A Fortune 200 company was presented with the opportunity

to establish a charitable foundation benefiting local chapters of a charity around the country. Although the corporation had no reason to believe the opportunity was not legitimate, it asked Klink & Co. to conduct a thorough background investigation of the individual who was the “brainchild” behind the proposed foundation.

Our analysis revealed that the individual behind the charitable concept was previously accused of financial malfeasance by former partners and business associates. In addition, he had filed for bankruptcy and was in significant debt to several creditors. Considering that the corporation was asking this individual to handle millions of dollars in the every day operation of the foundation, it chose to look in another direction to more effectively address its charitable intentions.

Thorough, complete and preemptive investigations are necessary in today’s business world. The cost of such an investigation is minimal when compared with the amount of damage that can be caused by one “bad” hire. And what kind of example is set if the leader of a firm lies to the board, management and employees. Can employees and management be expected to act differently?

WHAT ARE THE LEGAL REQUIREMENTS?

Prior to conducting an investigation, the executive candidate should complete a Fair Credit Reporting Act (FCRA) waiver authorizing access to records that shed light on his character.

Great care should be taken when hiring a firm to conduct the investigation. Be certain that the investigation team is

experienced and that the coverage of their search is truly historical and nationwide in scope. Often, firms assert that their coverage is nationwide, when in fact it is not.

The cheapest alternative is not necessarily the best. Most firms are not capable of understanding complex financial dealings, lawsuits, and related-party dealings. Remember, at the end of the day, the most important need is that every candidate be thoroughly vetted and that the company has undertaken reasonable due diligence to ensure the hiring of a qualified candidate with impeccable credentials.

CONCLUSION

In the past, conducting background checks on applicants and employees has been met with significant resistance, especially for executive-level candidates. There is an unfounded fear that candidates will be offended. There is a dangerous assumption that certain candidates are already “known” to the board or management. Thorough background investigations are a basis for confidence for management, the board, and the candidate.

The lessons of the past year have taught everyone that the financial impact of *not* conducting extensive background checks on executives could end up costing a company millions, if not billions, of dollars in lost stock value, corporate assets and hard earned reputations.

When the livelihood of thousands of investors, management and employees are reliant upon the ethics of the people at the top of the pyramid, there is only one prudent course of action: Analyze the

background of the candidate thoroughly and completely.

The Klink & Co., Inc. Communiqué is prepared in summary form and is not to be construed as legal advice or opinion on any specific fact or circumstance.

For more information regarding Pre-Employment Screening or other services, please call:

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