

**LYNDON GROUP**



**“Background Screening – Why Organizations Need To Assess”**

**Written by Doug Beeuwsaert, GRC Practice Leader, Lyndon Group and  
Katie Hartley, Marketing Specialist, Accurate Background**

Since Chapter Eight of the Federal Sentencing Guidelines for Organizations was first issued in 1991 by the United States Sentencing Commission, organizations have been aware of the need for employee screening as part of an effective compliance and ethics program. As part of the Guidelines, “organizations shall use reasonable efforts to not include within the substantial authority personnel of the organization any individual whom the organization knew or should have known through the exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program”. In response to this element, organizations typically consider how any prior misconduct relates to the specific job responsibilities to be performed, when the misconduct occurred and whether the individual has engaged in other misconduct.

With new regulations, a revision to auditing standards, updates to the Guidelines and pressure to reduce costs, if an organization hasn’t recently assessed their screening program, now is the time. Since the Guidelines were first issued and more recently, with the Sarbanes-Oxley Act (SOX), most organizations have implemented a background screening program for employees. However, we all have read about, or been faced with, CEOs, high-level executives or Board members who falsified their resume or employment application, or never corrected a biography containing inaccurate information that later became part of a public filing. We’ve also encountered situations where an agent, representing the organization, acted in an inappropriate manner, thereby putting his future with the organization at risk as well as creating potential liability for the organization.

While the embarrassment and reputational hit that an individual experiences is devastating and sometimes cannot be recovered, the wide-ranging negative impact and the potential harm to an organization’s reputation are compelling and legitimate reasons for organizations to review what screening processes are in place. If the reputational risk is not considered a significant motivation, the following reasons should further compel most organizations to audit and/or assess their background screening programs.

### **New SEC Proxy Disclosure Rules**

The Security and Exchange Commission adopted new proxy disclosure requirements for public companies in December 2009. The new rules require companies to annually disclose each director’s or nominee’s “skills, qualifications or particular areas of expertise that would benefit the company and should be disclosed to shareholders”. Essentially, they must annually disclose what led the Board to conclude that the person should serve as a director. The disclosure must be made annually and also include directors who are not up for re-election that year.

Public companies are now also required to disclose directorships held by each director and nominee at any time during the past five years, at any public company or registered investment company. The SEC expanded this disclosure to “include service on boards of those companies for the past five years (even if the director or nominee no longer serves on that board) and will allow investors to better evaluate the relevance of a director’s or nominee’s past board experience, as well as professional or financial relationships that might pose potential conflicts of interest (such as past membership on boards of major suppliers, customers, or competitors).” Additionally, disclosure of other legal actions involving a company’s executive officers, directors and nominees has changed from five years to ten years. The SEC believes this change provides investors with more extensive information regarding an individual’s competence and character.

In the past, companies may have simply administered a Directors and Officer Questionnaire or taken a director’s curriculum vitae and created a biography to include in the company’s proxy. Now, not only does that questionnaire need to be revised but it should be followed by a ‘Disclosure and Authorization Background Release Form’ for companies to verify the information submitted using a background check.

Accurate Background, a leading background screening company based in Lake Forest, California, recently conducted a survey of 124 companies and it revealed that only 21 of the 71 (30%) companies (with Boards) currently screen Board members and of the 50 that don't, only two plan on implementing a board screening program in 2010. Progressive vendors like Accurate Background offer an executive search package that is typically used for executive-level searches but can also be used to conduct these sensitive screening procedures for board members and nominees.

If your organization is not currently verifying the background information of Board members and nominees, these new disclosure requirements should convince you to re-evaluate that decision in order to ensure the accuracy and completeness of these disclosures.

### **Revised Internal Auditing Standards**

In January 2009, a revision to the International Professional Practices Framework of The Institute of Internal Auditors (The IIA) became effective that made an evaluation of the organization's ethics-related objectives, programs and activities a requirement. IIA Standard 2110 is intended for the internal audit activity within an organization to review the entire ethics program; the requirements outlined in the Federal Sentencing Guidelines are typically used as the basis for these evaluations. Either as part of the overall evaluation of the ethics-related programs or as a specific, periodic review, internal audit departments must now review employee screening programs.

These reviews should evaluate the design and operating effectiveness of the screening process controls including adherence to all legal requirements, search criteria and considerations, and adjudication guidelines. According to Dave Dickerson, President of Accurate Background, "Consistency in the search criteria and adjudication guidelines as well as a cohesive background screening policy are very important steps in avoiding a lawsuit for discrimination or non-compliance with Federal and State regulations. Background screening in itself is a good first step, but employers must set clear hiring standards to avoid potential liability." In addition to reducing exposure, according to Scott Farber, Partner at Grant Thornton LLP, the existence of an effective screening program strengthens the entity-level controls for SOX purposes and may result in the external auditors placing more reliance on the company's controls. Scott adds "There are benefits for having an effective employee screening program from a SOX perspective – conversely, the lack of appropriate screening may increase the risk of deficiencies in controls over financial reporting, depending upon the existence of other mitigating controls".

Some of the legal requirements that should be included in a review of the screening program include the Fair Credit Reporting Act (FCRA), Equal Employment Opportunity Commission (EEOC), State laws, industry-specific regulations, and any exceptions to the laws. For example, FCRA rules promote the accuracy, fairness and privacy of information in the files of consumer reporting agencies and have specific provisions requiring written notice and authorization as well as procedures for adverse actions (e.g., denying a job application, reassigning or terminating an employee, or denying a promotion). Risk of non-compliance may include legal consequences for employers who fail to get an applicant's permission before requesting a consumer report or who fail to provide pre-adverse action disclosures and adverse action notices to unsuccessful job applicants. The FCRA allows individuals to sue employers for damages in federal court, and in addition, the Federal Trade Commission (FTC), other federal agencies, and individual states may sue employers for non-compliance and impose civil penalties.

The FCRA rules cover the collection, usage, storage and disposition of consumer reports and require businesses and individuals to take appropriate measures to dispose of sensitive information derived from consumer reports. Also, according to the FTC, "Any business or individual who uses a consumer report for a business purpose is subject to the requirements of the Disposal Rule, a part of the Fair and Accurate Credit Transactions Act of 2003 (FACTA), which calls for the proper disposal of information in consumer reports and records to protect against unauthorized access to or use of the information." Non-compliance of the Disposal Rule may include charges of unfair and/or deceptive trade practices by the FTC as well as individual state attorney generals.

## Revised Federal Sentencing Guidelines

Revisions to the Federal Sentencing Guidelines for Organizations were issued in 2004 which states "the organization shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement, or modify each requirement set forth in order to reduce the risk of criminal conduct identified through this process." To meet this requirement, organizations must assess the following:

- a) the nature and seriousness of criminal conduct
- b) the likelihood that certain criminal conduct may occur because of the nature of the organization's business and;
- c) the prior history of the organization

If, because of the nature of an organization's business, there is a substantial risk that certain types of criminal conduct may occur, the organization must take reasonable steps to prevent and detect that type of criminal conduct; as stated earlier, one of those steps is an effective employee screening program.

Additionally, the revisions include an expansion of the definition of an effective compliance and ethics program to also require that organizations promote a culture that encourages a commitment to compliance with the law. To accomplish this, a well-documented and supported screening program, clearly communicating its purpose, will ensure that all interested parties know the organization's commitment to only hire and partner with individuals with similar values and those that meet the expectations of the organization.

As a result of these revisions, it now becomes imperative that organizations implement and periodically assess the effectiveness of the background screening program and ensure the risk of criminal conduct is reduced. Besides assessing the program for employees, organizations should ensure others that represent or act on their behalf receive adequate screening. There are numerous examples of agents, such as third-party distributors or consultants, with criminal backgrounds that have committed crimes that were not pre-screened and committed crimes once hired by the organization.

## Reduction of Overall Program Costs

With many organizations facing dwindling resources, both human and capital, it is critical that organizations ensure the cost effectiveness, process efficiency and consistency of their screening program. These objectives should also be included in the assessment in order to maximize the return on the investment while ensuring that a certain level of due diligence and thoroughness are maintained. As is the case with other governance controls, organizations should start with a risk assessment of the current screening program in place.

Areas that can be reviewed and questions that should be asked include:

- *Do protocols and requirements exist by position based on authority and responsibility and are they incorporated into company policy?*
  - This ensures consistency, eliminates unnecessary screening procedures and, in some cases, may add screening that doesn't currently exist but may decrease the company's vulnerability and exposure to legal ramifications. Of the 124 companies surveyed by Accurate Background, 65% have these protocols in place.
- *Are third-parties (vendors, contractors, etc.) who interact with your customers and have access to company assets screened?*
  - This will reduce potential liabilities should a third-party commit a crime while engaged by your organization. Only 32% of the companies surveyed require background screening for third-parties

who act on behalf of the company, and of those, 72% require the same level of background screening that is performed on their own employees.

- *Are adjudication guidelines documented and approved by senior management?*
  - Over half of the survey respondents (54%) do not have written adjudication guidelines in place. By documenting your organization's adjudication guidelines, your organization is able to streamline the screening process and ensure consistent handling with background "hits" by taking the personal bias out of the hiring decision. Documented guidelines should include clear direction regarding what information in the background check results in a "Meets" or "Doesn't Meet Requirements" hiring decision.
- *Has a historical analysis of prior years' screening results been completed?*
  - This type of analysis might identify trends, unidentified risks and areas to improve.
- *Do screening procedures and proper controls exist for internal promotions and transfers?*
  - Many organizations run a background check upon initial hire but don't have a policy in place for internal promotions and transfers of current employees. Background screening programs should not end with the initial background check; rather employers should establish an ongoing screening program that includes semi-annual background checks, annual background checks, and/or background checks for internal promotions and transfers. These types of ongoing background checks can consist of a more streamlined background screening process. For example, your organization might consider running a criminal search only in those areas where the employee has lived since the initial background check.
- *Is there a measurement program in place to gauge effectiveness of the background screening program?*
  - Although there is also a deterrent value to a properly communicated background screening program (applicants with misconduct in their past may not apply for employment), metrics that can be used to present to senior management and the Board include:
    - Turnaround time (number of days from input to results)
    - Number or % of resume / application inaccuracies detected
    - % of total employees receiving some level of screening
    - % of false positives generated by your background screening vendor
    - Termination for cause versus background screening results
- *Has a benchmarking study been conducted to compare to others within your industry and of similar size?*
  - This can determine if your program is at least on par with others that compare to you. Your background screening partner should be able to provide some guidance based on similar organizations in their client base as well as their knowledge of background screening best practices.
- *Has your background screening vendor provided a customer satisfaction survey?*
  - Background screening providers should be asked to monitor and provide customer satisfaction data detailing overall satisfaction with customer service and the products offered, overall satisfaction with fulfillment of needs, and areas of improvement.
- *Have you reviewed your organization's and your background vendor's record retention and privacy policies and controls?*
  - Record retention policies will help to ensure legal and regulatory compliance and potentially reduce costs and legal exposure.

## Summary

Proper administration and communication of a background screening program not only helps to ensure that the organization hires and does business with individuals who share their values, but it can serve as a deterrent for those candidates that may have a criminal past and because of the position for which they are applying, will not be eligible for hire.

Each organization should set goals and objectives for the screening program, then structure the program based on the culture and size of the organization and standard industry practices. Additionally, organizations must consider including the extended enterprise, such as agents, vendors, subcontractors and others who represent the organization. In some cases, organizations can insist that this group be included in their screening program, or require evidence that they have been adequately screened through their own program (but still according to the organization's policies).

Although 58% of the respondents to Accurate Background's survey indicated that their organization's background screening requirements had been audited or reviewed in the last 12 – 18 months, the scope of these audits is not known. However, an audit of the screening program that considers the areas noted above is not only prudent but is now a necessity for many organizations.