

The Risky Side of People

MANY ORGANIZATIONS HAVE FACED cases in which CEOs, high-level executives, or board members falsified their résumé or employment application, or never corrected a biography containing inaccurate information that later became part of a public filing. Some have encountered situations where an agent representing the organization acted inappropriately, creating a potential liability for the organization.

Auditors should provide assurance that background screening covers everyone who represents the organization.

BY DOUG BEEUWERT
AND KATIE HARTLEY

The wide-ranging negative impact and the potential harm to an organization's reputation are compelling and legitimate reasons for internal auditors to review the background screening processes their organization has in place and who the program covers. As part of their compliance and ethics program, most organizations conduct background screening on employees and typically consider how any prior misconduct relates to the specific job responsibilities to be performed, when it occurred, and whether the individual has engaged in other misconduct. However, internal auditors also need to ensure that these programs cover all individuals that represent the organization and resources are used effectively and efficiently to reduce potential liability and reputational risk.

ORGANIZATIONAL RISK

Since Chapter Eight of the U.S. Federal Sentencing Guidelines was first issued in 1991, organizations have been aware of the risk of not having a background screening program. Revisions to the Guidelines in 2004 state that "the organization shall periodically assess the risk of criminal conduct and shall take appropriate steps to design, implement, or modify each requirement set forth to reduce the risk of criminal conduct identified through this process." To

meet this requirement, organizations must assess:

- The nature and seriousness of criminal conduct.
- The likelihood that certain criminal conduct may occur because of the nature of the organization's business.
- The prior history of the organization.

Additionally, the revisions include an expansion of the definition of an effective compliance and ethics program to 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 — can ensure that all interested parties know the organization's commitment to hire and partner with only individuals with similar values and those that meet the expectations of the organization.

More recently, the U.S. Securities and Exchange Commission's (SEC's) new proxy disclosure rules for publicly listed companies are pushing companies to address potential risks posed by corporate directors. The rules require companies to disclose annually each director's or nominee's "skills, qualifications, or particular areas of expertise that would benefit the company and should be disclosed to shareholders." Additionally, the period in which U.S.-listed companies must disclose legal actions involving their executive officers, directors, and nominees has been extended from five years to 10 years.

Although the proxy rules point to a need for organizations to know more about the backgrounds of prospective directors, such screening is not common. In a recent survey of 124 U.S.-based companies by background screening company Accurate Background, only 30 percent of

respondents with a board of directors currently screen board members. Of the companies that don't, only two plan on implementing a board screening program this year. Thirty-two percent of respondents were companies with less than 3,000 employees, and 68 percent had from 3,000 to 50,000 employees; 57 percent were publicly listed companies.

Internal auditors should review board screening as part of their evaluation of their organization's program to address ethics-related risks, as directed by IIA Standard 2110: Governance. This evaluation can be performed either as part of the overall evaluation of ethics-related programs or as a specific, periodic review. Auditors 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. Additionally, ensuring screening protocols are in place for board members can provide assurance that the disclosures made in SEC filings accurately reflect the qualifications of all directors.

ASSESSING PROGRAM RISKS

With many organizations facing dwindling human and capital resources, it is critical that they ensure the cost effectiveness, process efficiency, and consistency of their screening program. These objectives also should be included in the assessment to maximize the return on 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.

■ *Do protocols and requirements exist by position based on authority and responsibility, and are they incorporated into company policy?* Establishing these protocols and requirements can ensure consistency, eliminate unnecessary screening procedures and, in some cases, may add screening that could decrease the company's vulnerability and exposure to legal ramifications. For example, education and professional certification verification may be conducted on all candidates who claim such credentials, but credit checks may only be conducted on those with access to certain company funds or consumer financial records.

■ *Are third parties who interact with the organization's customers and have access to its assets screened?* Such screening can reduce the risk of doing business with a third party with a criminal history and the potential liabilities should that third party commit a crime while engaged by the organization. However, only 32 percent of the 124 companies surveyed by Accurate Background require background screening for third parties who act on behalf of the company.

■ *Do applicants manually complete the required paperwork, and does human resources handle screening requests?* Considerable organizational time and resources can be reduced or eliminated if the organization's screening vendor offers applicant entry capability or can be integrated with the organization's applicant tracking system. When applicants enter their own information online, the level of duplicate requests is greatly decreased.

■ *Are adjudication guidelines documented and approved by senior management?* More than half of the survey respondents (54 percent) do not have written adjudication guidelines in place. By documenting these guidelines, organizations are able to streamline the screening process and ensure consistent handling of background database "hits" by taking the personal bias out of hiring decisions. Documented guidelines should include clear direction regarding what information in the background check results in a "meets requirements" or "doesn't meet requirements" hiring decision.

■ *Do screening procedures and appropriate 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 or transfers of current employees. Background screening programs should not end with the initial background check; rather employers should establish an ongoing screening program that considers annual background checks and checks for internal promotions and transfers. However, these types of ongoing screening can consist of a more streamlined process such as running

a criminal search only in those areas where the employee has lived since the initial background check.

■ *Has a historical analysis of prior years' screening results been completed?*

This type of analysis might reveal trends, unidentified risks, and areas to improve. For example, if checks conducted against a national criminal database do not result in any hits over time, but county criminal record searches provide all the information necessary for employment decisions, the organization might save money by eliminating checks against the national database.

■ *Have the record retention program, privacy policies, and related controls of both the organization and its background screening vendor been reviewed?* Record retention policies will help to ensure legal and regulatory compliance and may reduce costs and legal exposure.

Besides assessing the program for employees, auditors should review whether agents who act on their behalf, such as third-party distributors or consultants, receive adequate screening.

PROGRAM AUDITS ARE ESSENTIAL

Although 58 percent of the Accurate Background survey respondents indicated that their organization's background screening requirements had been audited in the past 12 to 18 months, the scope of these audits is not known. However, an audit of the screening program is not only prudent, but is now a necessity for many organizations. Appropriate administration and communication of a background screening program can help ensure that organizations hire and do business with individuals who share their values, as well as serve as a deterrent for those candidates who may have a criminal past and will not be eligible for hire in the position for which they are applying. 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.

TO COMMENT on this article, e-mail the authors at doug.beeuwsaert@theiia.org.

SEND RISK WATCH article ideas to Paul Sobel at paul.sobel@mirant.com.