

COULD A BETTER BACKGROUND CHECK HAVE PREVENTED A MASSIVE ACCOUNTING FRAUD?

“Chainsaw Al” is not the sort of nickname that most people would want but Albert J. Dunlap seemed to revel in it. The nickname was featured prominently in obituaries after his death early this year. The New York Times’s obit said that Dunlap earned it because of his “ardor for turning around troubled companies by laying off workers and closing factories.” He had other nicknames, including “the Shredder” and “Rambo in Pinstripes.”



Dunlap first came to prominence in 1994 when he was named chairman and CEO of Scott Paper. He cut costs and arranged the sale of the company to rival Kimberly-Clark the following year in what was hailed as a highly successful deal. Two years later, Dunlap became chairman and CEO of Sunbeam Corp., a publicly traded consumer products company based in Florida. Sunbeam’s products ranged from toaster ovens and hairdryers to barbecue grills. When Dunlap’s appointment was announced, the company’s stock price soared on the assumption that Chainsaw Al would work his magic.

Wall Street later learned that much of Sunbeam’s supposed profit was illusory, the product of crooked accounting practices. One gimmick involved “selling” barbecue grills to retailers on such generous terms that Sunbeam should never have recognized the revenue.

When the phony accounting practices were exposed, the end came quickly. Sunbeam’s board fired Dunlap in 1998. The company restated its results and its share price collapsed, triggering class-action securities fraud cases. The Securities and Exchange Commission accused Dunlap and others of orchestrating a massive accounting fraud. “At year-end 1997,” according to the SEC, “at least \$62 million of Sunbeam’s reported income of \$189 million came from accounting fraud.” Dunlap settled the SEC case as well as shareholder litigation.

One remarkable aspect of the Sunbeam saga is that it might have been avoidable if Dunlap had been vetted more thoroughly before he was hired. In other words, Sunbeam is not only the story of an accounting fraud. It also illustrates the importance of [due diligence](#) in preventing fraud.

In 2001 – three years after Dunlap was forced out of Sunbeam – the Times published an investigative piece in which it revealed that he had omitted one of his early jobs from his résumé and that his former employer had accused him of accounting fraud. Details appeared in [civil litigation filed in the 1970s](#). The allegations against Dunlap in the Sunbeam case were “remarkably similar to the ones he had faced two decades before,” according to the article.

The 2001 exposé cited court documents from litigation between Dunlap and his former employer. These were public records which the newspaper had obtained from the National Archives.

Dunlap denied the old fraud allegations, according to the article, and his lawyer “described them as ‘old and stale’ and of no interest now.” Dunlap’s successor at Sunbeam had a different view. “We were shocked when we heard about this,” he said, adding: “I find it most unusual that anyone could be hired as a chief executive of a major company without having their background thoroughly checked.”

What should have been done?

A thorough background check should obviously include litigation research in jurisdictions where that is possible, such as the United States. Since it isn’t possible to search every court, pre-employment background checks usually focus on the jurisdictions where the subject has spent significant time – as well as adjacent areas. Thus, for example, if the subject lives and works in Washington, D.C., it would be appropriate to conduct litigation research in D.C., Virginia, and Maryland. If the subject is being considered for a low- or mid-ranking job, the litigation research is usually restricted in time – for example to the past 10 years.

If the subject is being considered for a high-ranking position, such as CEO of a public company, a more thorough search is in order: Including additional jurisdictions and going farther back in time, perhaps to the beginning of the subject’s career. If such a search had been done on Al Dunlap, there’s a good chance that the old allegations of accounting fraud would have been discovered and the Sunbeam catastrophe could have been averted.

The lessons of the Dunlap saga should be clear to all of us. One lesson is that the failure to conduct a proper background check can have dire consequences. The other is that litigation research is a key part of background-checking.

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