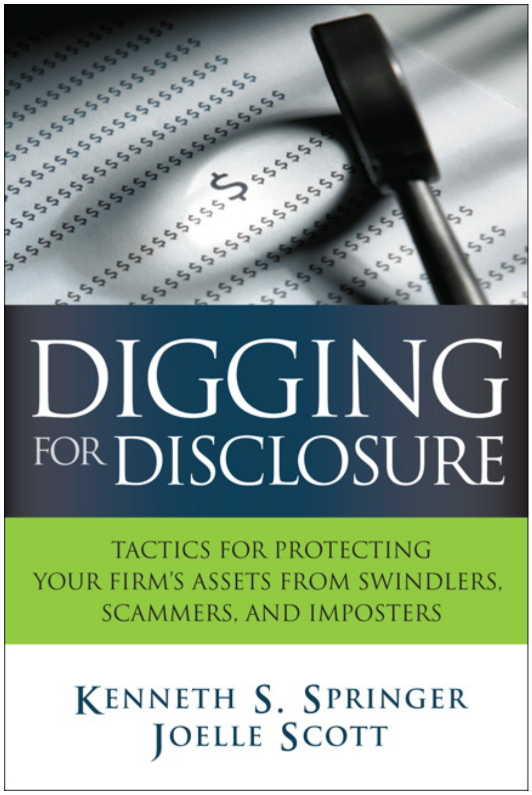
Digging for Disclosure provides practical advice to investors on how to prevent investment fraud through entertaining stories that illustrate the importance of knowing potential business partners and includes an examination of what investors would have discovered about infamous ponzi-schemers Madoff, Bayou, Stanford and others.



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Just When You Think You Know Someone

It is 6 a.m. on Friday. Your first week on the job. For the fifth day in a row, you still have to introduce yourself to the sleepy security guards in the lobby of the low-storied hedge fund hotel in Greenwich, Connecticut, that now houses your 13 employees. You find your way to your new windowed office and drop your dark brown leather satchel on the ledge—last year's Christmas present from your wife. Accustomed to seeing tall buildings and a famous skyline, you are still not convinced that clusters of small trees count as a "view." You stare out the window for a few idle moments. You swing around in your Aeron chair and glance over at the four Ivy League researchers pounding away at their black keyboards. You summon them to your office. You need an update.

You have spent the last three months convincing the five old-school members of the board of directors that you, a savvy former M&A specialist from New York City, are capable of running this private equity firm—the same firm that over the past four years has earned the reputation of successfully turning around troubled companies and securing investor money. Now you have your chance. With $15 million cash in your hand, you are tasked with selecting the next investment.

For the past week, your research team has spent countless hours focusing on target companies. When they rush to your office, eager to please the new boss, they show you the balance sheet of a struggling Midwestern plastics business that lacks the necessary funds to take the company to the next level. Two days later, you fly out there and meet the owner of the business. You like his enthusiasm. You walk through the facilities and meet a few of the 57 employees whose jobs you intend to save. Back in Connecticut, you do some legal due diligence and run some financial models. Over the course of six months, you get to know the owner, his employees, and the way the company operates; you like what you see.

You decide you want to acquire the company and prepare a term sheet. The thought of screwing up your first investment makes your palms sweat, so you decide to do a little more homework before you ink the deal. You call a private investigations firm like ours to check out the owner of the company.

One week later, we call you back. The owner of the company has, well, an interesting history: He was arrested and convicted on three separate occasions for "exposing himself" at the drive-thru of different local fast-food joints. Given that "wardrobe malfunction" was not an option on the police report, you rethink your decision.

Really?

Yes, really. The story illustrates that no matter how much you spend on legal and financial due diligence, how many company walk-throughs you endure, scotches you sip together or rounds of golf you play, a person's true character (or lack thereof) is often only unveiled when you run a background check that complements your own research. If a person you are about to invest in is solid, then the information uncovered in a background check will support that. If, however, the person is not who you thought, then you need to know this immediately in order to make sound investment decisions.

The Tactic: Turning Over Neighboring Stones

We found out about the exhibitionist tendencies of the business owner by reviewing criminal records in the areas where the owner lived and worked. Trouble is not confined to a person's hometown. You must consider where the person lives, works, and travels. The criminal matters filed against the pants-dropping executive were filed in a different state than where the executive resided. We always review criminal records and court records in multiple jurisdictions to make sure that if there is something to be found, we will find it.

If It's Criminal, Then It's Relevant

To the investor who thinks a person's extracurricular activities are irrelevant to the deal as long as the person produces or performs: Consider what your limited partners or co-investors would think of that philosophy in light of the case just described.

Moving Forward

You never *really* know the person who is responsible for your money. What's important is to be comfortable with his or her character. We all have different definitions of ethics, morals, and success. You need to confirm that the person who has access to your money meets your expectations, and background checks are an integral component of the process.

Whether for individual investments, acquisitions, or new hires, your due diligence process should, at the outset, include conducting an exhaustive background check. From that point forward, we also recommend incorporating the following

1. ***Dig deeper.*** If the background check uncovers any civil or criminal cases or bankruptcy filings, you should always review the documents filed in these matters. The same goes for any regulatory actions that have been taken against the company or person(s). Taking a look at these public records allows you to find out what the issue was and see the person's demeanor during the situation. If a person were accused of wrongdoing, did he or she embrace a Mel Gibson-esque attitude, or did the person cooperate with attorneys, law enforcement, and/or regulators? How did the matter get resolved? The answers to these questions may surprise you. Talk to independent third parties to confirm how it was resolved to make sure the matter will not become your problem in the future. If the problem happens again, you can explain to your board of directors, limited partners, co-investors, or others that you did everything to address the issue. You will not be subject to redress for being eager; you will, however, for being lazy.
2. ***Interview managers/management.*** If you find a person has been involved in any controversies, compromising reputational issues, or inflammatory lawsuits, or there were factual discrepancies on his resume, talk to the person. Document his statements so you have it in the file and on the record, should anything happen down the road. Also, public records only tell a part of the story. If you find an executive was sued for securities fraud, get the executive's side of the story. There may be mitigating circumstances that explain what happened.
3. ***Contact former employees.*** Former employees are constantly overlooked and undervalued in the due diligence process. These people often have enormous amounts of valuable information that will assist you in your deal.
4. ***Ongoing monitoring.*** A background check should not be considered finite. Conduct annual or biennial background checks, get daily news alerts, and monitor relevant blogs. Stay on top of

your investment. Just because someone met your investment standards at the beginning does not necessarily mean they will stay true to your expectations.

5. ***Consider a whistleblower hotline.*** Many investors do not realize how easy it is to implement an anonymous tip line. It is an inexpensive preventive type of insurance where you offer employees, vendors, and others a vehicle to anonymously report not only fraud and unethical behavior but also unsafe work conditions, violence in the workplace, drug use, and so on. There are no downsides to the hotline; it is a win-win for employees, investors, board members, and regulators.