

## Research in the field of economic crime in Slovakia

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### ABSTRACT

Consequences of the crime influence the life of the whole society, it permeates to all areas of social life, as well as it penetrates into the lives of ordinary citizens of Slovakia. One of the most significant crimes is the economic crime. The relevance and the seriousness of the economic crime are expressed by its immediate threat of economic life and of the prosperity of society. The relevance of this issue is underlined by the fact that in the recent years there is an increase of new and more dangerous forms of crime.

The aim of this paper is to examine the overall number of economic crime and the damages caused by these criminal activities in Slovakia during the last ten years. The emphasis will be put on the analysis of the number of business entities influenced by the economic crime, on the analysis of economic crime by the sectors of national economy and by the forms of economic crime in Slovakia. We will analyse the most common ways of committing tax frauds and accounting frauds, that distorts the business environment and it represents also a significant threat to the public finances. The complex accounting and tax issues enable the defrauders to commit accounting frauds and tax frauds; this is because of the deficiencies in the legislation, inefficient control processes and complexity of management. After that we analyse the number of Slovak companies with the owner from a tax haven. Within the analysis of secondary data in this paper appropriate mathematical and statistical methods will be used. Based on the evaluation of the results of research, conclusions and suggestions will be drawn.

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## 1. INTRODUCTION

In every society there are social norms that are obligatory for each person. The person is obliged to a certain form of social behaviour, while respecting the general, socially accepted and recognized rules. When these rules are not followed, it is punished by the society. Therefore, these social norms are an important regulator of social relations and processes. Preserving these norms creates the conditions for the existence of social life. When inability to accept and preserve the most important and especially the legal norms, there is committed a crime, delinquency.

Within the characteristics of the nowadays crime (especially to that it is organized, intellectualized and sophisticated) can be listed another characteristic, it is the internationalization tending to its globalization. From the massive point of view the crime penetrates across national borders and the criminal groups operate on a large territory regardless of their administrative division. Crime can be

distinguished in two types: the obvious crime, which is registered the state and the latent crime – the so called hidden crime, which is not recognized by the legal authorities because of variety of reasons and which is in the result several times bigger than the obvious crime. The best-known types of crime are the property crimes, violent crimes, organized crimes and economic crimes.

Economic crime can affect each market entity, regardless of whether it is aimed or not at achieving profit in its core activities. Especially for businesses could represent far-reaching and destructive consequences, which can even cause an existential threat or complete disappearance of the subject depending on the specific circumstances. The economic crime does not only cause material damage, it damages also suppliers, customers and other business partners; it can damage the image of the business entity and the morale of its employees. The economic crime in Slovakia is more and more frequent and its forms are more and more diverse. It is constantly developing and seeking new ways to “stay alive”. There is a paradox in that the more control mechanisms are implemented the higher is the rate of detection of fraud. This is why in the countries with more sophisticated tools of dealing with the economic crime the rate of economic crime is higher.

## **2. LITERATURE REVIEW**

The contemporary society understands the criminality as a summary of the behaviour that is defined by the Criminal Law as a criminal offense. Thus, the criminality is the incidence of crime expressed as the summary of crimes committed in a particular society for a certain period (respectively in a certain interval). (Madliak, 1998)

In the current European context, the issue of the crime of fraud is explained on different ways. According to Molín (2011) the fraudulence is a delinquent conduct that is aimed to bring an undue advantage to the detriment of another.

According to ISA 240, the definition of fraud is that it is “*an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage*” (International Federation of Accountants, 2009).

According Koprlová (2008), in the specialized Anglo-American terminology the mostly term is “Fraud”, but in German speaking countries there are starting to prefer the term “Dolus-Proceeding”. In both cases it always means the same thing: economic criminal activities are crimes that arise in economic life in the context of violation of the existing trust rules. Economic life means that such crimes are committed in connection to the economic activities carried out. This does not necessarily mean that they occur only in the context of the business activities, as the economic activities are carried out also by other entities such as non-profit organizations. Based on the definition of the American Institute for Internal Auditors by “Fraud” we mean the fraudulent and illegal activities related to intentional mislead or misconception.

Modern economic crime – as it says also Jozef Čentéš (2011) – has a wide diapason. In the classical dimension it's a matter of criminal acts threatening or violating market economy and economic discipline, crimes against currency and tax crimes, and so on. The common denominator of committing these crimes is that the perpetrators are abusing resources of the economic system and their conduct is motivated by profit.

In the widest meaning of the word – thus not in the legal meaning of the word – under the term 'Economic Crime' we mean all the legal and illegal practices under which the persons responsible for businesses – in particular their owners, managers, secretaries and other persons authorized to represent business entity – are causing damage to: people, nature, state, society, science, culture or to other legal subjects, in order to achieve, increase or safeguard profits (Suhányiová, Suhányi, Majiroš, 2015).

### **3. ANALYSIS OF THE ECONOMIC CRIME IN SLOVAKIA**

Slovakia is located in the Central Europe; it is a multiparty state with a unicameral Parliament and the President. It has an area of 49,036 km<sup>2</sup>, and about 5.41 million of inhabitants. It has borders with Czech Republic, Austria, Poland, Ukraine and Hungary. The capital is Bratislava. Slovakia is a member of NATO, OECD and UNO. It joined the EU in 2004. Since 2009 it is member of the European Monetary Union – Eurozone and the official currency became to be the Euro, which replaced the previous Slovak Crown. The International Code of Slovakia is "SK".

According to the Statistical Office of the Slovak Republic, the Criminality is a summary of the crimes committed by criminally responsible individuals – either intentionally or negligently – at a certain place per a certain period (generally in the country per year). Total Criminality includes all crimes discovered by the police committed by individuals and groups of persons. Data on criminality involves accomplished crimes and attempted crimes. Total Criminality is divided into the following three groups (Statistical Office of the Slovak Republic, 2015):

#### *1. General Criminality*

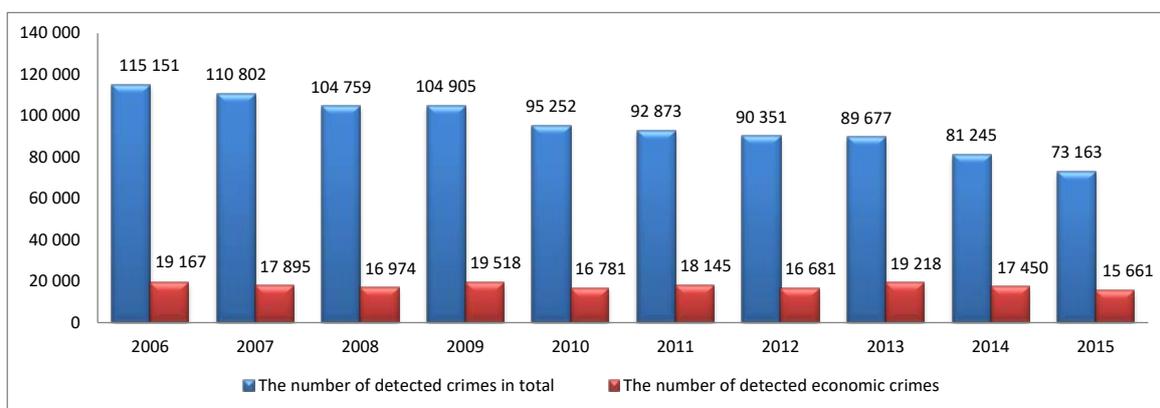
- Property Crimes: thefts, as well as damages to property
- Violent Crimes: murder, robbery, intentional bodily harm, dangerous threats, kidnapping, extortion, torture and so on
- Moral Crimes: rape, sexual abuse, child pornography or soliciting
- Other General Crimes: hooliganism, illegal production of narcotics and psychotropic substances, as well as obstruction of an official decision

#### *2. Economic Criminality*

3. *Residual Criminality*: malpractice, bodily harm by negligence, traffic accidents, animal cruelty and so on.

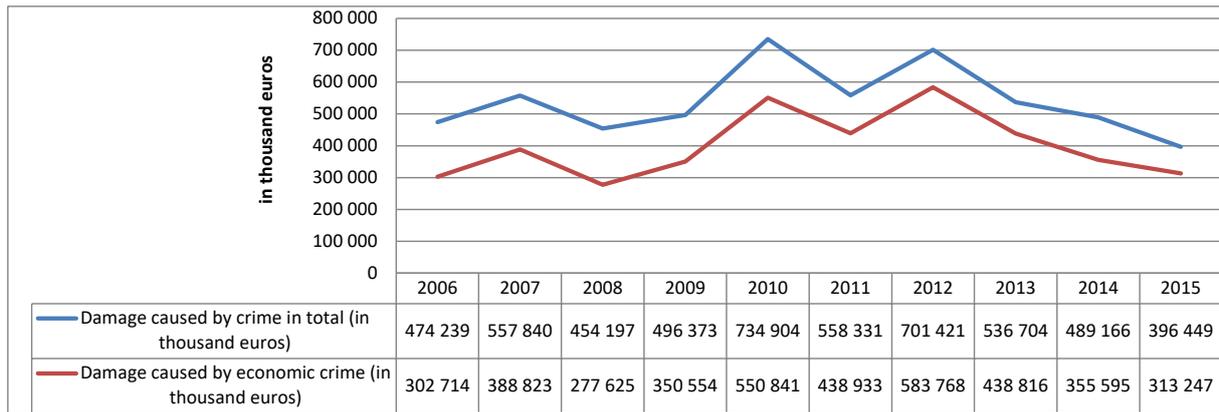
Economic Criminality is a specific type of criminality, causing economic damages to the country, companies and individuals. These include (according to the Criminal Code) the crimes that are:

- endangering the market economy (e.g. unauthorized trading, illegal employment, the misuse of participation in the economic competition, etc.)
- against the economic discipline (e.g. misrepresentation of financial and commercial records, harming the financial interests of the European Communities, insider trade, machinations in public procurement and public auction, consumer detriment, unfair commercial practices against consumers, etc.)
- against currency and the tax crimes (e.g. falsification and unauthorized production of money, insurance and tax evasion, non-payment of taxes and insurance, obstruction of tax administration, etc.)
- against industrial rights or copyright.



**Figure 1:** The total number of detected crimes and the number of economic crimes in Slovakia (self-elaboration based on the data from the Statistical Office of the Slovak Republic, 2016)

While the number of detected crimes decreases each year during the examined period, the number of detected economic crimes has a fluctuating tendency. The highest number of detected economic crimes was in the year 2009 and on the other hand the lowest was in the last year of the examined period, in 2015. The share of the detected economic crimes in the total number of detected crimes during the examined period is growing from year to year. While in 2006 the economic crimes accounted about 16.6% of the total number of detected crimes, in 2015 this share increased already to the level of 21.4% (Figure 1).



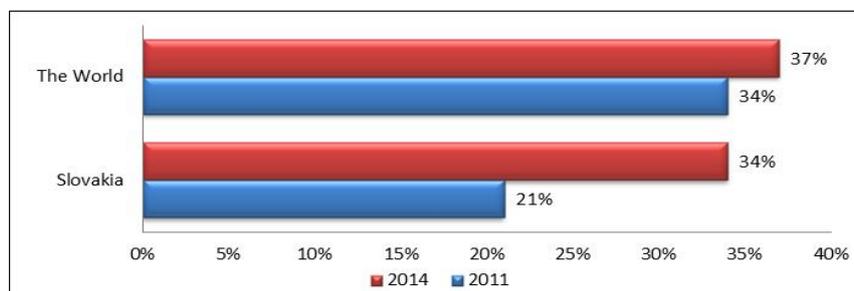
**Figure 2:** Damage caused by crime and economic crime

(self-elaboration based on the data from the Ministry of Interior of the Slovak Republic, 2016)

The Figure 2 shows that the highest damage caused by economic crime during the examined period was in 2012. The largest share in the reported damages is represented by the damages from frauds in the amount of 256,126 thousand euros and by the tax evasion and contributions evasion in the amount of 160,969 thousand euros.

If you calculate the average loss per detected economic crime, its highest value was in 2012 in the amount of 34.99 thousand euros, and the lowest value was in 2006 in the amount of 15.79 thousand euros. In 2015, the average loss per detected economic crime is 20.00 thousand euros.

Economic crime is constantly evolving, adapting to new conditions and its forms are increasingly sophisticated. Companies must therefore continually look for new and more effective methods of combating economic crime in order to protect their property. According to the survey made by PwC (Figure 3) about 34% of respondents have met with economic crime in the last year in Slovakia, that is more than a third. Compared to the survey made in 2011, this number represents an increase of up to 13%. Globally, the level of economic crime in 2014 reached the level of 37 % according to the survey (PwC, 2015).

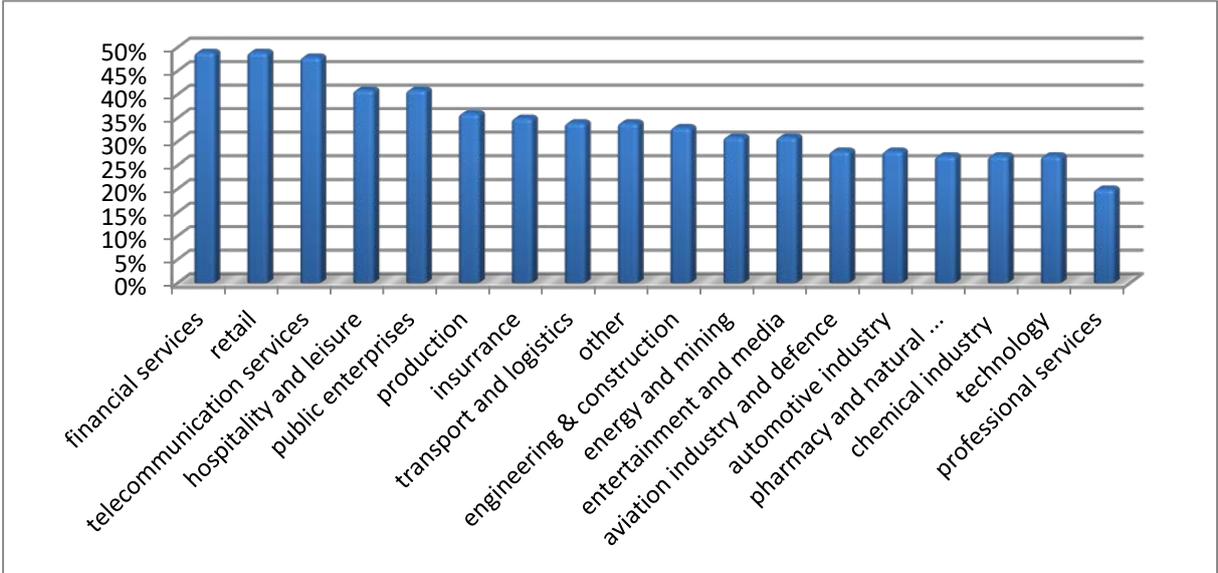


**Figure 3:** The number of companies affected by economic crime (in %)

(self-elaboration based on PwC, 2015)

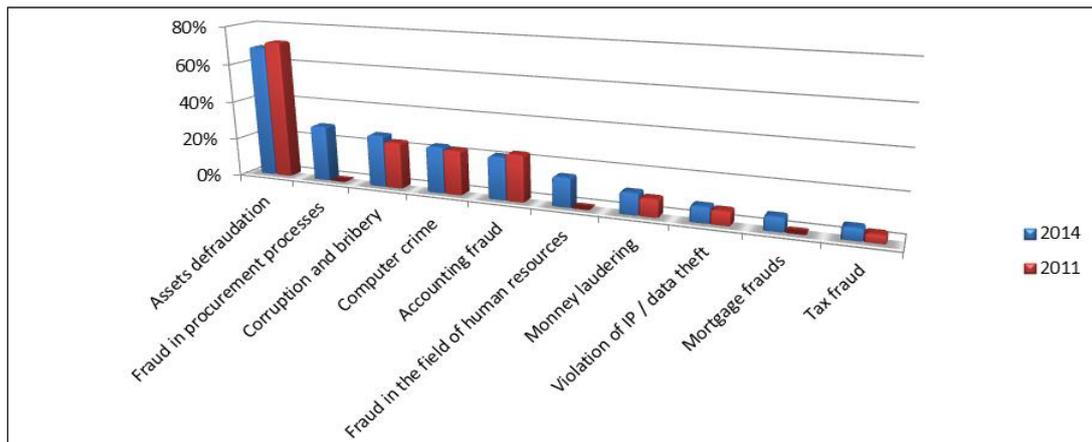
Looking at the economic crimes by the sectors of national economy it can be seen that three of the sectors are standing out above the others with the highest level of economic crime, these are the:

financial services, retail and telecommunication services (Figure 4). Financial services are related to the economic crime mainly in relation to the large cybercrime and money laundering activities. In retail, the reason for the increased fraud is mainly in the defraudation of assets. A relatively large group with a similar level of criminality consists of sectors as: transport, construction and energy sector, which are particularly vulnerable to the economic crime committed in the form of corruption, bribery and frauds in public procurement.



**Figure 4:** Economic crimes by sectors of national economy  
(self-elaboration based on PwC, 2015)

In the survey it was also found out that the share of simple types of fraud is decreasing in favour of the growth of more sophisticated forms of the economic crime. However, the top positions in the ranking of the most common forms of economic crime in a long-term period are the occupied by the following categories of fraud: asset defraudation, corruption and bribery and accounting fraud. Over time, by the PwC Company were included in the rankings also new categories of fraud – that almost immediately occupied the highest positions in the rankings. There are the following types of fraud: computer crime and fraud in procurement processes. The following chart (Figure 5) indicates the percentage of companies with a given form of economic crime encountered.



**Figure 5:** The most frequent forms of economic crime in the world  
(self-elaboration based on PwC, 2015)

#### 4. TAX FRAUDS AND ACCOUNTING FRAUDS IN SLOVAKIA

Business management is currently in a difficult situation and under an enormous pressure of the owners, of the market forecasting, of creditors and regulatory bodies. On the other hand, the complex tax and accounting legislation allows defrauders to commit fraud by the use of the defects of the legislation, of the inefficiency of control processes and management complexity.

Often can be seen incorrectness in the financial statements that may originate from fraud or error. The factor that makes a difference between the fraud and error is the fact of the intention – if the conduct that resulted in the incorrectness in the financial statements was intentional or unintentional. The intentional covering-up – or let us say: setting accounting methods and procedures in the way of enabling to cover-up the reality – is called Creative Accounting. There are different definitions of Creative Accounting, but all of them agree that creative accounting can be defined as “an approach that allows the targeted distortion of the economic condition of the company shown in the accounting”. The most common use of creative accounting is the handling with financial accounting to meet the requirements of the state – especially of the tax authorities. Companies tend to understate the profit to reduce the tax liability – for this may be used various methods and procedures.

Common mistakes detected during tax inspections in the Slovak Republic:

- Unauthorized deduction of value added tax,
- Application expenses unrelated to taxable income,
- Implementation of expenditure on the basis of fictitious documents,
- Undercutting the prices of assets, goods and services,
- Inclusion of ineligible expenditure in the tax base,
- Fictitious invoicing,

- Revenue-recognition,
- Reporting fictitious business trips, and so on.

In our experience, the most common frauds in the accounting of Slovak enterprises are:

- Falsification of financial statements,
- Overvaluation of income and assets,
- Underreporting of expenses and liabilities,
- Refusal of commitments, for example unrecognised financial transactions (invoices received, or other document)
- Accounting for one operation several times (duplication),
- Record the amount in error (typo),
- Incorrect or not included accrued transactions,
- Use of an incorrect account.

These errors may be due to bad internal control system of an accounting entity, poor circulation of accounting documents, poor internal directives, lack of inventory and so on.

The correctness of the double-entry bookkeeping and of the financial statements is controlled/verified by the auditors. As already mentioned above, 'fraud' is a broad legal concept. In terms of ISA (International Standards on Auditing), the auditor is concerned with fraud that causes a material misstatement in the financial statements. Two types of intentional misstatements are relevant to the auditor – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets. Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred (International Federation of Accountants, 2009).

At the date of 13<sup>th</sup> of July, 2015 there has been 784 active auditors and 236 audit firms in the Slovak Republic. Audit provides an overall protection of society. In the case of corporate entities (trading companies and cooperatives) in the Slovak Republic, they are obligated for audit if they fulfil at least two of the three following criteria (in two consecutive years):

1. if their assets exceed 1 million euros,
2. if their turnover exceeds 2 million euros,
3. if the number of employees exceeds 30.

In addition, the audit duty is regulated by specific laws, for example, a duty to audit have all the cities, municipalities and higher territorial units (regions), also foundations, political parties, etc. In 2013, about 3% of Slovak business entities were obligated to have an audit (Slovak Chamber of Auditors, 2015).

The present economic situation makes more and more business entities to think about the destination on which will end the money they invested in the state in the form of taxes. In many cases it is this speculation that leads them to tax avoidance. For most countries, the tax evasion represents a serious problem. Legal tax evasion involves the use of Tax Havens. The most often companies with an owner in the Tax Havens are the companies with activities in the field of trade business, of technical activities and of real estates. Since this is a legal business, there are no ways to reduce this phenomenon or to stop it. Slovakia is currently experiencing a boom in Tax Havens. The number of companies whose owner has an address in a Tax Haven reached the number of 4,266 at the end of 2014 and compared to previous year it increased by 9.3% (+364). The reason is that the entrepreneurs have a continual interest in tax optimization, in asset protection, in less red tape and in anonymous ownership. But, it can be partly attributed to the changes in legislation, e.g. to the introduction of withholding tax for offshore companies, or to the increased pressure on the release of information – as more and more countries abolished the bank secrecy. The rate of the check-outs of companies will vary depending on the policy of the state and changes in the laws affecting the business environment.

**Table 1:** The number of Slovak companies with owners from Tax Haven  
(self-elaboration based on Bisnode, 2016)

Country	Number of firms						Change 2010 – 2015
	2010	2011	2012	2013	2014	2015	
Bahamas	5	4	7	15	13	11	6
Belize	51	75	96	117	114	98	47
British Virgin Islands	78	81	78	88	101	138	60
Gibraltar	23	17	7	8	16	14	-9
Guernsey (United Kingdom)	7	6	6	6	10	9	2
Hong Kong	20	25	30	35	36	35	15
Jersey (United Kingdom)	11	9	16	13	10	10	-1
Cayman Islands	2	3	3	6	4	5	3
Cyprus	535	600	767	755	750	917	382
Liechtenstein	15	18	28	32	36	62	47
Latvia	16	26	44	49	69	71	55
Luxemburg	318	344	392	354	393	411	93
Malta	33	36	45	54	83	131	98
Marshall Islands	0	0	2	2	2	46	46
Monaco	11	16	18	21	24	19	-45
Netherlands Antilles	2	2	4	3	3	5	3
Netherlands	1,050	1,052	1,110	1,124	1,154	1,140	90
Panama	25	38	62	94	158	174	149
Isle of Man (United Kingdom)	4	5	5	4	5	6	2
Republic of Seychelles	18	65	180	220	205	254	236
United Arab Emirates	32	37	41	53	67	80	48

United States of America	601	671	760	859	1,028	1,064	463
<b>Total</b>	<b>2,846</b>	<b>3,119</b>	<b>3,693</b>	<b>3,902</b>	<b>4,266</b>	<b>4,700</b>	<b>1,790</b>

The number of companies, whose owner has an address in a Tax Haven in the examined period from 2010 to 2015, was continuously increasing. The number of companies increased by 160% in the number it makes 1790 companies. The highest increase in the outflow of companies was to the United States of America, in number 463, followed by Cyprus with the number 382 and the Seychelles with the number 236. In contrast, the largest decline occurred in Monaco. The biggest change in 2015 compared to 2014 was because of the outflow of companies to Cyprus, it was an increase represented by 167 companies. The continuing trend in the use of foreign companies in the context of business activities is not a surprise. The business entities are more oriented to the Netherlands and America, which have more weight in the business environment. The popular Tax Havens also include Cyprus, Luxembourg, Panama and Seychelles. The discussion about these destinations was opened thanks to the recent scandal called Panama Papers, which discovered how are some leading politicians and businessmen hiding their assets and how they avoid paying taxes. By us, the outflow of companies to the Tax Havens will continue despite the fact that the EU pressure on the exchange of information between the countries is increasing significantly. The companies will continue to explore the ways to reduce their tax burden. Between the years 2010 and 2015 the number of companies established in Tax Havens increased by over 160%.

## 5. CONSLUSIONS

Economic crimes are often very sophisticated; they are often very well treated in fact and in law. Over the time we can meet economic crime in Slovakia more frequently and its forms are more diverse. Its rate is increasing in the business entities from year to year increases. Therefore, the fact that economic crime continues to persist and it affects the business including all its processes, still remains. There is a paradox in that: the more control mechanisms are implemented, the higher is the rate of detection of fraud. The companies also use legislative advantages that are offered by Tax Havens, this is why they use foreign companies for their own businesses. In terms of tax and accounting, there are different ways to deceive public authorities, shareholders, investors and even auditors in order to hide or to distort the actual results and financial health of the company. In Slovakia there is a strong connection between the tax legislation and the accounting legislation. The companies are using financial information from accounting for determining the tax base of the most important taxes (VAT, income tax). The reason of the distorted reporting of accounting information is to pay the lowest possible taxes. Even though the cases of fraudulent reporting are less frequent than the other forms of economic crime, these frauds have the greatest impact.

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