

Investigation and Forensic Services

Economic crime: people, culture & controls

The 4th biennial Global Economic Crime Survey

Slovak Republic





Our survey reveals that fraud remains one of the most problematic issues for business worldwide. Across the globe, 43% of companies have been the victims of economic crime in the last two years. In Slovakia, 32% of surveyed companies reported economic crime, while in Central and Eastern Europe (CEE) as a whole it was 50%.

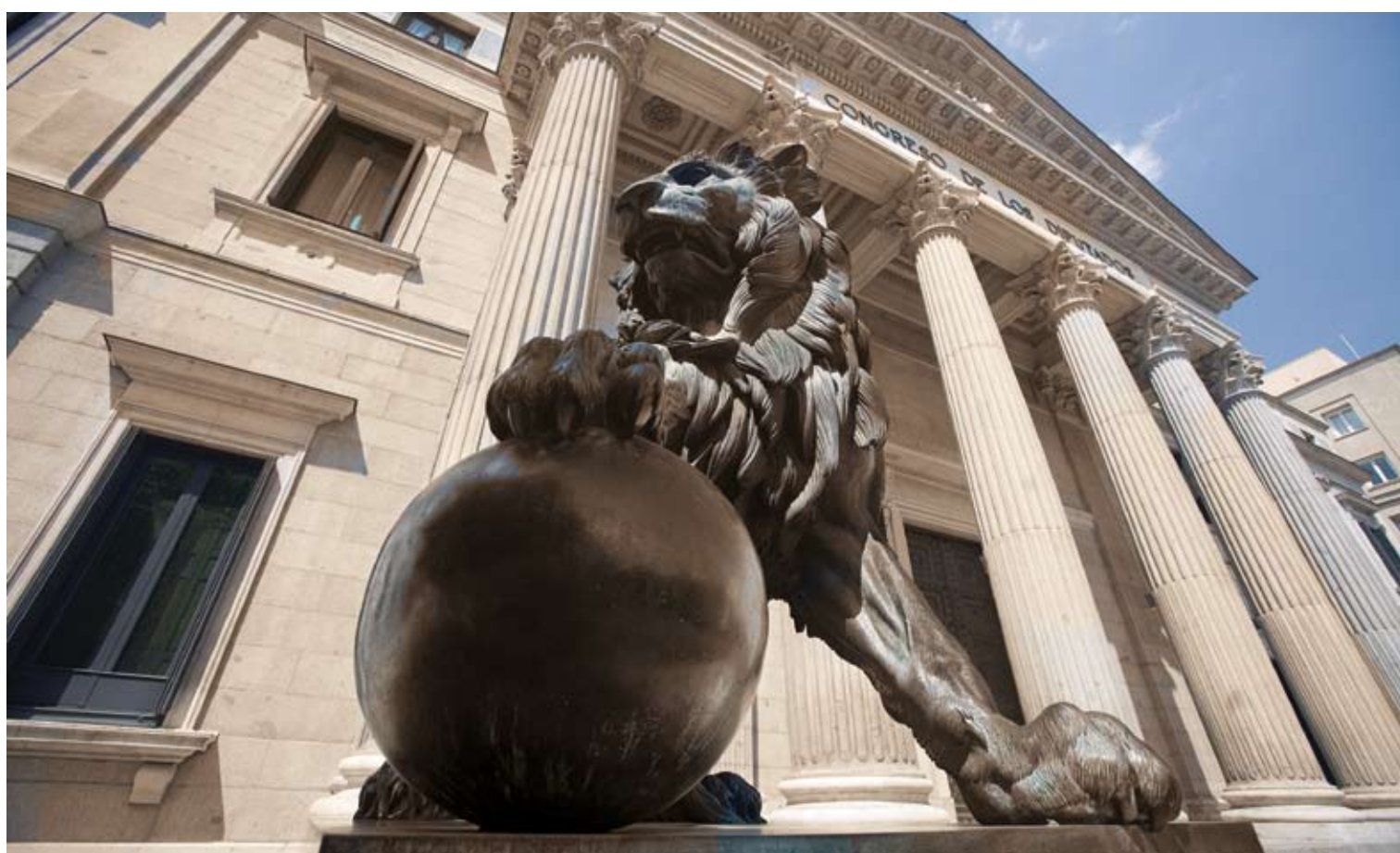
Introduction

We are pleased to present the 2007 PricewaterhouseCoopers Global Economic Crime Survey results - the largest study of its kind now available worldwide. In our fourth biennial survey, we interviewed senior representatives of more than 5,400 companies in 40 countries, for the first time including also 78 leading companies in Slovakia, providing us with unparalleled depth of insight into perceptions, awareness and impact of economic crime on business around the world.

To insure the complete confidentiality of responses, the survey was conducted on behalf of PricewaterhouseCoopers by the internationally renowned market and social research institute, TNS Emnid. For subsequent data analysis, we cooperated with Prof. Dr. Kai Bussmann, Chair of Criminology & Penal Law at Martin-Luther University in Halle-Wittenberg, as well as the independent Economic Crime Research Center at the Martin-Luther University.

Apart from the actual company survey, in which companies report their experiences in their own fight against economic crime, we added a case study section in which victimized companies provide detailed information on real-life crime incidents. We also look at a detailed profile of fraud perpetrators as well as the complicated interrelationship between comprehensive controls and corporate culture. We believe that the results of our analysis in these areas will allow companies to better understand the significant impact that economic crime can have on their business, assess the risks of fraud that they may face, and find ways to mitigate those risks.

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Key findings

- 32% of companies in Slovakia reported suffering one or more economic crimes in the past two years.
- The most widely reported type of crime is asset misappropriation (reported by 23% of companies), followed by corruption and bribery (13%).
- Corruption and bribery are perceived to be the greatest threat. Nearly 30% of all companies believe that corruption and bribery is the most prevalent type of economic crime in Slovakia.
- 22% of companies in Slovakia have been put into a position where they felt they were being asked to pay bribe in the last two years. Moreover, almost 36% of companies felt they lost an opportunity to a competitor whom they believe may have paid a bribe.
- The average direct financial loss from economic crime in Slovakia was USD 127,000 per company over the last two years. Only 7% of companies reported losses greater than USD 250,000. These figures appear very low compared to the global average of USD 2.4 million per company, or even in comparison with the Czech Republic (USD 1.7 million).
- In addition, companies in our Slovak survey have over the last two years spent on average nearly USD 108,000 in managing their cases of economic crime.
- 50% of the surveyed companies indicated that they had suffered collateral damage. The most serious collateral damage types cited included decline of working morale and damage to company reputation.
- The majority of perpetrators of the most serious offences¹ were male, on average just over 37 years old, and nearly 63% had a university degree. 70% of the perpetrators were newcomers to their companies (up to



2 years in their company). Majority (35%) of the main perpetrators of the most serious offences were either temporary workers or from a subsidiary; followed by line personnel (31%). 27% were senior or top management.

- In terms of fraud drivers, most frauds reported in Slovakia involved perpetrators' low commitment to brand, financial incentives (greed) and insufficient internal controls in the company.
- In most cases, companies brought criminal (50%) or civil charges (42%) against the perpetrators. However, nearly 13% of the companies surveyed stated that they had taken no action against the perpetrator. 16% of the perpetrators were sentenced, with 40% of the cases still pending or not yet at trial (as compared to 30% globally).
- Alarming, 79% of respondents indicated that they had not recovered any lost funds, compared to 58% globally and 63% in Central and Eastern Europe as a whole. This may be related to the fact 78% of companies in Slovakia do not have insurance to cover the losses and costs of economic crime, compared to a global average of 61% (71% in CEE).
- Most fraud (37%) was detected by chance (e.g. through internal/ external tip-offs or by accident). Of company-introduced fraud detection mechanisms, whistle blowing systems such as a hotline (30% of detections) and internal audit (11% of initial

detections) were the most effective. Whistle blowing seems particularly successful in Slovakia – globally, it accounts for only 8% of initial fraud detections, and for 10% in CEE. In the Czech Republic, whistle blowing has been on the rise for the last few years, but it still only accounts for about a half of the detections as in Slovakia.

- Companies are quite confident that their anti-fraud measures are effective, scoring higher in nearly every single measure in terms of effectiveness than companies globally or in CEE as a whole. Audit committees, external audit and electronic automated suspicious transactions reporting systems are considered to be the most effective measures for combating economic crime. This is quite surprising considering that very few cases were identified by these measures in Slovakia.
- While 32% of companies reported to have fallen victims to economic crime in our survey, only 5% of those interviewed considered it likely that their company would experience fraud over the next two years. Over 28% of the surveyed companies do not plan to take any actions to deal with economic crime.

¹ Profil páchateľa vychádza z údajov o páchateľoch dvoch najzávažnejších prečinov, uvedených jednotlivými spoločnosťami.

Fraud – is it really uncovered?

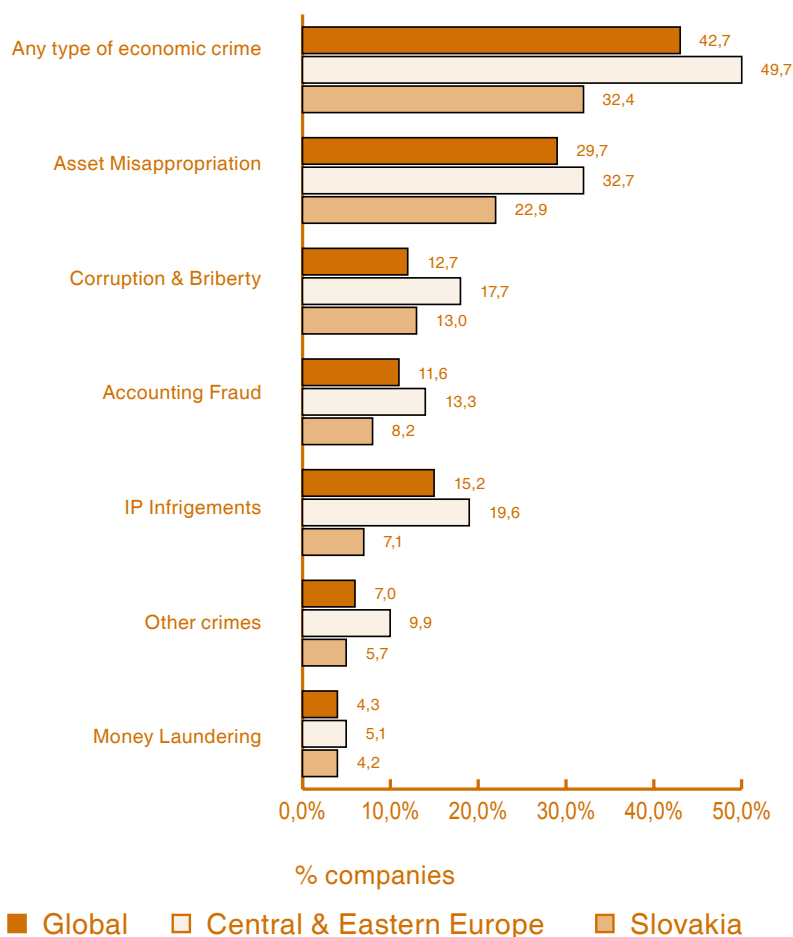
Our 2007 economic crime survey reveals that 32% of the 78 companies surveyed in Slovakia reported being subject to one or more significant economic crimes over the past two years. This figure is considerably lower than the Central and Eastern European average (50%) and even the global average of 43%. In comparison, in the neighbouring Czech Republic, the figures were nearly double, with 61% of companies reporting economic crime (63% in 2005).

At first glance it may be concluded that economic crime is less of an issue in Slovakia. However, the relatively low reported incidence of crime is more likely due to a combination of the following factors:

- A low awareness of economic crime within organisations and therefore a corresponding lack of detection and reporting of economic crime;
- Unwillingness to report economic crime (due to its stigma);
- Fraud risk management systems in companies, while seemingly plentiful and according to our correspondents' views rather effective, may actually not be set up and functioning properly (as is indicated by the fact that most fraud cases were detected by chance – see below).

Our experience in Slovakia and in other countries indicates that companies in Slovakia are no less threatened from economic crime than in the rest of the world. It is interesting to note that of the companies that did report suffering economic crime in Slovakia, the average number of fraud cases in the past two years was 19. We are, of course, conscious that in collecting this information we are reliant upon our respondents' opinions and the information that they have disclosed to us. Therefore, these figures must stand as a minimum percentage of companies that have suffered significant fraud in the previous two years: the actual figure may be much higher.

Incidents of economic crime per company over the past 2 years



Types of economic crime – does perception equal reality?

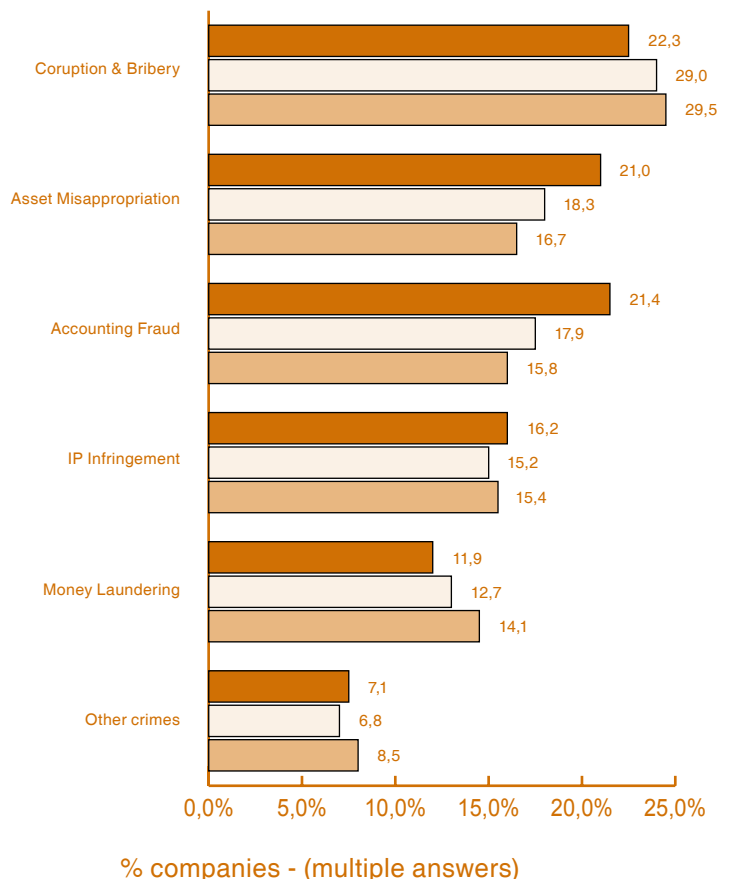
The most common types of fraud encountered were asset misappropriation (23%) and corruption and bribery (13%).

Asset misappropriation is also the most prevalent type of economic crime globally as well as in Central and Eastern Europe. This is not surprising as this is among the easiest frauds to detect; it involves taking of items with a defined value, and provides a clear indication of where management should concentrate its immediate attention in order to manage avoidable losses. Asset misappropriation is also the second highest economic crime in terms of perceived prevalence (17% of companies surveyed in Slovakia consider it to be the most prevalent type of economic crime).

Corruption is perceived as the most prevalent type of fraud, with 30% of surveyed companies believing that it is the most prevalent type of economic crime in the Slovakia. However, only 13% of surveyed companies reported to have experienced this type of economic crime (as compared to 18% in Central and Eastern Europe as a whole or 27% in the Czech Republic). This is somewhat in contrast to the fact that 22% of companies reported that they have been put in a position where they felt that their company was being asked to pay a bribe (as compared to 30% in both CEE and the Czech Republic) and 36% of companies felt they lost an opportunity to a competitor whom they believed may have paid a bribe (45% in CEE, 47% in the Czech Republic).



The most common type of fraud



Corruption – perceptions truer than reality?

What is the true incidence of corruption and bribery? Part of the difficulty in assessing the real levels of corruption & bribery relates to the nature of this crime. Corruption & bribery is often reported in the media and has been a hot topic in Slovakia and throughout CEE for a number of years. Hence, it is much more in the public eye than other types of economic crime, thus potentially increasing the perception of its incidence versus other, less publicised types of crime such as asset misappropriation or accounting fraud. On the other hand, corruption & bribery can be very difficult to prove, thus potentially reducing the number of reported cases.

Further analysis reveals that respondents' perceptions of the risks of this particular economic crime in their home countries were very similar to the worldwide findings reported in Transparency International's Corruption Perception Index of 2006 (CPI). This may be because many managers, while being reluctant to report on corruption in their own company, are quite able to provide a realistic estimate of their national risks. Furthermore, their opinions of corruption are influenced by definitions that employ neutral terms and may still regard this particular economic crime as one that is peculiar to public sector organisations and government. It is possible – even probable – that companies' perceptions generally appear to be more valid than the low actual incidence rates for corruption & bribery reported.

Despite the fact that 30% of companies surveyed thought that corruption and bribery is the most prevalent type of economic crime in Slovakia, only 8% of companies believe that they will likely become subject to this type of economic crime in the next two years. A full 48% of surveyed companies did not undertake any review of their corruption compliance programs in the past two years.

Overall, Slovak companies report much fewer incidents of more sophisticated economic fraud (accounting fraud, IP infringement) than companies globally.

Key Elements of Effective Anti-Bribery Compliance Programs

1. Create a control environment with the right structure and tone:

- CEO communication on “zero tolerance” for illegal acts and misconduct;
- Establish high quality, compliance organisation with well trained staff and clear processes.

2. Focus on the most important compliance risks:

- Perform risk assessments to identify high risk areas
- Adapt processes based upon the nature and source of risk.

3. Design compliance control activities to minimize risk of non-compliance:

- Establish control procedures for high bribery risk areas;
- Adopt protocols for investigating allegations of misconduct, illegal and non-compliance.

4. Establish processes and systems supporting compliance:

- Ensure effective reporting to key corporate governing bodies;
- Embed compliance into the IT systems.

The cost of fraud

The direct financial losses from economic crime reported by all of our respondents in Slovakia amounted to USD 2.89 million, or USD 127,000 on average per company over the past two years. In comparison, globally, the average cost of economic crime per company over the last two years was approximately USD 2.4 million, and in the Czech Republic, the average cost per company reached approximately USD 1.7 million in 2007. In Central and Eastern Europe as a whole the average cost per company was actually even much higher – USD 3.3 million.²

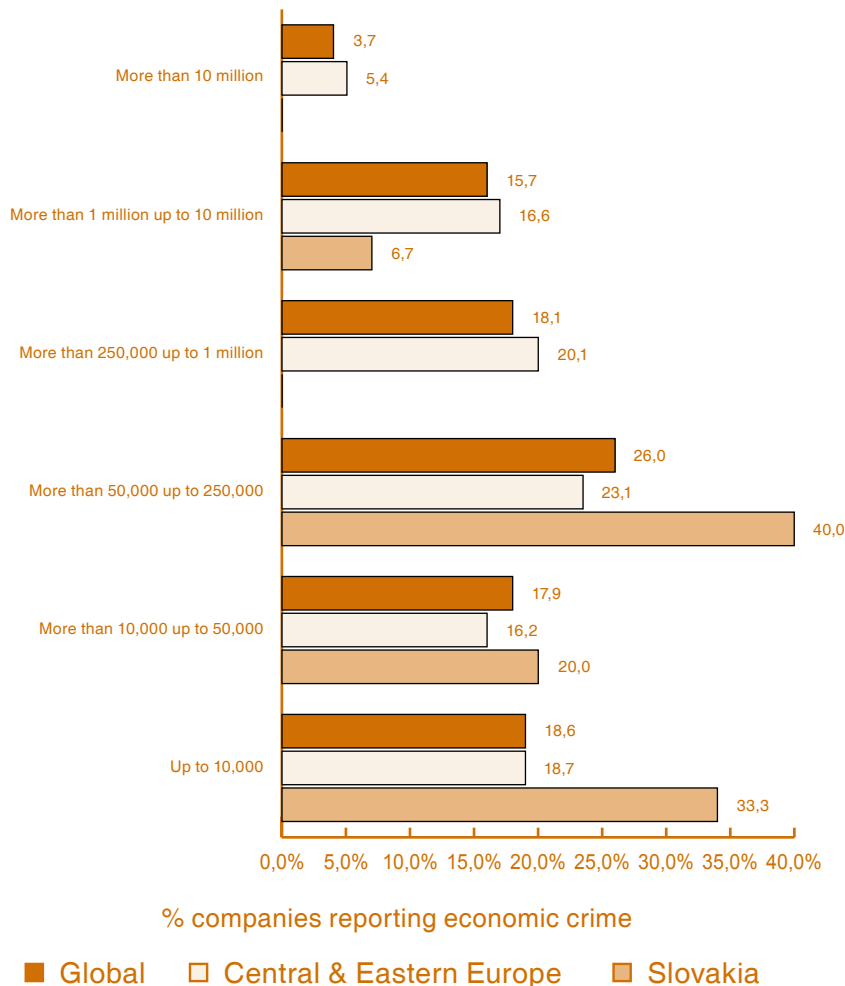
Similarly as with reported incidence of economic crime in Slovakia, we believe that these reported costs of economic crime may not correctly reflect the real situation.

In addition, companies in our survey that have suffered fraud over the last two years reported having spent on average approximately USD 108,000 in “management costs” related to dealing with the fall-out from a significant fraud, from the reallocation of management time to the possible costs of litigation in retroactive action, and from the need to manage additional public relations and investor relations campaigns to dealing with renewed regulatory oversight demands.

Besides the above-mentioned costs of economic crime, one should not ignore the collateral damage from fraud, i.e. damage to company’s brand and customer trust, to the share price and shareholder trust; to the company’s relationships with its suppliers; and to staff morale which can result in high staff turnover and loss of productivity.

50% of Slovak companies that suffered fraud reported collateral damage to their business, which was less than the average of companies in CEE as a whole (66%) and in the Czech Republic (64%). The most serious types of collateral damage cited included decline of working morale and damage to company reputation.

Overall losses from fraud in USD



² This is primarily due to very high fraud costs in Russia, where average direct cost of economic crime more than quadrupled over the past two years to USD 12.8 million per company.

Means of detecting and preventing fraud

The means by which fraud is detected can be split into two broad categories: detection by chance and detection through risk management controls and systems. According to our survey, the single largest way of detecting fraud in Slovakia was detection by chance (a combination of internal/external tip-offs and accidental detection) – 37% of cases of economic crime were initially detected this way.³



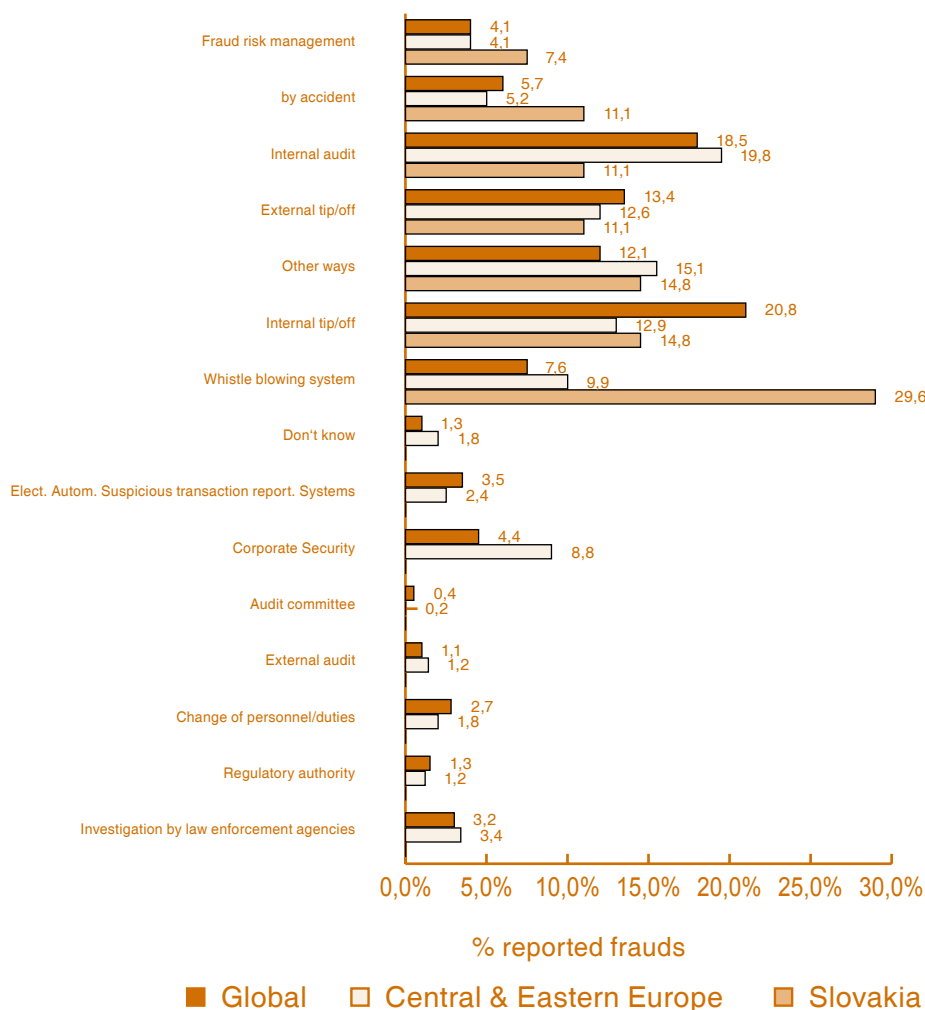
The second most important way of fraud detection was whistle blowing (30% of initial detections) – a system of anonymous fraud reporting, such as through a hotline. This is particularly interesting since globally, whistle blowing accounts for only 8% of initial fraud detections and 10% in CEE as a whole. This may be partly related to the fact that whistle blowing has been implemented by a larger proportion of companies in Slovakia (51%) than on a global level (42%) or even in CEE as a whole (33%).

Globally, internal audit is the most successful corporate control in detecting economic crime (19% cases of initial detections). In our Slovak survey, internal audit was second to whistle blowing with 11% of initial fraud detections, followed by fraud risk management with 7% detections.

Surprisingly, our survey in Slovakia did not register many other common ways of detecting economic crime in companies, such as corporate security, automated electronic suspicious transactions reporting, rotation of personnel, investigation by law enforcement agencies or detection by a regulatory authority.

These results contrast with companies' reports on their measures for the discovery and prevention of economic crime and their perception of their effectiveness. Only 2.6% of companies surveyed in Slovakia stated that they did not implement any measures for the discovery and prevention of

Means by which fraud was originally detected



³ Globally, surprisingly, the proportion of chance detections increased over the last two years, from 34% in 2005 to 41% in 2007. For details, see our Economic crime: people, culture and controls. The 4th biennial Global Economic Crime Survey, pg. 10

economic crime. Among the most frequently introduced measures are: internal controls (90%), internal and external audit (84% each), ethical guidelines or a code of conduct (79%) and compliance programs (59%). When asked how effective these measures were, most companies scored them very highly, in many cases higher than companies on a global or CEE level – for example, 79% of Slovak companies considered internal audit to be effective, 83% companies thought the same about external audit, 92% about audit committees, 80% about electronic automated suspicious transactions reporting systems. Yet, none of the above measures (with the exception of internal audit) were accountable for any fraud detections.

This could imply that companies may be focusing their control efforts in wrong places or that some of these systems may not be set up properly.

This may be related to the fact that our Slovak respondents reported relatively lower number of external consultations with regard to preventing or investigating economic crime than in CEE or globally: 10% of Slovak respondents received consultation from a forensic accountant or fraud investigator (CEE: 14%, but in the Czech Republic: 21%), 13% of Slovak companies consulted with law enforcement officers (33% in CEE and 30% globally), 33% consulted with an audit firm (45% and 46% in CEE and globally, respectively). Nearly 40% of Slovak respondents did not receive any external consultation on preventing or dealing with economic crime (as compared to 27% in CEE and 28% globally).

Our global research revealed that companies that had more frequently taken professional advice from law enforcement officers, lawyers or forensic accountants, were able to ensure that their fraud risk management tools were not only more effective and efficient, but also closed gaps between systems. A lack of such advice and of fraud awareness may lead companies into a cycle of deceptive security, neither knowing the risks that they face, nor being aware of their vulnerability to new types of fraud.

According to our survey, the single largest way of detecting fraud in Slovakia was a combination of internal/external tip-offs and accidental detection.

The drivers for fraud

For someone to commit fraud, it is generally accepted by criminologists and fraud investigators that three conditions must be present: the opportunity to commit fraud (corporate causes – the levels of control and the ethical culture of the firm), the incentive to commit fraud, and the fraudster’s ability to rationalise their own actions (the perpetrators’ personal reasons).

For the purpose of this research, we simplified these into two areas:

- a. the perpetrators’ personal reasons for committing fraud (i.e. their incentive and ability to rationalise their actions to themselves)
- b. the organisational reasons that allowed fraud to occur (i.e. the levels of control and the ethical culture in the firm).

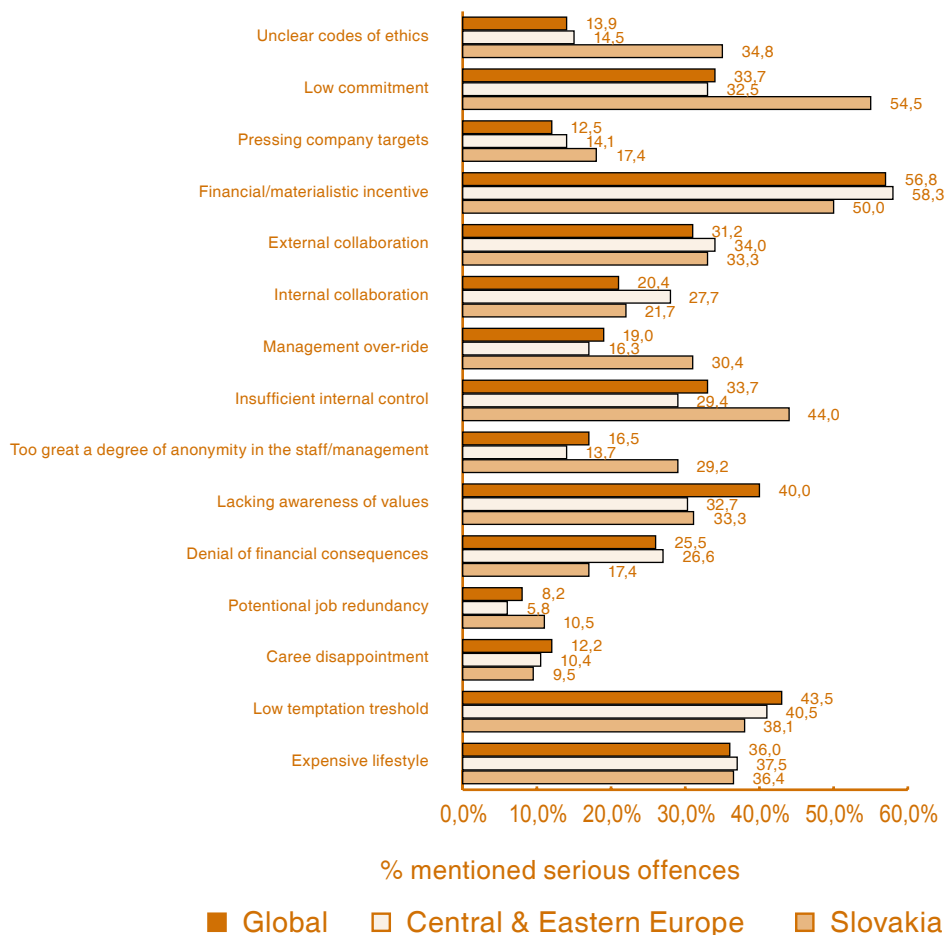
In terms of the fraudster’s personal reasons, what stood out in Slovak companies were:

- Incentives: financial incentives – i.e. greed (50%) and the need to maintain an expensive lifestyle (36%)
- Means of self-rationalisation: the perpetrator’s low temptation threshold (38%) and the lack of awareness of values or of his own wrongdoing (33%)

In terms of corporate causes, it is important to notice that while insufficient company controls appear to have played a significant role in nearly a half of the cases perpetrated (44%), perhaps an even more important role is played by a company’s culture (and the employee’s relation to it). In 54% of cases the employees appear to have had a low level of commitment to the firm, while they have also been unclear about the company’s ethics (35% of cases). Company’s culture is therefore vital in establishing an ongoing, effective fraud risk management programme.

All these reasons appear to be common worldwide, even though the insufficient company controls and particularly the perpetrator’s low commitment to brand as well as lack of clarity regarding codes of conduct or corporate ethics are more pronounced in Slovakia than on the global level (as well as in the rest of Central and Eastern Europe).

Reasons for committing economic crime





The typical perpetrator

The typical perpetrator of the most serious offences was male (86%) and on average 37 years old, which is somewhat younger than globally and in CEE as a whole (average age of 39 and only around 20% of perpetrators younger than 30, while in Slovakia, nearly 32% of perpetrators were younger than 30). The vast majority of fraudsters (63%) had a university degree, which is higher than globally (50%) and in CEE (61%).

41% of Slovak companies reported that the perpetrator of the most serious offence was a member of their own staff, while 41% of the main perpetrators were the company's customers or clients and 15% were external parties without any business relations with the firm.

A full 70% of the internal perpetrators were newcomers to their companies - they had been in their company as well as in their position for up to two years. The majority (35%) of the internal perpetrators were either temporary workers or from a subsidiary; followed by line personnel (31%). 27% were senior or top management.

Compared to our global results as well as those from Central and Eastern Europe as a whole, Slovakia had fewer perpetrators among long-term employees in high and middle management positions. This correlates with the above mentioned fraud drivers – it is the young newcomers to the companies, many of them temporary workers, who will demonstrate low commitment to the firm and low understanding of corporate ethics and look for opportunities to commit fraud. This could also explain the relatively low losses caused by economic crime in Slovakia – as our global research shows, frauds committed by senior and middle management cause the greatest financial and collateral damage to a business.⁴

At the same time, however, this presents a question of whether there may be more fraud committed by high or middle management perpetrators, who are more skilled in bypassing sophisticated control systems and thus so far their acts are going undetected?

⁴ For more details, see our Economic crime: people, culture and controls. The 4th biennial Global Economic Crime Survey, pg. 14

Dealing with fraudsters

Once an alleged fraud has been detected, steps must be taken to investigate and authenticate any such claims. According to our survey, once an allegation had been made, most companies surveyed in Slovakia called in law enforcement to investigate (44%), launched an internal investigation through internal audit (40%), involved the compliance department (40%) or other internal bodies (52%), or called in the in-house counsel (32%). Additionally, 48% of respondents in Slovakia sought help in investigating the offence from an external investigator or a forensic accountant. This is significantly higher than the Central and Eastern European average (39%) and the rest of the world (35%).

In the majority of cases, the offence was officially reported internally to the executive management board (86%); only 43% of offences were reported to law enforcement and only 10% to a regulator (60% of offences globally and 56% in CEE were reported to law enforcement; 31% of offences globally and 35% in CEE were reported to a regulator).

Once a company confirms a suspected fraud, an appropriate action against the perpetrator is essential in order to deter other potential fraudsters and to show stakeholders in the business that the organisation will not tolerate such malpractice. The range of reported responses and sanctions varied. In most cases, either criminal (50%) or civil charges (42%) were filed; internal perpetrators were usually dismissed (33%) or the business relationship with an external perpetrator was terminated (46%). Nearly 13% of companies however stated that they did not take any action against the perpetrator. Only 16% of perpetrators were sentenced, with 40% cases still pending or not yet come to trial (globally, the sentence rate was 20% with 30% cases still pending).

Recovery of lost assets

Besides deterring other fraudsters with a prompt and decisive response, recovering financial losses is another important aim for companies. Alarming, 79% of respondents in Slovakia indicated that they had not recovered any lost funds, compared to 58% globally and 63% in Central and Eastern Europe as a whole. On average, Slovak companies managed to recover nearly 9% of their losses – while globally, it was approximately 28% of the amount lost and in the Czech Republic 31%. This may be related to the fact 78% of companies in Slovakia do not have insurance to cover the losses and costs of economic crime, compared to a global average of 61% (71% in CEE).

Fraud in the future

Fraud remains a serious problem. On a global scale, levels of economic crime have not dropped significantly over the course of this decade and despite that, companies remain confident – as they have in our previous studies – that their controls will limit their exposure to fraud in the future. The same goes for Slovakia, where alarmingly only 5% of companies believe that it is likely that their organisation would be subject to economic crime over the next two years. In our opinion this may well be a sign of over-confidence, especially given the large proportion of fraud which was detected by chance.

The fight against fraud is a constant struggle. Our biennial study continues to show that in order to assess and manage its risks, a constant re-evaluation of all fraud risk management activities is necessary. Equally importantly, companies must strive to establish a culture that supports anti-fraud controls with clear and ethical guidelines, engendering loyalty to the organisation's brand, and showing (through retroactive action) that every perpetrator, no matter what their position and function in the company, will be subject to equivalent sanctions. As with all crimes and unwanted business risks, a move from after the fact reaction to prevention is the most valuable move.

Contacts

- **Matt Pottle**
Territory Senior Partner
Tel: +421 (0) 2 59350 502
e-mail: matt.pottle@sk.pwc.com
- **Jan Vylita**
Director
Tel: +421 (0) 2 59350 417
e-mail: jan.vylita@sk.pwc.com

