

Ways to Counter Retrieval of “Shadow Income” from Businesses with Fixed Assets in Hospitality

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Abstract: The article provides recommendations to improve effectiveness of internal control and counter the implementation of “shadow income” schemes. The article reveals the diagrams of retrieving “shadow income” from businesses’ fixed assets in collective accommodation establishments. It was revealed that the most effective means to counter the implementation of the “shadow” schemes is to retrieve income from transactions with fixed assets of collective accommodation facilities are regular inventory of fixed assets; activities to enhance the effectiveness of internal control; the concentration of the main efforts of performing internal control activities prior to the inspection; improved follow-up on the basis of a comprehensive analysis of contracts and original documents. This article demonstrates just some of the constantly developing and refined by stakeholders schemes to retrieve of the “shadow income”. The described “shadow income” schemes will help the hospitality employees to effectively counter threats and challenges from within disintegrating economy.

Key words: Fixed assets • Collective accommodation establishments • “Shadow income” scheme • Internal control

INTRODUCTION

The fixed assets have a very significant place in services industry activities and above all, in hospitality industry and other collective accommodation establishments.

The exploitation of fixed assets in collective accommodation establishments (CAE) allows management and staff to retrieve a ‘shadow income’. This research area has also been of enduring interest to scientists [1].

Axel Dreher, Friedrich Schneider [2,3] hypothesized that the shadow economy and corruption are substitutes in high income countries. Results show that there is no robust relationship between corruption and the shadow economy when perceptions-based indices of corruption are used. While corruption in one form or another has always been with us, it has had variegated incidence in different times at different places, with varying degrees of damaging consequences [4-6].

Shadow Income: The results of research [7] project suggest that the size of the shadow economy as

estimated with the currency approach often yields the highest possible values. Other approaches and plausibility considerations produce much lower values, which seem to be much more realistic. Consequently, policy considerations to strengthen the control mechanisms should be met with utmost skepticism.

The “shadow income” may be retrieved at all stages of operation: exploitation, repair and disposal of fixed assets.

Asset acquisition in hotels and other collective accommodation establishments may be concealed by the founders of the CAE, who can contribute assets as a shared capital, as well as sale, inheritance or gift.

The most preferable way for CAE managers to retrieve “shadow income” is buying and selling the property (Figure 1).

CAE management uses the supplier’s competition as a base of the “shadow income” scheme during the asset acquisition. Therefore, in order to sell goods suppliers offer discounts to buyers, which can be as high as 10-15%.

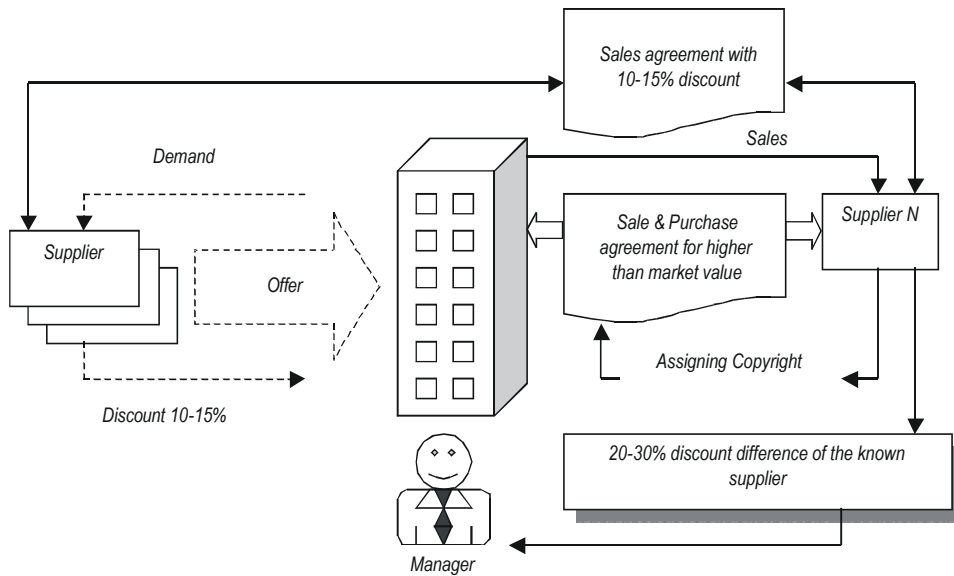


Fig. 1: “Shadow income” retrieving scheme by CAE management at fixed assets acquisition stage.

However, the sales and purchase agreement might be completed without major equipment suppliers, who offer discounts, but by involving a company into a scheme, controlled by the number of interested CAE manager. The implementations method of the “shadow income” scheme implementation is when the 'firm' purchases equipment from the 'supplier' at a discounted price, at the same time entering into a sales agreement with the CAE firm. In addition, the contracted price may be overestimated by 10-15%. Thus, the difference of 20-30% from the discounted price of the known supplier remains in the "company" and then shared with the interested parties of the CAE management.

The Signs of Such Transactions Are:

- The firm appears in several transactions;
- The firm cannot be found in the internet search engines or there is no information about the goods on the website of the company;
- The price of the equipment is higher than the market value;
- Original documents contain the equipment numbers with product code;
- Original documents do not state the discount;
- The warranty documents and other equipment documents contain suppliers stamps.

In order to counter the implementation of this kind of 'shadow' schemes, internal control function must be implemented, especially at sale and purchase agreements

stage. The effectiveness of control is increased by the introduction of the negotiation and bidding procedures and the effectiveness of the in-depth analysis of the original documents.

Due to lack of working capital, CAE management is not encouraged to purchase any type of assets, but to lease. The main tool here is a financial lease (leasing). In order to extract the 'shadow income" CAE management uses leasing (Fig. 2).

The principle of "shadow income" retrieval scheme by means of leasing is a property acquisition at a price, few times below the market value. In this case, the severity of payments is transferred from the future owner of the property to CAE organisations.

Therefore, when calculating the lease payments accelerated depreciation may be applied. As a result, the lesser overstates the amount of lease payments and also tolerate the amount of actual redemption payment. The amount of formal redemption payment may be much less than the market value of movable assets, which will be located in the temporary possession and use of the lessee for a short period of time. One of the conditions listed in the leasing agreement, which will assist the realisation of the "shadow income" scheme is possibility to transfer leasing payments rights to third party. As a result of the "shadow" scheme a person, specified by CAE manager, can acquire the movable property. Following the implementation of the scheme an interested person can bag the difference between market and redemption value of property.

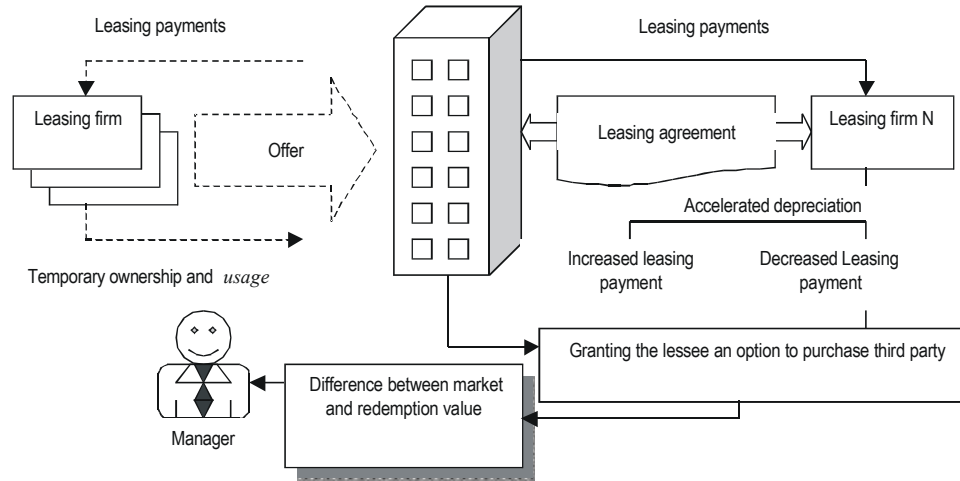


Fig. 2: 'Shadow' income" retrieval scheme by means of financial lease (leasing) used by CAE management.

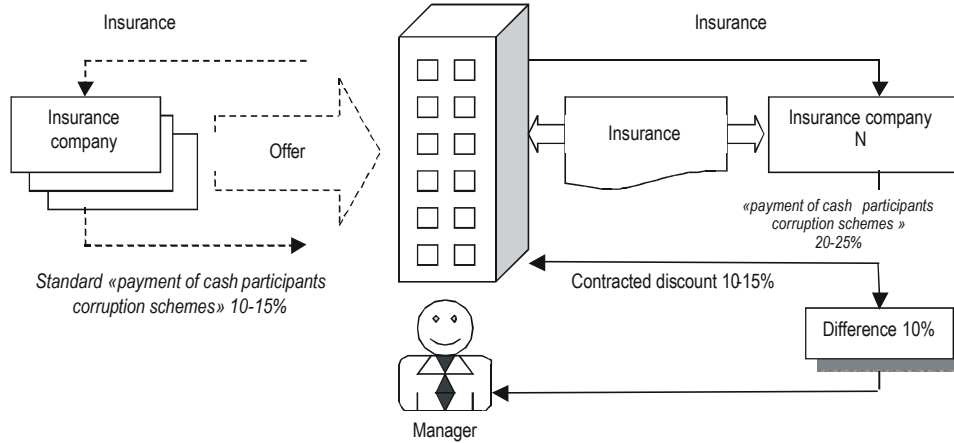


Fig. 3: "Shadow income" retrieving scheme by CAE management while insuring property.

The essential feature of the 'shadow income' schemes performed by CAE management is the low cost of indemnity payments [8].

In order to counter the implementation of this kind of 'shadow' schemes, internal control function must be implemented, especially at a lease calculating stage and redemption payments.

Following the acquisition of ownership or rights of ownership and (or) utilisation, the CAE must insure hazardous industrial facilities and vehicles. This also raises the possibility of retrieving the 'shadow of income" (Figure 3).

The base of "shadow income" retrieval scheme while insuring the property is insuring property by unknown insurance companies, who offer at the expense of quality and quantity much bigger "payment of cash participants corruption schemes" compared to standard.

Since the size of the standard "payment of cash participants corruption schemes" is well

known, CAE management sign the insurance contract with informal conditions of 10% "payment of cash participants corruption schemes" and official contract with a 10-15% discount. In this case, an unknown insurance company, which provides 20-25% discount, may soon leave the market [9,10].

One of the signs of the "shadow income" schemes in property insurance or liability is an entry into a relationship with the unknown insurance companies.

In order to counter the implementation of this kind of 'shadow' schemes, internal control function must be implemented, especially at stage when the insurance company is being selected.

During the operation plant and equipment wear out and require maintenance and repair. In this case, CAE management has the opportunity to retrieve a "shadow income" (Figure 4).

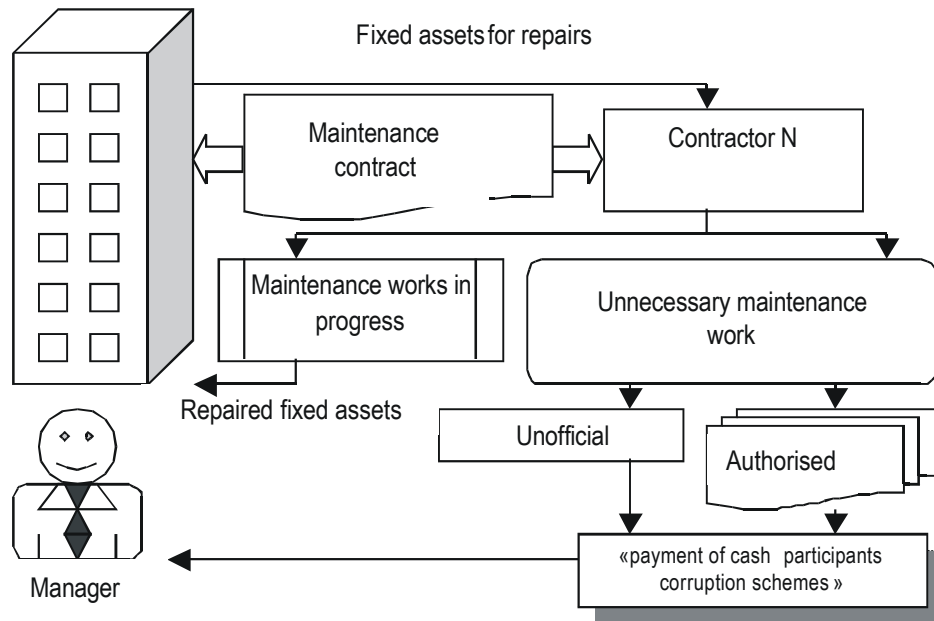


Fig. 4: "Shadow income" retrieving scheme by manager at a repair stage of movable property of collective accommodation facilities.

The principle of retrieving "shadow income" thought the schemes related to the repair and maintenance of plant and equipment is by including a set of works that are not required. As a result of an additional work, CAE management is able to retrieve additional cash previously agreed "payment of cash participants corruption schemes". In addition, further work may be a "purely formal". In the first case, CAE management enters the "shadow income" schemes for income redistribution, in the second case, the actions of stakeholders discernible signs of a crime.

Signs of the implementation of these "shadow income" schemes are the following:

- The fixed assets are serviced in the same maintenance organizations;
- Repair intervals for the fixed assets become more frequent;
- The amount spend on repairs of fixed assets become more significant.

In order to counter the implementation of this kind of 'shadow' schemes, internal control function must be implemented in an equipment inspection process and especially at a stage of the repair acceptance checks.

The effectiveness of pre-control, even under the inspection commission sent in for repair of property, may oppose the so-called "expert opinion" and

recommendations from the maintenance organization to carry out more work and (or) the replacement of certain parts and components. Therefore, it is appropriate to receive an alternative expert opinions or conclusions from certified repair organizations. Effectiveness of follow-up increased by a detailed analysis of primary documents.

Retrieving the "shadow income" from property repair is carried out using the above scheme.

The principle of the "shadow income" schemes from the property repair works is an advantage of the CAE management over the difficulties related to the verification of the hidden works, specific drafting estimates, methods and costs of repairs and accounting of construction materials. The most widely used method is to include cost estimates and materials into the work rates, replace of the same type of less expensive rates for more expensive rates and materials, in violation of the sequence of total calculations, budget calculations and etc.

Practice shows that the ability to retrieve "shadow income" appears with the start of any repair work. This means that the start of construction works is a sign of the realization of shadow schemes.

In the process of ownership and use of plant and equipment, the CAE management have the opportunity to retrieve the "shadow income". Here are two options: exploitation and ownership of fixed assets that don't belong to management for their own benefit or rent plant and equipment out.

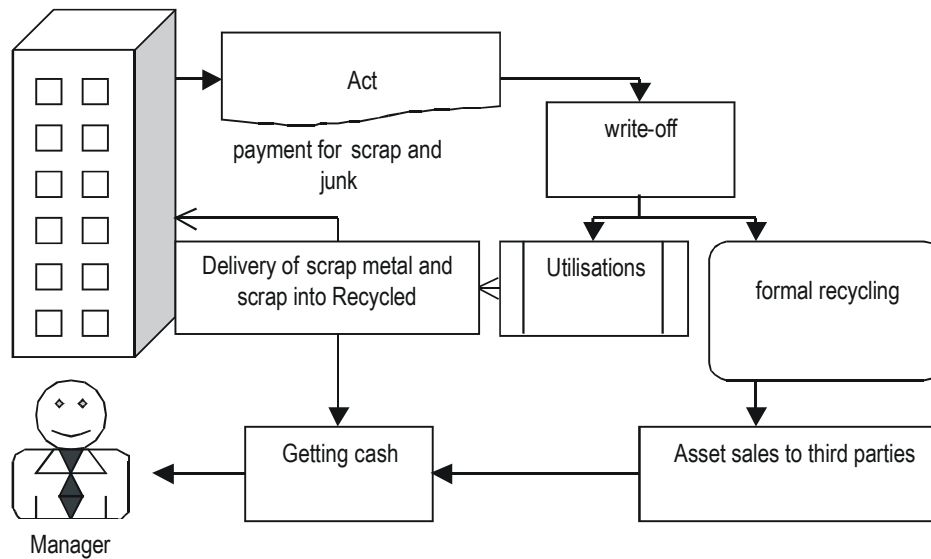


Fig. 5: "Shadow income" scheme retrieved by a manager by writing off the assets.

The principle of the "shadow income" schemes for rental income is the ability to establish rental per square meter different from the market value, as well as renting unused land or property without issuing the lease. In the first case, the actions of stakeholders supported by the professional appraisal report. And the price can vary – up and down.

The Signs of Such Transactions Are:

- The calculation of rent reports are used mostly the same appraiser;
- There are differences in the price of rent space by various tenants.

In order to counter the implementation of this kind of "shadow income" schemes, control function must be implemented in the preliminary stage of control pricing in the rental and monitoring through regular inventory of fixed assets.

The life cycle is completed by disposal of fixed assets (write-off) and subsequent disposal of decommissioned assets. Here, the management and staff of CEB have the ability to get the "shadow" of income (Figure 5).

The principle of retrieving the "shadow income" schemes is writing-off assets in order to get cash for the surrender of scrap, waste paper and scrap collection points for recycling and disposal of formal suitable for further use of the property and its subsequent sale to third parties. In some cases there may be an early fixed assets write-off, as it were justified uneconomical future repairs and maintenance.

The Signs of Such Transactions Are:

- Payments for delivery of scrap and scrap is minimal or not received in the CAE accounts;
- More and more cases of early fixed assets written off;
- The fixed assets are sold to third parties at prices below market value.

The effectiveness of follow-up helps to analyze the ways and means of implementing materials obtained from dismantling of fixed assets, matching the weight of scrap and scrap from the amounts received for his surrender to collection points, analysis of the causes of early cancellation of fixed and study entities - customers and equipment.

RESULTS AND DISCUSSION

Thus, the above extraction scheme "shadow" of income from fixed assets to the following conclusions:

- Fixed assets might be used as tools to retrieve "shadow of income" by management and staff;
- Retrieval of "shadow income" by management can be implemented at all stages of the life cycle of fixed assets;
- "Shadow income" can be retrieved with or without any evidence of a crime;
- Retrieved "shadow income" by CAE management is always associated with loss of profits
- To retrieve the "shadow income" it is necessary to use third party contractors or CAE;

- Scheme of "shadow" incomes" have both general and specific features;
- Counter tool against the "shadow" of income can be an effective system of internal control.

Most effective means to counter the implementation of the "shadow" schemes is to retrieve income from transactions with fixed assets of collective accommodation facilities are:

- Regular inventory of fixed assets;
- Activities to enhance the effectiveness of internal control;
- The concentration of the main efforts of performing internal control activities prior to the inspection;
- Improved follow-up on the basis of a comprehensive analysis of contracts and original documents.

CONCLUSION

This article demonstrates just some of the constantly developing and refined by stakeholders schemes to retrieve of the "shadow income". However, the author believes that the described "shadow income" schemes will help the hospitality employees to effectively counter threats and challenges from within disintegrating economy.

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