



## Analysis and Audit of Equity Capital in Joint-Stock Companies

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### ABSTRACT

One of the most important goals of any enterprise is to maintain a source of income, i.e. own capital. Equity is property that is free from liabilities and is used as assets. The financial stability of the enterprise is determined by the structure and value of equity capital (EC). The structure, dynamics and value of equity capital influence the adoption of managerial decisions of a short-term and long-term nature.

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**Introduction.** Equity capital characterizes the total value of the funds of a joint-stock company owned by it and used by it to form a certain part of the assets. This part of the asset, formed at the expense of equity invested in them, represents the net assets of the joint-stock company. Own capital includes various sources of financial resources in terms of their economic content, principles of formation and use: authorized, additional, reserve capital, retained earnings, special purpose funds and other reserves. Also,

own funds include gratuitous receipts and government subsidies. The amount of the authorized capital must be determined in the charter and other constituent documents of the organization. It can be changed only after making appropriate changes to the constituent documents.

One of the most important goals of any enterprise is to maintain a source of income, i.e. own capital. Equity is property that is free from liabilities and is used as assets. The financial stability of an enterprise is determined by the structure and amount of equity capital (EC). The structure, dynamics and value of equity capital influence the adoption of managerial decisions of a short-term and long-term nature [1].

According to Professor Yu.A. Babaev, equity is capital minus attracted capital (liabilities), which consists of a combination of authorized, additional and reserve capital, retained earnings and other reserves (trust funds and reserves) [4]. In the textbook "Finance" by Lyudmila Drobozina, it is said that the equity capital of an enterprise is the difference between the sum of assets and the sum of external liabilities of the enterprise. Its value can only be determined by calculation based on balance data [3].

The main purpose of the analysis of equity in joint-stock companies is to identify the main sources of its formation and to establish the consequences of their changes for the financial stability of the organization, to determine the organization's ability to preserve capital.

Tasks of equity analysis:

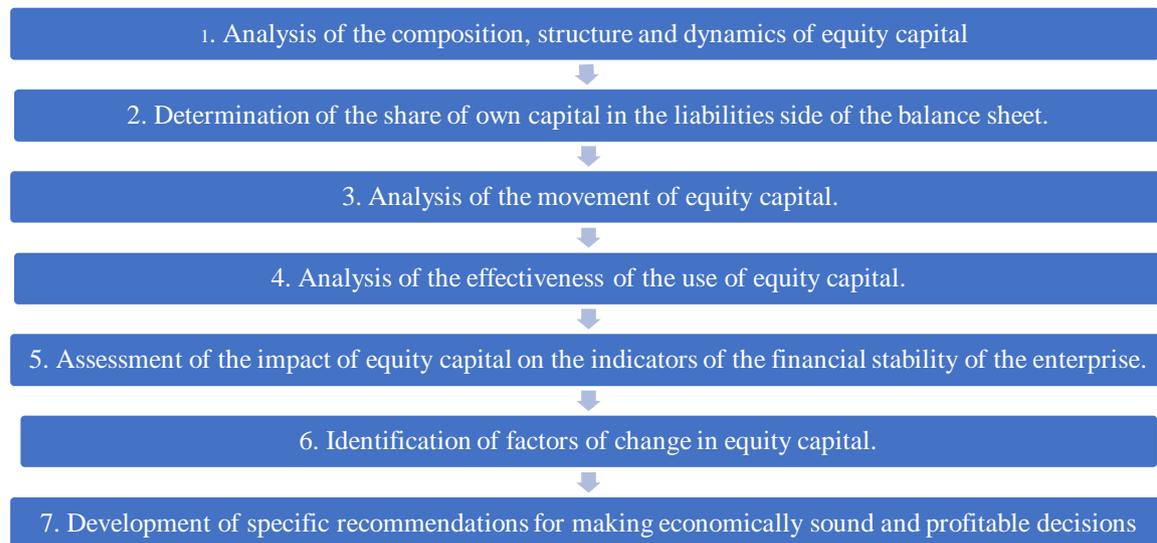
- study of the composition, structure and dynamics of the equity capital of an economic entity;
- assessment of the changes that have occurred in the liabilities side of the balance sheet in terms of increasing the level of financial stability of the enterprise;
- identification of factors of change in their value;
- determination of the required amount of equity capital for the break-even activity of the joint-stock company;
- evaluate the effectiveness of the use of equity capital;
- assessment of the investment attractiveness of a joint stock company;
- substantiation of the optimal variant of equity replenishment reserves.
- determination of the total amount of own capital, its changes and the direction of movement in the process of economic activity of the joint-stock company;
- development of specific recommendations for making economically sound and profitable decisions, etc.

Currently, there is no approved methodology for the financial analysis of the equity capital of a joint-stock company in practice, so scientists and economists develop and offer their own unique schemes for analyzing equity capital. According to scientists, it is their methods that reflect the full range of information to interested users about the structure of capital, its dynamics, the processes of formation, use, management and forecasting, and they are also easy to adapt and apply in production.

Theoretical and practical aspects of the stages of conducting an economic analysis of equity in joint-stock companies are reflected in the works of such foreign scientists as T.I. Grigorieva, L.T. Gilyarovskaya, A.D. Sheremet, I.A. Zhulega, E.A. Markaryan, G.P. Gerasimenko, S.E. Markaryan, N.V. Kuznetsova, S.A. Ershova, G.V. Savitskaya and others.

**Material and Methods.** Based on the studied existing modern methods and techniques of economic analysis, in our opinion, the analysis of equity should be carried out in the following order (Fig.

1).



**Figure 1. Model for conducting an economic analysis of equity in joint-stock companies.**

1. Analysis of the composition, structure and dynamics of equity capital in joint-stock companies.

In the process of analysis, it is necessary to study in detail the composition of equity capital, find out the reasons for the change in its individual components and evaluate these changes, as well as analyze in detail the movement of equity capital. When analyzing the structure of equity, it is necessary to take into account the characteristics of each of its components. The capital structure of an organization (the share of its own and borrowed sources) has a direct impact on the financial independence and financial stability of the organization. Equity capital is characterized by ease of attraction, ensuring a more stable financial condition of the organization and reducing the risk of bankruptcy. The higher the share of equity in the total amount of capital, the higher the barrier that protects investors and creditors from possible losses, and the lower the risk of loss.

The need for own capital at an optimal level is due to the requirement for self-financing of a joint-stock company, since it is a guarantee of its independence and independence. The peculiarity of equity capital is that it is invested on a long-term basis, therefore it is exposed to the greatest risk for its owners.

For each current period, sustainable growth rates depend on the increase in equity, the source of which is retained earnings. Of all sources of financial resources, profit is a constantly reproducible resource. Other sources, such as: issue of shares, issue of bonds, loans are of a one-time nature for a certain period of time[2].

2. Determination of the share of own capital in the liabilities side of the balance sheet.

It is with this that the analysis of equity capital should begin, since its size and share in the liability of the balance sheet of an economic entity determines the degree of its independence from borrowed funds and, consequently, financial stability. In order to assess the change in the share of equity capital in the sources of financing, it is necessary to find out due to which of its components this change occurred. The excess of equity capital over borrowed capital, as well as the outpacing of its growth rates over the growth rates of borrowed funds, is a sign of a “good” balance.

3. Analysis of the movement of equity capital.

For the analysis of the movement of equity, the coefficients of receipt and disposal are used. The

equity inflow ratio is the ratio of the value of equity capital received to the value of equity capital at the end of the period. It shows what part of the equity from the available at the end of the reporting period is made up of newly received funds in his account. The equity retirement ratio is the ratio of the value of retired equity to the value of equity at the beginning of the period. It shows how much of the equity capital with which the company started operations in the reporting period was used in the course of the business entity's activities. The excess of the values of the coefficients of receipt over the coefficients of retirement characterize the process of increasing equity (a positive trend), and the opposite situation will indicate the loss (reduction) of equity, which is regarded as a negative trend.

#### 4. Analysis of the effectiveness of the use of equity capital.

To analyze the effectiveness of the use of equity, two main indicators are used: the turnover ratio of equity (the ratio of revenue to the average annual cost of equity), return on equity (the ratio of net profit to the average annual value of equity). The first coefficient shows the rate of turnover of capital invested by the owners, the second reflects the profit received from each ruble of funds invested by the owners. The higher both ratios, the better the organization's own capital is used. These indicators are of interest not only to shareholders, but also to potential investors.

5. Assessment of the impact of equity capital on the indicators of the financial stability of the enterprise. To assess this impact, a system of indicators is used. The main coefficients included in it are the coefficient of autonomy and the coefficient of provision with own working capital.

**Discussion.** The autonomy ratio (equity concentration ratio) is the ratio of equity to the balance sheet. It shows the share of own funds in the total amount of funding sources and characterizes the independence of an economic entity from borrowed funds. An increase in the autonomy coefficient indicates an increase in financial independence and a decrease in the risk of financial difficulties. However, its significant value may indicate the inability to attract credit resources. The recommended value of the coefficient for industrial enterprises is 0.5 due to the fact that production is of a capacious nature, and equity capital is directed mainly to the formation of non-current assets and, above all, fixed assets.

The coefficient of provision with own working capital is calculated as the ratio of own working capital to current assets. It shows what part of current assets is formed at the expense of own sources. The lower limit of this indicator is 0.1 (at least 10% of working capital should be financed from equity), the optimal value is considered to be more than 0.3-0.5.

The practical use of the coefficient method for the analysis of equity enables users to obtain up-to-date data on the financial and economic condition of a joint-stock company, its stability, profitability and future prospects. And also you can make analytical reports for internal use, making cost-effective decisions.

#### 6. Identification of factors of change in equity capital.

Determining the impact of various factors on equity is possible using the following models: a system of SWOT-analysis of financial activities; model "DuPont" - integrated analysis system (1-table); objectively oriented system of integral financial analysis; factor analysis of the dynamics of the value of net assets; portfolio analysis, etc.

7. Development of specific recommendations for making economically sound and profitable decisions.

**Table 1****Analysis of equity capital using financial ratios of JSC O'zkimyo sanoatloyiha [5]**

| №  | Indicators            | Definition           | Reporting period |       |       | Change (+,-) |               |
|----|-----------------------|----------------------|------------------|-------|-------|--------------|---------------|
|    |                       |                      | 2019             | 2020  | 2021  | 2021 vs.2020 | 2020 vs. 2019 |
| 1. | Admission rate        | ECi / ECep           | -                | -     | -     | -            | -             |
| 2. | Retirement rate       | ECcr / ECbp          | -                | -     | -     | -            | -             |
| 3. | Equity turnover ratio | NR / ECac            | 3,76             | 4,21  | 3,22  | -0,99        | 0,45          |
| 4. | Return on equity      | (NP / ECac)*100      | 14,23            | 28,99 | 23,51 | -5,48        | 14,76         |
| 5. | Autonomy coefficient  | EC / TS              | 0,61             | 0,60  | 0,66  | 0,06         | -0,01         |
| 6. | Working capital ratio | (EC + LTL- LTA) / CA | 0,55             | 0,49  | 0,48  | -0,01        | -0,06         |

Legend: ECi - incoming equity capital, ECep - cost of equity at the end of the period, ECcr - cost of retired equity capital, ECbp - cost of equity at the beginning of the period, NR - net revenue, ECac - average annual cost of equity, NP - net profit , TL - total liability, LTL - long-term liabilities, LTA - long-term assets, CA - current assets, TS – total sources.

The DuPont model was used in the factor analysis of the return on equity ratio

$$R_{\text{ek}} (\text{ROE}) = R_{\text{a}} (\text{ROA}) * M_{\text{r}} (\text{DR}) = \text{NP} / \text{NR} * \text{NR} / \text{A} * \text{A} / \text{EC}$$

The model allows you to calculate the influence of factors on the return on equity.

**Table 2****Factor analysis of equity based on the financial statements of O'zkimyo sanoatloyiha JSC**

| №  | Indicators                          | Reporting period |            |            | Change (+,-) |               |
|----|-------------------------------------|------------------|------------|------------|--------------|---------------|
|    |                                     | 2019             | 2020       | 2021       | 2021 vs.2020 | 2020 vs. 2019 |
| 1. | Net profit, thousand soums          | 220060.00        | 517925.20  | 481804.30  | -36120,9     | 297865,2      |
| 2. | Net proceeds, thousand soums        | 5816050.00       | 7530672.80 | 6603264.30 | -927408,5    | 1714622,8     |
| 3. | The value of assets, thousand soums | 2604004.00       | 3266035.80 | 3206290.80 | -59745       | 662031,8      |
| 4. | Own capital, thousand soums         | 1605707.00       | 1966690.90 | 2132663.50 | 165972,6     | 360983,9      |
| 5. | Sales profitability (1/2), %        | 3,78             | 6,87       | 7,29       | 0,42         | 3,09          |
| 6. | Asset turnover                      | 2,23             | 2,30       | 2,06       | -0,24        | 0,07          |

|  |   |                   |       |       |       |       |
|--|---|-------------------|-------|-------|-------|-------|
|  | (2/3), sum                                      |                   |       |       |       |       |
| 7.   | Ratio of assets to equity (3/4), thousand soums | 1,62              | 1,66  | 1,50  | -0,16 | 0,04  |
| 8.   | Return on equity (1/4), %                       | 13,70             | 26,33 | 22,59 | -3,74 | 12,63 |
| Analysis of the influence of factors on the change in equity capital (2021 vs. 2020) |   |                   |       |       |       |       |
| A)   | Change the profitability of the implementation  | 0,42*2,30*1,66    |       |       | 1,6   |       |
| B)   | Change in asset turnover                        | 7,29*(-0,24)*1,66 |       |       | -2,9  |       |
| C)   | Change in the ratio of assets to equity         | 7,29*2,06*(-0,16) |       |       | -2,4  |       |

As can be seen from the table, in the reporting year, the return on equity is 31.77% (2021), compared to the previous year, it decreased by 3.74%. This change was influenced by an increase in the profitability of sales, asset turnover, the ratio of assets to equity capital. The profitability of sales in the reporting year is equal to 7.29%, compared with the previous year increased by 0.42%. In turn, this led to an increase in return on equity by 1.6%. Asset turnover in the reporting year is 2.06, compared with the previous year decreased by 0.24. As a result, the return on equity decreased by 2.9%. The ratio of assets to equity capital in the reporting year is 1.5, compared to the previous year it decreased by 0.16. This led to a decrease in return on equity by 2.4%.

**Results.** Based on all the calculations, we can make a generalizing conclusion that the decrease in net revenue and net profit led to a decrease in the profitability of sales and asset turnover. And they eventually had a negative impact on reducing the return on equity. At present, the analysis of equity in all joint-stock companies is given a central place, and our study allowed us to supplement the existing methods of analysis and formulate a certain sequence of stages in the analysis of equity in joint-stock companies. It consists of several procedures, namely: the formulation of goals, objectives, methods and techniques of analysis; conducting comparative, horizontal, vertical analysis; selection of certain coefficients of dynamics, composition and efficiency of the use of equity capital, their calculation and evaluation; assessment of the efficiency of capital use and determination of the influence of factors on capital; use of analysis data in making managerial decisions. In our opinion, it is precisely this sequence of conducting an analysis of the equity capital of a joint-stock company that will allow internal and external users to receive up-to-date information and build an accounting and analytical system more rationally, that is, aimed at maximizing profits and minimizing losses.

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