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## **THE ORGANIZATION AND METHODS OF CONTROL OVER EQUITY RIGHTS ISSUE**

**Abstract.** It was established during the research that an effective system of control over equity rights issue allows not only to reduce risks of accounting errors and to provide exact information for financial reporting, but also to properly maintain the economic security of an issuer. This justifies the necessity of designing a control system, which will cover all the aspects of equity rights as an instrument for funding an issuer's business activities.

Taking into account the fact that the key to achieve more effective control over operations with equity rights lies within using workable techniques and procedures for monitoring at each stage of control, a program for control over operations with equity rights issue is developed in the study. The program is based on the principles of systematic approach and integrates all stages of control. It also contains information background of all the steps and their documentation.

Due to the significant amount of economic information generated by accounting systems of equity rights issuers, as well as the limitations of existing communication channels, the described integrated approach to exercising control over equity rights issue and to finding practical solutions for developing a program of control procedures and their documentation will enable to make managerial decisions on the equity capital on the basis of complete and accurate information.

**Keywords:** equity rights, issue, issuer, investor, control equity rights  
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**Introduction.** Without an efficient system of control, the risk of errors in accounting records of equity rights and in the relevant data disclosed in financial reports will be significant. Therefore, in order to ensure expediency and accuracy of operations with equity rights and to provide managerial staff and other users with accurate information it is advisable to establish a workable system of control over equity rights which will cover all the aspects of their performance. Control procedures are of high importance for both issuers of equity rights and investors depending on their managerial goals.

The current legislation of Ukraine provides for mandatory control over issuers of equity rights (shares) that is institutionalized in the form of annual external audits. External audits are carried out by state government bodies and public representatives. However, for more efficient corporate management, there is a need for a well-functioning system of internal control that is performed by the Supervisory Board, the auditing committee, the internal auditing service, etc., and also by the meeting of shareholders who have certain supervisory functions.

**Literature review and the problem statement.** The undertaken analysis of scholarly articles on control over equity rights proves that although some researchers, such as H. Astapova, M. Belopolsky, M. Bielousov, J. Gailbraith, H. Dźwigoł, K. Knedler, A. Mazurek, I. Mantsurov, W. Meckling, M. Miliavskiy, O. Nusinova, V. Pashutina, O. Pylypenko, O. Pereverziev, K. Puchacz, R. Savchenko, I. Spasibo-Fatieieva, O. Khudik and others have considered these matters, there is no comprehensive solution to the absence of an integral system of control over equity rights. Since the researchers have rather paid attention to protection of equity rights and rights violations, the suggested control measures are mainly targeted at control over the equity capital, the authorized capital or financial investments. The aim of this study is to outline the program for monitoring operations with equity rights, which will allow fulfilling systematically approach to solving the problems of control, coordinating control procedures and regulating their information support.

However, such concepts as "corporate auditing" or "internal auditing" are under consideration in a number of studies. The concept of internal auditing has been developed by V. Honchar, T. Kamenska, O. Makeeva, V. Ponomariova, V. Savchuk and others.

**Research results.** At the state level, National Securities and Stock Market Commission of Ukraine occupies a special place in exercising control over equity rights, because according to the Law of Ukraine "On State Regulation of Securities Market in Ukraine [On State Regulation of Securities Market in Ukraine Act 1996] this authority is vested with the power to regulate securities that embody equity rights. Among high-level regulatory acts which govern equity rights it is important to focus attention upon the Act of Ukraine "On Joint Stock Companies" [On Joint Stock Companies Act 2008], since it includes basic principles of issuing equity rights (shares).

In countries where the development level of corporate sector of economy is high, internal control over equity rights has paramount importance, because the need to improve the investment climate of economy demands special attention of regulatory authorities to defending investors' rights. However, business practices of domestic enterprises prove that a properly-designed system of internal control is rarely found in Ukrainian companies.

As Y. M. Umantsiv [Umantsiv 2012] indicates, "...the limitations of effective development of Ukrainian model of corporate governance lie within the fact that a number of participants have specific interests concerning corporate strategy and establishment of corporate surveillance, as well as amount of influence on decision-making process." However, it should be noticed that what the author described as a potential conflict of interests is typical for corporate governance. "Assessing shareholders' capabilities and behavior", A. Halchynskiy [Halchynskiy 2011] states, "enables to identify the causes of corporate conflicts and justify the strategy of corporate control. The latter considerably balances the interests of equity rights holders."

A search through scholarly and practical literature on control matters leads to the conclusion that along with the concept of "control over equity rights", the concepts of "corporate control", "corporate audit" and "corporate management" are also employed.

According to M. Miliavskiy [Miliavskiy 2012], corporate control "covers the examination of conditions for establishing equity rights of each holder and includes the following procedures: maintaining a balanced ratio according to per cent owned by participants; applying the same methods for calculating shares of each holder; implementing methods for redistributing mutual funds of partners;

adhering to the requirements of equity carve-out and redemption; enforcing liabilities of corporations to their stockholders. However, being an element of corporate governance, control is intended to perform the task of continued facilitation of efficient corporate functioning, since it is an essential condition for pursuing economic interests of shareowners."

It must be noted that some authors mistakenly believe that corporate governance should be considered as management of equity rights. They argue that an owner of such rights has ownership over some part of the authorized capital stock of business partnership, including corporate governance rights. We view the concept of corporate governance as much broader than management of equity rights, because it includes integrated monitoring, control and decision-making over all the activities of an enterprise.

From R.O. Savchenko's [Savchenko 2014] point of view, corporate governance is "a system of relationship between government authorities, corporate officials and shareholders, which ensures balance of interests and is targeted at optimization of corporate profitability in accordance with current legislation and in line with international experience."

We believe that "control over equity rights", "corporate control", "corporate audit" and "corporate governance" are related but not identical concepts. The system of corporate control consists of corporate audit which is one of the control procedures and is based on the principles of documentary inspection. At the same time, a number of methods of control over equity rights may not be included in corporate audit. Among them are the following: control over decision-making processes, some elements of working control over equity rights.

We consider that for designing an integral system of control over equity rights, it is essential to determine the object and the subject matter of such a control, to outline the main objectives of control procedures and to establish a system of information support for control-related activities. Thus, the object of control over equity rights issue are operations related to issuing, modifying and liquidating equity rights, whereas the subject matter of control is the expediency and legitimacy of these operations as well as their accurate and complete disclosure in accounting and reporting.

In most highly-developed countries, the legislation provides for a compulsory establishment of audit committee within the supervisory board. However, in Ukraine, decisions about audit committees are left to the consideration of an enterprise and usually made towards ignoring this alternative. Most frequently, internal control in Ukrainian corporations is performed by a revision commission, members of which are shareholders of a corporation.

According to S.V. Didenko [Didenko 2008], "the Ukrainian legislation does not provide for a compulsory establishment of internal audit departments, but practical activities prove that the establishment of such a department is useful." While agreeing with the author's point of view, we need to add that the department of internal control must report to the corporate board, because the main responsibilities of such a department include maintaining control over using equity rights for funding its activities as well as determining risks of this way of funding.

Furthermore, the need to develop more favourable investment climate in the country requires legislative/regulatory mechanisms for adjusting the rights of minority shareholders. This problem has been in the focus of attention of both theorists and practitioners of economic and law studies. In particular, I. Spasibo-

Fateeva [Spasibo-Fateeva 2009] stresses that “allegation of rights violation of minority shareholders arises quite often, but minor shareholders are also involved in forcible takeovers. ... In order to illegally take over an attractive enterprise, some concerned parties engage minority shareholders, whose derivative actions block the activity of an enterprise.”

Although some legal and regulatory measures should be taken to promote the establishment of proper institutional environment of equity rights functioning, for achieving greater efficiency of control over equity rights it is necessary to apply a comprehensive approach and to use techniques and methods of control procedures at each stage of control. Accordingly, a program for control over corporate rights is developed (Table 1), which is based on the principles of systematic approach and integrates all stages of control. It also contains information background of all the steps and their documentation.

Table 1. The program of control over equity rights

No	Content procedures	Information support	Documentation of control results
1	2	3	4
<i>1. Preliminary control (carried out before making business operation with equity rights)</i>			
1	Economic calculations of feasibility of operations with equity rights for managing sources of corporate finance	Balance sheet (Statement of financial position), Statement of financial results (Statement of comprehensive income), Statement of owner's equity, Notes to financial statements	Calculations of economic feasibility of corporate equity issuing (modifying, liquidating)
2	Compliance inspection of a set of documents related to equity rights operation to the requirements of current legislation and statutory records	Sets of documents in accordance with statutory requirements	Compliance test of documents related to equity rights issuing (modifying, liquidating) to the requirements of current legislation
<i>2. Current control (carried out in the course of making business operation with equity rights)</i>			
1	Inspection of documentary evidence (organizational, administrative, specialized and primary documents) for disclosure of a transaction in accounting	A set of organizational, administrative, specialized and primary documents, which is according to the order of accounting policies constitutes a system of documentary ensuring for accounting of operations with equity rights	
2	Inspection of actual entry of material assets to repay contributions of founders and shareholders to the registered capital	A set of primary documents that confirm actual entry of material assets to repay contributions of founders and shareholders to the registered capital	
3	Inspection of arrears of shareholders' contributions to the registered capital	1. Organizational documents related to decision-making on issuing (modifying, liquidating)	Inventory report on arrears of shareholders' contributions to the registered capital

		<p>equity rights.</p> <p>2. Primary documents related to entering of material assets to repay contributions of founders and shareholders to the registered capital</p> <p>3. Turnover balance sheets by analytical accounts for the account "Settlements with participants".</p> <p>4. Financial statement of enterprise</p>	
4	Inspection of accuracy of dividend calculations	<p>1. Organizational documents related to decision-making on distribution of profits and dividend payments</p> <p>2. Primary documents related to distribution and taxation of dividends, and to the flow of funds</p>	Account of control over accuracy of dividend calculations
<i>3. Follow up control (carried out on the basis of results over the reporting period or of business operation with equity rights)</i>			
1	Inspection of reporting indicators related to operations with equity rights		
2	Inspection of disclosure in financial statement of arrears in shareholders' contributions to the registered capital	<p>1. Turnover balance sheet.</p> <p>2. Financial statement of enterprise</p>	
3	Inspection of disclosure in financial statement of arrears in payments to participants		
4	Inspection of preparation and submission of statement on ultimate beneficiaries		
5	Inspection of validation of internal reporting on operations with equity rights	Statement of operations with equity rights	
	Economic calculations of changes in financial position of enterprise	Balance sheet (Statement of financial position), Statement of financial results	Calculation of changes in financial position caused by issuing, modifying, or

over the period during which equity rights have been issued in order to change sources for funding an issuer's activities	(Statement of comprehensive income), Statement of owner's equity, Notes to financial statements (over a number of reporting periods)	liquidating equity rights
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At the stage of preliminary control, which is carried out before making operation with equity rights, it would be advisable to assess feasibility of issuing equity rights, to compare this way of funding activities with other possible. This kind of control will enable to avoid unjustified financing and to optimize the flow of funds. Financial statement of an enterprise and analytical indicators of internal reporting applied to making operational decisions can be used as information support for establishing the control procedures.

In addition to the overall program of control it would also be appropriate to develop a set of documents for organizing and compiling information, and recording the results of analysis and control over operations with equity rights issued. In particular, it is preferable to systematize the results of the above-mentioned control procedures in a "Calculation of economic feasibility of issuing (modifying, liquidating) equity rights", that will include analysis of structure and dynamics of main sources for funding activities, analysis of some income/expenditure measures and performance indicators, analysis of correspondence between the growth rate of profit and equity capital and the growth rate of assets and sales, the amount and cost of borrowing, as well as analysis of profitability of equity capital. The application of the Calculation will provide the opportunity to generalize information relevant to feasibility of operations with equity rights by analyzing the equity capital over the period of time, determining the rate of its growth and documenting appropriate conclusions based on the developed model.

Also, at the stage of preliminary control, but after making a decision on issuing, it is essential to check whether all documents are compliant to the current legislation and internal regulations. Incorrectly completed documents may lead to rejection of registering equity rights, irrelevance of operations with equity rights or liquidation of issued equity rights; they may also be a powerful tool for a third party in the processes of conflict resolution or trials in court. In order to conduct the above-described control procedures it would be advisable to carry out a "Compliance Test of documents related to issuing (modifying, liquidating) equity rights to the requirements of current legislation". The Test defines what document corresponds to the type of operation with equity rights, procedures for documenting and deficiencies in documentation.

As soon as issuing (or modifying) is registered, it is time to undertake current control, which includes control procedures in the course of making operations with equity rights. In particular, it implies inspection of documentary evidence for disclosure of operations in accounting. Among the documents are organizational, administrative, specialized and primary documents, which according to the order of accounting policies constitutes a system of documentary ensuring for accounting of operations with equity rights

Also, it is advisable to control arrears of shareholders' contributions to the registered capital. This requires reconciliation of documents related to decision-making on issuing (modifying, liquidating) of equity rights with primary documents related to entry of material assets to repay contributions of founders and shareholders to the registered capital

Furthermore, turnover balance sheets by analytical accounts of settlements with participants and financial statements of enterprise, in particular, statement of financial position (balance sheet) and statement of owner's equity may serve as information support. For documenting this kind of control it would be advisable to draw up an "Inventory Report on arrears of shareholders' contributions to the registered capital", which contains the information on conducting an inventory count of legal entities' arrears of contributions to the registered capital. This evidence is obtained by external confirmation procedures (cross-audit), as well as by conducting an inventory count based on documentary audit and cross-checks of documents.

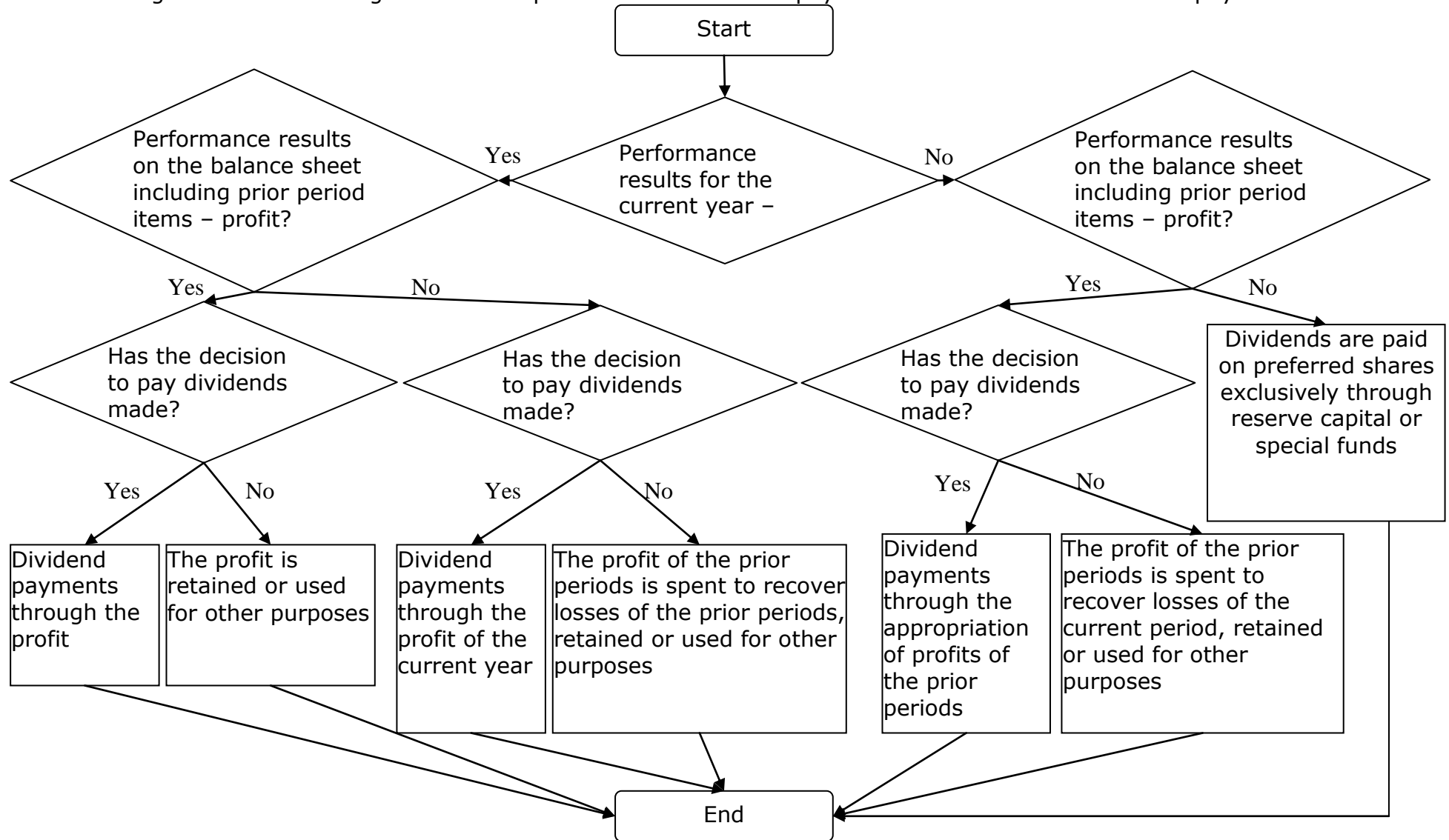
It is also important to exercise control over actual entry of material assets to repay contributions of founders and shareholders to the registered capital. This control implies inspection of primary documents that confirm actual entry of material assets to repay contributions of founders and shareholders to the registered capital.

In general, inventory procedures are an efficient way of current control. However, they are not frequently performed in the course of making business operations with equity capital, because there are no developed methods for conducting inventory counts. Inventory counts of equity capital components should be carried out through documentary inspection of operations related to formation and changes of the registered capital; repayment of contributions to the registered capital; formation and changes of the capital due to increases in the value of assets; changes in additional capital, particularly in contributed capital; formation and changes of reserve capital; formation and utilization of retained earnings in equity; origination and repayment of unpaid capital and disposed capital by maturity.

As well as the above, a particular attention should be paid to control over accuracy of calculations and payments of dividends, and feasibility of decision-making related to dividend payments. V. Pashutina [Pashutina 2013] correctly points out that "a reasonable dividend policy based on the balance between respecting shareholders' rights to participate in the appropriation of profit and to receive its part (dividends) and facing a need to invest to further development, is a key element for long-term growth of company value." However, it is common practice, when an issuer conceals real income in order to avoid dividend payments. Also, it should be noted that dividend payments are possible even in case of loss over the period of time (drawing 1). Among the possible sources of dividend payments are not only profits made during the current period, but also retained earnings of prior periods, as well as surplus reserves or other established reserves, funds etc. Yet, at the same time, in case of profit a decision could be made to retain profit or to use it for other purposes.

For exercising control over operations with dividend payments, it would make sense to compile an "Account of control over accuracy of dividend calculations" which would take into account sources of dividend payments and civil status of shareholders. This is needed to exercise control over taxation of shareholders' incomes.

Drawing 1. Model of making decisions on possibilities of dividend payments and sources of income to pay out dividends





The final stage of control over operations with equity rights is defined as monitoring that is carried out when these operations have been completed. It includes:

- 1) Inspection of reporting indicators relevant to operations with equity rights;
- 2) Inspection of disclosure in financial statement of arrears in shareholders' contributions to the registered capital;
- 3) Inspection of disclosure in financial statement of arrears in payments to participants;
- 4) Inspection of preparation of statement on ultimate beneficiaries;
- 5) Inspection of validation of internal reporting on operations with equity rights;
- 6) Economic calculations of changes in financial position of enterprise over the period during which equity rights have been issued.

This control procedure is analytical and allows us to draw conclusions on the ongoing operations and their results, to identify committed errors and to avoid the errors in the future. In exercising this control, it is advisable to make a "Calculation of changes in financial position caused by issuing, modifying, or liquidating equity rights" that includes information on: analysis of structure and dynamics of main sources for funding activities over the period examined; analysis of some income/expenditure measures and performance indicators; analysis of correspondence between the growth rate of profit and equity capital and the growth rate of assets and sales; analysis of the amount and cost of borrowing; analysis of profitability of equity capital.

**Conclusions.** With the significant amount of economic information, applying an integrated approach may considerably reduce the risk of information errors in communication channels, and thus lower the risk of taking erroneous managerial decisions. Therefore, through a comprehensive approach to exercising control over equity rights from the issuer's point of view, a program of control procedures is proposed and a set of documents for organizing control procedures and documenting control results is developed. This will enable to make managerial decisions on the basis of complete and thorough information.

The findings of the research will facilitate the flow of accurate information on business activities of an enterprise and deviations from the planned performance. They will also contribute to full and timely disclosure of formation and changes of equity rights in accounting and financial reporting, and to efficient managerial decision-making.

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