

## UNIT -1

### UNDERWRITING OF SHARES

#### **INTRODUCTION:**

A Public company cannot make the first allotment of shares unless it gets the minimum subscription from the public. In order to get minimum subscription from the public, a public company, generally enters into an underwriting agreement with one or more underwriters.

#### **Meaning of Underwriting:**

Underwriting is an agreement entered into by a company with one or more persons, called **underwriters**, who undertake to take up the whole or a certain portion of the unsubscribed shares or debentures of a company for a certain **remuneration called underwriting commission**.

#### **Meaning of Underwriters:**

Underwriters are those who underwrite the share or debentures issued by public companies. They may be individuals or institutions like banks, specialized financial institutions, firms and joint stock companies.

#### **Underwriting Commission:**

The consideration payable to the underwriters by a public company for underwriting the shares or debentures is called underwriting commission.

In other words, the consideration payable to the underwriters for the risk they undertake in underwriting the shares of debentures of a public company.

**Underwriting Commission** = Gross Liability x Issue price x % of Commission

#### **Maximum limits of Underwriting Commission:**

- Maximum commission of **5%** of the issue price of the share
  
- Maximum commission of **2 ½ %** of the issue price of debentures .

No underwriting is payable to any one on shares & debentures not offered to public.

**Advantages of Underwriting:**

1. As underwriters guarantee the sale of shares and debentures, subscription of capital of the company becomes certain.
2. When there is an underwriting arrangement, a company is relieved from the trouble of raising the required capital
3. When there is an underwriting arrangement, a company can be sure of getting the required capital within a specified period of time
4. When there is an underwriting arrangement, a company need not bother about money market condition.
5. The underwriters provide expert advice to the company as regards the issue of shares and debentures.
6. The risk of discredit to a company due to the failure of public issue of shares or debentures can be overcome through underwriting, as the unsubscribed shares or debentures are taken up by the underwriters.
7. Underwriters assures the safety of funds of the investors.

**Types of Underwriting:**

1. On the basis of number of shares or debentures underwritten.
2. On the basis of liability of the underwriters.

**1. On the basis of number of shares or debentures underwritten:**

- a. Complete Underwriting
- b. Partial Underwriting

**a. Complete Underwriting:**

A Complete underwriting is one under which the whole of the issue of shares or debentures of a company is underwritten by one or more underwriters.

**b. Partial Underwriting:**

A Partial underwriting is one under which the part of the issue of shares or debentures of a company is underwritten by one or more under writers.

**2. On the basis of liability of the underwriters:**

- a. Pure or Open under writing
- b. Firm underwriting

**a. Pure or Open underwriting:**

A Pure underwriting is an arrangement under which an underwriter agree to take up the shares or debentures of a company only when the shares or debentures underwritten by him or them is not fully subscribed by the public.

**b. Firm underwriting:**

A Firm underwriting means when an underwriter agrees to take up a definite number of shares or debentures in addition to the shares or debentures he has to take under the underwriting agreement.

In case of firm underwriting the underwriters get priority over the general public, if shares or debentures are oversubscribed .

**Marked and Unmarked Applications:**

**Purpose of Marked applications:**

When the issue of shares or debentures of a company is underwritten by two or more underwriters, to determine the liability of each underwriter, it becomes necessary that the applications for shares or debentures should bear the official stamp of each underwriter.

**Marked Application:**

The applications received by the company bearing the official stamp of the individual underwriter or the respective underwriters are called marked applications.

**Unmarked Applications:**

The applications received by the company directly from the public which do not bear the official stamp of the underwriter or underwriters are called unmarked applications.

**Sub-Underwriting:**

An underwriter may, in turn, enter into sub-agreements with other underwriters called Sub-Underwriters under which the sub-underwriters undertake to underwrite some shares or debentures of a company underwritten by the underwriter for some commission. Such an arrangement is called sub underwriting.

Sub-underwriting is resorted to by an underwriter for the purpose of reducing the risk he has undertaken in underwriting the shares or debentures of a company

**Accounting Entries:**

The following are the entries to be passed when the shares are undersubscribed by the public for which the underwriter is liable to subscribe for:

**1. When Shares or Debentures are issued at par**

Underwriter's A/c Dr

To Share Capital/Debentures A/c

(with the nominal value of shares or debentures allotted to underwriter)

**2. When shares or debentures are issued at premium**

Underwriter's A/c Dr

To Share capital/ Debentures A/c

To Share Premium/Debentures Premium A/c

**3. When shares or debentures are issued at a discount**

Underwriter's A/c

Discount on issue of shares /Debentures A/c Dr

To Share capita / Debentures A/c

**4. When underwriting commission becomes due to the underwriter**

Commission on Issue of Shares A/c

Commission on Issue of Debentures A/c

To Underwriter's

**5. For the balance due from the underwriter to the company, which will be received in cash**

Bank A/c Dr

To Under writer's A/c

**Index**

1. When there is Complete and Open underwriting
2. When there is Complete and Firm underwriting
3. When there is Partial and Open underwriting
4. When there is Partial and Firm underwriting
5. Problems on Journal Entries and ledger Account

**General Format: Statement showing Underwriter's Liability**

| Particulars                 | No of Shares |
|-----------------------------|--------------|
| Gross Liability             | XXX          |
| Less: Unmarked Applications | XXX          |
|                             | XXX          |
| Less Marked Applications    | XXX          |
| Net Liability               | XXX          |
|                             | XXX          |
| Add Firm Under writing      | XXX          |
|                             | XXX          |
| Total Liability             | XXX          |

**A. When firm underwriting (included in total subscription) is treated as par with Unmarked application**

| Particulars  | Underwriters |     |     |     |
|--|--------------|-----|-----|-----|
|  | A            | B   | C   | D   |
| Gross liability  | xxx          | xxx | xxx | Xxx |
| Less: <u>Unmarked Applications (Total applications received-total marked applications)</u> | xxx          | xxx | xxx | xxx |
|  | xxx          | xxx | xxx | xxx |
|  | xxx          | xxx | xxx | xxx |

|                                  |     |     |     |     |
|----------------------------------|-----|-----|-----|-----|
| Less: <u>Marked Applications</u> |     |     |     |     |
| <b>Net liability</b>             | xxx | xxx | xxx | xxx |
| Add : Firm Underwriting          | xxx | xxx | xxx | xxx |
| <b>Total liability</b>           | xxx | xxx | xxx | xxx |

**B.. When firm underwriting (included in total subscription) is treated as par with Marked application**

| Particulars  | Underwriters |     |     |     |
|--|--------------|-----|-----|-----|
|  | A            | B   | C   | D   |
| Gross liability  | xxx          | xxx | xxx | xxx |
| Less: <u>Unmarked Applications (Total applications received-marked applications + firm underwriting)</u> | xxx          | xxx | xxx | xxx |
|  | xxx          | xxx | xxx | xxx |
| Less: <u>Marked Applications + Firm underwriting</u>   | xxx          | xxx | xxx | xxx |
| <b>Net liability</b>   | xxx          | xxx | xxx | xxx |
| Add : Firm Underwriting  | xxx          | xxx | xxx | xxx |
| <b>Total liability</b>   | xxx          | xxx | xxx | xxx |

**I. When there is Complete and Open underwriting:**

1. The Akshay Ltd issued 40,000 equity shares. The whole of the issue was underwritten as follow:

A-50%, B-30% and C-20%

Applications for 30,000 shares were received in all , out of which applications for 9000 shares had the stamp of A, those for 6,000 shares that of B and those for 5,000 shares that of C. Determine the liability of the underwriters & also underwritten Commission payable at the rate of 5%

2. Tilak Ltd incorporated on 1<sup>st</sup> Jnauary 2004 issued a prospectus inviting applicatioins for 20,000 equity shares of Rs. 10 each. The whole issued was fully underwritten by A,B,and C as follows:

A-10,000 shares, B-6,000 shares and C-4,000 shares

Applications were received for 16,000 shares of which marked applications were as follows:

A-8,000 shares, B-2850 shares, C-4,150 shares.

You are required to find out the liabilities of the individual underwriters & Calculate the Commission payable @ the rate of 4%

3. Srinidhi Ltd made a public issued of 40,000 equity shares of Rs. 10 each. The entire issue was underwritten by five underwriters as follows: A-25%, B-15%, C-10%, D-30% and E-20%. Applications bearing the rubber stamp of an underwriter are to be applied in relief of his liability.

As a result of the issue the following marked applications were received:

A – 5,500 shares

B – 4,100 shares

C – 3,700 shares

D – 3,300 shares

E – 3,400 shares

Not bearing rubber stamp (unmarked application) 12000 shares

You are required to find out the liabilities of individual underwriters & Calculate the commission payable @ 2.5%

4. Saketh Ltd company issued prospectus inviting applications for 3,50,000 Equity shares of Rs.10 each. The whole issue was fully underwritten by A,B,C and D as follows:

A-1,40,000 shares, B-1,05,000 shares, C-70,000 shares, D-35,000 shares

Applications were received from 3,15,000 shares of which marked applications were:

A-1,54,000 shares, B-77,000 shares, C-63,000 shares and D-7,000 shares

Calculate the liability of the underwriters. & Calculate underwriting commission payable @ 4%

5. A Company Issued 1,00,000 shares of Rs.10 each. The whole issue was fully underwritten by A, B, C and D as follows:

A: 40,000: B: 30,000: C:10,000: D: 20,000

The Company received applications for 90,000 shares of which marked applications were as follows:

A-44,000, B-22,000, C-2,000, D-18,000,

6. Ashwini Ltd, issued 50,000 equity shares of Rs. 100 each which were underwritten as follows:

A-20,000 shares:            B-15,000 shares

C-10,000 shares:            D-5,000 shares

The company received applications for 44,000 shares of which marked forms were as under:

A-24,000 shares:    B-8,000 shares

C-6,000 shares:    D-3,000 shares

Determine the liability of each underwriter.

## **II. When there is Complete and Firm underwriting**

7. Vinay Ltd has authorized capital of Rs. 50,00,000 divided into 1,00,000 equity shares of Rs. 50 each. The entire issue was underwritten as follows :

X-30,000 Shares (Firm underwriting-5000 shares)

Y-15,000 Shares (Firm underwriting -2000 shares)

Z-5,000 Shares (Firm underwriting-1000 shares)

***Out of the total issue, 45,000 shares including firm underwriting were subscribed***

The following were the marked forms:

X-16000 shares, Y-10,000 shares, Z-4000 shares.

Calculate the liability of each one of the underwriters treating.

- a. Firm underwriting as marked applications and
- b. Firm underwriting as unmarked applications

8. The Yogesh Ltd issued 20,000 shares which were underwritten by three different persons as follows:

A-10,000 shares, B-6,000 shares, C-4,000 shares

In addition there was firm underwriting by:



A-1,000 shares, B-500 shares, C-1,500 shares

***The company received applications for 15,200 shares including firm underwriting and the number of marked forms were as below:***

A-3,000 shares, B-4,500 shares, C-1,700 shares

***Show the allocation of liability of the underwriters assuming that the underwriting agreement did not provide any relief for firm application***

9. Dinesh Ltd issued 2,00,000 shares of Rs. 10 each. The entire issue was underwritten as follows:

A-1,00,000 shares (Firm underwriting 20,000 shares)

B-60,000 shares (Firm underwriting 10,000 shares)

C-40,000 shares (Firm underwriting 10,000 shares)

Shares applied for were 1,80,000 ***the following being the marked forms including firm underwriting. Which is also regarded as marked forms.***

A-70,000 shares

B-28,000 shares

C-32,000 shares

Calculate the liability of each underwriter.

10. Prakash Ltd. Issued 1,00,000 equity shares of Rs. 10 each at par. The entire issue was underwritten follows:

Vinay – 60,000 shares (Firm underwriting 8,000 shares)

Yogesh – 30,000 shares (Firm underwriting 10,000 shares)

Dinesh – 10,000 shares (Firm underwriting 2,000 shares)

***The total applications including firm underwriting were for 80,000 shares.***

Vinay – 20,000 shares

Yogesh – 14,000 shares

Dinesh – 6,000 shares

The underwriting contract provided that credit for unmarked applications be given to the underwriters in proportion to the shares underwritten.

Determine the liability of each underwriter and the amount of commission payable to them, assuming the rate to be the maximum allowed by law.

11. X Ltd invited applications from public for 2,50,000 shares of Rs.10 each at a premium of Rs. 5 per share. The entire issued was underwritten by underwriters P,Q,R,& S to the extent of 30%, 20%, 30% and 20% respectively with the provision of firm underwriting of 7,500, 2,500, 5000, and 2,500 shares respectively. The underwriters were entitled to the maximum commission as per law in force and practice laid down by SEBI.

*The company received applications for 1,75,000 shares excluding firm underwriting.* Out of which marked applications were 47,500, 52,500, 25,000 and 20,000 were marked in favour of P, Q, R and S respectively.

Calculate the liability of each on of the underwriters treating.

- c. Firm underwriting as marked applications and
- d. Firm underwriting as unmarked applications

Also ascertain the underwriters commission payable to different underwriters

12. Apoorva Ltd issued 5,00,000 equity shares of Rs. 10 each at a premium of 20%.

The whole of the issue is underwritten by A, B, C as under:

A – 2,50,000 shares (Firm underwriting 25,000 shares)

B-1,50,000 shares (Firm underwriting 15,000 shares)

C- 1,00,000 shares (Firm underwriting 10,000 shares)

The underwriting commission is 5% on the issue price and the company agreed to treat firm underwriting applications as marked forms.

The company received applications for 4,00,000 equity shares (*excluding firm underwriting*) of which marked forms were as under:

A-1,15,000 shares

B-1,25,000 shares

C-1,30,000 shares

You are required to show:

- a. Net liability of underwriters in terms of number of shares

b. Commission due to each underwriter and

Net amount due from each underwriter to the company

13. Nischal Ltd issued 2,50,000 shares of Rs. 10 each which was under written as follows

Mr. A – 75,000 shares (Firm underwriting 8,000 shares)

Mr

. B – 62,500 shares( Firm underwriting 12,000 shares)

Mr. C – 62,500 shares(Firm underwriting Nil)

Mr. D- 50,000 shares (Firm underwriting 30,000 shares)

***The total applications excluding firm underwriting but including marked applications were for 1,80,000 shares.*** The marked applications were as under. Mr. A-40,000 shares, Mr.B-36,000 shares, Mr.C-24,000 shares, and Mr.D – 48,000 shares. Calculate the net liability of each underwriter treating:

a. Firm underwriting as marked applications and

b. Firm underwriting as unmarked applications

14. Sahana Company issued 30,000 shares of Rs. 10 each. These were underwritten as follows : X-18,000 shares, Y-7,500 shares, Z-4,500 shares

In addition there was a firm underwriting as follows: X-2,400 shares, Y-900 shares and Z-3,000 shares. ***Total subscriptions received by the company (Excluding firm underwriting and marked application were 4,500 shares)***

Marked applications were X-3,000 shares, Y-6,000 shares and Z-1,500 shares \

Determine the liability of under writers.

15. Nishanth Ltd, issued 1,00,000 equity shares of Rs.100 each P,Q,R and S underwrite the entire issued the entire issue in the proportion of 40%, 30%, 20% and 10% respectively in consideration of commission in each at 4%. They also apply for firm shares as under:

P-3,000, Q-2,000, R-2,000 and S-3,000 shares

Besides the firm applications from the underwriters the public apply for 60,000 shares of which marked applications are as under

P-10,000, Q-6,000, R-8,000 and S-16,000 shares

Show the number of shares to be taken up by each of the under writers treating:

- c. Firm underwriting as marked applications and
- d. Firm underwriting as unmarked applications

Also find out the commission payable to the underwriters.

### **III. When there is Partial and Open underwriting**

16 Akshara Ltd, issued 80,000 shares of Rs. 10 each at a premium of 20%. Mrs. A underwriters 80% of the issue. The company receives application for 75% of the issue of which 40,000 applications bear the rubber stamp of Mr. A Underwriting commission of 4% of the issue price. Determine the liability of Mr.A and calculate the underwriting commission.

17. Manjesh Ltd issued 10,000 shares of Rs.10 each at a premium of 10%. These shares were underwritten by J and K to the extent of 5,000 shares and 3,000 shares respectively.

The total applications received by the company were 8,000 shares of which the marked applications were : J-1,200 shares, K-300 shares

Prepare a statement of underwriter's liability

18. Ganesh Ltd issue 20,000 equity shares of Rs.100 each. The issue was underwritten as follows:

A-30%, B-30%, and C-20%

Applications for 15,000 shares were received by the company in all. Determine the liability of the underwriters

### **IV. When there is Partial and Firm underwriting**

19. M,N and O underwrote 80% of an issue of 10,000 preference shares of Rs. 10 each in the ratio of 2:2:1. The Firm and marked applications of the underwriter's are as follows:

| Underwriters | Firm  | Marked |
|--------------|-------|--------|
| M            | 1,200 | 2,000  |
| N            | 1,000 | 1,500  |
| O            | 800   | 500    |

Applications for 8,000 shares were received in all  
Prepare a statement showing the liability of each of the underwriters.

### **V.Problems on Journal Entries and ledger Account**

20. Swamy is an underwriter, who has agreed to underwrite the new issue of 25,000 shares of Rs.10 each of Malnad Company, For this work, the company agreed to give a commission of 10% to swamy. It was also agreed that this commission is to be paid 75% in fully paid shares and the balance in cash. Further, Swamy had agreed to purchase another 3,000 shares as firm underwriting.

As the company did not receive sufficient demand for shares from the public, Swamy had to take up 40% of the total issued shares. Later, it was found by Swamy that the shares of the company could be sold in the stock exchange at a profit of 12% and he decided to show this profit, suitably in the Shares A/c.

With the help of the above information, prepare journal entries and the shares A/c in Swamy's Books and Journal entries in the books of the company.

21. H Ltd. Issues 1,000 equity shares of Rs. 100 each at Rs/.95 and 500, 12% debentures of Rs. 100 each a Rs. 95. The whole of the issue has been underwritten by Chopra. For the maximum commission allowed by law. The whole of shares were applied for but only 400 debentures were applied for. All applications were accepted. Give Journal entries and show the entries in the Balance sheet assuming all amounts have been received.

### **2 Marks Questions:**

1. What is meant by Underwriting?
2. What is Partial Underwriting?
3. What is underwriting agreement?
4. State the various types of underwriting
5. Distinguish between complete and partial underwriting
6. Distinguish between open and firm underwriting

7. Distinguish between marked and unmarked forms
8. Distinguish Gross Liability and Net Liability underwriters.
9. What is underwriting commission
10. Who is an underwriter?
11. What is pure underwriting?
12. What is the maximum rate of commission payable to an underwrite shares and debentures of a company as per las?
13. What is meant by firm underwriting?
14. What are the types of under writing?