UNDERWRITING OF SHARES AND DEBENTURES

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NEED FOR UNDERWRITING

- Mandatory requirement of 90% subscription as per SEBI.
- To overcome the risk of undersubscription, failure to return money if Min sub is not met.
- A specialised group has emerged who take up shares or debentures not subscribed by public in case of public offer and existing shareholders in case of rights issue.

MEANING OF UNDERWRITING

Contract between company and underwriters.

Underwriters agree to take whole or portion of shares or debentures floated but not subscribed by public.

In consideration of underwriting commission.

Individuals, partnership firms, joint stock companies can become underwriters.

UNDERWRITING COMMISSION

- Remuneration payable to underwriters for underwriting the issue of shares or deb of a company.
- Payable at a specified rate
- On the issue price of whole of shares or deb underwritten
- Not dependent on the fact whether whole of the issue may be subscribed by the public.
- Not payable on the shares taken up by the promoters, employees, directors, their friends and business associates.
- Usually in addition to brokerage.

LEGAL PROVISIONS

- Articles to authorise payt of commission.
- Commission to be paid out of proceeds or profits or both.
- Max 5 % as rate of commission on shares.
- Max 2.5 % as rate of commission on deb.
- No commission on sec not offered to public for subscription.
- Prospectus to disclose name of underwriters, rate & amount of commission, no. of sec to be underwritten.
- Copy of contract to the Registrar.

UNDERWRITING COMMISSION & BROKERAGE

UNDERWRITING COMMISSION	BROKERAGE
Remuneration payable to underwriters for underwriting the issue of shares or deb	Amount payable to brokers who merely procure or try to procure subscription to shares or deb

UNDERWRITERS & BROKERS

BASIS	UNDERWRITERS	BROKERS
MEANING	Individuals, partnership firms, joint stock companies can become underwriters.	brokers merely procure or try to procure subscription to shares or deb
Responsibility	Take up the responsibility to take up the shares & deb not subscribed by public or existing shareholders	Do not take up responsibility to take up the shares & deb not subscribed by public or existing shareholders

DISCLOSURE IN BALANCE SHEET

- Shown under " other current assets/other non-current assets
- To depend upon whether the amount will be amortised within 12 months/ after 12 months
- May also appear under both
- Details will be shown in Notes to Accounts.

CERTAIN TERMS

Sub-underwriters

- To spread the risk of under-subscription
- Main underwriter may enter into subsidiary contracts with certain persons.
- Underwriters working under main underwriters are called sub-underwriters
- Company is not party to these contracts

Marked Applications

- Bear the stamp of an underwriter
- Benefit is given to particular underwriter in whose favour applications have been marked

Unmarked Applications

- Do not Bear the stamp of an underwriter
- Unmarked applications are received directly from public.
- Benefit is given first to company to the extent issue is not underwritten by underwriters in case of partial undertaking.
- If there is surplus, then benefit of such unmarked applications is given to the underwriters.

CERTAIN TERMS

Full Underwriting

- Whole of the issue of shares or deb is underwritten by on e or more underwriters.
- If S Ltd. Makes a public issue of 40,000 Eq shares of 10 each at a premium of 490 per share and the entire issue is underwritten by A, B, C in the ratio of 2:2:1.
- Benefit of unmarked applications is given to underwriters.

Partial Underwriting

- When a part of issue of shares or deb is underwritten
- If S Ltd. Makes a public issue of 40,000 Eq shares of 10 each at a premium of 490 per share and the 20000 Eq shares are underwritten by A, B, C in the ratio of 2:2:1, it is called partial underwriting.
- Benefit of unmarked applications is first given to company. In case of above example,(40,000-20,000) shares will be given to company.
- Benefit of unmarked applications will be given to the underwriters

Sole & Joint Underwriting

- When the issue of sec is underwritten by only one underwriter. : Sole Underwriting
- When the issue of sec is underwritten by only two or more underwriters- Joint Underwriting.

CERTAIN TERMS

Normal/Pure/ Conditional Underwriting	Firm Underwriting
• Underwriter takes up agreed proportion of sec not taken up by the public. • underwriter not liable if the sec are fully or over subscribed	• Underwriter takes up specified number of sec irrespective of no. of sec subscribed by the public. • underwriter makes a commitment to take specified number of sec in addition to unsubscribed sec

ACCOUNTING TREATMENT

1. *For receipt of application money*

Bank A/c Dr.

To Share Application A/c

(Being the application money received on -- shares @ ₹ -- per share)

2. *For allotment of shares to the underwritten and transfer of application money to share capital assuming that: Whole of premium is payable at the time of application.*

Underwriters' A/c (individually) Dr.

Share Application A/c Dr.

To Share Capital A/c

To Securities Premium A/c

(Being the allotment of shares to the underwriters --- and transfer of application money to share capital as per Board's resolution dated....................

3. *For underwriting commission payable to the underwriters*

Underwriting Commission A/c Dr.

To Underwriters' A/c (individually)

(Being the underwriting commission payable)

4. *For receipt of balance from the underwriters*

Bank A/c Dr.

To Underwriters' A/c (individually)

(Being the balance received from the underwriters after adjusting underwriting commission)

ACCOUNTING TREATMENT

5. *For payment of balance of underwriting commission to the underwriters*

Underwriters' A/c (individually) Dr.

To Bank A/c

(Being payment of balance of underwriting commission)

6. *For making the allotment money due*

Share Allotment A/c Dr.

To Share Capital A/c

(Being the allotment due on --- shares @ ₹ --- per share)

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7. *For receipt of allotment due*

Bank A/c Dr.

To Share Allotment A/c

(Being the allotment money received on -- shares @ ₹ -- per share)

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DETERMINATION OF LIABILITY OF UNDERWRITERS

- Issue is FULLY underwritten without firm underwriting
- Issue is FULLY underwritten with SOME firm underwriting
- Issue is PARTIALLY underwritten without firm underwriting
- Issue is PARTIALLY underwritten with SOME firm underwriting

ISSUE IS FULLY UNDERWRITTEN WITHOUT FIRM UNDERWRITING

CASE 1: IF THE WHOLE ISSUE IS UNDERWRITTEN BY ONE UNDERWRITER

- If the whole of the issue has been underwritten by one person, he is responsible to subscribe all the securities which have not been subscribed by the public .
- Determination of marked and unmarked applications becomes unnecessary.
- Liability of underwriter= Shares or Deb offered – Total applications (marked and unmarked) received

EXAMPLE

Example : A Ltd. issued 5,00,000 equity shares of ₹ 10 each at ₹ 15 each. The issue was fully underwritten by B. The company received applications for 4,00,000 equity shares which includes marked applications for 3,00,000 equity shares.

In this case, B's liability will be for 5,00,000 - 3,00,000 -1,00,000 = 1,00,000 shares. The underwriter will get full credit for the unmarked 1,00,000 shares also.

If the shares or debentures are over subscribed or fully subscribed by the public, the underwriter is not liable to take up any shares or debentures of the company.

CASE 2: IF THE WHOLE ISSUE IS UNDERWRITTEN BY A NUMBER OF UNDERWRITERS

(*b*) **If the whole issue is underwritten by a number of underwriters :** In this case, the liability of the underwriters is determined in either of the following two ways :

(*i*) ***Division of unmarked applications between the underwriters in the ratio of their gross liability:*** Under this method, the liability of the underwriters is determined as follows :

Step 1. Calculate gross liability (if it is not given) of underwriters in the agreed ratio.

Step 2. Subtract marked applications from the corresponding gross liability of the underwriters.

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CASE 2: IF THE WHOLE ISSUE IS UNDERWRITTEN BY A NUMBER OF UNDERWRITERS

Step 3. Compute unmarked applications and divide them between different underwriters in the ratio of their gross *liability*. If the resultant figures are all positive and/or zero, then they represent the net liability of the underwriters. If some of the resultant figures are negative, then go to Step 4.

Step 4. Add all the negative figures (surplus) and then divide their sum between the underwriters having positive figures in the ratio of gross liability *inter se*. Repeat this Step until all the figures become positive and/or zero.

DIVISION OF UNMARKED APPLICATIONS

(ii) ***Division of unmarked applications between the underwriters in the ratio of gross liability less marked applications***: Under this method, the liability of the underwriters is computed as given below :

Step 1. Calculate gross liability (if it is not given) of underwriters in the agreed ratio.

Step 2. Subtract marked applications from the corresponding gross liability of the underwriters. If some of the resultant figures are negative, then total of all the negative figures should be allocated in the ratio of gross liability *inter se*.

Step 3. Calculate the number of unmarked applications and then divide their total between different underwriters in the ratio of gross liability as reduced by marked applications after allocating negative figures, if any. If some of the resultant figures at this stage are negative, go to Step 4, otherwise they will represent the net liability of each underwriter.

Step 4. Add all the negative figures (surplus) and then divide their sum between the underwriters having positive figures in the ratio of gross *liability less marked application* (i.e. in the same ratio as applied in Step 3) *inter se*. Repeat this Step until all the figures become positive and/or zero

NOTE

Notes

As the liability of the underwriters varies under the two methods, the underwriting contract should contain a clause in this respect. In the examination if the question is silent about the method to be adopted, the students may divide the unmarked applications between the underwriters in the ratio of their gross liability and append a note to this effect.

QUESTIONS

A Ltd. issued 1,00,000 equity shares of ₹ 10 each, The whole of the issue was underwritten as follows

A - 40%; B - 30% and C - 30%

Applications for 80,000 shares were received in all, out of which applications for 20,000 shares had the stamp of A; those for 10,000 shares that of B and those for 20,000 that of C. The remaining applications did not bear any stamp. Determine the liability of the underwriters.

SOLUTION

STATEMENT SHOWING THE LIABILITY OF UNDERWRITERS

Particulars	*Number of Shares*		
	A	*B*	*C*
Gross liability in the agreed ratio 4:3 :3	40,000	30,000	30,000
Less: Marked applications	20,000	10,000	20,000
Balance	20,000	20,000	10,000
Less: Unmarked applications allocated in the ratio of gross liability, i.e., 4: 3 :3	12,000	9,000	9,000
Net liability	8,000	11,000	1,000

Alternatively, if credit for unmarked applications is given to the underwriters in the ratio of gross *liability less marked applications,* the liability of the underwriters will be as follows :

	Number of Shares		
	A	*B*	*C*
Gross liability	40,000	30,000	30,000
Less: Marked applications	20,000	10,000	20,000
Balance	20,000	20,000	10,000
Less: Unmarked applications in the ratio of 2: 2 :1	12,000	12,000	6,000
Net liability	8,000	8,000	4,000

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QUESTION

Ridhan Ltd. came up with public issue of 90,00,000 Equity Shares of ₹ 10 each at ₹ 15 per share A, B and C took underwriting of the entire issue in 3:2: 1 ratio. Application were received for 81,00,000 shares. The marked applications were as follows:

A: 24,00,000 shares; B: 21,00,000 shares; C: 18,00,000 shares.

Commission payable to underwriters is at 5% on the issue price of the shares.

You are required (*i*) to compute the liability of each underwriter as regards the number of shares to be taken up; and (*ii*) pass journal entries in the books of Ridhan Ltd. to the record the above transactions.

SOLUTION

1. Statement showing the computation of liability of the underwriters

Particulars	*Number of Shares*		
	A	*B*	*C*
Gross liability (in 3:2:1 ratio)	45,00,000	30,00,000	15,00,000
Less: Marked applications	24,00,000	21,00,000	18,00,000
Balance	25,00,000	9,00,000	-3,00,000
Less: Surplus of 3,00,000 shares of C allocated to A and B in the ratio of gross liability *inter se*, i.e., 3:2	1,80,000	1,20,000	+3,00,000
Gross liability **less** marked applications	19,20,000	7,80,000	Nil

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Particulars	Number of Shares		
	A	B	C
Less: Unmarked applications for 18,00,000 shares allocated to A and B in their gross liability *inter se*, i.e., 3: 2	10,80,000	7,20,000	-
Net liability of the underwriters	8,40,000	60,000	Nil

In the Books of Ridhan Ltd.

JOURNAL ENTRIES

Date	Particulars		L.F.	Dr. (₹)	Cr.(₹)
	Bank A/c (81,00,000 × ₹ 15)	Dr.		12,15,00,000	
	To Equity Share Application and Allotment A/c				12,15,00,000
	(Being the application money received on 81,00,000 shares @ ₹ 15 per shares)				
	A's A/c (8,40,000 × ₹ 15)	Dr.		1,26,00,000	
	B's A/c (6,00,000 × ₹ 15)	Dr.		9,00,000	
	Equity Share Application and Allotment A/c	Dr.		12,15,00,000	
	To Equity Share Capital A/c				9,00,00,000
	To Securities Premium A/c				4,50,00,000
	(Being allotment of shares to underwriters - 8,40,000 to A, 60,000 to B; application money credited to Equity Share Capital Account and Securities Premium Account as per Board's Resolution dated ....)				
	Underwriting Commission A/c	Dr.		63,75,000	
	To A's Capital A/c (45,00,000 × ₹ 15 × 5/100)				33,75,000
	To B's Capital A/c (30,00,000 × ₹ 15 × 5/100)				22,50,000
	To C's Capital A/c (15,00,000 × ₹ 15 × 5/100)				7,50,000
	(Being the underwriting commission due to A, B and C @ 5% on the issue price of the shares underwritten)				

	Bank A/c (₹ 1,26,00,000 - ₹ 33,75,000) Dr. To A's A/c (Being the amount received from underwriter A for the shares taken up by him after adjustment of his commission)		92,25,000	92,25,000
	B's A/c (₹ 22,50,000 - ₹ 9,00,000) Dr. To Bank A/c (Being the amount paid to underwriter B after adjusting the shares taken by him against underwriting commission due to him)		13,50,000	13,50,000

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Date	Particulars	L.F.	Dr. (₹)	Cr.(₹)
	C's A/c Dr. To Bank A/c (Being the underwriting commission paid to C)		7,50,000	7,50,000

Note: Marked application of C is more than the shares underwritten by him. Therefore, he is not required to take any shares but will get underwriting commission on the shares underwritten by him.