

1. UNDERWRITING

MODEL - WISE ANALYSIS OF PREVIOUS EXAMINATIONS

MODEL NO.	N - 09	M - 10	N - 10	M - 11	N - 11	M - 12	N - 12	M - 13	N - 13	M - 14	N - 14	M - 15	N - 15	N - 15	M - 16	N - 16
Model - 1	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Model - 2	-	4	-	-	-	-	05	12	-	08	-	-	08	-	-	-
Model - 3	-	-	-	05	-	-	-	-	-	-	-	-	-	-	-	-
Model - 4	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-

Model - 1 : Complete underwriting without firm underwriting

Model - 2 : Complete underwriting with firm underwriting

Model - 3 : Partial underwriting with firm underwriting

Model - 4 : Theory

Introduction: In case of Public Ltd. Companies minimum subscription must be received in order to name that issue as a successful one & to get the certificate of commencement of business. Companies in order to ensure minimum subscription take the help of the procedure called underwriting.

Definition: Underwriting is an agreement whereby the underwriters (i.e. persons or institutions) gives the guarantee to the Company that in case the shares and debentures offered to the public, are not fully subscribed by the public, the balance of shares and debentures will be taken up by the underwriters.

Underwriters: They may be Individuals, Partnership firms or Joint Stock Companies, Banks or Financial Institutions. Generally issue of shares or debentures of a company is underwritten by two or more firms rather than by a single individual. Ex: ICICI, IDBI, IFCI, LIC, UTI, Nationalized Banks etc.

Underwriters Vs Brokers:

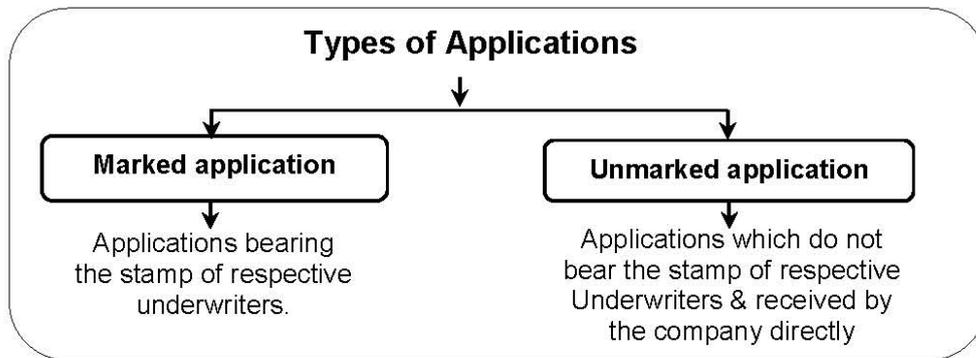
Underwriters	Brokers
Defined as above	Brokers only help in getting the shares or debentures sold and do not offer any guarantee to take the unsubscribed shares.
Consideration paid is called Under-writing commission.	Brokerage

Underwriting Commission:

- It is the consideration which is payable to the underwriters for underwriting the shares/ debentures.
- Given on issue price of underwritten shares irrespective of number of shares subscribed by the public.
- The maximum rate of commission payable to underwriters is:
 - In case of Equity shares - 5% of issue price (or) the rate prescribed by the AOA which ever is lower.
 - In case of debentures - 2.5% of issue price (or) the rate prescribed by the AOA which ever is lower.

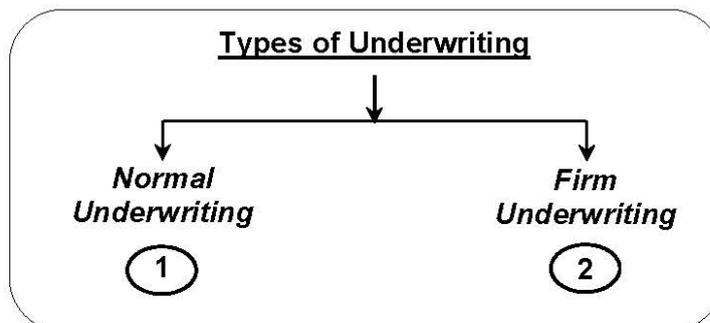
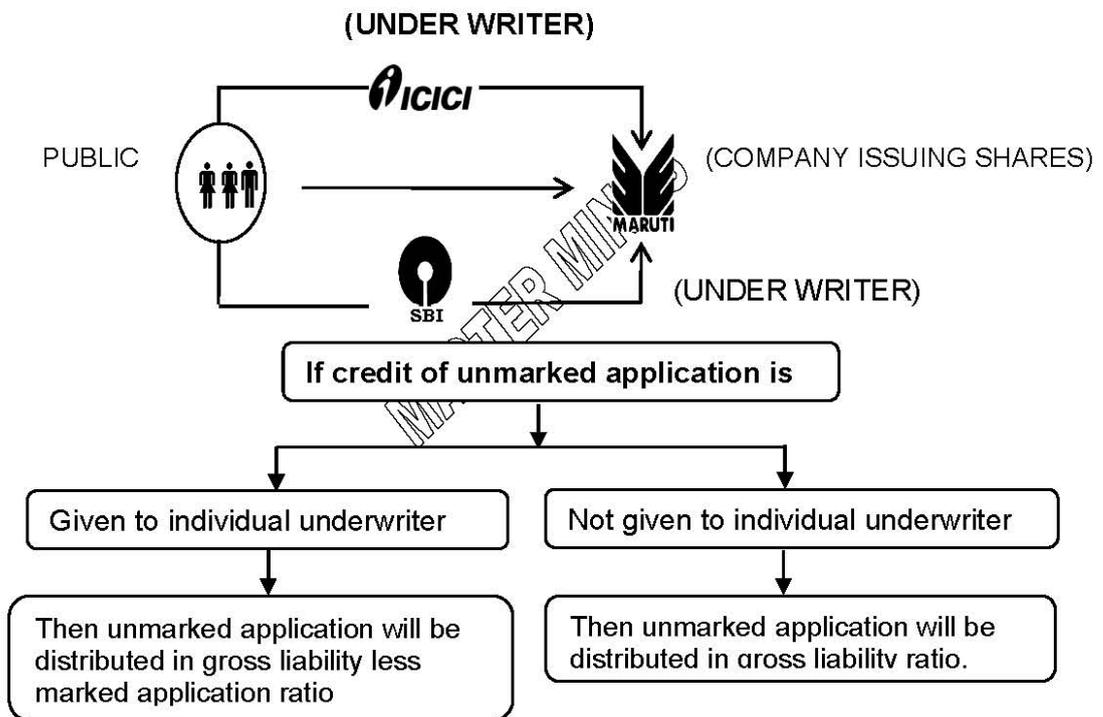
Notes:

- Underwriters will also get brokerage, if they take risk of placing shares/debentures before public.
- No Underwriting commission will be given if the issue is privately placed. *E.g.:* Shares issued to promoters, Employees, Directors etc.,
- Practically underwriting commission will be given as per SEBI guidelines which is 2.5% of issue price of shares & debentures.



Importance of division of applications:

1. If there is only one Underwriter all subscribed applications benefit will be given to such Underwriter.
2. If there is more than one Underwriter, subscribed application benefit should be given in which ratio? In order to clear such ambiguity, applications are divided as above.



1) Normal Underwriting:

- a) **Complete Underwriting:** If the whole of the issue of shares/debentures is underwritten, it is said to be Complete Underwriting. It may be under written by:
 - (i) One firm /Institution (or)
 - (ii) More than One firm /Institution.

b) **Partial Underwriting:** If only part of the issue of shares/debentures of a company is under written it is said to be Partial Underwriting. The part of the issue of shares/debentures, may be underwritten by:

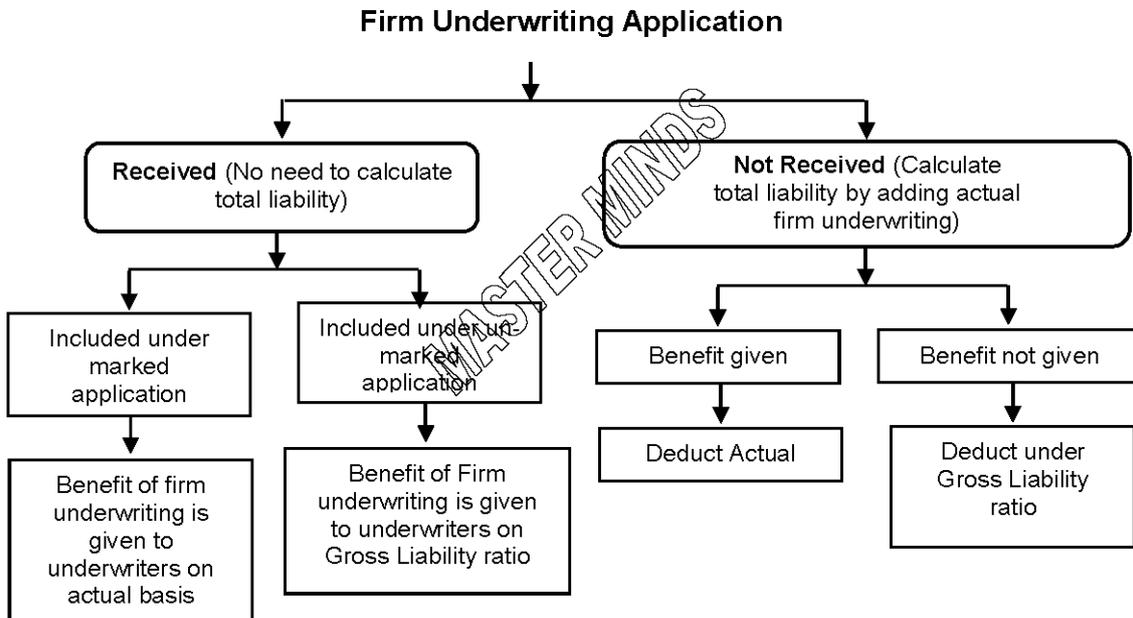
- (i) One person / Institution (or)
- (ii) More than one person / Institution

Notes:

- a. Company is said to be underwriter for the balance shares
- b. In case the information as regards the number of applications that are marked and those that are unmarked is not available (for instance, in an examination) it should be assumed that out of the total number of applications received a number proportionate to the value of the issue underwritten has been received through the underwriters.

2) Firm/Committed Underwriting:

- a) It refers to definite commitment by the underwriter/underwriters to take up specified numbers of shares/debentures of a company irrespective of the no. of shares/debentures subscribed by the public.
- b) If issue is undersubscribed, for underwriters this is in addition to unsubscribed shares or debentures.



Concept of Sub-Underwriter: An underwriter may appoint several underwriters to work under him. Such underwriters are termed as sub-underwriters. They have no contract with the company. They get their remuneration from the underwriters who are responsible to them.

Accounting treatment relating to Underwriting of shares & debentures

Date	Particulars	Amount (Rs.)
1.	When shares or debentures are allotted to underwriters in respect of their liability: Underwriters A/c Dr To Share Capital A/c (or) To Debentures A/c	With the value of the shares or debentures taken up by the underwriters.
2.	When commission becomes payable to the underwriters: Underwriting Commission A/c Dr To Underwriters A/c	With the amount of commission due on the total issue price of the shares underwritten.

3.	When the net amount due from the underwriters on the shares or debentures taken up by them is received: Bank A/c To Underwriters A/c	Dr Dr	With the net amount due.
4.	When the net amount due to the underwriters for commission on the shares or debentures underwritten is paid: Underwriters A/c To bank a/c	Dr. Dr.	With the net amount due.

Notes:

Total underwriting commission is not generally paid in cash. Instead the same is adjusted against the money due on shares or debentures taken up by the underwriters and only the net amount (i.e., total amount due on shares or debentures taken up by the underwriters minus the underwriting commission) is received from the underwriters.

PROBLEMS FOR CLASSROOM DISCUSSION

Problem 1: Determination of Liability of underwriters as per agreement in case of full underwriting: Sun flow Ltd. issued 50,000 equity shares the whole of the issue was underwritten as follows: Red - 40%, White - 30%, Blue - 30%. Applications for 40,000 shares were received in all, out of which applications for 10,000 shares had the stamp of red; those for 5,000 shares that of white and those for 10,000 shares that of Blue. The remaining applications for 15,000 shares did not bear any stamp. Determine the liability/Net liability of the underwriters, when (i) Credit for unmarked applications is given in the ratio of Gross liability. (ii) Credit for unmarked applications is given in the ratio of Gross liability less marked applications.

(Ans.: Case (i) Net Liability Red 4,000, White 5,500, Blue 500, Case

(ii) Net Liability Red 4,000, White 4,000, Blue 2,000)

(Solve Problem No: 1 of Assignment Problems as rework)

Note: _____

Problem 2: (PRINTED SOLUTION AVAILABLE) Complete underwriting-Firm Underwriting-Determination of liability in case it is clearly given that subscriptions totaled excludes firm underwriting : A company made a public issue of 1,25,000 equity shares of Rs.100 each, Rs.50 payable on application. The entire issue was underwritten by A, B, C and D in the proportion of 30% and 25%, 25% and 20% respectively. Under the terms agreed upon, a commission of 2% was payable on the amounts underwritten.

A, B, C & D also agreed on firm underwriting of 4,000, 6,000, Nil and 15,000 shares respectively.

The total subscriptions, excluding firm underwriting, including marked applications were for 90,000 shares. Marked applications received were as under:

A – 24,000, C-12,000, B-20,000, D-24,000

Ascertain the liability of the individual underwriters and also show the journal entries that you would make in the books of the company. All workings should form part of your answer.

(SM) (Ans: Net liability for underwriter C=10,000 shares)

(Solve Problem No: 2 of Assignment Problems as rework)

Note: _____

Copyrights Reserved
To **MASTER MINDS**, Guntur

Problem 3: (PRINTED SOLUTION AVAILABLE) Private Placement–Complete underwriting –Firm underwriting in unmarked forms: Libra Ltd. came up with an issue of 20,00,000 equity shares of Rs.10 each at par. 5,00,000 shares were issued to the promoters and the balance offered to the public was underwritten by three underwriters Anand, Vijay and Ashok – equally with firm underwriting of 5,00,000 shares each. Subscriptions totaled 12,97,000 shares included the marked forms which were:

Anand	4,25,000 shares
Vijay	4,50,000 shares
Ashok	3,50,000 shares

The underwriters had applied for the number of shares covered by firm underwriting. The amounts payable on application and allotment were Rs.2.50 and Rs.2.00 respectively. The agreed commission was 5%.

Pass summary journal entries for –

- The allotment of shares to the underwriters;
- The commission due to each of them; and
- The net cash paid and or received.

Note: Unmarked applications are to be credited to underwriters equally. Benefit of firm underwriting is given individual underwriter. **(SM)**

(Ans.: Amount Paid to Anand Rs. 1,50,000, Vijay Rs. 1,50,000, Amount Received by the company from Ashok Rs. 88,500)

(Solve Problem No: 3 of Assignment Problems as rework)

Note: _____

Problem 4: (PRINTED SOLUTION AVAILABLE) Computation of liability of each Underwriter–when benefit of firm underwriting is not given to individual underwriters: A company made a public issue of 2,00,000 equity shares of Rs. 10 each at a premium of Rs. 2 per share. The entire issue was underwritten by the underwriters L, M, N and O in the ratio of 4:3:2:1 respectively with the provision of firm underwriting of 5,000, 4,000, 2,000 and 2,000 shares respectively.

The company received application for 1,50,000 shares (excluding firm underwriting) from public, out of which applications for 55,000, 40,000, 42,000 and 8,000 shares were marked in favour of L, M, N and O respectively.

Calculate the liability of each underwriter as regards the number of shares to be taken up assuming that the benefit of underwriting is not given to the individual underwriter.

(PM) *(Ans: Net Liability L=20,000; M=16,500; N=2,000; O=11,500)*

(Solve Problem No: 4 of Assignment Problems as rework)

Note: _____

Problem 5: Complete underwriting-Firm Underwriting-Determination of liability in case it is not clear that whether subscriptions totaled includes firm underwriting or not : Sourav Flour Mills Pvt. Ltd. Floated a public issue of 1,50,000 Equity shares having face value of Rs.10 each at par. A,B&C has taken underwriting of the issue in equal share with the firm underwriting of 25,000;20,000 &20,000 shares respectively. Applications were received for 1,46,000 shares out of which the marked applications were as under:-

A-24,600	B-20,000	C-15,000
----------	----------	----------

Credit of unmarked applications is to be given to underwriters equally. The agreed underwriting commission was 5%. Total amount payable on application and allotment was Rs.5 and balance in calls.

Compute the following:

- (i) Liability of each underwriter (In shares as well as in amount).
- (ii) Commission due to underwriters
- (iii) Net cash paid/received from underwriters.

Also pass journal entries for above.

(Nov-15-3(b))

(Solve Problem No: 5,6 and 7 of Assignment Problems as rework)

Note: _____

Problem 6: Complete underwriting-Determination of underwriting commission along with Brokerage: Rosy Ltd made a public issue of 4,00,000 equity shares of Rs.10 each, Rs.2 payable on application. The entire issue was underwritten by five underwriters as follows:

A – 25%, B – 25%, C – 25%, D: 10% and E – 15%. Under the underwriting terms, a commission of 2% was payable on the amount underwritten. Further, the underwriter was at liberty to apply, during the tenure of public issue, for any number of shares in which case he was entitled to a brokerage equal to 1/2% of the par value of shares so applied for.

Applications received were to be analyzed on the basis of rubber stamp of the underwriters, who was to be given credit for the number of applications received bearing his rubber stamp. Applications received which did not bear any rubber stamp were considered as 'direct applications' to be credited to all the underwriters in the ratio of their respective underwriting commitment. If, any such credit being given a "surplus" was to result in respect of any underwriter, as compared to his commitment, such surplus was to be distributed amongst the remaining underwriters in the ratio of their respective underwriting commitments.

Bearing rubber stamp of	A	1,02,000 shares
- Do -	B	95,000 shares
- Do -	C	60,000 shares
- Do -	D	32,000 shares
- Do -	E	51,000 shares
Not bearing any stamp		<u>10,000 shares</u>
		<u>3,50,000 shares</u>

Included in the number of applications mentioned against D in the above table was an application made by D himself for 10,000 shares. The underwriters were informed of the amounts due to or from them, the amounts were duly received or paid. Show with the aid of necessary workings, the entries to record the amount so received or paid. (SM)

(Ans: Received C=52,000;D=4,300;E=1,200 and Paid A=20,000;B=18,000)

Note: _____

Problem 7: Partial underwriting Vs complete underwriting: Wye Co. Ltd invited the public to subscribe to the following:

- a. 10,000 equity shares of Rs.100 each at a premium of 5% and
- b. 2,500, 4% debentures of Rs.100 each @ Rs. 96, Rs.2,50,000

60% of the shares and the whole of the issue of debentures were underwritten by M/s. Sure & Fast for the maximum commission allowable under the law. The applications from the public totalled 6,000 shares and 2,000 debentures. The underwriters fulfilled their obligations. Show the journal entries that would appear in the books of the company.

(Solve Problem No: 8 of Assignment Problems as rework)

Note: _____

Problem 8: (PRINTED SOLUTION AVAILABLE) Partial underwriting with firm underwriting: A entered into an underwriting agreement with B Ltd. for 60% of the issue of 15% Rs.50,00,000 debentures with a firm underwriting of Rs.5,00,000. Marked applications were for Rs.35,00,000 debentures. Calculate the liability of underwriter & the commission payable to him. **(Nov.2009)(Ans.: Commission Rs. 75,000)**

Note: _____

Problem 9: (PRINTED SOLUTION AVAILABLE) Partial underwriting and determination of liability in case of non-availability of information of marked forms in total subscriptions: X Limited issued 10,000 equity shares of Rs.10 each. The issue was underwritten as follows: A-30%, B-30%, and C-20%. However, the company received applications for 8,000 shares only. Determine the liability of the respective underwriters. **(Ans.: Net Liability A 600, B 600, C 400, Company - 400)**

Note: _____

Problem 10: (PRINTED SOLUTION AVAILABLE) Accounting treatment of underwriting transactions in the books of Sub-underwriter: A enters into a contract with B Ltd., to underwrite its 5,000 shares of Rs.10 each in consideration of 5% commission. He also enters into an agreement with C to sub-underwrite 1,000 shares of B Ltd. at a commission of 3%. The public subscribes for 2,000 shares only and subsequently shares were taken up by A, who sold his shares @ Rs.9 per share. The shares taken up by C were sold @ Rs.10 per share. Expenses of underwriting amount to Rs.600. Prepare Underwriting Account in the books of A.

Note: _____

ASSIGNMENT PROBLEMS

Problem 1: Determination of Liability of underwriters as per agreement in case of full underwriting: Newton Limited incorporated on 1st January, 2013 issued a prospectus inviting applications for 20,000 equity shares of Rs.10 each. The whole issue was fully under written by Adams, Benzamin and Clayton as follows:

Adam 10,000 shares;

Benzamin 6,000 shares;

Clayton 4,000 shares

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

Adam 8,000 shares ; Benzamin 2,850 shares; Clayton 4,150 shares

You are required to find out the liabilities of individual underwriters.

(SM) (May, 2008 – Similar Problem)

(Ans.: Net Liability for Adams Rs. 1,281, Benzamin Rs. 2,719, Clayton – Nil)

Problem 2: Private Placement–Complete underwriting–Firm underwriting in unmarked forms: A Joint stock company resolved to issue 10 lakh equity shares of Rs.10 each at a premium of Re.1 per share. 1 Lakh of these shares were taken up by the directors of the company, their relatives, associates and friends, the entire amount being received forthwith. The remaining shares were offered to the public, the entire amount being asked for with applications. The issue was underwritten by X, Y and Z for a commission @ 2% of the issue price, 65% of the issue was underwritten by X, while Y's and Z's shares were 25% and 10% respectively.

Their firm underwriting was as follows: X: 30,000 shares, Y: 20,000 shares and Z: 10,000 shares. The underwriters were to submit unmarked applications for shares underwritten firm with full application money along with members of the general public. Marked applications were as follows: X - 1,19,500 shares, Y - 57,500 shares and Z 10,500 shares. Unmarked applications totalled 7,00,000 shares. Accounts with the underwriters were promptly settled.

You are required to (i) Prepare a statement calculating underwriter's liability for shares other than shares underwritten firm. (ii) Pass journal entries for all the transactions including cash transactions. (May-2001, PM) (Ans.: Net Liability X – 4,000, Y- Nil, Z – 8,500)

Problem 3: Private Placement–Complete underwriting–Firm underwriting in unmarked forms: Scorpio Ltd. came out with an issue of 45,00,000 equity shares of Rs.10 each at a premium of Rs.2 per share. The promoters took 20% of the issue and the balance was offered to the public. The issue was equally underwritten by A & Co.; B & Co. and C & Co.

Each underwriter took firm underwriting of 1,00,000 shares each. Subscriptions for 31,00,000 equity shares were received with marked forms for the underwriters as given below:

A & Co.	7,25,000 shares
B & Co.	8,40,000 shares
C & Co.	13,10,000 shares
Total	28,75,000 shares

The underwriters are eligible for a commission of 5% on face value of shares. The entire amount towards shares subscription has to be paid along with application. You are required to:

- Compute the underwriters liability (number of shares)
- Compute the amounts payable or due to underwriters, and
- Pass necessary journal entries in the books of Scorpio Ltd. relating to underwriting.

(Nov-2005,PM)

(Ans.: a) Total Liability (Number of shares) A & Co. Rs. 2,57,500, B & Co. Rs. 1,42,500, C & Co. Rs. 1,00,000, b) Net Amount to be paid by underwriters A & Co. Rs.24,90,000, B & Co. Rs. 11,10,000, C & Co Rs.6,00,000)

Problem 4: Computation of liability of each Underwriter–when benefit of firm underwriting is not given to individual underwriters: Outset Ltd. invited applications from public for 1,00,000 equity shares of Rs.10 each at a premium of Rs.5 per share. The entire issue was underwritten by the underwriters P, Q, R and S to the extent of 30%, 30%, 20% and 20% respectively with the provision of firm underwriting of 3,000 2,000, 1,000 and 1,000 shares respectively. The underwriters were entitled to the maximum commission permitted by law.

The company received applications for 70,000 shares (excluding firm underwriting) from public out of which applications for 19,000, 10,000, 21,000 and 8,000 shares were marked in favour of P, Q, R and S respectively.

Calculate the liability of each underwriter. Also ascertain the underwriting commission payable to different underwriters. (SM)

(Ans.: Total Liability (Number of Shares) P. 6,500, Q. 14,500, R. 1,000, S. 8,000)

Problem 5: Computation of Amounts payable or due to underwriters: A company issued 1,50,000 shares of Rs.10 each at a premium of Rs.10. The entire issue was underwritten as follows:

X – 90000 shares (Firm underwriting 12000 shares)

Y – 37500 shares (Firm underwriting 4500 shares)

Z – 22500 shares (Firm underwriting 15000 shares)

Total subscriptions received by the company (excluding firm underwriting and marked applications) were 22500 shares.

The marked applications (excluding firm underwriting) were as follows:

X – 15000 shares; Y – 30000 shares; Z – 7500 shares

Commission payable to underwriters is at 5% of the issue price. The underwriting contract provides that credit for unmarked applications be given to the underwriters in proportion to the shares underwritten and benefit of firm underwriting is to be given to individual underwriters.

- i) Determine the liability of each underwriter (number of shares);
- ii) Compute the amounts payable or due from underwriters; and
- iii) Pass Journal Entries in the books of the company relating to underwriting. (PM)

(Ans: Total Liability (in shares) X-55,500, Y-4,500, Z-15,000 Net amount receivable-
X - Rs.10,20,000, Y - Rs.52,500, Z - Rs.2,77,500)

Problem 6: Complete underwriting-Firm Underwriting-Determination of liability in case it is not clear that whether subscriptions totaled includes firm underwriting or not : Ram Limited invited applications from public for 10,00,000 equity shares of Rs. 10 each at a premium of Rs. 5 per share. The entire issue was underwritten by the underwriters X, Y, Z and T to the extent of 30%, 30%, 20% and 20% respectively with the provision of firm underwriting of 30,000, 20,000, 10,000 and 10,000 shares respectively. The underwriters were entitled to the maximum 2.5% commission.

The company received applications for 7,00,000 shares from public, out of which applications for 1,90,000, 1,00,000, 2,10,000 and 80,000 shares were marked in favour of X, Y, Z and T respectively.

Calculate the gross liability of each underwriter in terms of shares. Also ascertain the underwriting commission, payable to or by different underwriters. (RTP - M12)

(Note: Solve the problem assuming that the benefit of firm under writing is given)

(Answer: Total Liability (in shares) X-57,500, Y-47,500, Z-10,000, T-85,000.
Underwriting commission due X - Rs.1,12,500, Y - Rs.1,12,500, Z - Rs.75,000, T - Rs.75,000)

Problem 7: Complete underwriting-Firm Underwriting-Determination of liability in case it is not clear that whether subscriptions totaled includes firm underwriting or not Rathnam Chemicals Limited planned to set up a unit for manufacture of shoes. For the purpose of financing the unit, the Board of Directors have issued 15,00,000 equity shares of Rs. 10 each. 30% of the issue was reserved for promoters and the balance was offered to the public. P, Q and R have come forward to underwrite the public issue in the ratio of 3:1:1 and also agreed for firm underwriting of 30,000; 20,000 and 10,000 shares respectively. The underwriting commission was fixed at 4%. The amount payable on application was Rs. 2.50 per share and allotment was Rs. 2.50 per share. The details of subscriptions excluding firm underwriting are:

Marked forms of P 5,50,000 shares

Marked forms of Q 2,00,000 Shares

Marked forms of R 1,50,000 Shares

Unmarked forms 50,000 Shares

You are required to show

- a) The allocation of liability among underwriters with workings assuming that the benefit of firm underwriting is given to individual underwriters.
- b) Journal entries for:
 - i) the allotment of shares to the underwriters,
 - ii) the commission due to each of them and,
 - iii) the net cash paid or received. (RTP-N09 & RTP-M13)

(Ans: Total Liability (in shares) P-35,000, Q-20,000, R-45,000 Commission due P- Rs.2,52,000, Q - Rs.84,000, R - Rs.84,000 Net cash paid P-2,39,500, Q -84,000 Net cash received R-3500)

Problem 8: Partial underwriting: Moonlit Ltd., issued 50,000 equity shares, of which only 60% was underwritten by Green. Applications for 45,000 shares were received in all out of which application for 26,000 were marked. Determine the liability of Green.

(Ans.: Net Liability: Green 4,000, Com.1,000)

9. Write short note firm underwriting and partial underwriting along with firm underwriting?
(M04, N05)
10. What do you understand by firm underwriting? Pass the Accounting Entries relating to firm underwriting in the books of company and underwriter?
(N99, M01, N07)

ABC ANALYSIS

	A Category	B Category	C Category
Classroom Problems	2,3,4,5,8	1,7,9	6,10
Assignment Problems	1,2,3,4,5	6,7,9,10	8

Copyrights Reserved
To **MASTER MINDS**, Guntur

Verified by: G.S.R Sir
Executed by: Narendra

THE END

MASTER MINDS