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For – LNMU B. Com part -2 ,PAPER -IV CORPORATE ACCOUNTING (Hons.)

Lecture -6, unit-1 Accounting for share capital and Debentures

Underwriting of

Shares and Debentures

Ques- What is Under Writing Agreement?

Ans- Underwriting is an agreement, with or without conditions, to subscribe to the securities of a company when existing shareholders of the company or the public do not subscribe to the securities offered to them.

An underwriting agreement is a contract between a group of investment bankers who form an underwriting group or syndicate and the issuing corporation of a new securities issue.

In other words

Underwriting of shares and debentures is an agreement between company and a person or a group of persons to provide guarantee that in case shares or debentures are not fully subscribed by the public they will purchase balance of shares and debentures.

When a company goes in for an initial public offer (IPO), it may face certain uncertainty about Whether its offer of shares or other securities will be subscribed in full or not. As per SEBI Guidelines 14(4)(b) , it is required that if the company is not able to collect 90% of

The offer amount, then it needs to compulsorily return the money to those Who have subscribed to the shares and causing lot of issue expenses to go waste. This Uncertainty could be avoided by the help of a specialized group of risk-redeemers — called Underwriters.

SOLE UNDERWRITERS AND JOINT UNDERWRITERS

Sole Underwriters:

When the issue is underwritten by only one underwriter, such underwriting is Termed as 'Sole Underwriting'.

For example, if an issue of 1,00,000 shares of Rs.10 each of X Ltd is

Underwritten by A, it is the case of Sole Underwriting. IN such a case, the distinction between marked and unmarked Applications is not of such significance.

Joint Underwriters:

The company may enter into underwriting arrangement with number of underwriters. This Arrangement is called Joint Underwriting (Co-underwriting). An individual underwriter will be Responsible only to the extent of shares underwritten by him.

For example, if an issue of 1,00,000 shares of Rs.10 each of X Ltd. Is underwritten by A,B, C, D in the ratio of 2:2:1:1, it is the case of Joint Underwriting.

In such case, the benefit of unmarked applications is given to the Underwriters in the ratio of their gross liability. The benefit of marked applications is given to the concerned Underwriters in whose favor applications have been marked.

Ques- comment on the following :

1. ***Conditional underwriting***
2. ***Sub-Underwriting Agreement***
3. ***Pure Underwriting***
4. ***Firm Underwriting***
5. ***Partial Underwriting***
6. ***Full underwriting***

- ***Conditional underwriting:***

Under this type of agreement, the underwriter agrees to take up agreed proportion of Shares, not taken up by the public. If the shares are fully subscribed by the public, the Underwriter does not take up any share.

- ***Sub-Underwriting Agreement:*** *If underwriters feel that there is big risk in underwriting of particular company then they can transfer such risk to other person by sub-under writing agreement.*

- ***Pure Underwriting :*** *In this type of agreement liability of underwrites will arise only if issue of shares or debentures is under-subscribed.*

- ***Firm-Underwriting :*** *Under this type of agreement, the underwriter agrees to take up a specified number of shares irrespective of the number of shares subscribed for by the public. Unless it has otherwise agreed, the underwriters' liability is determined without considering the number of shares taken up 'firm' by him.*
  For Example, the entire issue X Ltd. Is underwritten as follows:
  A 1,60,000 Shares (Firm Underwriting 3,600 Shares)
  B 1,60,000 Shares (Firm Underwriting 2,000 Shares)
  C 80,000 Shares (Firm Underwriting 1,200 Shares)
  D 80,000 Shares (Firm Underwriting 10,000 Shares)

In this case only 4,63,200 shares (i.e. 4,80,000 shares – firm underwriting of 16,800 shares) will be offered to public and 16,800 shares will be taken by the underwriters even if the issue is oversubscribed.

The benefit of firm underwriting may be given either

- ✓ ***To an individual underwriter on the basis of his individual firm underwriting, or***
- ✓ ***To all the underwriters in the ratio of their gross liability***

That is Firm Underwriting may be treated at par with either 'Marked Applications' or 'Unmarked Application'.

- ❖ ***Partial underwriting :***

When a part (say 75%) of the whole issue is underwritten by the underwriters it is called as partial Underwriting.

For Example, X Ltd. Decided to make a public issue of 1,00,000 equity shares of Rs.10 each Out of which 90,000 shares are underwritten by A, B, C, D in the ratio of 2:2:1:1. It means10,000 shares are underwritten by Company itself.

In this case if figure of marked application is not given separately,(Marked applications = Total number of applications received x percentage Of underwriting.)

For the uncovered portion we can say company is liable, but company will Not take its own share rather it will remain unsubscribed.

- ***Full underwriting:***

  When the whole issue is underwritten by the underwriter(s) it is called as full Underwriting.
  For Example, X Ltd. Decided to make a public issue of 1,00,000 equity shares of Rs.10 each Which is entirely underwriter by A, B, C, D in the ratio of 2:2:1:1

In such case, the benefit of unmarked applications is given to the underwriter in the ratio Of their gross liability.

Ques-* What *is maximum rate of Underwriting Commission on shares and Debentures as per Companies Act?

Ans.: UNDERWRITING COMMISSION

It may be paid in cash or in fully paid-up shares or debentures or a combination of all these.

- ✓ ***Companies Act, 2013 provides that payment of commission should be authorized by Articles of Association and the maximum commission payable will be as under:***
  - i. ***In case of shares 5% of the issue price of the shares***
  - ii. ***In case of debentures 2 % of the issue price of the debentures***
- ✓ ***Underwriting commission is not payable on the amounts taken up by the promoters, employees, directors, their friends and business associates.***
- ✓ ***Commission is payable on the whole issue underwritten irrespective of the fact that whole of the issue may be taken over by the public.***

- ✓ ***Commission is calculated on issue price unless otherwise mentioned.***

Ques-How liability of Co-Underwriters will be determined in case of Joint Underwriting?

Ans.: Liability of each underwriter will be decided by following steps :-

(i) At first, shares or debentures of each underwriters as per Agreement is mentioned in each column in a table.

(ii) Marked shares of each underwriter will be deducted out of shares As per agreement.

(iii) Unmarked shares will be deducted in proportion of benefit of Unmarked shares given to each under writer or the proportion for Which under writing agreement is signed.

(iv) In case of firm under writing, underwriters shares can be treated as Marked or unmarked. If nothing is given in this regard, such shares Can be treated as marked shares.

(v) If after deducting marked or unmarked shares balance liability of Under writer is negative, then this negative balance will be Apportioned to other under-writers in the

ratio of their liability for Which underwriting agreement was signed or any other given ratio.

(vi) After adjustment of negative balance liability of each under writer Is known as net liability.

(vii) In underwriters agree to take shares of firm underwriting in Addition to under writing shares then in last, shares of firm under Writing will be added in net liability. It is known as gross liability of Each underwriter.

Ques- Explain the Accounting Treatment for Under Writing in the books of Company and Underwriters?

Ans.: Following entries will be passed on in the books of company for under Writing :-

(i) For Under Writing Commission :

Underwriting Commission A/c Dr.

To Underwriter's A/c

(Underwriting commission due to underwriters.)

(ii) To Issue Balance Shares to Underwriters :

Underwriter's A/c Dr.

To Equity Share Capital A/c

(Shares allotted to underwriters under underwriting agreement)

(iii) To Receive Final Payment :

Bank A/c Dr.

To Underwriter's A/c

(Final payment received from underwriters)

Note : If there is no liability of underwriter to purchase shares or Amount of commission exceeds amount of gross liability, then Following entry will be passed:-

(iv) To Make Final Payment :

. Underwriter's A/c Dr.

To Bank A/c

(Final payment made to underwriter.)

(v) To Write Off Commission Account :

Reserve/Securities Premium/ P&L A/c Dr.

To underwriting commission A/c

(Commission Account written off)

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Accounting Treatment in the Books of Underwriter :

Journal Entries :

(1) For Underwriting Commission :

X Company A/c Dr.

To Underwriting Commission A/c

(Commission due from X Company)

(2) For Share Received From Company :

Shares/Debentures (Investment) in X Company A/c Dr.

To X Company A/c (at issue price only)

(Balance shares received from X Company)

(3) To Transfer Commission into Share Account :

Underwriting Commission A/c Dr.

To Shares/Debentures (Investment) A/c

(Commission transferred into shares account)

(4) To Make Final Payment :

X Company A/c Dr.

To Bank A/c

(Final payment made to company)

(5) When Underwriters are not Liable to take Shares and Commission is Received :

Bank A/c Dr.

To X Company A/c

. (Commission received from Company)

Note : If amount payable on shares is less than commission then Also this entry will be passed for the balance of amount.

(6) To Close Commission A/c when it is not Transferred to Share A/c:

P&L A/c Dr.

To Underwriting Commission A/c

(Commission transferred to P&L A/c)