Underwriting of Shares and Debentures

Paper 5: Advanced Accounting Chapter 4 Unit 2

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Learning Objectives

- Learn the provisions of companies Act regarding underwriting of shares.
- Determine the liability of underwriters whether shares are fully underwritten or partially underwritten.
- Account for firm underwriting of shares.

Need for Underwriting

Shares/ Debentures may remain Unsubscribed

- Setback in Operations/ Reputation

Underwriter Promotes Subscription

Meaning

- Underwriting is an agreement
- made between the person called underwriter and company
- where underwriter gives guarantee for subscribing certain no of shares among the public.
- If shares were under subscribed among the public then shortfall should be taken by the underwriter as per agreement.

How Underwriting can be done

- By a single person or
- Jointly by two or more persons

Who can be underwriter ?

1
- Individual

2
- Partnership Firm

3
- Company

Role of Central Government in raising funds

Financial Institutions to help companies raise capital like

Industrial Finance Corporation	Industrial Credit and Investment Corporation of India	Life Insurance Corporation of India

Consideration to Underwriter

- The underwriter is paid a commission as per the agreement.
- Commission can be paid in cash or in kind i.e., by issue of securities.

Legal Compliance

Section 76 of the Companies Act

- Commission can be paid only at a rate authorized by the Articles.
- It can not exceed 2½% of the issue price of debentures and 5% of issue price of shares.
- It is paid only on the securities offered among the public for subscription

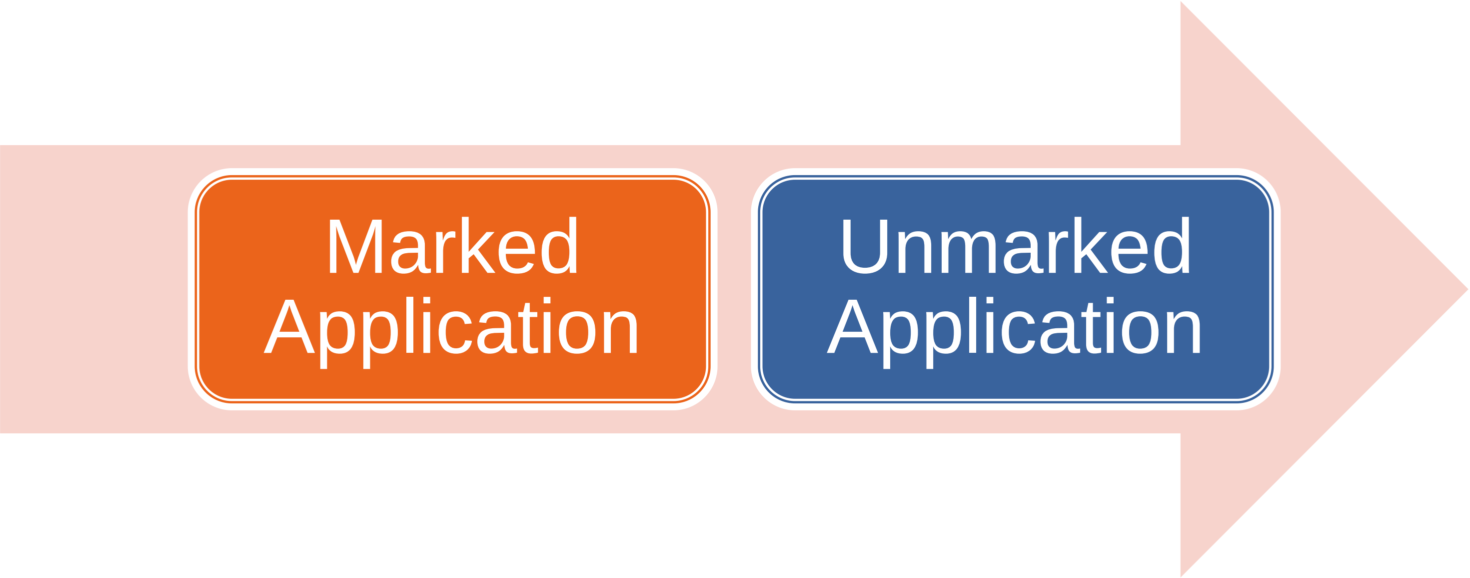
Types of Underwriting Contract

- Normal Underwriting
- Firm Underwriting

Determination of liability in Respect of a Normal Underwriting Contract

If the whole of the issue has been underwritten by one person, he is responsible to subscribe for all the shares or debentures that have not been subscribed by the public.

Types of Application



What is Marked Application ?

These applications bear the stamp of the underwriter and the credit for these applications are given to the individual underwriter.

What is Unmarked Applications ?

These applications do not bear the stamp of the underwriter.

How the unmarked application apportioned ?

- If the entire issue is underwritten, the credit for these applications is given to the underwriters either in the ratio of their gross liability or liability after deducting the marked application.
- If the entire issue is not underwritten, first the credit goes to the account of the portion not underwritten and the rest will be apportioned in the same manner as discussed above.

example

A company comes out with public issue of 100000 shares of rs 10 each. Only 80% of issue were under written by the underwriter.

Total application received	82000 Shares
Marked application received	55000 Shares
Unmarked application recd.	27000 Shares

In the above case unmarked application of 27000 shares will be adjusted to the account of the portion not underwritten by the underwriter i.e., 20000 shares and balance 7000 unamrked application will be adjusted with underwriter's liability.

Underwriter has to buy shortfall in shares i.e.,18000 shares.

Firm Underwriting

It is a firm commitment by an underwriter to take up a specified number of shares irrespective of the number of shares subscribed by the public.

Accounting treatment for Firm Underwriting

When credit for firm underwriting given to individual underwriter

Firm underwriting shall be deducted from the gross liability first and the calculation shall be done without considering the firm underwriting and after determining the liability on account of underwriting, firm underwriting is added.

Accounting treatment for Firm Underwriting - 2

When credit for firm underwriting not given to individual underwriter

If the credit for firm underwriting is not to be given to the individual underwriter, those shall be treated as unmarked applications.

Determining Liability of Underwriters

Gross liability	***
Less : Firm underwriting	***
Less : Marked applications	***
Less: Unmarked applications	***
+/- : Surplus of any underwriter	

- credited to others in G.L. ratio***

Liability of the underwriter	***
Add: Firm underwriting	***
Total liability of the underwriter	***

Journal Entry:
For Underwriting Commission

Underwriting commission Dr.

To Underwriters

Illustration 1

- IPCC Dec 2012 Marks 5

Problem Statement 1

Newton Limited incorporated on 1st January, 2011 issued a prospectus inviting applications for 20,000 equity shares of ` 10 each. The whole issue was fully underwritten by Adams,Benzamin and Clayton as follows:

Adams 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:

Adams 8,000 shares

Benzamin 2,850 shares

Clayton 4,150 shares

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

Solution

- **Issue size of shares : 20000**
- **application received : 16000**
- **Shares to be subscribed by underwriter : 4000**

Particulars	***Adams***	***Benzamin***	***clayton***	***Total***
Gross Liability	***10000***	***6000***	***4000***	***20000***
Less Marked application	***8000***	***2850***	***4150***	***15000***
	-------	***-------***	***-------***	***------***
	2000	***3150***	***(150)***	***5000***

Solution cont.....

Particulars	Adams	Benzamin	clayton	Total
	2000	3150	(150)	5000
Less credit for unmarked appl.	500	300	200	1000
	-------	-------	-------	------
	1500	2850	(350)	4000
Surplus of clayton adju. in the gross liability ratio	219	131	350	---
	------	------	------	------
Net Liability	1281	2719	Nil	4000

Illustration 2

- IPCC Dec 2012 Marks 10

Problem statement 2

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 underwriter, 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.

Problem statement cont……

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

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		*10,000 shares*
Total application received		*3,50,000 shares*

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.

Problem Summary & Discussion

Total Issue Size = 400000 Shares

Marked Applications = 340000 Shares

Unmarked Applications = 10000 Shares

Short Fall in Public Subscription = 50000 Shares

Gross Liability Ratio = 5:5:5:2:3

D made Application on his own account for 10000 Shares on which he is entitled to get brokarage @ ½ %

Solution

Statement showing net liability of underwriters:

Particulars	A	B	C	D	E
Gross Liability	1,00,000	1,00,000	1,00,000	40,000	60,000
Less: Marked application	1,02,000	95,000	60,000	32,000	51,000
	(2000)	5,000	40,000	8,000	9,000
Less: Unmarked application (in gross liability ratio)	(2,500)	(2,500)	(2,500)	(1,000)	(1,500)

Solution cont……

Particulars	A	B	C	D	E
	(4,500)	2,500	37,500	7,000	7,500
Adjustment for surplus of					
'A ' in gross liability ratio	4,500	(1,500)	(1,500)	(600)	(900)
Net Liability	Nil	1,000	36,000	6,400	6,600

Solution cont….

Statement showing amount due from / due to underwriter:

Particulars	A	B	C	D	E
Net Liability in shares	Nil	1000	36000	6400	6600
Amount receivable @ Rs2 per sh.					
i.e., net liability X Rs 2	nil x 2	1000 x 2	36000 x 2	6400 x 2	6600 x 2
	= nil	= 2000	= 72000	= 12800	= 13200
Underwriting commission payable					
@2% of issue price	20000	20000	20000	8000	12000
Brokerage payable @1/2%				500	
	20000	18000	52000	4300	1200
	Payable	Payable	Receivable	Receivable	Receivable

Journal Entry

Bank A/C	Dr.57,500	
Underwriting commission A/c	Dr.80,000	
Brokerage on shares A/c	Dr. 500	
To Equity Share Aplication A/c		1,00,000
To Bank A/c		38,000

Equity Share Aplication A/c	Dr. 1,00,000	
To Equity Share Capital		100000

Solution cont….

Alternatively

(1)	C A/c	Dr.	52,000
	D A/c	Dr.	4,300
	E A/c	Dr.	1,200
	Underwriting Commission A/c	Dr.	80,000
	Brokerage on shares A/c	Dr.	500
	To Equity Share Application		1,00,000
	To A A/c		20,000
	To B A/c		18,000

Solution cont….

(2)	Bank A/c	Dr.57,500	
	To C A/c		52,000
	To D A/c		4,300
	To E A/c		1,200
(3)	A A/c	Dr.20,000	
	B A/c	Dr.18,000	
	To Bank A/c		38,000

Illustration 3

- IPCC Dec 2012 Marks 10

Problem Statement 3

J. Ltd. issued 20,000 shares which were underwritten as follows :

A -12,000 shares; B- 5,000 shares and C- 3,000 shares. The underwriters made applications for firm underwriting as :

A-1,600 shares; B - 600 shares; and C-2,000 shares.

The total subscriptions excluding firm underwriting but including marked applications were for 10,000 shares.

The marked applications were as under ;

A - 2,000 shares; B- 4,000 shares; and C- 1,000 shares

You are required to show the allocation of liability of the underwriters.

Problem Summary & Discussion

Total Issue Size = 20000 Shares

Total Application including Firm Underwriting = 14200 Shares

Marked Applications = 7000 Shares

Firm Underwriting = 4200 Shares

Unmarked Applications = 3000 Shares

Short Fall in Public Subscription = 5800 Shares

Gross Liability Ratio = 12:5:3

Solution

- Issue Size : 20000
- Total application recd
  Including firm underwriting: 10000+1600+600+2000 14200
- Shares to be subscribed by the U/W excluding Firm U/W 5800

Underwriter	A	B	C	Total
Gross Liability	12000	5000	3000	20000
Less: Firm U/W	1600	600	2000	4200
	--------	--------	---------	--------
	10400	4400	1000	15800
Less: Marked App.	2000	4000	1000	7000
	--------	-------	------	---------

Solution 1 continue….

	8400	400	Nil	8800
credit for unmarked applic. in the gross liability ratio	1800	750	450	3000
	--------	---------	-------	--------
	6600	(350)	(450)	5800
Adj. for surplus	(800)	350	450	
	--------	--------	--------	-------
	5800	Nil	Nil	5800
Add : Firm Underwriting	1600	600	2000	4200
	--------	-------	-------	--------
No. of shares to be purchased by underwriter	7400	600	2000	4200
	=====	=====	=====	=====

Illustration 4

- IPCC Dec 2012 Marks 10

Problem Statement 4

Libra Ltd. came up with an issue of 20,00,000 equity shares of Rs10 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 50,000 shares each. Subscriptions totalled 12,97,000 shares including 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 —

(a) The allotment of shares to the underwriters;

(b) The commission due to each of them; and

(c) The net cash paid and or received.

Note: *Unmarked applications are to be credited to underwriters equally.*

Problem Summary & Discussion

Total Issue Size = 2000000 Shares

Shares Issued to Promoters = 500000 Shares

Shares offered for public subscriptions = 1500000 Shares

Total Application including Firm Underwriting = 1297000 Shares

Marked Applications = 1225000 Shares

Firm Underwriting = 150000 Shares

Unmarked Applications = 72000 Shares

Short Fall in Public Subscription = 53000 Shares

Gross Liability Ratio = 1:1:1

Solution

(1) Calculation of Liability of Underwriters

	Anand	**Vijay**	**Ashok**
Gross Liability (No. of shares)	5,00,000	5,00,000	5,00,000
Less : Firm Underwriting	(50,000)	(50,000)	(50,000)
	4,50,000	4,50,000	4,50,000
Less : Marked Applications	(4,25,000)	(4,50,000)	(3,50,000)
	25,000	—	1,00,000
Less : Unmarked Applications	(36,000)	—	(36,000)
(equally)*	(11,000)	—	64,000
Less : Adjustment of Anand's surplus	11,000	—	(11,000)
Net liability, excluding firm underwriting	—	—	53,000
Add: Firm underwriting	50,000	50,000	50,000
Gross liability	50,000	50,000	1,03,000

Solution Cont……

(2) Calculation of Amounts Payable by Underwriters

	Anand	**Vijay**	**Ashok**
Liability (No. of shares)	50,000	50,000	1,03,000
Amount payable @ Rs 4.50 per share	**2,25,000**	**2,25,000**	**4,63,500**
Less : Amount paid on Firm Applications			
of 50,000 each @ ` 2.50	(1,25,000)	(1,25,000)	(1,25,000)
Balance payable by underwriter	**1,00,000**	**1,00,000**	**3,38,500**
Underwriting Commission	2,50,000	2,50,000	2,50,000
Amount Paid to underwriter	1,50,000	1,50,000	—
Amount received by the Co.	—	—	**88,500**

Journal

(1)	Bank A/c	Dr. 3,75,000	
	To Share Application A/c		3,75,000

(Application money received on firm applications
for 50,000 each @ ` 2.50 per share from Anand, Vijay & Ashok)

(2)	Anand	Dr. 1,00,000	
	Vijay	Dr. 1,00,000	
	Ashok	Dr. 3,38,500	
	Share Application A/c	Dr. 3,75,000	
	To Share Capital A/c		9,13,500

(Allotment of shares to underwriters 50,000 to Anand;
50,000 to Vijay and 1,03,000 to Ashok; application and
allotment money credited to share capital)

Journal Cont........

(3)	Underwriting Commission A/c	Dr. 7,50,000	
	To Anand		2,50,000
	To Vijay		2,50,000
	To Ashok		2,50,000

(Amount of underwriting commission payable to Anand, Vijay and Ashok @ 5% on the amount of shares underwritten.)

(4)	Bank A/c	Dr. 88,500	
	To Ashok		88,500

(Amount received from Ashok on shares allotted less Underwriting commission)

(5)	Anand	Dr. 1,50,000	
	Vijay	Dr. 1,50,000	
	To Bank A/c		3,00,000

(Amount paid to Anand & Vijay in final settlement of underwriting commission due less amount payable on shares allotted payable to him.)

Illustration 5

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Problem Statement 5

A company made a public issue of 1,25,000 equity share of Rs.100 each, Rs. 50 payable on application. The entire issue was underwritten by four parties, A, B, C, and D in the portion of 30%, 25%, 25% and 20% respectively. Under the terms agreed upon a commission of 2% was payable on the amounts underwritten.

A, B, C, and D had also agreed on ‘Firm’ underwriting of 4,000, 6,000, Nil and 15,000 share respectively.

The total subscriptions, excluding Firm underwriting, including marked application 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 underwriter and also show the journal entries that you would make in the books of the company. All working should form part of your answer.

Problem Summary & Discussion

Total Issue Size = 125000 Shares

Total Application received including Firm Underwriting = 115000 Shares

Total Applications excluding Firm Underwriting including Marked Applications = 90000 Shares

Total Marked Applications = 80000 Shares

Unmarked Applications = 10000 Shares

Short Fall in Public Subscription = 10000 Shares

Gross Liability Ratio = 6:5:5:4

Solution

When the benefit of firm underwriting is given to individual underwriters

(1) Statement showing total no. of marked application excluding firm underwriting :

A		B		C		D		
24000	+	20000	+	12000	+	24000	=	80,000 Shares

(2) Statement showing total no. unmarked application:

Total application recd. excluding firm underwriting	90000 shares
Total marked application excluding firm underwriting	<u>80000</u> shares
Unmarked Application	10000 shares

Solution Cont.......

(3) Statement showing Underwriters liability:

Particulars	A	B	C	D
GROSS liability in 30:25:25:20	37500	31250	31250	25000
Less-firm underwriting	4000	6000	nil	15000
	33500	25250	31250	10000
Less-marked app	24000	20000	12000	24000
	9500	5250	19250	(14000)
Less-unmarked app (in gross liability ratio i.e.,30:25:25:20	3000	2500	2500	2000
	6500	2750	16750	(16000)
surplus of D given to A;B & C in 30:25:25	(6000)	(5000)	(5000)	16000

Solution Cont……

Particulars	A	B	C	D
	500	(2250)	11750	-
surplus of B adj with A and C	(500)	2250	(1750)	-
Net liability	-	-	10000	-
Add:Firm underwriting	4000	6000	-	15000
Gross liability	4000	6000	10000	15000

Solution cont.....

Statement showing amount due from underwriter:

	A	B	C	D
No. of shares to be subscribed as per previous table	4,000	6,000	10,000	15,000
Amount due on application	2,00,000	3,00,000	5,00,000	7,50,000
No. Of shares incl. firm u/w X Rs 50				
U/W Commission payable	(75000)	(62500)	(62500)	(50000)
	1,25,000	2,37,500	4,37,500	7,00,000

journal

Bank A/c	Dr 60,00,000	
Underwriting Commission A/c	Dr 2,50,000	
To Equity share Application A/c		62,50,000
Equity share Application A/c	Dr 62,50,000	
To Equity Share Capital		6250000

Alternative Solution to Problem no.5

When the benefit of firm underwriting is not given to individual underwriter:

(1) Statement showing total no. of marked application excluding firm underwriting :

A	B	C	D	
24000 +	20000 +	12000 +	24000 =	80,000 Shares

(2) Statement showing total no. unmarked application:

Total application recd. excluding firm underwriting	90000 shares
Total marked application excluding firm underwriting	80000 shares
Unmarked Application	10000 shares
Add: Firm underwriting	25000 shares
Total unmarked application	**35000 shares**

Solution cont….

(3) Statement showing Underwriters liability:

Particulars	A	B	C	D
GROSS liability in 30:25:25:20	37500	31250	31250	25000
Less-marked app	24000	20000	12000	24000
	13500	11250	19250	1000
Less-unmarked application 35000 in gross liability ratio i.e.,30:25:25:20	10500	8750	8750	7000
	3000	2500	10500	(6000)
surplus of D given to A;B & C in 30:25:25	(2250)	(1875)	(1875)	6000
Net liability	750	625	8625	Nil
Add: Firm Underwriting	4000	6000	---	15000
Total Liability	4750	6625	8625	15000

Illustration 6

- IPCC Dec 2012 Marks 10

Problem Statement 6

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.

Problem Summary & Discussion

Total Issue Size = 100000 Shares

Total Application received excluding Firm Underwriting = 70000 Shares

Total Marked Applications = 58000 Shares

Unmarked Applications = 12000 Shares

Short Fall in Public Subscription = 23000 Shares

Gross Liability Ratio = 3:3:2:2

Firm Underwriting should be treated as Unmarked Applications

So Total no of unmarked Applications = 12000 + 7000=19000 Shares

Solution

Assuming that the benefit of firm underwriting is not given to individual underwriters

(1) Statement showing total no. of marked application excluding firm underwriting :

P		Q		R		S	
19000	+	10000	+	21000	+	8000	= 58,000 Shares

(2) Statement showing total no. unmarked application:

Total application recd. excluding firm underwriting	70000 shares
Total marked application excluding firm underwriting	58000 shares
Unmarked Application	12000 shares
Add: Firm underwriting	7000 shares
Total unmarked application including firm u/w	**19000 shares**

Solution cont….

Statement showing underwriters liability:

	P	Q	R	S	Total
Gross Liability	30,000	30,000	20,000	20,000	1,00,000
Less: Marked applications (excluding firm underwriting)	(19,000)	(10,000)	(21,000)	(8,000)	(58,000)
Balance	11,000	20,000	(1,000)	12,000	42,000
Less: Surplus of R allocated to P, Q and S in the ratio of 3:3:2	(375)	(375)	1,000	(250)	- .
Balance	10,625	19,625	-	11,750	42,000

Solution cont….

	P	Q	R	S	Total
Balance	10,625	19,625	-	11,750	42,000
Less: Unmarked applications including firm underwriting	(5,700)	(5,700)	(3,800)	(3,800)	(19,000)
Net Liability	4,925	13,925	(3,800)	7,950	23,000
Less: Surplus of R allocated to P, Q and S in the ratio of 3:3:2	(1,425)	(1,425)	3,800	(950)	- .
	3,500	12,500	-	7,000	23,000
Add: Firm underwriting	3,000	2,000	1,000	1,000	7,000
Total Liability	6,500	14,500	1,000	8,000	30,000

Problem from RTP for May 2013 examination

- IPCC Dec 2012 Marks 8

Problem statement 7

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 ` 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 undertwriting of 30,000; 20,000 and 10,000 shares respectively. The underwriting commission was fixed at 4%. The amount payable on application was ` 2.50 per share and allotment was ` 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

Problem cont..

You are required to show

(i) the allocation of liability among underwriters with workings assuming that the benefit of firm underwriting is given to individual underwriters.

(ii) Journal entries for:

a) the allotment of shares to the underwriters,

b) the commission due to each of them and,

c) the net cash paid or received.

Problem Summary & Discussion

Total Issue Size = 1500000 Shares

Issue of Shares reserved for Promoters = 30% of 1500000=450000 Shares

Shares offered among public = 1050000 Shares

Total Marked Applications excluding Firm Underwriting = 900000 Shares

Unmarked Applications = 50000 Shares

Short Fall in Public Subscription = 1050000-900000-50000 =100000 Shares

Gross Liability Ratio = 3:1:1

Solution

Allocation of liability among underwriters

	P	Q	R	Total
Gross liability (in shares)	6,30,000	2,10,000	2,10,000	10,50,000
Less: Marked Applications	(5,50,000)	(2,00,000)	(1,50,000)	(9,00,000)
	80,000	10,000	60,000	1,50,000
Less: Unmarked Applications (In the ratio of 3:1:1)	(30,000)	(10,000)	(10,000)	(50,000)
	50,000	-	50,000	1,00,000
Less : Firm undertaking	(30,000)	(20,000)	(10,000)	(60,000)
	20,000	(20,000)	40,000	40,000
Surplus of Q distributed between P & R in the ratio of 3:1	(15,000)	20,000	(5,000)	- .
	5,000	-	35,000	40,000
Add: Firm undertaking	30,000	20,000	10,000	60,000
Underwriters' Liability	35,000	20,000	45,000	1,00,000

Solution cont….

Calculation of amounts payable to/by underwriters:

	P	Q	R
Liabilities (No. of shares)	35,000	20,000	45,000
Less: Firm undertaking (No. of shares)	(30,000)	(20,000)	(10,000)
Net liability (No. of shares)	5,000	-	35,000
Amount payable on application			
@ ` 2.50per share	12,500	-	87,500
Underwritting commission			
receivable by underwriters @ 4%	2,52,000	84,000	84,000
Amount Payable to underwriters	2,39,500	84,000	-
Amount receivable from underwriters			3,500

Solution cont.....

Computaion of underwriting commission:

Commission of P @ 4% = 2,52,000 =(6,30,000 shares x ` 10 x 4%)

Commission of Q @ 4% = 84,000 =(2,10,000 shares x ` 10 x 4%)

Commission of R @ 4% = 84,000 =(2,10,000 shares x ` 10 x 4%).

Journal entry

(1)	Bank A/c	Dr. 1,50,000	
	To Share application A/c		1,50,000

(Being share application money received on firm application for shares 30,000 to P, 20,000 to Q & 10,000 to R @ ` 2.5 per share)

(2)	P's A/c	Dr. 12,500	
	R's A/c	Dr. 87,500	
	To Equity share Capital A/c		1,00,000

(Allotment of shares to underwriters: 5,000 shares to P and 35,000 shares to R)

(3)	Underwriting Commission A/c	Dr. 4,20,000	
	To P's A/c		2,52,000
	To Q's A/c		84,000
	To R's A/c		84,000

(Underwriting commission payable @ 4% on the amount of shares underwritten)

Journal entry cont.....

(4)	P's A/c		Dr. 2,39,500	
	Q's A/c		Dr. 84,000	
		To Bank A/c		3,23,500

(Amount paid to P and Q in final settlement)

(5)	Bank A/c		Dr. 3,500	
		To R's A/c		3,500

(Amount received from R on shares allotted less underwriting commission)

Summary

- Underwriting is an agreement by which a person called underwriter lakes the responsibility of taking up the shares and debentures not subscribed by the public in a public issue in consideration of commission.
- Underwriting can be done by a single person or jointly by two or more persons.
- As per section 76 of the Companies Act, the commission that can be paid can not be more than 2.5% of the issue price of the debentures and 5% in the case of shares.
- **Marked Applications :** These applications bear the stamp of the underwriter and the credit for these applications are given to the individual underwriter.

Summary Cont…

- **Unmarked Applications:** These applications do not bear the stamp of the underwriter. For the credit of these applications following points are relevant.

  a) If the entire issue is underwritten, the credit for these applications is given to the underwriters either in the ratio of their gross liability or liability after deducting the marked application.

  b) If the entire issue is not underwritten, first the credit goes to the account of the portion not underwritten and the rest will be apportioned in the gross liability ratio.

Summary cont…

- **Firm underwriting:** It is a firm commitment by an underwriter to take up a specified number of shares irrespective of the number of shares subscribed by the public. So the firm underwriting shall be deducted from the gross liability first and the calculation shall be done without considering the firm underwriting (if the credit is to be given for firm underwriting to the individual underwriters) and after determining the liability on account of underwriting, firm underwriting is added.

But if the credit for firm underwriting is not to be given to the individual underwriter, those shall be treated as unmarked applications.

Thank You