# Unit – 2 : Underwriting of Shares and Debentures

**Learning Objectives**

After studying this unit, you will be able to

- Learn the provisions of the 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.

## 2.1 Introduction

Underwriting an issue of shares or debentures involves entering into a contract with a person known as underwriter, who may be an individual, partnership or company, undertaking that in the event of the shares or debentures not being subscribed by the public or only a part of them being subscribed, he shall take up the balance. In view of the magnitude of such an obligation, issues of shares or debentures are rarely underwritten by one person. They are either underwritten by two or more persons jointly or only a part of the issue is underwritten and, in respect of rest, the company takes the risk of the capital being not subscribed by the public.

## 2.2 Underwriting Commission

The function of an underwriter has great economic significance. It provides an assurance to the company that it would be able to raise the stipulated amount of capital by the issue of shares or debentures and, on the basis of such an assurance; company can proceed to draw up its investment programme. The Central Government has recently set up a number of financial institutions for helping companies to raise capital. One of the forms in which such a help is rendered is by underwriting the issues of shares and debentures, made by the companies. The prominent institutions that render this service are: Industrial Finance Corporation, Industrial Credit and Investment Corporation of India and Life Insurance Corporation of India.

In consideration of such a service, the underwriter is paid a commission. The Companies Act, 2013 places certain restrictions on the rate of commission and the conditions under which it can be paid. It provides that commission only at a rate authorized by the Articles, not exceeding 2½% of the issue price of debentures and 5% of issue price of shares, can be paid. No commission can be paid in respect of shares or debentures which have not been offered to the general public for subscription.

## 2.3 Provisions in the Companies Act affecting Underwriting

**Disclosure in the Prospectus** - According the Companies Act, it is necessary that when any issue of shares or debentures is underwritten, the names of the underwriters and the opinion of the directors that the resources of the underwriters are sufficient to discharge their obligations should be stated.

**Disclosure in the Statutory Report** - According to clause (6) of the Form prescribed for such a report, a brief description of each underwritten contract should be given and, if any contract has not been carried out fully, the extent to which it has not been carried out and reasons therefore should be stated. In addition, particulars of any commission paid or payable to any Director, Manager, or their associates should be disclosed.

## 2.4. Underwriting Contract

There are two types of underwriting contract

(i) Normal Underwriting

(ii) Firm Underwriting

### 2.4.1 Determination of liability in Respect of a Normal Underwriting Contract

**2.4.1.1 Determination of liability where whole of the issue has been underwritten by one person:** 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. In such a case, it is not necessary to know the number of applications which had originated through the underwriter and those which had flowed directly to the company.

**2.4.1.2 Determination of liability where only part of the issue has been underwritten:** In such a case the company is treated as having underwritten the balance of shares which have not been underwritten. In this assumption, the unmarked applications are treated as marked so far as the company is concerned.

Suppose, a company has issued 10,000 shares of which only 6,000 have been underwritten by X; marked applications exceed 6,000. In such a case, X would not be liable to subscribe for any shares. If, however, there are marked applications for only 5,000 shares X would have to subscribe for 1,000 shares provided on his doing so the total number of shares allotted (including those to X) does not exceed 10,000. If it does, the number of shares which X must subscribe will be reduced to that extent.

**2.4.1.3 Determination of liability where the whole or part of the issue has been underwritten by two or more underwriters:** In the case in which whole or only part of an issue has been underwritten by a number of underwriters, a difficulty may arise in determining the liability of each of the underwriters; such a difficulty may arise in deciding the basis on which the unmarked applications, *i.e.* the applications which have directly flowed to the company should be allocated among the different underwriters. Marked applications are those

applications which are received through an underwriter and such applications are to his credit against his overall obligations.

The allocation of unmarked applications to the underwriters can be done in any one of the two ways: according to one method, the unmarked applications are allotted in the proportion of gross amount of capital underwritten; alternatively these are allocated in proportion to the gross amount of capital underwritten as reduced by the marked applications. How the liability of underwriters is determined by following one or the other method, is explained below :

Elahi Buksh & Co. Ltd. issued 10,000 equity shares. These were underwritten as follows:

| | | | | | |
|---|---|---|---|---|---|
| A | 40% | B | 35% | C | 25% |

In all, applications for 8,000 shares were received; applications for 2,000 shares have the stamp of A; those for 1,000 shares that of B, and those for 2,000 shares that of C. There were thus applications for 3,000 shares which did not bear any stamp or which were unmarked. If credit for unmarked applications is given to A, B and C in proportion to their gross liability, the liability of each of the underwriters will be as shown below:

| | A | B | C |
|---|---|---|---|
| Gross liability as underwritten | 4,000 | 3,500 | 2,500 |
| *Less*: Unmarked applications | | | |
| 3,000 shares in the ratio of 40:35:25 | (1,200) | (1,050) | (750) |
| Gross Liability of underwriters | 2,800 | 2,450 | 1,750 |
| Marked applications | 2,000 | 1,000 | 2,000 |
| Balance | 800 | 1,450 | (250) |
| Credit to A and B for C's surplus (ratio 40:35) | (133) | (117) | 250 |
| Actual liability | 667 | 1,333 | — |

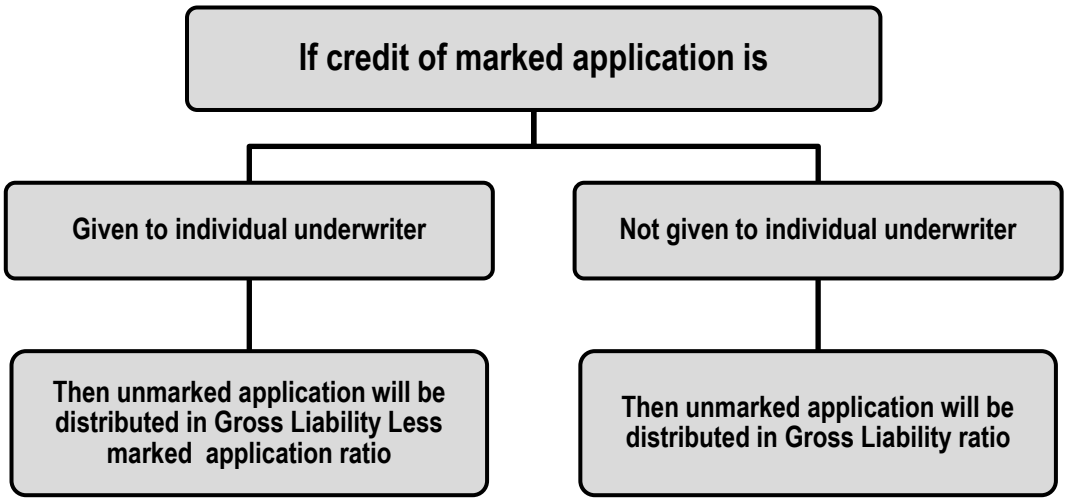
If however, the other view is taken that unmarked applications should be credited to different underwriters in the ratio of liability after credit for marked applications has been given - the position will be as follows :

| | A | B | C |
|---|---|---|---|
| Gross liability | 4,000 | 3,500 | 2,500 |
| *Less*: marked applications | (2,000) | (1,000) | (2,000) |
| Liability net of marked applications | 2,000 | 2,500 | 500 |
| *Less*: Unmarked applications | (1,200) | (1,500) | (300) |
| (Shares in ratio of 20:25:5) | | | |
| Net liability | 800 | 1,000 | 200 |

The liability in this case could also be determined by simply apportioning the total number of shares yet to be subscribed (2,000 in the above case) in the proportion of the balance of the liability after credit for marked forms has been given. Since the liability of each underwriter

may vary widely if one or the other method is followed, the underwriting contract should specify the method to be followed.

**Note:** Students are advised to clarify the position by way of suitable note in the examination.




In case the information as regards the number of applications that are marked and those that are unmarked is not available in the given question, 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.

The surplus shown by the particular underwriters is to be credited to the other underwriters in same proportion as for unmarked applications.

**Illustration 1**

*Newton Limited incorporated on 1st January, 2013 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**

**Statement of Net Liability of Underwriters**

| | Gross liability | Marked appli-cations | Number of Unmarked applications in the ratio of gross liability | Shares Total (2) + (3) | Surplus of Clayton in the ratio of 10:6 | Total (4)+(5) | Net liability (1)- 6) |
|---|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) | (7) |
| Adams | 10,000 | 8,000 | 500 | 8,500 | 219 | 8,719 | 1,281 |
| Benzamin | 6,000 | 2,850 | 300 | 3,150 | 131 | 3,281 | 2,719 |
| Clayton | 4,000 | 4,150 | 200 | 4,350 | -350 | 4,000 | – |
| | 20,000 | 15,000 | 1,000 | 16,000 | – | 16,000 | 4,000 |

*Note:* The applications are for 16,000 shares out of which 15,000 are marked. Hence unmarked applications are for 1,000 shares.

### 2.4.2 Firm Underwriting

It signifies a definite commitment to take up a specified number of shares irrespective of the number of shares subscribed for by the public. In such a case, unless it has been otherwise agreed, the underwriter's liability is determined without taking into account the number of shares taken up 'firm' by him that is to say, the underwriter is obliged to take up :

(*i*) The number of shares he has applied for 'firm'; and
(*ii*) The number of shares he is obliged to take up on the basis of the underwriting agreement.

In other words, in such cases the obligation or liability of the underwriter is the aggregate of shares to be taken up under firm commitment and the shares as per underwriting commitment.

Let us say, A underwrites 60% of an issue of 10,000 shares and besides applies for 1,000 shares, 'firm'. In case there are marked applications for 4,800 shares he will have to take 2,200 shares, *i.e.* 1,000 shares for which he applied 'firm' and 1,200 shares to meet his liability of underwriting contract. If, on the other hand, the underwriting contract has provided that abatement would be allowed in respect of shares taken up 'firm' the liability of A in the above-mentioned case would only be for 1,200 shares in total.

#### 2.4.2.1 When the Issue is Fully Underwritten [with Firm Underwriting]

There are two alternative ways:

(i) The benefit of firm underwriting is not given to individual underwriter, or

(ii) The benefit of firm underwriting is given to individual underwriter.

**(i) The benefit of firm underwriting is not given to individual Underwriter:**

For determining the liability of individual underwriter, the following steps are followed:

**Step 1** Compute gross liability in the usual manner (if it has not been given).

**Step 2** Subtract marked applications (excluding firm underwriting) from gross liability of respective underwriters. If some of the resultant figures are found negative, then add all negative figures and divide the resultant in the ratio of gross liability.

**Step 3** Determine the number of unmarked applications as follows:

| | |
|---|---|
| Total subscriptions (excluding firm underwriting) | ****** |
| Less: Marked applications (excluding firm underwriting) | ****** |
| **Unmarked applications by public** | ****** |
| Add: Applications under firm underwriting | ****** |
| **Total unmarked applications** | ****** |

Divide the above calculated unmarked applications in the ratio of **gross liability.**

If the resultant figures of Step 3 are all positive or zero, then it represents **net liability** as per agreement. After this step, go to Step 5 (skip Step 4).

**If some of the resultant figures are negative, then continue to Step 4.**

**Step 4** Add all the negative figures and divide the resultant between the underwriters having positive figures in the ratio of **gross liability.** Repeat Step 4 unless all figures are non-negative. Now these figures represent the **net liability** as per agreement. After this step, to Step 5.

**Step 5** Add firm underwriting with the **net liability** as per agreement. The resultant figures represent **total liability.**

**Here,**

**(1) Firm underwriting is treated as unmarked applications and divided in the ratio of gross liability.**

**(2) The liability of underwriter consists of:**

**(a) Net liability as per agreement; and**

**(b) Firm underwriting.**

**(ii) The benefit of firm underwriting is given to individual underwriter**

For determining the liability of individual underwriter, the following steps are followed:

**Step 1** Compute gross liability in the usual manner (if it has not been given).

**Step 2** Subtract marked applications (excluding firm underwriting) from gross liability of respective underwriters. If some of the resultant figures are found negative, then add all negative figures and divide their sum in the ratio of gross liability.

**Step 3** Determine the number of unmarked applications as follows:

| | |
|---|---|
| Total subscriptions (excluding firm underwriting) | ****** |
| *Less*: Marked applications (excluding firm underwriting) | ****** |
| **Unmarked applications by public** | ****** |

Divide the above calculated unmarked application in the **ratio of gross liability.**

**Step 4** Subtract "firm underwriting" of individual underwriter from the respective figures of Step 3.

If the resultant figures of Step 4 are all positive or zero, then that represents net liability as per agreement. After this step, go to Step 6 (skip Step 5).

**If some of the resultant figures are negative, then continue to Step 5.**

**Step 5** Add all negative figures and divide it between the underwriters having positive figures in the ratio of gross liability. Repeat Step 5 unless all figures are non-negative. Now these figures represent the net liability as per agreement. After this step, go to Step 6.

**Step 6** Add firm underwriting with the net liability as per agreement. The resultant figures represent total liability.

**Here,**

**(1) Firm underwriting is not treated as unmarked applications.**

**(2) Firm underwriting is credited to individual underwriters separately.**

**(3) The liability of Underwriter consists of:**

**(a) Net liability as per agreement; and**

**(b) Firm underwriting.**

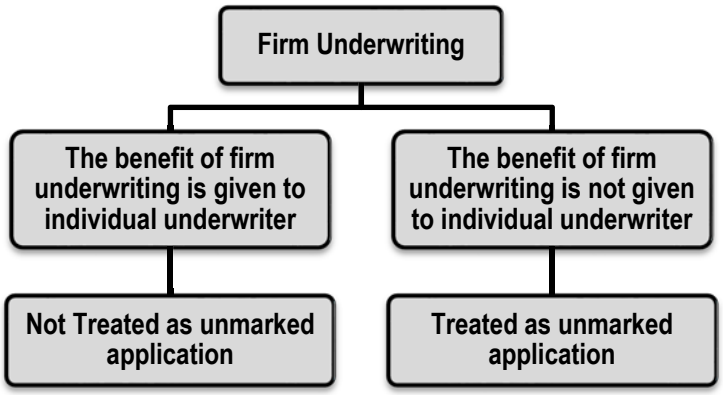



**Illustration 2**

*Rosy Ltd. made a public issue of 4,00,000 equity shares of ₹ 10 each, ₹ 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.*

*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* |
| | | *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.*

**Solution**

**Journal Entry**

| | | Dr. ₹ | Cr. ₹ |
|---|---|---|---|
| Bank A/c | Dr. | 57,500 | |
| Underwriting commission A/c | Dr. | 80,000 | |
| Brokerage on shares A/c | Dr. | 500 | |
| To Equity Shares applications A/c | | | 1,00,000 |
| To Bank A/c | | | 38,000 |

**Working Notes: (for description of the columns see below)**

| Name | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 | 11 | 12 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| A. | 1,00,000 | 1,02,000 | 2,500 | 1,04,500 | –4,500 | 1,00,000 | — | — | 20,000 | — | — | 20,000 |
| B. | 1,00,000 | 95,000 | 2,500 | 97,500 | 1,500 | 99,000 | 1,000 | 2,000 | 20,000 | — | — | 18,000 |
| C. | 1,00,000 | 60,000 | 2,500 | 62,500 | 1,500 | 64,000 | 36,000 | 72,000 | 20,000 | — | 52,000 | — |
| D. | 40,000 | 32,000 | 1,000 | 33,000 | 600 | 33,600 | 6,400 | 12,800 | 8,000 | 500 | 4,300 | — |
| E. | 60,000 | 51,000 | 1,500 | 52,500 | 900 | 53,400 | 6,600 | 13,200 | 12,000 | — | 1,200 | — |
| | 4,00,000 | 3,40,000 | 10,000 | 3,50,000 | — | 3,50,000 | 50,000 | 1,00,000 | 80,000 | 500 | 57,500 | 38,000 |

**Column No.**

(1) Commitment—No. of Shares

(2) Marked Applications

(3) Additional proportionate no. of direct applications or unmarked applicaitons

(4) Total (2) + (3)

(5) Allocation of surplus – done in the ratio of underwriting i.e 25:25:10:15 (B, C, D & E)

(6) Total (4)+(5) – this will be the total credited applications

(7) Final Deficit (1)—(6): Commitment – Total Credited Applicaitons

(8) Amount Receivable from underwriters due @ ₹ 2 per share.

(9) Underwriting Commission due @ 2 % nominal value.

(10) Brokerage due @ 1/2%: Only payable to D for 10,000/- shares applied by him on par value of the shares i.e on Rs 100,000

(11) Due from underwriters.

(12) Due to underwriters.

**Illustration 3**

*Libra Ltd. came up with an issue of 20,00,000 equity shares of ₹ 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 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 ₹ 2.50 and ₹ 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. Benefit of firm underwriting is given to individual underwriter.*

**Solution**

**Libra Ltd.**
**Journal**

| | | Dr. ₹ | Cr. ₹ |
|---|---|---|---|
| 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) | | | |
| 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) | | | |
| 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.) | | |
| Bank A/c Dr. | 88,500 | |
| To Ashok | | 88,500 |
| (Amount received from Ashok on shares allotted less underwriting commission) | | |
| 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.) | | |

**Working Notes :**

**(1) Calculation of Liability of Underwriters**

| | Anand | Vijay | Ashok |
|---|---|---|---|
| Gross Liability (No. of shares) | 5,00,000 | 5,00,000 | 5,00,000 |
| *Less* : Marked Applications(excluding firm underwriting) | (4,25,000) | (4,50,000) | (3,50,000) |
| | 75,000 | 50,000 | 1,50,000 |
| *Less* : Unmarked Applications (equally) | (24,000) | (24,000) | ( 24,000) |
| | 51,000 | 26,000 | 1,26,000 |
| *Less* : Firm Underwriting | (50,000) | (50,000) | (50,000) |
| | 1,000 | (24,000) | 76,000 |
| Surplus of Vijay distributed between Anand & Ashok equally | (12,000) | 24,000 | (12,000) |
| | (11,000) | - | 64,000- |
| Surplus of Anand allocated to Ashok totally | 11,000 | — | (11,000) |
| | 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 |
| Total liability of underwriters | 50,000 | 50,000 | 1,03,000 |

**(2) Calculation of Amounts Payable by Underwriters**

| | Anand | Vijay | Ashok |
|---|---|---|---|
| Liability (No. of shares) | 50,000 | 50,000 | 1,03,000 |
| Amount payable @ ₹ 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 | 1,00,000 | 1,00,000 | 3,38,500 |
| Underwriting Commission Receivable | 2,50,000 | 2,50,000 | 2,50,000 |
| Amount Paid | 1,50,000 | 1,50,000 | — |
| Amount received by the Co. | — | — | 88,500 |

**Illustration 4**

*A company made a public issue of 1,25,000 equity shares of ₹ 100 each, ₹ 50 payable on application. The entire issue was underwritten by four parties: 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, and 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.*

**Solution:**

When the benefit of firm underwriting is given to individual underwriters.

**(i) Total marked applications:**

| A | B | C | D | |
|---|---|---|---|---|
| 24,000 | +20,000 | +12,000 | +24,000 | = 80,000 |

**(ii) Shares subscribed excluding firm underwriting**

| | | |
|---|---|---|
| Total applications | 90,000 | shares |
| *Less* : Marked applications | (80,000) | shares |
| Unmarked | 10,000 | |

**(iii) Statement showing Liability of underwriters**

| | *A* | *B* | *C* | *D* | *Total* |
|---|---|---|---|---|---|
| Gross liability (30:25:25:20) | 37,500 | 31,250 | 31,250 | 25,000 | 1,25,000 |
| *Less* : Marked applications | (24,000) | (20,000) | (12,000) | (24,000) | (80,000) |
| | 13,500 | 11,250 | 19,250 | 1,000 | 45,000 |
| *Less* : Unmarked (in Gross Ratio) | (3,000) | (2,500) | (2,500) | (2,000) | (10,000) |
| | 10,500 | 8,750 | 16,750 | –1,000 | 35,000 |
| *Less* : Firm underwriting | (4,000) | (6,000) | – | (15,000) | (25,000) |
| | 6,500 | 2,750 | 16,750 | –16,000 | 10,000 |

| | | | | | |
|---|---|---|---|---|---|
| *Less* : Surplus of 'D'allotted to A, B & C (30:25:25) | (6,000) | (5,000) | (5,000) | – | – |
| | 500 | (2,250) | 11,750 | – | 10,000 |
| Surplus of 'B' allotted | 500 | – | 1,750 | – | – |
| Net liability | – | – | 10,000 | – | 10,000 |

**(iv) Statement of underwriters' liability**

| | | | | | |
|---|---|---|---|---|---|
| Firm | 4,000 | 6,000 | – | 15,000 | 25,000 |
| Others | – | – | 10,000 | – | 10,000 |
| | 4,000 | 6,000 | 10,000 | 15,000 | 35,000 |

**(v) Amounts due from underwriters**

| | A | B | C | D | Total |
|---|---|---|---|---|---|
| Shares to be subscribed as per (iv) above | 4,000 | 6,000 | 10,000 | 15,000 | 35,000 |
| Amount due @ ₹ 50 per share | 2,00,000 | 3,00,000 | 5,00,000 | 7,50,000 | 17,50,000 |
| *Less* : Commission due of shares underwritten | (75,000) | (62,500) | (62,500) | (50,000) | (2,50,000) |
| | 1,25,000 | 2,37,500 | 4,37,500 | 7,00,000 | 15,00,000 |

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

(i) Total marked applications = 24,000+20,000+12,000+24,000 = 80,000

(ii) Shares subscribed excluding 'Firm' underwriting but including

| | | |
|---|---|---|
| Marked applications | 90,000 | shares |
| *Add:* 'Firm' underwriting | 25,000 | shares |
| Total subscription | 1,15,000 | shares |
| *Less:* Marked Applications | (80,000) | shares |
| Balance being unmarked | 35,000 | shares |

**(vi) Check:**

| | | | |
|---|---|---|---|
| (a) | Taken by public - unmarked applications | 10,000 | shares |
| (b) | Public through underwriters - marked | 80,000 | shares |
| (c) | By underwriters - under agreement | 35,000 | shares |
| | | 1,25,000 | shares |

**Journal Entry**

| | | ₹ | ₹ |
|---|---|---|---|
| Bank A/c | Dr | 60,00,000 | |
| Underwriting Commission A/c | Dr | 2,50,000 | |
| Equity share Application A/c | | | 62,50,000 |

**Illustration 5**

*Outset Ltd. invited applications from public for 1,00,000 equity shares of ₹ 10 each at a premium of ₹ 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.*

**Solution**

Calculation of liability of each underwriter assuming that the benefit of firm underwriting is not given to individual underwriters

| | | | | | (Number of shares) |
|---|---|---|---|---|---|
| | 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 |
| *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 |

**Calculation of underwriting commission:**

As per law in force, underwriting commission is payable @ 5% of the issue price of shares.

Underwriting commission payable to P and Q = 5% of (₹ 15 × 30,000 shares) = ₹ 22,500.

Underwriting commission payable to R and S = 5% of (₹ 15 x 20,000 shares)= ₹ 15,000.

**Working Note:**

| | |
|---|---|
| Application received from public | 70,000 shares |
| Add: Shares underwritten firm | 7,000 shares |
| Total application | 77,000 shares |
| *Less*: Marked applications | (58,000 shares) |
| Unmarked application including firm underwriting | 19,000 shares |