Underwriting of Shares and Debentures

Practical Question - Part 1

CA Darshak Doshi

Assistant Professor In Department Of Accounting And Finance

SIES College Of Commerce And Economics Sion East Mumbai

Email for comments, suggestions and copy rights issues – dgdoshi89@gmail.com

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Liability of the Underwriters

Gross Liability :

It is the contractual liability as determined by the underwriting agreement to sell specified number of shares to public. It is the liability underwritten by underwriter specified in the underwriting agreement. In case of joint underwriting, agreed ratio of gross liability of underwriters is always according to the underwriting agreement.

Underwriting commission is always calculated on the basis of the gross liabilities of each underwriter irrespective of whether the shares are subscribed by the public or whether the underwriters have to take the remaining shares.

Net Liability :

This refers to the number of shares to be taken by each underwriter when the public has not subscribed. Firm applications are added to get the total liability of underwriter.

Underwriting of Shares and Debentures

Statement of Liability of Underwriters (No Firm Underwriting) (No. Of Shares)

Step	Particulars	Basis	A	B	C	Total
1	Gross liability (As Underwritten)	Agreed Ratio	xxx	xxx	xxx	xxx
2	Less: Marked Application	Actual	xxx	xxx	xxx	xxx
3	Balance	(1 – 2)	xxx	xxx	xxx	xxx
4	Less: Un Marked Application	GL / (3)	xxx	xxx	xxx	xxx
5	Net Liability	(3 – 4)	xxx	xxx	xxx	xxx

GL – Gross Liability

When an issue is underwritten by more than one underwriter i.e. a case of Joint Underwriting, a difficulty may arise in deciding the basis on which unmarked applications should be allocated among different underwriters. The allocation between the underwriters can be done by any one of the two methods:

1. To be allocated in the ratio of gross liability.
2. To be allocated in the ratio of liability as calculated (in step 3) after reducing marked applications from gross liability.

Total Applications Received = Total Un Marked Applications + Total Marked Applications

Underwriting of Shares and Debentures

Question 1 :

Tata Ltd decided to issue 1,00,000 equity shares. The whole issue was underwritten by 3 Underwriters SBI 40%, HDFC 30% and ICICI 30%. Applications for 80,000 shares were received in all out of which applications for 20,000 shares had the stamp of SBI, those for 10,000 shares had the stamp of HDFC, and 20,000 shares had the stamp of ICICI. The remaining applications did not bear any stamp. Calculate the liability of underwriters.

Solution:

Total Applications Received = Total Un Marked Applications + Total Marked Applications

Total Un Marked Applications = Total Applications Received – Total Marked Applications

Total Un Marked Applications = 80,000 – (20,000 + 10,000 + 20,000)

Total Un Marked Applications = 80,000 – 50,000

Total Un Marked Applications = 30,000 Shares

Note:

Since the question does not mention about how to allocate the un marked applications among the underwriters we will solve the question with the methods.

In examination solve only with one method and mention the same as assumption. Solving the question with 1st method i.e. allocating un marked application in the **ratio of gross liability should be preferred**.

Method 1: Un marked applications to be allocated in the ratio of **Gross Liability**

Statement of Liability of Underwriters **(No. Of Shares)**

Step	Particulars	Basis	SBI	HDFC	ICICI	Total
1	Gross liability (As Underwritten)	4:3:3	40,000	30,000	30,000	1,00,000
2	Less: Marked Application	Actual	(20,000)	(10,000)	(20,000)	(50,000)
3	Balance	(1 – 2)	20.000	20.000	10,000	50,000
4	Less: Un Marked Application	Gross Liability (4:3:3)	(12,000)	(9,000)	(9,000)	(30,000)
5	**Net Liability**	**(3 – 4)**	**8,000**	**11,000**	**1,000**	**20,000**

Method 2: Un marked applications to be allocated in the ratio of liability as calculated after reducing marked applications from gross liability.

Statement of Liability of Underwriters **(No. Of Shares)**

Step	Particulars	Basis	SBI	HDFC	ICICI	Total
1	Gross liability (As Underwritten)	4:3:3	40,000	30,000	30,000	1,00,000
2	Less: Marked Application	Actual	(20,000)	(10,000)	(20,000)	(50,000)
3	Balance	(1 – 2)	20.000	20.000	10,000	50,000
4	Less: Un Marked Application	Ratio of Balance (2:2:1)	(12,000)	(12,000)	(6,000)	(30,000)
5	**Net Liability**	**(3 – 4)**	**8,000**	**8,000**	**4,000**	**20,000**

Underwriting of Shares and Debentures

Question 2 :

X Ltd decided to issue 50,00,000 Equity shares of Rs 10 each. The whole issue was underwritten by A, B and C as below:

A: 15,00,000 Shares
B: 25,00,000 Shares
C: 10,00,000 Shares

Applications were received for 48,50,000 shares, of which the marked applications were as follows:

A: 12,00,000 Shares
B: 25,00,000 Shares
C: 8,50,000 Shares

Calculate the number of shares to be taken up by the underwriters, Unmarked applications are to be distributed amongst the underwriters in the ratio of their gross liability.

Solution:

Total Applications Received = Total Un Marked Applications + Total Marked Applications

Total Un Marked Applications = Total Applications Received – Total Marked Applications

Total Un Marked Applications = 48,50,000 – (12,00,000 + 25,00,000 + 8,50,000)

Total Un Marked Applications = 48,50,000 – 45,50,000

Total Un Marked Applications = 3,00,000 Shares

Statement of Liability of Underwriters **(No. Of Shares)**

Step	Particulars	Basis	A	B	C	Total
1	Gross liability (As Underwritten)	3:5:2	15,00,000	25,00,000	10,00,000	50,00,000
2	Less: Marked Application	Actual	(12,00,000)	(25,00,000)	(8,50,000)	(45,50,000)
3	Balance	(1 – 2)	3,00.000	0	1,50,000	4,50,000
4	Less: Un Marked Application	3:5:2	(90,000)	(1,50,000)	(60,000)	(3,00,000)
5	Balance	(3 – 4)	2,10,000	(1,50,000)	90,000	1,50,000
6	Less: Surplus of B adjusted	3:2	(90,000)	1,50,000	(60,000)	0
7	**Net Liability**	**(5 – 6)**	**1,20,000**	**0**	**30,000**	**1,50,000**

Question 3 :

Ace Ltd decided to issue 1,00,000 equity shares. The whole issue was underwritten by 5 underwriters as follows - A: 25%, B: 15%, C: 10%, D: 30% and E: 20%. Applications bearing stamp of underwriters A: 13,750, B: 10,250, C: 9,250, D; 8,250, E: 8,500 were received. 30,000 Shares did not bear mark of any underwriter. Find the liability of individual underwriters. Unmarked applications are to be distributed amongst the underwriters in the ratio of their liability.

Solution:

Total Applications Received = Total Un Marked Applications + Total Marked Applications

Total Applications Received = 30,000 + (13,750 + 10,250 + 8,250 + 9,250 + 8,500)

Total Applications Received = 30,000 + 50,000

Total Applications Received = 80,000

Statement of Liability of Underwriters **(No. Of Shares)**

Step	Particulars	Basis	A	B	C	D	E	Total
1	Gross liability (As Underwritten)	5:3:2:6:4	25,000	15,000	10,000	30,000	20,000	1,00,000
2	Less: Marked Application	Actual	(13,750)	(10,250)	(9,250)	(8,250)	(8,500)	(50,000)
3	Balance	(1 – 2)	11,250	4,750	750	21,750	11,500	50,000
4	Less: Un Marked Application	5:3:2:6:4	(7,500)	(4,500)	(3,000)	(9,000)	(6,000)	(30,000)
5	Balance	(3 – 4)	3,750	250	(2,250)	12,750	5,500	20,000
6	Less: Surplus of C adjusted	5:3:6:4	(675)	(375)	2,250	(750)	(250)	0
7	Balance	(5 – 6)	3,125	(125)	0	12,000	5,000	20,000
8	Less: Surplus of B adjusted	5:6:4	(42)	125	0	(50)	(33)	0
9	**Net Liability**	**(7 – 8)**	**3,083**	**0**	**0**	**11,950**	**4,967**	**20,000**

Quick Revision:

Gross Liability
Net Liability

Statement of Liability of Underwriters (No Firm Underwriting) (No. Of Shares)

Step	Particulars	Basis	A	B	C	Total
1	Gross liability (As Underwritten)	Agreed Ratio	xxx	xxx	xxx	xxx
2	Less: Marked Application	Actual	xxx	xxx	xxx	xxx
3	Balance	(1 – 2)	xxx	xxx	xxx	xxx
4	Less: Un Marked Application	GL / (3)	xxx	xxx	xxx	xxx
5	Net Liability	(3 – 4)	xxx	xxx	xxx	xxx

The allocation between the underwriters can be done by any one of the two methods:

1. To be allocated in the ratio of gross liability.
2. To be allocated in the ratio of liability as calculated (in step 3) after reducing marked applications from gross liability.

Total Applications Received = Total Un Marked Applications + Total Marked Applications

Thank You !!!

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