

Related Aspects of Company Accounts

Lesson 6

KEY CONCEPTS

■ Buy back ■ Escrow account ■ ESOP ■ Underwriting ■ Firm Underwriting ■ Marked Application ■ Unmarked Application

Learning Objectives

To understand:

- Accounting treatment and conditions for ESOPs
- Accounting procedure and conditions of buy-back of shares
- Equity Shares with differential rights
- Meaning and types of Underwriting
- Difference between marked application and unmarked applications
- Firms Underwriting
- Liability of underwriters

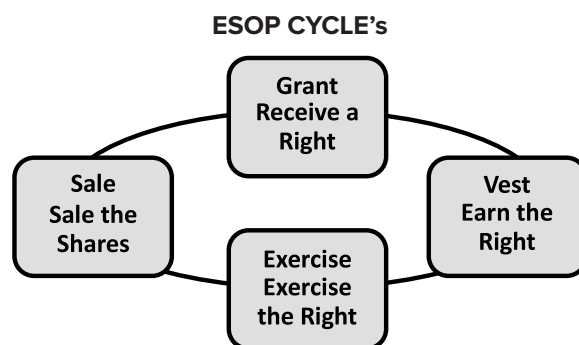
Lesson Outline

- Employee Stock Option Plan 'ESOP'
- Buy-Back of Shares
- Equity Shares with Differential Rights
- Explanatory Statement Annexed to Notice
- Underwriting of Shares/Debentures
- Firms Underwriting
- Lesson Round-Up
- Test Yourself
- List of Further Readings

EMPLOYEE STOCK OPTION PLAN (ESOP)

ESOP means a scheme under which the company grants option (a right but not an obligation) to an employee to apply for shares of the company at a predetermined price. This right is exercisable by the employee, during the specified period.

Section 2(37) of the Companies Act, 2013 states that the “employee stock option” means the option given to the whole time director, officers or employees of a company which gives such directors, officers or employees the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a predetermined price. The SEBI has issued guidelines for ESOS of listed companies. These guidelines are also applicable for Employee Stock Purchase Scheme (ESPS), which implies a scheme under which the company offers shares to employee as part of public issue or otherwise.



Important Terms of ESOP

Grant: Grant means giving an option to the Employees to subscribe to the shares of the company at the pre-determined price.

Grant Date: It is the date of agreement between the enterprise and its employees to the terms of Employees Stock Option Plan (ESOP).

Vesting: A process to give right to employees to apply for shares of the company. **Vesting Date:** It is the date on which the employee becomes entitled to apply for the shares once he has satisfied the vesting conditions.

Vesting Period: The period between the grant date and the date on which all the specified vesting conditions of an Employees Stock Option Plan (ESOP) need to be satisfied.

Exercise: It means applying by the employee for issue of shares against the option vested in him.

Exercise Period: Period after vesting within which the employee must exercise the right to apply for shares against the option vested in him in pursuance of the Employees Stock Option Plan.

Exercise Price: The price payable by the employee for exercising the option granted in pursuance of the Employees Stock Option Plan.

Value of Option: Difference between the market price and the issue price of the security.

A company issuing the options has to fulfill following prescribed conditions:

- (a) these shares are of the same class of shares already issued;
- (b) it is authorised by a special resolution passed by the company;
- (c) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;
- (d) not less than one year has, at the date of issue, elapsed since the date on which the company had commenced business; and
- (e) these shares are issued in accordance with SEBI regulations, if the shares are listed.

Accounting for ESOP

For accounting purposes, employee share-based payment plans are classified into the following categories:

Equity-settled: Under these plans, the employees receive shares.

Cash-settled: Under these plans, the employees receive cash based on the price (or value) of the enterprise's shares.

Employee share-based payment plans with cash alternatives: Under these plans, either the enterprise or the employee has a choice of whether the enterprise settles the payment in cash or by issue of shares.

An enterprise should measure the fair value of shares or stock options granted at the grant date, based on market prices, if available, taking into account the terms and conditions upon which those shares or stock options were granted. If market prices are not available, the enterprise should estimate the fair value of the instruments granted using a valuation technique to estimate what the price of those instruments would have been on the grant date in an arm's length transaction between knowledgeable, willing parties. The valuation technique should be consistent with generally accepted valuation methodologies for pricing financial instruments (e.g., use of an option pricing model for valuing stock options) and should incorporate all factors and assumptions that knowledgeable, willing market participants would consider in setting the price. Vesting conditions, other than market conditions, should not be taken into account when estimating the fair value of the shares or stock options at the grant date. Instead, vesting conditions should be taken into account by adjusting the number of shares or stock options included in the measurement of the transaction amount so that, ultimately, the amount recognized for employee services received as consideration for the shares or stock options granted is based on the number of shares or stock options that eventually vest.

Hence, on a cumulative basis, no amount is recognized for employee services received if the shares or stock options granted do not vest because of failure to satisfy a vesting condition (i.e., these are forfeited), e.g., the employee fails to complete a specified service period, or a performance condition is not satisfied.

Equity-settled Employee Share-based Payment Plans

An enterprise should recognize as an expense (except where service received qualifies to be included as a part of the cost of an asset) the services received in an equity-settled employee share-based payment plan when it receives the services, with a corresponding credit to an appropriate equity account, say, 'Stock Options Outstanding Account'. This account is transitional in nature as it gets ultimately transferred to another equity account such as share capital, securities premium account and/or general reserve as recommended in the Guidance Note.

If the shares or stock options granted vest immediately, the employee is not required to complete a specified period of service before becoming unconditionally entitled to those instruments. In the absence of evidence to the contrary, the enterprise should presume that services rendered by the employee as consideration for the instruments have been received. In this case, on the grant date, the enterprise should recognize services received in full with a corresponding credit to the equity account.

If the shares or stock options granted do not vest until the employee completes a specified period of service, the enterprise should presume that the services to be rendered by the employee as consideration for those instruments will be received in the future, during the vesting period. The enterprise should account for those services as they are rendered by the employee during the vesting period, on a time proportion basis, with a corresponding credit to the equity account.

To apply the requirements of the Guidance Note on Employee Share Based Payments, the enterprise should recognize an amount for the employee services received during the vesting period based on the best available estimate of the number of shares or stock options expected to vest and should revise that estimate, if necessary, if subsequent information indicates that the number of shares or stock options expected to vest differs from previous estimates. On vesting date, the enterprise should revise the estimate to equal the number of shares or stock options that ultimately vest. Market conditions, such as a target share price upon which vesting (or right to exercise) is conditioned, should be taken into account when estimating the fair value of the shares or stock options granted. On exercise of the right to obtain shares or stock options, the enterprise issues shares on receipt of the exercise price. The shares so issued should be considered to have been issued at the consideration comprising the exercise price and the corresponding amount standing to the credit of the relevant equity account (e.g., Stock Options Outstanding Account). In a situation where the right to obtain shares or stock option expires unexercised, the balance standing to the credit of the relevant equity account should be transferred to general reserve.

Cash-settled Employee Share-based Payment Plans

For cash-settled employee share-based payment plans, the enterprise should measure the services received and the liability incurred at the fair value of the liability. Until the liability is settled, the enterprise is required to re-measure the fair value of the liability at each reporting date and at the date of settlement, with any changes in fair value recognized in profit or loss for the period.

Employee Share-based Payment Plans with Cash Alternatives

For employee share-based payment plans in which the terms of the arrangement provide either the enterprise or the employee with a choice of whether the enterprise settles the transaction in cash or by issuing shares, the enterprise is required to account for that transaction, or the components of that transaction, as a cash-settled sharebased payment plan if, and to the extent that, the enterprise has incurred a liability to settle in cash (or other assets), or as an equity-settled share-based payment plan if, and to the extent that, no such liability has been incurred.

Accounting for employee share-based payment plans is based on the fair value method. There is another method known as the 'Intrinsic Value Method' for valuation of employee share-based payment plans. Intrinsic value, in the case of a listed company, is the amount by which the quoted market price of the underlying share exceeds the exercise price of an option. In the case of a non-listed company, since the shares are not quoted on a stock exchange, value of its shares is determined on the basis of a valuation report from an independent valuer.

Illustration 1:

A Company has its share capital divided into shares of Rs. 10 each. On 1st April, 20X1 it granted 10,000 employees' stock options at Rs. 40, when the market price was Rs. 130. The options were to be exercised between 15th March, 20X2 and 31st March, 20X2. The employees exercised their options for 9,500 shares only; the remaining options lapsed. The company closes its books on 31st March every year. Show Journal Entries.

Solution:

Journal Entries

(Amount in ₹)

Date	Particulars	Dr. ₹	Cr. ₹
15th March 20X2 to	Bank A/c (9,500 x ₹40) Dr.	3,80,000	
	Employee compensation expense A/c		
	[9,500 x (₹130-₹40) Dr.	8,55,000	
31st March 20X2	To Equity share capital A/c (9,500 x ₹10)		95,000
	To Securities premium A/c [9,500 x (₹130-₹10)]		11,40,000
	(Being allotment to employees of 9,500 equity shares of ₹10 each at a premium of ₹120 per share in exercise of stock options by employees)		
31st March 20X2	Profit and Loss A/c Dr.	8,55,000	
	To Employee compensation expense A/c		8,55,000
	(Being transfer of employee compensation expense to profit and loss account)		

Illustration 2

ABC Ltd. grants 1,000 employees stock options on 1.4.20X0 at Rs. 40, when the market price is Rs. 160. The vesting period is 2½ years and the maximum exercise period is one year. 300 unvested options lapse on 1.5.20X2. 600 options are exercised on 30.6.20X3. 100 vested options lapse at the end of the exercise period. Pass Journal Entries giving suitable narrations.

Solution:**In the books of ABC Ltd.****Journal Entries**

<i>Date</i>	<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
31.3.20X1	<p>Employees compensation expense account Dr. 48,000</p> <p style="padding-left: 40px;">To Employee stock option outstanding account 48,000</p> <p>(Being compensation expenses recognized in respect of the employee stock option i.e. 1,000 options granted to employees at a discount of ₹ 120 each, amortized on straight line basis over 2½ years)</p> <p>(1,000 stock options x ₹ 120 / 2.5 years)</p>	48,000	48,000
	<p>Profit and loss account Dr. 48,000</p> <p style="padding-left: 40px;">To Employees compensation expenses account 48,000</p> <p>(Being expenses transferred to profit and loss account at year end)</p>	48,000	48,000
31.3.20X2	<p>Employees compensation expenses account Dr. 48,000</p> <p style="padding-left: 40px;">To Employee stock option outstanding account 48,000</p> <p>(Being compensation expense recognized in respect of the employee stock option i.e. 1,000 options granted to employees at a discount of ₹ 120 each, amortized on straight line basis over 2½ years)</p> <p>(1,000 stock options x ₹ 120 / 2.5 years)</p>	48,000	48,000
	<p>Profit and loss account Dr. 48,000</p> <p style="padding-left: 40px;">To Employees compensation expenses account 48,000</p> <p>(Being expenses transferred to profit and loss account at year end)</p>	48,000	48,000
31.3.20X3	<p>Employee stock option outstanding account (W.N.1) Dr. 12,000</p> <p style="padding-left: 40px;">To General Reserve account (W.N.1) 12,000</p> <p>(Being excess of employees compensation expenses transferred to general reserve account)</p>	12,000	12,000
30.6.20X3	<p>Bank A/c (600 × ₹ 40) Dr. 24,000</p> <p>Employee stock option outstanding account (600 × ₹ 120) Dr. 72,000</p> <p style="padding-left: 40px;">To Equity share capital account (600 × ₹ 10) 6,000</p> <p style="padding-left: 40px;">To Securities premium account (600 × ₹ 150) 90,000</p> <p>(Being 600 employee stock option exercised at an exercise price of ₹ 40 each)</p>	24,000 72,000	6,000 90,000

01.10.20X3	Employee stock option outstanding account (W.N.2) Dr.	12,000	
	To General reserve account (W.N.2)		12,000
	(Being ESOS outstanding A/c on lapse of 100 options at the end of exercise of option period transferred to General Reserve A/c)		

Working Notes:

- On 31.3.20X3, ABC Ltd. will examine its actual forfeitures and make necessary adjustments, if any, to reflect expenses for the number of options that actually vested. Considering that 700 stock options have completed 2.5 years vesting period, the expense to be recognized during the year is in negative i.e.

No. of options actually vested (700 x 120)	₹ 84,000
Less: Expenses recognized ₹ (48,000 + 48,000)	(₹ 96,000)
Excess expense transferred to general reserve	₹ 12,000

- Similarly, on 1.10.20X3, Employee Stock Option Outstanding Account will be

No. of options actually vested (600 x 120)	₹ 72,000
Less: Expenses recognized	(₹ 84,000)
Excess expense transferred to general reserve	₹ 12,000

Employee Stock Options Outstanding will appear in the Balance Sheet under a separate heading, between 'Share Capital' and 'Reserves and Surplus'.

Illustration 3:

P Ltd. granted option for 8,000 equity shares of nominal value of Rs. 10 on 1st October, 20X0 at Rs. 80 when the market price was Rs. 170. The vesting period is 4½ years, 4,000 unvested options lapsed on 1st December, 20X2, 3,000 options were exercised on 30th September, 20X5 and 1,000 vested options lapsed at the end of the exercise period. Pass Journal Entries for above transactions.

Solution:

In the books of P Ltd.

Journal Entries

Date	Particulars	Dr. (₹)	Cr. (₹)
31.3.20X1	Employees compensation expense account Dr. To Employee stock option outstanding account (Being compensation expenses for 6 months recognized in respect of the employee stock options i.e. 8,000 options granted to employees at a discount of ₹ 90 (170-80) each, amortized on straight line basis over 4½ years [(8,000 stock options x ₹ 90) / 4.5 years] x 0.5) (W.N.1)	80,000	80,000

<i>Date</i>	<i>Particulars</i>	<i>Dr. (₹)</i>	<i>Cr. (₹)</i>
	Profit and loss account Dr. 80,000 To Employees compensation expenses account (Being expenses transferred to profit and loss account at the year end)		80,000
31.3.20X2	Employees compensation expense account Dr. 1,60,000 To Employee stock option outstanding account (Being compensation expense recognized in respect of the employee stock option i.e. 8,000 options granted to employees at a discount of ₹ 90 each, amortized on straight line basis over 4½ years 2 (8,000 stock options x ₹ 90) / 4.5 years) x 1 year)		1,60,000
	Profit and loss account Dr. 1,60,000 To Employees compensation expense account (Being expenses transferred to profit and loss account at year end)		1,60,000
31.3.20X3	Employee stock option outstanding account (W.N.2) Dr. 40,000 To General Reserve account (W.N.2) (Being excess of employees compensation expenses transferred to general reserve account)		40,000
31.3.20X4	Employees compensation expense account Dr. 80,000 To Employee stock option outstanding account		80,000
	(Being compensation expenses recognized in respect of the employee stock option i.e. 4,000 options at a discount of ₹ 90 each, amortized on straight line basis over 4½ years) (4,000 stock options x ₹ 90) / 4.5 years)		
	Profit and loss account Dr. 80,000 To Employees compensation expenses account (Being expenses transferred to profit and loss account at year end)		80,000

Date	Particulars	Dr. (₹)	Cr. (₹)
31.3.20X5	Employees compensation expense account Dr. To Employee stock option outstanding account (Being compensation expenses recognized in respect of the employee stock option i.e. 4,000 options at a discount of ₹ 90 each, amortised on straight line basis over 4½ years) [(4,000 stock options x ₹ 90) / 4.5 years]	80,000	80,000
	Profit and loss account Dr. To Employees compensation expense account (Being expenses transferred to profit and loss account at year end)	80,000	80,000
30.9.20X5	Bank A/c (3,000 × ₹ 80) Dr. Employee stock option outstanding Dr. To Equity share capital account (3,000 × ₹ 10) To Securities premium (₹ 170 – ₹ 10) × 3,000 (Being 3,000 employee stock option exercised at an exercise price of ₹ 80 each)	2,40,000 2,70,000	30,000 4,80,000
	Employee stock option outstanding account (W.N.3) Dr. To General reserve account (W.N.3) (Being ESOS outstanding A/c transferred to General Reserve A/c on lapse of 1000 vested options at the end of the exercise period)	90,000	90,000

Working Notes:

- Fair value = ₹ 170 – ₹ 80 = ₹ 90
- At 1.12.X3, 4,000 unvested option lapsed on which till date expenses recognized to be transferred to general reserve =

$$2,40,000 - (4000 \times 90 \times \frac{2.5}{4.5}) = 40,000$$

- Expenses charged on lapsed vested options transferred to general reserve
= 1,000 × ₹ 90 = ₹ 90,000

Disclosure in the Director's Report – The Board of Directors shall inter alia disclosure either in the Director's Report or in the annexure to the Director's Report the following details of the ESOS:

- Options granted;
- The pricing formula;
- Options vested;

- (d) Options exercised;
- (e) The total number of shares arising as a result of exercise of option;
- (f) Options lapsed;
- (g) Variation of terms of options;
- (h) Money realized by exercise of options;
- (i) Total number of options in force;
- (j) Employee wise details of options granted to:
 - (i) Senior managerial personnel;
 - (ii) Any other employee who receives a grant in any one year of option amounting to 5% or more of option granted during that year;
 - (iii) Identified employees who were granted option, during any one year, equal to or exceeding 1% of the issued capital (excluding outstanding warrants and conversions) of the company at the time of grant;
- (k) 'diluted earnings per share' pursuant to the issue of shares on exercise of option calculated in accordance.

BUY-BACK OF SHARES

When a company has substantial cash resources, it may like to buy its own shares from the market particularly when the prevailing rate of its shares in the market is much lower than the book value; or what the company perceives to be its true value. Buy-back of shares enables the company to go back to its shareholders and offers to purchase from them the shares they hold. Buy-back of Securities is a very important tool for companies that wants to reduce their Share Capital.

Conditions for Buy-Back of Shares

must be authorized by its articles

a special resolution has been passed at a general meeting of the company authorizing the buy-back, but the same is not required when the buy-back is 10% or less of the total paid up equity capital and free reserves of the company; and such buy-back has been authorized by the Board by means of a resolution passed at its meeting

the buy-back is 25% or less of the aggregate of paid up capital and free reserves of the company But in case of number of Equity Shares, the same shall be taken as 25% of paid up equity capital only

Debt Equity ratio should be 2:1, where Debt is aggregate of secured and unsecured debts owed by the company after buy-back, and Equity is the aggregate of the paid up capital and its free reserves

all the shares or other specified securities for buy-back are fully paid up

If shares or securities are listed, buy-back will be in accordance with the regulations made by the Securities and Exchange Board in this behalf

the buy-back in respect of unlisted shares or other specified securities will be in accordance with the Companies (Share and Debentures) Rules, 2014

no offer of buy-back shall be made within a period of one year from the date of the closure of the preceding offer of buy-back, if any.

Explanatory Statement – Section 68(3) of Companies Act, 2013:

The notice of the meeting at which the special resolution is proposed to be passed shall be accompanied by an explanatory statement stating –

- (a) a full and complete disclosure of all material facts;
- (b) the necessity for the buy-back;
- (c) the class of shares or securities intended to be purchased under the buy-back;
- (d) the amount to be invested under the buy-back; and
- (e) the time-limit for the completion of buy-back.

As per the rules, following more details is to be included in the Explanatory Statement:

- (f) the date of the board meeting at which the proposal for buy-back was approved by the Board of Directors of the company;
- (g) the number of securities that the company proposes to buy-back;
- (h) the method to be adopted for the buy-back;
- (i) the price at which the buy-back of shares or other securities shall be made;
- (j) the basis of arriving at the buy-back price;
- (k) the maximum amount to be paid for the buy-back and the sources of funds from which the buy-back would be financed;
- (l) Shareholding:
 - (a) it is the aggregate shareholding of the promoters and of the directors of the promoter, where the promoter is a company, of the directors and key managerial personnel, as on the date of the notice convening the general meeting;
 - (b) the aggregate number of equity shares purchased or sold by persons mentioned in sub-clause (a) during a period of twelve months preceding the date of the board meeting at which the buy-back was approved and from that date till the date of notice convening the general meeting;

- (c) the maximum and minimum price at which purchases and sales referred to in sub-clause (b) were made along with the relevant date.
- (m) if the persons mentioned in l (a) intend to tender their shares for buy-back –
 - (a) the quantum of shares proposed to be tendered;
 - (b) the details of their transactions and their holdings in the last twelve months, prior to the date of the board meeting at which the buy-back was approved including information of number of shares acquired, the price and the date of acquisition.
- (n) a confirmation that there are no defaults subsisting in repayment of deposits, interest payment thereon, redemption of debentures or payment of interest thereon, or redemption of preference shares, or payment of dividend due to any shareholder, or repayment of any term loans, or interest payable thereon to any financial institution or banking company;
- (o) a confirmation:
 - (a) that the Board of Directors have made a full enquiry into the affairs and prospects of the company and that they have formed the opinion- general meeting is convened there shall be no grounds on which the company could be found unable to pay its debts;
 - (b) about the company's prospect for the year immediately following that date, its management character and initiations, its financial resources that will be available during that year so that the company shall be able to meet its liabilities as and when they fall due and shall not be rendered insolvent within a period of 1 year from that date; and
 - (c) the directors have taken into account the liabilities(including prospective and contingent liabilities), as if the company were being wound up under the provisions of the Companies Act, 2013.
- (p) a report addressed to the Board of Directors by the company's auditors stating that-
 - (i) they have inquired into the company's state of affairs;
 - (ii) the amount of the permissible capital payment for the securities in question is in their view properly determined;
 - (iii) that the audited accounts on the basis of which calculation with reference to buy-back is done is not more than six months old from the date of offer document; and
 - (iv) the Board of Directors have formed the opinion as specified in point 'o' on reasonable grounds and that the company, with regard to its state of affairs, shall not be rendered insolvent within a period of one year from that date.

Other Conditions for Buy back

- Every buy-back shall be completed within a period of one year from the date of the resolution or special resolution, as the case may be, passed by the Board. [Section 68(4)]
- The buy-back can be :
 - (a) from the existing shareholders or security holders on a proportionate basis;
 - (b) from the open market;
 - (c) by purchasing the securities issued to employees of the company pursuant to a scheme of stock option or sweat equity. [Section 68(5)]

- Before making such buy-back, file with the Registrar, a declaration of solvency signed by at least two directors of the company, one of whom shall be the managing director, if any, Form No. SH.9 may be prescribed and verified by an affidavit to the effect that the Board of Directors has made a full inquiry into the affairs of the company as a result of which they have formed an opinion that it is capable of meeting its liabilities and will not be rendered insolvent within a period of one year from the date of declaration adopted by the Board. [Section 68(6)]
- Company shall extinguish and physically destroy the shares or securities so bought back within seven days of the last date of completion of buy-back. [Section 68(7)]
- Where a company completes a buy-back of its shares or other specified securities, it shall not make a further issue of the same kind of shares or other securities including allotment of new shares or other specified securities within a period of six months except by way of:
 - (a) bonus issue, or
 - (b) in the discharge of subsisting obligations such as conversion of warrants, stock option schemes, sweat equity or conversion of preference shares or debentures into equity shares.
- Company shall maintain a register in Form No. SH.10 of the shares or securities so bought, the consideration paid for the shares or securities bought back, the date of cancellation of shares or securities, the date of extinguishing and physically destroying the shares or securities. The register of shares or securities bought back shall be maintained at the registered office of the company and shall be kept in the custody of the secretary of the company or any other person authorized by the board in this behalf. The entries in the register shall be authenticated by the secretary of the company or by any other person authorized by the Board for the purpose.
- A company shall, after the completion of the buy-back under this section, shall file with the Registrar a return in Form No. SH.11 containing such particulars relating to the buy-back within thirty days of such completion. There shall be annexed to the return, a certificate in Form No. SH.15 signed by two directors of the company including the managing director, if any, certifying that the buy-back of securities has been made in compliance with the provisions of the Act and the rules made thereunder.
- If a company makes any default in complying with the provisions of this section or any regulation made by the Securities and Exchange Board, for the purposes of clause (f) of sub-section (2), the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than one lakh rupees but which may extend to three lakh rupees.

Transfer of certain sums to Capital Redemption Reserves Account (Section 69)

Where a company purchases its own shares out of free reserves or securities premium account, a sum equal to the nominal value of the shares so purchased shall be transferred to the Capital Redemption Reserve Account and details of such transfer shall be disclosed in the balance sheet. The Capital Redemption Reserve Account may be applied by the company, in paying up unissued shares of the company to be issued to members of the company as fully paid bonus shares.

Prohibition on buy-back in following circumstances (Section 70)

No company shall directly or indirectly purchase its own shares or other specified securities –

- (a) through any subsidiary company including its own subsidiary companies;
- (b) through any investment company or group of investment companies; or
- (c) if a default, is made by the company, in the repayment of deposits accepted either before or after the commencement of this Act, interest payment thereon, redemption of debentures or preference shares

or payment of dividend to any shareholder, or repayment of any term loan or interest payable thereon to any financial institution or banking company. Provided that the buy-back is not prohibited, if the default is remedied and a period of three years has lapsed after such default ceased to subsist.

No company shall, directly or indirectly, purchase its own shares or other specified securities in case such company has not complied with the provisions of:

- (a) Sections 92: Annual Return
- (b) Section 123: Declaration and Payment of Dividend
- (c) Section 127: Failure to pay Dividend
- (d) Section 129: Failure to give True and Fair Statement.

Modes of Buy-Back

A company may buy-back its shares or other specified securities by any one of the following methods:

- a) from the existing share holders or other specified securities holders on a proportionate basis through the tender offer;
- b) from the open market through—
 - i) book-building process,
 - ii) stock exchange;
- c) from odd-lot holders, provided that no offer of buy-back for fifteen per cent or more of the paid up capital and free reserves of the company shall be made from the open market.

Disclosures, filing requirements and timelines for public announcement and draft letter of offer

When a company proposes to buy-back its own shares, and it has been authorised by a special resolution or a resolution passed by the board of directors, as the case may be, shall make a public announcement within two working days from the date of declaration of results of the postal ballot for special resolution/board of directors resolution in at least one English National Daily, one Hindi National Daily and one Regional language daily, all with wide circulation at the place where the Registered Office of the company is situated and the said public announcement shall contain all the material information as specific in these Regulations. A copy of the public announcement along with the soft copy, shall also be submitted to SEBI, simultaneously, through a merchant banker.

The company shall within five working days of the public announcement file the following :

- a) A draft letter of offer, along with a soft copy, containing disclosures as specified in these regulations through a merchant banker who is not associated with the company.
- b) A declaration of solvency in specified form and in a manner provided in Section 68(8) of the Companies Act, 2013.
- c) Prescribed fees as specified in these regulations.

SEBI may provide its comments on the draft letter of offer within seven working days of the receipt of the draft letter of offer. Letter of Offer shall be dispatch to the Shareholders.

The company shall dispatch the letter of offer along with the tender form to all securities holders which are eligible to participate in the buy-back offer not later than five working days from the receipt of communication of comments from SEBI.

Note:

- Letter of Offer may also be dispatched through electronic mode in accordance with the provisions of the Companies Act, 2013.

- On receipt of a request from any shareholder to receive a copy of the letter of offer in physical form, the same shall be provided.

If in case an eligible public shareholder does not receive the tender offer/offer form, even though he can participate in the buy-back offer and tender shares in the manner as provided by SEBI.

The date of the opening of the offer shall be not later than five working days from the date of dispatch of the letter of offer. It shall be remain opened for a period of ten working days.

The company shall provide the facilities for tendering of shares by the shareholders and settlement of the same, through the stock exchange mechanism in the manner as provided by SEBI.

Escrow account

Regulation 9(xi) of SEBI (Buy back of Securities) Regulations, 2018 provides that a company shall, with in two working days of the public announcement as and by way of security for performance of its obligations under the regulations, deposit in an escrow account such sum as specified below:

The escrow amount shall be payable in the following manner:

- a) if the consideration payable does not exceed Rupees 100 crores; 25 per cent of the consideration payable;
- b) if the consideration payable exceeds Rupees 100 crores; 25 per cent upto Rupees 100 crores and 10 per cent thereafter.

The escrow account referred to in this regulation shall, subject to appropriate margin as specified by the SEBI, consist of-

- a) cash including bank deposits deposited with any scheduled commercial bank, or
- b) bank guarantee issued in favour of the merchant banker by any scheduled commercial bank, or
- c) deposit of frequently traded and freely transferable equity shares or other freely transferable securities, or
- d) government securities, or
- e) units of mutual funds invested in gilt funds and overnight schemes, or
- f) a combination of above

Accounting for Buy-Back

Buy-back of shares is just the opposite of issue of shares. Just as shares may be issued at par, at a premium, even buy-back may be at par, at a premium or at a discount. The basis of accounting for buy-back is Section 68 of the Companies Act, 2013. This Section not only permits a company to buy-back or redeem its equity shares, but also specifies the sources from out of which repurchase is to be effected.

According to Section 68(1), a company may buy-back its shares or other specified securities from out of:

1. Its free reserves, or
2. The securities premium account, or
3. The proceeds of any shares or other specified securities.

However, no buy-back of shares shall be made out of the proceeds of an earlier issue of the same kind of shares or same kind of other specified securities. This Section also lays down that all the shares or other specified securities for buy-back are fully paid up.

As per Section 69, when a company purchases its own shares out of free reserves. Then a sum equal to the nominal value of the shares so purchased shall be transferred to the Capital Redemption Reserve Account and details of such transfer should be disclosed in the balance sheet.

The Capital Redemption reserve account may be applied by the company, in paying up unissued share of the company to be issued to members of the company as fully paid bonus shares.

EQUITY SHARES WITH DIFFERENTIAL RIGHTS

According to Section 43 of the Companies Act, 2013, Equity share capital may be Equity Share Capital with voting right or Equity Share Capital with differential right as to dividend, voting or otherwise.

Rule 4 of the Companies (Share Capital and Debentures) Rules 2014 deals with equity shares with differential rights.

Which Company may issue equity shares with differential rights:

A company limited by shares shall issue equity shares with differential rights as to dividend, voting or otherwise, when it complies with the following conditions:

- (a) The articles of association of the company authorize the issue of shares with differential rights.
- (b) The issue of shares is authorized by an ordinary resolution passed at a general meeting of the shareholders. Where the equity shares of a company are listed on a recognized stock exchange, the issue of such shares shall be approved by the shareholders through postal ballot.
- (c) The voting power in respect of shares with differential rights of the company shall not exceed seventy four per.
- (d) cent of total voting power including voting power in respect of equity shares with differential rights issued at any point of time.
- (e) The company has not defaulted in filing financial statements and annual returns for three financial years immediately preceding the financial year in which it is decided to issue such shares.
- (f) The company has no subsisting default in the payment of a declared dividend to its shareholders or repayment of its matured deposits, or redemption of its preference shares, or debentures that have become due for redemption, or payment of interest on such deposits, or debentures or payment of dividend.
- (g) The company has not defaulted in payment of the dividend on preference shares or repayment of any term loan from a public financial institution, or State level financial institution, or scheduled Bank that has become repayable or interest payable thereon, or dues with respect to statutory payments relating to its employees to any authority or default in crediting the amount in Investor Education and Protection Fund to the Central Government. Provided that a company may issue equity shares with differential rights upon expiry of five years from the end of the financial Year in which such default was made good.
- (h) the company has not been penalized by Court or Tribunal during the last three years of any offence under the Reserve Bank of India Act, 1934, the Securities and Exchange Board of India Act, 1992, the Securities Contracts Regulation Act, 1956, the Foreign Exchange Management Act, 1999 or any other special Act, under which such companies being regulated by sectoral regulators.

This may be noted here that the, penalty by regulators itself causes no disqualification.

EXPLANATORY STATEMENT ANNEXED TO NOTICE

The explanatory statement to be annexed to the notice of the general meeting or of a postal ballot shall contain the following particulars, namely:-

- (a) The total number of shares to be issued with differential rights;
- (b) The details of the differential rights;
- (c) The percentage of the shares with differential rights to the total post-issue paid up equity share capital, including equity shares with differential rights issued at any point of time;
- (d) The reasons or justification for the issue;
- (e) The price at which such shares are proposed to be issued either at par or at a premium;
- (f) The basis on which the price has been arrived at;
- (g) In case of:
 - (i) Private placement or preferential issue-
 - (a) details of total number of shares proposed to be allotted to promoters, directors and key managerial personnel;
 - (b) details of total number of shares proposed to be allotted to persons other than the promoters, directors and key managerial personnel, and their relationship, if any, with any of the promoters, director or key managerial personnel;
 - (ii) Public issue-
 - Reservation, if any, for different classes of applicants including promoters, directors or key managerial personnel;
- (h) The percentage of voting right which the equity share capital with differential voting right shall carry to the total voting right of the aggregate equity share capital;
- (i) The scale or proportion in which the voting rights of such class or type of shares shall vary;
- (j) The change in control, if any, in the company that may occur consequent to the issue of equity shares with differential voting rights;
- (k) The diluted earnings per Share (EPS) pursuant to the issue of such shares, calculated in accordance with the applicable accounting standards;
- (l) The pre- and post-issue shareholding pattern along with voting rights as per clause 35 of the listing agreement issued by Security Exchange Board of India from time to time.

Please note here, Clause 35 is specially made applicable to the company issuing equity shares with differential rights for the purpose of these sub-rules.

No Conversion:

The company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and vice versa.

Disclosure requirement in Board's Reports

The Board of Directors shall, *inter alia*, disclose the following details in the Board's Report for the financial year in which the issue of equity shares with differential rights was completed,

The total number of shares allotted with differential rights;

The details of the differential rights relating to voting rights and dividends;

The percentage of the shares with differential rights to the total post-issue equity share capital with differential rights issued at any point of time and percentage of voting rights which the equity share capital with differential voting right shall carry to the total voting right of the aggregate equity share capital;

The price at which such shares have been issued;

The particulars of promoters, directors or key managerial personnel to whom such shares are issued;

The change in control, if any, in the company resolution from the issue of equity shares with differential voting rights;

The diluted Earning per Share (EPS) pursuant to the issue of each class of shares, calculated in accordance with the applicable accounting standards;

The pre and post issue shareholdings pattern along with voting rights in the format specified under sub- rule (2) of rule 4.

General Rights available:

The holders of the equity shares with differential rights shall enjoy all other rights such as bonus shares, and rights shares etc., which the holders of equity shares are entitled to, subject to the differential rights with which such shares have been issued.

Entry in Register of Members:

Where a company issues equity shares with differential rights, the Register of Members maintained under Section 88 shall contain all the relevant particulars of the shares so issued along with details of the shareholders.

However, according to the Companies (Share Capital and Debentures) Amendment Rules, 2014 of 18th June 2014, it is hereby clarified that equity shares with differential rights issued by any company under the provisions of the Companies Act, 1956 (1 of 1956) and the rules made thereunder, shall continue to be regulated under such provisions and rules. This means provisions of earlier Act shall continue to apply.

UNDERWRITING OF SHARES / DEBENTURES

Underwriting is an agreement, with or without conditions, to subscribe to the securities of a body corporate when existing shareholders of the corporate or the public do not subscribe to the securities offered to them. 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. If the public issue does not get fully subscribed, the project for which the funds are being raised cannot be implemented. As per law, 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.

To avoid the risk of under subscription companies may seek the help of a specialized group of risk redeemers called underwriters. The function of the underwriters is to arrange subscription of floated shares. If the whole or a certain portion of the shares or debentures of the company are not applied for by the public, the underwriters themselves apply or persuade others to apply for those shares or debentures. The underwriters, as risk takers, and are entitled to get commission at prescribed rates.

It can be easily comprehended that when the floated shares are likely to be undersubscribed, the underwriters come to the forefront. In other cases they remain in the background, acting as catalysts arranger of sale to the investing public.

Before entering into an agreement with the company, the underwriters assess the following:

- (a) worth of the public issue;
- (b) market response to the issue; and
- (c) their own ability to get the issue fully subscribed.

Depending upon the risk assessment of the issue, the underwriters decide on their amount of commission. Owing to under subscription, if the issue is devalues, the underwriters pay up the required amount and deduct their commission from that.

From the viewpoint of the issuer company, the following are generally observed:

- (a) While selecting underwriters and finalizing underwriting arrangements, lead merchant bankers shall ensure that the underwriters do not overexpose themselves so that it may become difficult to fulfill underwriting commitments.
- (b) The overall exposure of underwriter(s) belonging to the same group or management in an issue shall be assessed carefully by the lead merchant banker.
- (c) The lead merchant banker shall satisfy themselves about the ability of the underwriters to discharge their underwriting obligations satisfactorily.
- (d) The lead merchant banker shall:
 - (i) incorporate a statement in the offer document to the effect that in the opinion of the lead merchant banker, the underwriters' assets are adequate to meet their underwriting obligations;
 - (ii) Obtain underwriters' written consent before including their names as underwriters in the final offer document.
- (e) In order to ascertain the underwriters' worth, the lead merchant banker(s) shall undertake a minimum underwriting obligation of 5% of the total underwriting commitment, or Rs. 25 lacs whichever is less.

- (g) The outstanding underwriting commitments of a merchant banker shall not exceed 20 times its net worth, any point of time.
- (h) The lead merchant banker shall ensure that the relevant details are included in the offer document underwriters.

It should be noted that as per the latest SEBI Guidelines underwriting is not mandatory. Under the SEBI rules, no person other than a share broker or merchant banker can act as an underwriter unless he holds a certificate granted by SEBI. Regarding underwriting, the following disclosures should be made in the Offer Document:

- (a) Names and addresses of the underwriters and the amount underwritten by them.
- (b) Declaration by the Board of Directors of the issuing company that the underwriters have sufficient resources to discharge their respective obligations.

Underwriting Agreement

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. The purpose of the underwriting agreement is to ensure that all of the players understand their responsibility in the process, thus minimizing potential conflict. The underwriting agreement is also called an underwriting contract.

Sub-Underwriters

In order to spread the risk of under subscription, the principal underwriters may enter into subsidiary agreements with sub-underwriters. Such agreements are made between the underwriters alone, with the company not being a party thereto. As per agreement, the company pays commission at a prescribed rate to the principal underwriters, who in turn, disburse commission to the sub-underwriters. Sometimes an additional commission is paid to the principal underwriters to encourage sub-underwriting. This is known as over-riding commission. The payment of an over-riding commission enables the company to deal with first one or two underwriters instead of a number of them.

Underwriting Commission

It may be paid in cash or in fully paid up shares or debentures or a combination of all these. It is paid on the issue price of the shares or debentures so underwritten. As per the provision of Section 40 of the Companies Act, 2013, commission is payable, if the following conditions are satisfied:

- (a) The payment of the commission is authorized by the articles;
- (b) the commission may be paid out of proceedings of the issue or the profit of the company or both.
- (c) The commission paid or agreed to be paid does not exceed in the case of shares, five per cent of the price at which the shares are issued or the amount or rate authorized by the articles, whichever is less, and in the case of debentures, two and a half per cent of the price at which the debentures are issued or the amount or rate authorized by the articles, whichever is less;
- (d) the prospectus of the company shall disclose -
 - (i) the name of the underwriters;
 - (ii) the rate and amount of the commission payable to the underwriter; and

Case 1: When the Issue is fully underwritten [without Firm Underwriting]

If the entire issue has been underwritten by one underwriter, the determination of his liability is very simple. The total number of applications (both marked and unmarked) are deducted from the number of shares underwritten and the resultant figure is treated as a liability of the underwriter. For example, X Ltd. issued 1,00,000 equity shares of Rs. 10 each. The issue was fully underwritten by A. However, the company received applications for 80,000 shares which includes marked applications for 60,000 shares.

Here, A's liability will be $1,00,000 - 60,000 - 20,000 = 20,000$ shares. A would get full credit for the unmarked 20,000 applications.

Case 2: If the entire issue has been underwritten by a number of underwriters, certain difficulties may arise in respect of division of unmarked applications.

The unmarked applications can be divided between the underwriters in the following two ways.

Method 1

Under this method, all unmarked applications are divided between the underwriters in the ratio of gross liability of individual underwriter. For determining the liability of individual underwriter, the following steps are followed:

Step 1 Compute gross liability (if it has not been given) of individual underwriter on the basis of agreed ratio. For example, X Ltd. issued 1,00,000 Equity shares of Rs. 10 each. The issue was underwritten as : A-30%; B-40% and C-30%. Here the gross liability will be: A-30% of 1,00,000 = 30,000 Shares; B-40% of 1,00,000 = 40,000 shares C-30% of 1,00,000 = 30,000 shares.



Step 2 Subtract marked applications from gross liability of respective underwriters.



Step 3 Determine the number of unmarked applications. (Unmarked application = Total applications received less marked applications). Divide unmarked applications between different underwriters in the ratio of gross liability, as per our example, in the ratio of 3:4:3. If the resultant figures are all positive or zero, then stop here. Now these figures represent the net liability of each underwriter. If some of the resultant figures are negative, then continue to Step 4.



Step 4 Add all negative figures and divide the resultant ones between the underwriters having positive figures in the ratio of gross liability inter se (for details see Illustration 3). Repeat Step 4 unless all figures are non-negative. Now these figures represent the net liability of each underwriter.

Method 2

Under this method, all unmarked applications are divided between the underwriters in the ratio of gross liability less marked applications. For determining the liability of individual underwriter following steps are followed:

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



Step 2 Subtract marked applications from gross liability of respective underwriters. If some of the resultant figures are negative, add all negative figures and divide their sum in the ratio of gross liability *inter se*.



Step 3 Determine the number of unmarked applications. Divide unmarked applications between different underwriters in the ratio of gross liability less marked applications, i.e., the resultant figures of Step 2. If the resultant figures of Step 3 are all positive or zero, stop here. Now these figures represent the net liability of each underwriter.

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



Step 4 Add all negative figures and divide their sum between the underwriters having positive figures in the same ratio of Step 3. Repeat Step 4 unless all figures are non-negative. Now these figures represent the net liability.

Case 3: If a part of the issue of shares or debentures is underwritten only by one underwriter:

In such a case, only a part of the whole issue, say 60% or 70% is underwritten only by one underwriter and so far as the balance 40% or 30% of the issue is concerned, the company itself is said to have underwritten the same. As such, the unmarked applications are treated as marked as far as the company is concerned.

In such a case, the gross liability of the underwriter will be that part of the issue of shares or debentures which is underwritten, say 60% or 70% and the net liability will be determined by deducting the marked applications (the applications sent through him) from the gross liability. Thus, the net liability will be determined as follows:

Net liability = Gross liability (say 60% or 70% of the issue) – Marked applications.

It is to be noted here that if the marked applications exceed or equal the number of shares or debentures underwritten, the underwriter is free from his liability and cannot be called upon to take up any shares or debentures of the company. Similarly, if all the shares or debentures are subscribed, the underwriter is free from his liability in spite of the fact the marked applications are less than the number of shares or debentures underwritten.

Case 4: If the part of the issue of shares or debentures is underwritten by a number of underwriters:

In such a case only a part of the whole issue, say 60% or 70% or 80% is underwritten by a number of underwriters and so far as the balance 40% or 30% or 20% is concerned, the company itself is said to have underwritten the same. As such, the unmarked applications are treated as marked so far as the company is concerned. In such a case, the method of determining the net liability of the respective underwriters is similar to the method discussed above.

FIRM UNDERWRITING

In the case of 'firm underwriting', the underwriters take up the agreed number of shares or debentures 'firm underwritten' in addition to unsubscribed shares or debentures, if any. In such an instance, an underwriter is not allowed to set off his firm underwriting against his liability otherwise determined, that he will have to subscribe both for shares/debentures 'underwritten firm' and for shares which he has to take under the underwriting contract, ignoring firm underwriting.

While computing the individual liability of the underwriters, the 'firm underwriting' can be dealt with in any of the following manner in the absence of any specific instructions:

- (a) The 'firm underwriting' may be adjusted against the individual liability of each underwriter separately or may be treated at par with marked applications.

When firm underwriting is treated at par with marked applications. In such a case, the statement of liability of underwriters will be as under:

Gross Liability (agreed ratio-total shares underwritten)
 Less: Marked applications including firm underwriting.....
 Balance left
 Less: Unmarked application (ratio of Gross liability)
 Net liability
 Add: Firm underwriting.....
 Total Liability.....

- (b) The benefit of 'firm underwriting' may be shared by all underwriters or firm underwriting may be treated at par with unmarked applications. In such case, the shares/debentures underwritten firm will be included in the unmarked forms. In such case, the state of liability of underwriters will appear as shown above except that shares/debentures underwritten firm by each underwriter will not be specifically adjusted against his individual liability but will be included in the total unmarked forms to be distributed amongst all underwriters in the ratio of their gross liability.

Illustration 4

Sunflow 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 of the underwriters.

Solution:

Net Liability of Underwriters

<i>Particulars</i>	<i>Red (40%) Shares</i>	<i>White (30%) Shares</i>	<i>Blue (30%) Shares</i>
Gross liability in the agreed ratio of 40 : 30 : 30	20,000	15,000	15,000

Less: Marked applications	10,000	5,000	10,000
Balance left	10,000	10,000	5,000
Less: Unmarked applications in the ratio of gross liability, i.e., 40 : 30 : 30	6,000	4,500	4,500
Net liability	4,000	5,500	500

Illustration 5

Monlit 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.

Solution:

Gross liability of Green being 60% of 50,000 shares,

i.e., $60/100 \times 50,000 = 30,000$ shares

Less: Marked applications = 26,000 shares

Net liability of Green = 4,000 shares

Notes:

- (1) If the marked applications were for 30,000 shares or more, Green would have had no liability at all.
- (2) If the applications received by the company were for all the 50,000 shares, Green would have no liability at all even though the marked applications were for 26,000 shares.
- (3) If the applications received by the company were for 48,000 shares, Green's liability would have been restricted to $(50,000 - 48,000) = 2,000$ shares, even though the marked applications were for 26,000 shares.

Sometimes, it may so happen that the information as to the marked applications and unmarked applications may not be given in the problem. In such a case, it has to be assumed that out of the total applications received by the company, the number of applications proportionate to that part of the issue underwritten have been received through the underwriters.

Illustration 6

Goods Earths Ltd., issued 30,000 6% Debentures of ₹ 100 each. 60% of the issue was underwritten by Black. Applications for 28,000 debentures were by the company.

Determine the liability of Black.

Solution:

Gross liability of Black being 60% of 30,000 debentures i.e., $60/100 \times 30,000 = 18,000$ debentures

Less: Marked applications assumed 60% of 28,000 i.e., $60/100 \times 28,000 = 16,800$ debentures

Net liability of Black = 1,200 debentures

Alternatively, Black's liability can be determined in the following way:

Number of debentures not subscribed for by the public = (30,000 – 28,000)
= 2,000 debentures

Black's liability = 60% of 2,000 debentures
= $60/100 \times 2,000 = 1,200$ debentures

Illustration 7

Satellite Ltd., issued 12% 10,000 Preference Shares of ₹ 10 each. The issue was underwritten as follows: Apple 30%, Mango 30%, Orange 20%.

Application for 8,000 shares were received by the company in all. Determine the liability of the respective underwriters.

Solution:

<i>Particulars</i>	<i>Apple (30%) Shares</i>	<i>Mango (30%) Shares</i>	<i>Orange (20%) Shares</i>
Gross liability in the agreed ratio 30: 30 : 20	3,000	3,000	2,000
Less: Marked application, i.e., 8,000 application in 30%, 30%, 20%	2,400	2,400	1,600
Net liability	600	600	400

Alternatively, the liability of the respective underwriters can also be determined in the following manner:

Shares issued 10,000
 Less: Applications received 8,000
 Unsubscribed shares 2,000
 Apple's liability = 30% of 2,000 = 600 shares
 Mango's liability = 30% of 2,000 = 600 shares
 Orange's liability = 20% of 2,000 = 400 shares
 Total liability of Apple, Mango and Orange = 600 + 600 + 400 = 1,600 shares.

which represent 80% of the total issue underwritten. The balance (2,000 - 1,600) = 400 shares representing 20% of the issue not underwritten will remain as unissued.

Illustration 8

Emess Ltd. issued 40,000 shares which were underwritten as:

P: 24,000 shares Q: 10,000 shares and R: 6,000 shares. The underwriters made applications for firm underwriting as under:

P: 3,200 shares; Q: 1,200 shares; and R: 4,000 shares. The total subscriptions excluding firm underwriting (including marked applications) were 20,000 shares.

The marked applications were - P: 4,000 shares; Q: 8,000 shares; and R: 2,000 shares.

Prepare a statement showing the net liability of underwriters.

Solution:

Statement of Underwriters' Liability
(Firm underwriting shares are treated as unmarked applications)

<i>Particulars</i>	<i>P</i>	<i>Q</i>	<i>R</i>	<i>Total</i>
Gross Liability	24,000	10,000	6,000	40,000
Less: Marked applications	4,000	8,000	2,000	14,000
Balance	20,000	2,000	4,000	26,000
Less: Unmarked applications in the ratio of gross liability (12:5:3)	8,640	3,600	2,160	14,400
Balance	11,360	(-1,600)	1,840	11,600
Credit of Q's over subscription to P & R in the ratio of 12:3	(1,280)	<u>+1,600</u>	(320)	-
Net Liability	10,080	-	1,520	11,600
Add: Firm underwriting	<u>3,200</u>	<u>1,200</u>	4,000	8,400
Total Liability	<u>13,280</u>	<u>1,200</u>	5,520	20,000

Alternate Answer

Statement of Underwriters' Liability
(Firm underwriting shares are treated as marked applications)

<i>Particulars</i>	<i>P</i>	<i>Q</i>	<i>R</i>	<i>Total</i>
Gross Liability	24,000	10,000	6,000	40,000
Less: Unmarked applications 6,000 in ratio of gross liability (12:5:3)	<u>3,600</u>	<u>1,500</u>	<u>900</u>	<u>6,000</u>
Balance	20,400	8,500	5,100	34,000
Less: Marked application plus shares underwritten firm	<u>7,200</u>	<u>9,200</u>	<u>6,000</u>	<u>22,400</u>

Balance	13,200	- 700	- 900	11,600
Credit for Q's and R's over subscription	<u>- 1,600</u>	<u>+700</u>	<u>+900</u>	=
Net Liability	11,600	-	-	11,600
Add: Firm Underwriting	<u>3,200</u>	<u>1,200</u>	<u>4,000</u>	<u>8,400</u>
Total Liability	<u>14,800</u>	<u>1,200</u>	<u>4,000</u>	<u>20,000</u>

Illustration 9

Sam Limited invited applications from public for 1,00,000 equity shares of 10 each at a premium of Rs. 5 per share. The entire issue was underwritten by the underwriters A, B, C and D 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 from public out of which applications for 19,000, 10,000, 21,000 and 8,000 shares were marked in favour of A, B, C and D respectively.

Calculate the liability of each one of the underwriters. Also ascertain the underwriting commission @ 2.5% payable to the different underwriters.

Solution:**Liability of Underwriters (No. of shares)**

	Total	A	B	C	D
Less: Unmarked Applications	12,000	3,600	3,600	2,400	2,400
Balance	88,000	26,400	26,400	17,600	17,600
Less: Marked Applications	58,000	19,000	10,000	21,000	8,000
Balance	30,000	7,400	16,400	- 3,400	9,600
Less: Firm Underwriting	7,000	3,000	2,000	1,000	1,000
Balance	23,000	4,400	14,400	- 4,400	8,600
Adjustment	-	- 1,650	- 1,650	+4,400	- 1,100
Net Liability	23,000	2,750	12,750	-	7,500
Total Liability including firm underwriting	30,000	5,750	14,750	1,000	8,500

Note: The above answer is arrived at by treating 'firm underwriting shares' on par with marked applications. Alternatively, the 'firm underwriting shares' may be treated on par with un-marked applications. Then, the answer will be as follows:

		Shares			
Applications received including firm underwriting		77,000 (70,000 + 7,000)			
Less: Marked Applications		58,000			
Un-marked Applications		19,000			
Liabilities of Underwriters (No. of shares)					
<i>Particulars</i>	<i>Total</i>	<i>A</i>	<i>B</i>	<i>C</i>	<i>D</i>
Gross Liability	1,00,000	30,000	30,000	20,000	20,000
Less: Unmarked Applications	19,000	5,700	5,700	3,800	3,800
Balance	81,000	24,300	24,300	16,200	16,200
Less: Marked					
Applications	58,000	19,000	10,000	21,000	8,000
Balance	23,000	5,300	14,300	- 4,800	8,200
Adjustment	—	- 1,800	- 1,800	+4,800	1,200
Net Liability	23,000	3,500	12,500	—	7,000
Add: Firm Underwriting	7,000	3,000	2,000	1,000	1,000
Total Liability	30,000	6,500	14,500	1,000	8,000
Underwriting Commission					
The underwriting commission is payable at the rate of 2.5% of the issue price of shares.					
Thus, the commission payable to A= 30000 x 15 x 2.5/100 = 11250					
B = 11250					
C = 20000x15x2.5/100 = 7500					
D = 7500					

Illustration 10:

Lillies Ltd. issued 1,00,000 equity shares, where the issue was underwritten by 3 underwriters as follows: A 40%; B 30%; C 30%.

Applications for 60,000 shares were received in all, out of which applications for 20,000 shares had the stamp of A; those for 10,000 shares that of B and those for 20,000 shares that of C. The remaining applications for 10,000 shares did not bear any stamp.

Determine the liability of the underwriters.

Solution:

Net Liability of Underwriters

<i>Particulars</i>	<i>A (40%) Shares</i>	<i>B (30%) Shares</i>	<i>C (30%) Shares</i>
Gross liability in the agreed ratio of 40 : 30 : 30	40,000	30,000	30,000
Less: Marked applications	20,000	10,000	20,000
Balance left	20,000	20,000	10,000
Less: Unmarked applications in the ratio of gross liability, i.e., 40 : 30 : 30 (10,000 Unmarked)	4,000	3,000	3,000
Net liability	16,000	17,000	7,000

Illustration 11:

Ramona 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.

Solution:

Gross liability of Green being 60% of 50,000 shares = 30,000 shares

Less: Marked applications Net liability of Green = 26,000 shares

Net liability of Green = 4,000 shares

Notes:

- (1) Had the marked applications been were for 30,000 shares or more, Green would have had no liability at all.
- (2) Had the applications received by the company been for all the 50,000 shares Green would have had no liability at all, even though the marked applications were for 26,000 shares.
- (3) Had the applications received by the company been for 48,000 shares, Green's liability would have had restricted to $(50,000 - 48,000) = 2,000$ shares, even though the marked applications were for 26,000 shares.

Working Assumption: In case the marked and unmarked applications is not be given in the question, then one can assume the number of applications received as marked applications (as proportionate to that part of the issue underwritten as received through the underwriters.)

Illustration 12:

ABC Ltd. issued 30,000, 6% debentures of Rs. 100 each. 60% of the issue was underwritten by Delton. Applications for 28,000 debentures were received by the company. Determine the liability of Delton.

Solution:

Gross liability of Delton being 60% of 30,000 debentures = 18,000 debentures

Less: Marked applications (assumed 60%) i.e., $60/100 \times 28,000$ = 16,800 debentures

Net liability of Delton = 1,200 debentures

Alternatively Delton's liability can be determined in the following way:

Number of debentures not subscribed for by the public = $(30,000 - 28,000)$ = 2,000 debentures

Delton's liability = 60% of 2,000 debentures = 1,200 debentures

Illustration 13:

Binsar Ltd. issued 12% 10,000 Preference Shares of Rs 10 each. The issue was underwritten as follows: Apple 30%, Mango 30%, Orange 20%. Application for 8,000 shares were received by the company in all. Determine the liability of the respective underwriters.

Solution:

<i>Particulars</i>	<i>Apple (30%) Shares</i>	<i>Mango (30%) Shares</i>	<i>Orange (20%) Shares</i>
Gross liability in the agreed ratio or 30 : 30 : 20	3,000	3,000	2,000
Less: Marked application, i.e., 8,000 application in the ratio of 3/10 : 3/20 : 2/10	2,400	2,400	1,600
Net liability	600	600	400

Alternatively the liability of the respective underwriters can also be determined in the following manner:
Shares issued 10,000

Less: Applications received 8,000 Unsubscribed shares 2,000

Apple's liability = 30% of 2,000 = 600 shares

Mango's liability = 30% of 2,000 = 600 shares

Orange's liability = 20% of 2,000 = 400 shares

Total liability of Apple, Mango and Orange = 600 + 600 + 400 = 1,600 shares.

which represent 80% of the total issue underwritten. The balance $(2,000 - 20\%$ of the issue not underwritten will remain as unissued. $1,600) = 400$ shares representing

Illustration 14:

Emess Ltd. issued 40,000 shares which were underwritten. P: 24,000 shares Q: 10,000 shares and R: 6,000 shares. The underwriters made applications for firm underwriting as under:

P: 3,200 shares; Q: 1,200 shares; and R: 4,000 shares. The total subscriptions excluding firm underwriting (including marked applications) were 20,000 shares.

The marked applications were - P: 4,000 shares; Q: 8,000 shares; and R: 2,000 shares

Prepare a statement showing the net liability of underwriters

Solution:

Working Note: Firm underwriting shares are treated as unmarked applications.

Statement of Computation of Liability

<i>Particulars</i>	<i>P</i>	<i>Q</i>	<i>R</i>	<i>Total</i>
Gross Liability	24000	10000	6000	40000
Less: Marked Applications	4000	8000	2000	14000
Balance	20000	2000	4000	26000
Less: Unmarked Applications in ratio of gross Liability (12:5:3)	8640	3600	2160	14400
Balance Net	11360	(1600)	1840	11600
Credit of Q's capital over P & R in ratio of 12:3	(1280)	+1600	(320)	
Net Liability	10,080	0	1,520	11,600
Add: Firm Underwriting	3,200	1,200	4,000	8,400
Total Liability	13,280	1,200	5,520	20,000

Illustration 15:

Sam Limited invited applications from public for 1,00,000 equity shares of Rs 10 each on a premium of X 5 per share. The entire issue was underwritten by the underwriters Anita, Babita, Chavi and David 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 from public out of which applications for 19,000, 10,000; 21000 and 8,000 shares were marked in favour of Anita, Babita, Chavi and David respectively.

Calculate the liability of each one of the underwriters. Also ascertain the underwriting commission @ 2.5% payable to the different underwriters.

Solution:

Statement of Liability of Underwriters:

Note: by treating 'firm underwriting shares' on a par with marked applications

<i>Particulars</i>	<i>Anita</i>	<i>Babita</i>	<i>Chavi</i>	<i>David</i>	<i>Total</i>
Gross Liability	30000	30000	20000	20000	100,000
Less: Marked Applications	19000	10000	21000	8000	58000
Balance	11000	20000	(1000)	12000	42000
Less: unmarked Applications in ratio of gross Liability(30;30:20:20)	3600	3600	2400	2400	12000
Balance Net	7400	16400	(3400)	9600	30000
Less: Firm Underwriting	3000	2000	1000	1000	7000
Balance	4400	14400	(4400)	8600	23000
Less: Credit of excess to others in ratio (30:30:20)	(1650)	(1650)	+4400	(1100)	
Net Liability	2750	12750	0	7500	23000
Total Liability, including Firm Underwriting	5750	14750	1000	8500	30000

Alternatively, the 'firm underwriting shares' may be treated on a par with unmarked applications.
 Applications received including firm underwritten = 70,000 + 7,000 = 77,000

Less: Marked application = 58,000

Net Unmarked Application liability of underwriters (No. of Shares) = 19,000

<i>Particulars</i>	<i>Anita</i>	<i>Babita</i>	<i>Chavi</i>	<i>David</i>	<i>Total</i>
Gross Liability	30000	30000	20000	20000	100,000
Less: unmarked Applications in ratio of gross Liability (30:30:20:20)	5700	5700	3800	3800	19,000
Balance	24300	24300	16200	16200	81,000
Less: Marked Application	19000	10000	21000	8000	58000
Balance Net	5300	14300	(4800)	8200	23000
Adjustment of excess	(1800)	(1800)	+4800	(1200)	
Balance	3500	12500	-	7000	23000
Add: Firm Liability	3000	2000	1000	1000	7000
Total Liability, including Firm Underwriting	6500	14500	1000	8000	30000

Calculation of Underwriting commission

<i>Underwriting commission is payable at the rate of 2.5% of the issue price of shares;</i>	<i>Amount</i>
A = 30000 * 15 * 2.5%	11,250
B = 30000 * 15 * 2.5%	11,250
C = 20000 * 15 * 2.5%	7,500
D = 20000 * 15 * 2.5%	7,500

LESSON ROUND-UP

- A company, other than a listed company, which is not required to comply with Securities and Exchange Board of India Employee Stock Option Scheme Guidelines shall not offer shares to its employees under a scheme of employees' stock option (hereinafter referred to as "Employees Stock Option Scheme").
- ESOP means a scheme under which the company grants option (a right but not an obligation) to an employee to apply for shares of the company at a predetermined price. This right is exercisable by the employee, during the specified period.
- Section 2(37) of the Companies Act, 2013 states that the "employee stock option" means the option given to the whole time director, officers or employees of a company which gives such directors, officers or employees the benefit or right to purchase or subscribe at a future date, the securities offered by the company at a predetermined price.
- When a company has substantial cash resources, it may like to buy its own shares from the market particularly when the prevailing rate of its shares in the market is much lower than the book value or what the company perceives to be its true value.
- As per Section 68, 69, 70 of the Companies Act, 2013 states that a company may purchase its own shares or other specified securities out of its free reserves, and the proceeds of any other shares or other specified securities.
- Buy-back is permissible: (a) from the existing security holders on a proportionate basis through the tender offer; or (b) from the open market.
- Regulation 10(1) of the Securities and Exchange Board of India provides that a company shall, as and by way of security for performance of its obligations on or before the opening of the offer of re-purchase, deposit in an escrow account such sum as is specified in 10(2).
- According to Section 43 of the Companies Act, 2013, Equity share capital may be Equity Share Capital with the voting right or Equity Share Capital with differential right as to dividend, voting or otherwise.
- Rule 4 of the Companies (Share Capital and Debentures) Rules 2014 deals with equity shares with differential rights.
- The company shall not convert its existing equity share capital with voting rights into equity share capital carrying differential voting rights and vice versa.

- The holders of the equity shares with differential rights shall enjoy all other rights, such as bonus shares, rights shares etc., which the holders of equity shares are entitled to, subject to the differential rights with which such shares have been issued.
- Where a company issues equity shares with differential rights, the Register of Members maintained under section 88 shall contain all the relevant particulars of the shares so issued along with details of the shareholders.
- Underwriting is an undertaking or guarantee given by the underwriters to the company that the shares or debentures offered to the public will be subscribed for in full.
- An underwriting agreement may be: Complete Underwriting, Partial Underwriting and Firm Underwriting.
- Applications bearing the stamp of the respective underwriters are called marked applications and the applications received directly by the company which do not bear any stamp of the underwriters are known as unmarked applications.

TEST YOURSELF

1. For accounting purposes, employee share-based payment plans are classified as:
 - (a) Equity settled and cash settled.
 - (b) Liability settled and cash settled.
 - (c) Equity settled, cash settled and employees share based payment plans with cash alternatives.
2. Under the Companies Act 2013, there shall be a minimum period of:
 - (a) two years between grant of options and vesting of option
 - (b) one year between grant of options and vesting of option
 - (c) six months between grant of options and vesting of option.
3. The excess of the market price of the share under ESOS over the exercise price of the option is:
 - (a) Exercise Price
 - (b) Intrinsic Value
 - (c) Fair value
4. Which amount would be recognized for Share based payment?
 - (a) Fair value of Share prices/ value
 - (b) Amount as per agreement
 - (c) Fair value of goods/ services received unless it is not reliably measurable then fair value of share prices would be used

Answer

[1. (c); 2. (b); 3. (b) 4. (c)]

