(150)

UNIVERSITY EXAMINATIONS

2021/2022 ACADEMIC YEAR

FOURTH YEAR SECOND SEMESTER
MAIN EXAM

FOR THE DEGREE OF BACHELOR OF COMMERCE

COURSE CODE: BCA 448E

COURSE TITLE: BANKRUPTCY AND REORGANIZATION

DATE: 16TH MAY, 2022 **TIME: 9.00AM - 11.00AM**

INSTRUCTIONS TO CANDIDATES

1. Answer Question One in Section A and Any other TWO (2) Questions in Section B
2. Question one carries **30** marks and each of the other two questions carry **20** marks each

TIME: 2 Hours

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QUESTION ONE (COMPULSORY)

Onyango, carrying on a business as a trader in Kisumu, finds himself insolvent, and on 15 August 1997 files his petition in bankruptcy. The following balances are extracted from the books of his business on that date:

	Sh.'		Sh.'000
Onyango's Capital	1,200,000	Shop – land and buildings	4,200,000
Mortgage on shop (land and buildings)	3,210,000	Furniture and fittings	1,000,000
Loan – I.C.D.C. Ltd.	1,200,000	Stock of goods	575,100
Loan – Barclays Bank Ltd.	600,000	Debtors	641,300
Loan – Co-operative Bank Ltd.	200,000	Onyango drawings	1,314,000
Loan – Paul	100,000	Cash on hand	2,000
Loan – Mak'Oduor	20,000		
Trade creditors	1,140,000		
N.H.I.F., N.S.S.F. and P.A.Y.E.	36,000		
Salaries and wages payable	18,000		
Bank overdraft	18,000		
	7,532,400		7,532,400

The following information is provided:

1. The trade creditors includes Sh.30, 000 owing to Kisumu City in respect of rates in for the current period and a small loan from Onyango's friend Waititu for Sh. 10,000.
2. The amount owing for salaries and wages and statutory payroll deductions are for 1997.
3. There is 210,000 interest unpaid on the mortgage as at 15 August 1997, which has not been recorded in the books.
4. The loan from I.C.D.C. Ltd. is secured by a second mortgage on the shop (land and buildings). The unrecorded interest owing as at 15 August 1997 was Sh.96, 000.
5. The loan from the Co-operative Bank Ltd. was obtained when Onyango pledged his wholly owned piece of land as security. The value of the piece of land is sh.300, 000. There is no interest outstanding on his loan.
6. The interest on loan from Paul was to vary with profits, but since the business has been operating at a loss, there is no interest due.
7. There is no interest outstanding on the loan from Barclays Bank Ltd.
8. Mak'Odour is Onyango's brother-in-law.
9. The value of the assets is estimated to be:

	Sh.
Shop – land and buildings	4,200,000
Furniture and fittings	800,000
Stock of goods	200,000

10. Of the debtors, Sh.400, 000 are thought to be good and Sh.200, 000 doubtful, of which Sh.150, 000 should be collectable.
11. Onyango's uncle died recently and he will be receiving Sh.50, 000 as an inheritance.

12. Onyango has no personal creditors outside the business, but he has other personal assets, beside the piece of land, amounting to Sh.60, 000, exclusive of household and personal effects.

Required:

a) A statement of affairs for Onyango as at 15 August 1997 in good form. (15 marks)
b) A deficiency account as at that date. (4 marks)
c) A profit and loss account for the period ended 15 August 1997. (3 marks)
d) Explain the key roles of official receiver bankruptcy (8 marks)

(Total 30 marks)

SECTION B

QUESTION TWO

Ongenza Ltd, a local company operating in the mineral water bottling industry, is in financial difficulty due to the unfavorable economic conditions. The company's statement of financial position as at 31st December, 2021 was as given below:

Ongeza Ltd,
Statement of financial position as at 31st October,2021.

		Sh. '000'	Sh. '000'
Non-Current Assets:			
Land			8,000
Building -	at NBV		6,000
Machinery -	at NBV		2,800
Intangible assets -	Investments		4,500
-	Goodwill		6,000
-	Patents and trademarks		500
Current Assets:			
Inventories		7,200	
Trade receivables		4,000	
Cash		100	11,300
Total assets:			**39,100**
Equity and Liabilities:			
Equity shares of sh.10 at par value			20,000
12% debentures			8,000
Interest payable on debentures			6,000
Loan from directors			720
Accumulated loss			2,000
			(5,800)
Current liabilities:		3,000	30,920
Bank overdraft		5,180	8,180
Sundry payables			**39,100**
Total capital liabilities			

Additional information:

The authorized share capital of Ongeza Ltd is 5 million ordinary shares of sh.10 each and one million 10% preference shares of sh.10 each.It was decided during a meeting of the shareholders and directors of the company to carry out a scheme of internal reconstruction, with effect from 1st January, 2022, as follows:

1. Assets are to be adjusted to their fair value as follows:

	Sh.'000'
Trade receivables	3,600
Inventories	6,400
Machinery	2,000
Buildings	5,000
Accumulated depreciation charged:	
Buildings	1,500
Machinery	1,600

2. Each ordinary share is to be re-designated as a share of sh. 1.50. The ordinary shareholders are to accept a reduction in the nominal value of their shares from sh. 10 to sh.1.50.In addition, the shareholders are to subscribe for a new issue on the basis of one share for every two held at a price of sh.3.00 per share.
3. The existing preference shares are to be exchanged for a new issue of sh. 6 million 15% preference shares of sh.10 each and 800,000 ordinary shares of sh.1.50 each.
4. The debenture holders are accept 200,000 ordinary shares of sh.1.50 each in lieu of interest payable. The 12% debentures are to be converted to 14% debentures. A further sh.2 million of 14% debentures of sh. 100 each are to be issued and taken up by the existing debenture holders at sh.90 each.
5. Sh.800, 000 of the loan from directors is to be cancelled. The balance of the loan is be settled by the issue of 200,000 ordinary shares of sh.1.50 each.
6. The investments are to be sold at their current market price of sh.6 million.
7. The bank overdraft is to be paid in full.
8. A sum of sh.3.18 million is to be paid to offset the sundry payables immediately and the balance in four equal instalments at the end of each quarter
9. All intangible assets are to be eliminated.
10. It is estimated that under the new arrangement, the net profit before interest and tax will be sh.5 million per year.

There will be no tax liability relating to the company for the next five years.

Required

a) Journal entries to effect the scheme of reconstruction. (10 marks)

b) Statement of financial position as at 1st November, 2021(immediately after reconstruction). (8 marks)

c) A statement showing how the anticipated profits under the new arrangement will be distributed to the various providers of credit. (2 marks)

(Total 20 marks)

QUESTION THREE

ThefollowingaretheBalanceSheetofRitoLtd.andArimaLtd.asonMarch31,2017.

It was decidedthat ArimaLtd. willacquire thebusiness ofRito Ltd. forenjoying thebenefits ofcarrying forwardofbusinessloss.Thefollowingschemehasbeenapprovedforthemerger:

(i) Arima Ltd. will reduce its shares to sh.10 per share and then consolidate sh.10 such shares into one share of sh.100each.
(ii) Banksagreedtowaivetheloanofsh.18, 000ofArimaLtd.
(iii) ShareholdersofRitoLtd.willbegivenonesharesofArimaLtd.inexchangeofeverysha reheldinRitoLtd.
(iv) SundryCreditorsofArimaLtd.includessh.30, 000 payable to Rito Ltd.
(v) AftermergertheproposeddividendofRitoLtd.willbepaidtoShareholdersofRitoLtd.
(vi) RitoLtd.willcancel20%holdingofArimaLtd.investmentwhichwasheldatacostofsh .75,000.
(vii) AuthorisedCapitalofArimaLtd.willberaisedaccordinglytocarryoutthescheme.

Liabilities	**RITO LTD. Sh.**	**ARIMA LTD.**	**Assets**	**RITO LTD.**	**ARIMA LTD.**
ShareCapital:			FixedAssets-netofdeprecation	810	255
EquitySharesof`10 0eachfullypaidup	600	300	Investments(including investment inArimaLtd.)	310	-
			Debtors	120	45
Reserves&Surplus	240	-	CashatBank	75	-
10%Debentures	150	-	Accumulatedloss	-	240
LoansfromBanks	75	135	Profit&LossA/c		
BankOverdrafts	-	15			
SundryCreditors	90	90			
UnpaidDividends	60	-			
	1,215	**540**		**1,215**	**540**

Required:

a) Pass necessary entries in the books of Arima Ltd. (8 marks)

b) Balance Sheets of the business asonMarch31,2017. (10 marks)

c) Explain sources of contingent liability in a reconstructed entity. (2 marks)

(Total 20 marks)

QUESTION FOUR

ThefollowingistheBalanceSheetasat31stMarch,2017ofHospitalLtd.

Hospital Ltd

BalanceSheetasat31stMarch,2017ofHospitalLtd.

Liabilities	Sh.`000	**Assets**	`Sh.'000
ShareCapital:		FixedAssets(includinggoodwillof sh.100,000)	1,180,000
8,500 Equity Shares of sh. 10.each fully paid up	850,000	Investments	40,000
4,000Cumulative preference shares of sh.10 fully paid up	400,000	StockinTrade	275,000
SecuritiesPremium	20,000	BankBalances	65,000
GeneralReserve	60,000	Trade Debtors	150,000
TradeCreditors	380,000		
	1,710,000		**1,710,000**

Contingentliability:

Preference Dividends in arrears sh.60, 000.

The stakeholders of the companydecideduponthefollowingschemeofreconstructions,whichwasdulyapprovedbyallstakeholders andputintoeffectfrom1stApril,2017.

i) ThePreferenceSharesaretobeconvertedinto12%unsecure debenturesofsh.10eachwithregardto70%ofthedues(inducingarrearsofdividends)andforthebalanceEquitySharesof sh.50paidupwouldbeissued. TheauthorizedCapitalofthecompanypermittedtheissueofadditionalshares.

ii) EquitySharesswouldbereducedtoshareofSh.5.00eachpaidup. Sincegoodwillhasnovalue,thesameistobewrittenoff thefully.

iii) Themarketvalueofinvestmentsaretobereflectedat` 60,000.

iv) ObsoleteitemsinStockofsh.75, 000aretobewrittenoff.BadDebtstotheextentof5%ofthetotaldebtors wouldbeprovidedfor.Fixedassetstobewrittendownbysh.180, 000.

v) The company carried on trading, for six months up to 30th September, 2017 and made a net profit of sh.100, 000after writing off depreciation at 25% p.a. on the revised value of fixed assets. The half yearly working resulted in anincreaseofSundryDebtorsbysh. 80,000,stockbysh.70, 000andCashbysh.50,000.

a) YouarerequiredtoshowtheJournalentreesforgivingeffecttotheabovearrangement. (10 marks)

b) BalanceSheetofthecompanyasat30thSeptember,2017. (10 marks

(Total 20 marks)

QUESTION FIVE

a) Explain the evidence that must prevail for a registrar to declare a company defunct.(10 marks)

b) A compulsory winding up order was made on 30 November 2003 against Hasara Ltd. A summary of the company's balance sheet as at that date was as follows:

Non-current assets:	**Sh. "000"**	**Sh. "000"**	**Sh. "000"**
Goodwill			
Freehold property			2,689
Plant and machinery			4,940
Shares in subsidiaries			14,620
			22,249
Current assets:			
Stocks		19,180	
Debtors		9,040	
Cash in hand		20	
		28,240	
Current liabilities:			
Bank overdraft	22,790		
Creditors	20,900		
Customs and excise tax	200		
Accruals	399		
Debenture interest due	100	(44,389)	(16,149)
			6,100
Financed by:			
Share capital 5,000,000 ordinary shares of Sh.20 each – fully paid			10,000
400,000 ordinary shares of Sh.20 each- Sh.12.50 paid			5,000
			15,000
Revenue reserves:			
Retained profits (losses)			(12,900)
Shareholders' funds			2,100
Non-current liability:			
10% debentures			4,000
			6,100

Additional information:

1. The 10% debentures are secured by a first charge on freehold property and the bank overdraft is secured by a floating charge on the assets.
2. The accruals consisted of:

	Sh.
Directors fee, 6 months to 30 November 2003.	75,000
Managers salary, 2 months to 30 November 2003	80,000
Wages of 3 workmen, 4 weeks to 30 November 2003	18,000
Rates – half year to 30 November 2003	20,000
Taxes for the year to 30 November 2001	120,000
Miscellaneous expenses	86,000
	399,000

3. A holder of 20,000 of the partly paid shares was bankrupt and it was anticipated that his trustees would be in a position to pay a dividend of 25% to his unsecured creditors.
4. The company's assets were estimated to be realized as follows:

	Sh. "000"
Freehold property	4,480
Plant and machinery	14,000
Stocks	18,760

5. The debtors were considered to be good except as to Sh. 520,000 of which Sh. 400,000 were doubtful and were expected to realize Sh.110, 000. The remaining Sh.120, 000 were considered bad. Goodwill was regarded as valueless.
6. Legal proceedings for breach of contract were pending against the company as at 30 November 2003. The company was considered to have a poor defense and attempts were being made to settle the claim out of court for Sh.100, 000 plus costs estimated at Sh.80, 000. No provision for this claim is included in the balance sheet.
7. The company had incurred losses of Sh.3, 040,000, Sh.3, 840,000 and 6,020,000 respectively in each of the three years ended 30 November 2003. The aggregate of the sums charged to the profit and loss accounts during the three years in respect of depreciation, debenture interest and directors' remuneration were Sh.2, 380,000, Sh.600, 000 and Sh.1, 800,000 respectively.

Required:

Statement of affairs as at 30 November 2003. (10 marks)

(Total 20 marks)