



The Co-operative University College of Kenya
(A Constituent College of Jomo Kenyatta University of Agriculture & Technology)

END OF SEMESTER EXAMINATION APRIL, 2016

EXAMINATION FOR THE DEGREE OF BACHELOR OF COMMERCE
(YR III SEM II)

UNIT CODE: HBA 2305

UNIT TITLE: BANKRUPTCY AND INSOLVENCY

DATE: 13TH APRIL, 2016

TIME: 9:00 AM – 11:00 AM

INSTRUCTIONS:

Answer Question **ONE** and any other **TWO** questions.

QUESTION ONE

Swara Ltd has been suffering from financial distress for several years. It has been decided that the company be reconstructed.

The following is the statement of financial position of Swara Ltd as at 30 June 2015.

Statement of financial position as at 30 June 2015

	Shs."000"	Shs."000"
Non-current assets		
Land and building	2,134,200	
Plant and machinery	1,591,200	
Furniture and fixtures	594,600	
Investments	345,000	
Goodwill	390,000	
Patents	240,000	
Preliminary expenses	<u>100,800</u>	5,395,800
Current assets		
Inventories	975,00	
Trade receivables	858,000	
Cash at bank	<u>271,200</u>	<u>2,104,200</u>
		<u>7,500,000</u>
Equity and liabilities		
Capital and reserves		
8% preference shares of shs.50 each	3,600,000	
Ordinary shares of shs.10 each	3,000,000	
Retained earnings	<u>(2,520,000)</u>	4,080,000
Non-current liabilities		
4% debentures		2,400,000
Current liabilities		
Trade payables	876,000	
Accrued debenture interest	<u>144,000</u>	<u>1,020,000</u>
		<u>7,500,000</u>

Additional information:

1. On 1 July 2015 a new company, Tumo Ltd was formed to take over Swara Ltd. Tumo Ltd was formed with an authorized share capital comprising 600 million ordinary shares of shs.10 each and 40 million 6% preference shares of shs.100 each.
2. Preference dividends in Swara Ltd were two years in arrears.
3. Three ordinary shares of shs.10 each credited at shs.5 each in Tumo Ltd would be issued for each 8% preference share in Swara Ltd. In addition, one fully paid 6% preference share of shs.100 each in Tumo Ltd would be issued for every four 8% preference shares in Swara Ltd. The 8% preference shareholders would, however, pay the balance to make their ordinary shares fully paid.
4. The 8% preference shareholders in Swara Ltd would forego half of the preference dividends in arrears and would receive fully paid 6% preference shares of shs.100 each in Tumo Ltd for the balance of the arrears of the preference dividends.
5. One ordinary share of shs.10 each credited at shs.5 each in Tumo Ltd would be issued for every two ordinary shares in Swara Ltd. The ordinary shareholders would, however, pay the balance to make their shares fully paid.
6. The debenture holders would receive half of their dues (excluding accrued interest) in 6% debentures of Tumo Ltd and the balance in fully paid ordinary shares of Tumo Ltd. Interest accrued on debentures would be paid in cash by Tumo Ltd after taking over Swara Ltd.
7. Trade payables would be taken over by the new company and immediately settled by issue of fully paid ordinary shares of shs.10 each of equal value.
8. The assets were transferred to Tumo Ltd at the following values.

	Shs.'000'
Land and buildings	2,880,000
Plant and machinery	1,770,000
Furniture and fixtures	510,000
Investments	197,400
Inventories – at book value less 10%	
Trade receivables – at book value less 5%	
Cash at bank – at book value.	
9. Tumo Ltd paid shs.30 million to Swara Ltd to cater for liquidation expenses.
10. Tumo Ltd issued for cash and at par all the remaining ordinary shares and preference shares not issued as part of the settlement of the purchase consideration on acquisition of Swara Ltd.
11. All the above transactions were completed on 1 July 2015.

Required

- a) The following accounts in the books of Swara Ltd.
 - i. Realisation account. (6 marks)
 - ii. Tumo Ltd account. (4 marks)
 - iii. Preference shareholders sundry members' account. (4 marks)
 - iv. Ordinary shareholders sundry members' account. (4 marks)
- b) Journal entries in the books of Tumo Ltd to record the purchase of Swara Ltd. (8 marks)
- c) Statement of financial position of Tumo Ltd as at the close of business on 1 July 2015. (4 marks)

QUESTION TWO

A compulsory winding up order was made on 30 November 2015 against Hasara Ltd. a summary of the company's balance sheet as at that date was as follows:-

Non-current assets:	Shs.'000'	Shs.'000'	Shs.'000'
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Goodwill			2,689
Freehold property			4,940
Plant and machinery			<u>14,620</u>
			22,249

Current assets:

Stocks		19,180	
Debtors		9,040	
Cash in hand		<u>20</u>	
		28,240	

Current liabilities

Bank overdraft	22,790		
Creditors	20,900		
Customs and excise tax	200		
Accruals	399		
Debenture interest due	<u>100</u>	<u>(44,389)</u>	<u>(16,149)</u>
			<u>6,100</u>

Financed by:

Share capital			
500,000 ordinary shares of shs.20 each fully paid			10,000
400,000 ordinary shares of shs.20 each shs.12.50 paid			<u>5,000</u>
			15,000

Revenue reserves:

Retained profits (losses)			<u>(12,900)</u>
Shareholder's funds			2,100

Non-current liability:

10% debentures			<u>4,000</u>
			<u>6,100</u>

Additional information:

- 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.
- The accruals consisted of:

Shs.'000'

Directors fees, 6 months to 30 November 2015	75
Managers salary, 2 months to 30 November 2015	80
Wages of 3 workmen, 4 weeks to 30 November 2015	18
Rates – half year to 30 November 2015	20
Taxes for the year to 30 November 2013	120
Miscellaneous expenses	<u>86</u>
	<u>399</u>

- 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.
- The company's assets were estimated to be realized as follows:-

Shs.'000'

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

- The debtors were considered to be good except as to shs.520,000 of which shs.400,000 were doubtful and were expected to realize shs.110,000. The remaining shs.120,000 were considered bad. Goodwill was regarded as valueless.
- Legal proceedings for breach of contract were pending against the company as at 30 November 2015. The company was considered to have a poor defence and attempts were being made to settle the claim out of court for shs.100,000 plus costs estimated at shs.8,000. No provision for this claim is included in the above balance sheet.
- The company had incurred losses of shs.3,040,000, shs.3,840,000 and shs.6,020,000 respectively in each of the three years ended 30 November 2015. 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 shs.2,380,000, shs.600,000 and shs.1,800,000 respectively.

Required:

- a) Statement of affairs as at 30 November 2015. (10 marks)
 b) Deficiency account as at 30 November 2015. (10 marks)

QUESTION THREE

Korir, carrying out a business as a trader in Nairobi, finds himself insolvent and on 15 March 2001 files his own petition in bankruptcy. The following balances are extracted from the books of his business on that date:

	Shs.		Shs.
Capital	180,000	Shop, land and buildings	600,000
Mortgage on shop, land and building	450,000	Furniture and fittings	150,000
Loan – ICDC	180,000	Stock of goods	81,405
Loan – Barclays Bank	90,000	Debtors	96,195
Loan - Co-operative Society	30,000	Korir – drawings	197,100
Loan – A Kariuki	15,000	Cash in hand	300
Loan – W Kuria	3,000		
Trade creditors	171,000		
Salaries, wages payable	2,700		
NHIF, NSSF, PAYE	540		
Bank overdraft	<u>2,760</u>		
	1,125,000		<u>1,125,000</u>

The following additional information is available:

- Trade creditors include shs.4,500 owing to Nairobi City Council in respect of rates for the current period and a small loan from his friend Malu for shs.1,500.
- The amount owing for salaries, wages and payroll deductions are for 2001.
- There is shs.31,500 interest unpaid on the mortgage as at 15 March 2001 which has not been recorded in the books.
- The loan from ICDC is secured by a second mortgage on the shop, land and building. The unrecorded interest owing as at 15 March 2001 is shs.14,400.
- The loan from the co-operative society was obtained when Korir pledged his wholly owned farm as security. farm is valued at shs.145,000. There is no interest outstanding on his loan.
- The interest on the loan from A. Kariuki was to vary with profits, but since the business has been operating loss, there is no interest due.
- There is no interest outstanding on the loan from Barclays bank.
- W. Kuria is Korir's brother-in-law.
- The value of assets are estimated to be:

	Shs.
Shop, land and building	630,000
Furniture and fittings	120,000
Stock of goods	30,000

- Of the debtors, shs.60,000 are thought to be good and shs.30,000 doubtful of which shs.22,500 should be collectable.
- Korir's uncle died recently and he will be receiving shs.7,500 as an inheritance.
- Korir has no personal creditors outside the business but he has other personal assets as well as the small piece of land amounting to shs.9,000 exclusive of household and personal effects.

Required

- a) A statement of affairs for Korir as at 15 March 2001 in good form. (10 marks)
 b) A deficiency account. (8 marks)
 c) A detailed listing of the amounts you have included as unsecured and preferential creditors. (2 marks)

Preliminary expenses	7,250	
Goodwill	55,000	
Trade payables		43,500
Trade receivables	31,200	
Bank overdraft		51,000
Leasehold property: Cost	80,000	
Accumulated amortization		30,000
Plant and machinery: Cost	210,000	
Accumulated depreciation		62,500
Inventory	<u>79,175</u>	
	<u>577,000</u>	<u>577,000</u>

Approval of the court was obtained for a scheme of capital reduction whose terms were as follows:

1. The par value of the preference shares was to be reduced to Sh. 7.5 per share.
2. The par value of the ordinary shares was to be reduced to Sh. 1.25 per share.
3. One Sh.1.25 ordinary share was to be issued for each Sh.10 preference dividend in arrears. The preference dividend had not been paid for the past three financial years (financial year to 31 October 2015 inclusive).
4. The balance on the share premium account was to be utilized for purposes of capital reduction.
5. The value of plant and machinery was to be written down to Sh. 75 million.
6. The accumulated losses as well as goodwill were to be written off.
7. After the resolution authorizing the scheme of capital reduction had been passed, 50,000,000 ordinary shares were issued at par for cash, payable in full upon application.

Assume all the transactions were completed on 31 October 2015.

Required:

- a) Capital reduction account as at 31 October 2015. (8 marks)
- b) Members' accounts as at 31 October 2015. (4 marks)
- c) Balance sheet as at 1 November 2015 after completion of all the transactions. (8 marks)