MACHAKOS UNIVERSITY COLLEGE

(A Constituent College of Kenyatta University)
University Examinations for 2015/2016 Academic Year

SCHOOL OF BUSINESS AND ECONOMICS

DEPARTMENT OF BUSINESS ENTREPRENEURSHIP AND MANAGEMENT SCIENCES

FIRST SEMESTER EXAMINATION FOR DEGREE IN BACHELOR OF COMMERCE

BAC 306: BANKRUPTCY AND REORGANIZATION

Date: 30/11/2015 **Time: 2:00 – 4:00 PM**

INSTRUCTIONS: ANSWER QUESTION ONE AND ANY OTHER TWO QUESTIONS

QUESTION ONE

a) Elaborate five acts of bankruptcy on which a petition may be founded. (10 marks)

b) Korir carrying out a business as a trader in Nairobi finds himself insolvent and on 15 March 2014 files his own petition in bankruptcy. The following balances are extracted from the books of his business on that date:

	Sh.		Sh.
Capital	180,000	Shop, loan 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		
Loan – W. Kuria	3,000	Cash in hand	300
Trade creditors	171,000		
Salaries, wages payable	2,700		
NHIF, NSSF, PAYE	540		
Bank overdraft	2,7600		
	1,125,000		1,125,000

The following additional information is available:

1. Trade creditors include Sh.4,500 owing to Nairobi City council in respect of rates for the current period and a small loan from his friend Macharia Sh.1,500.
2. The amount owing for salaries, wages and payroll deductions are for 2014
3. There is Sh.31,500 interest unpaid on the mortgage as at 15 March 2014 which has not been recorded in books.
4. The loan from ICDC is secured by a second mortgage on the shop, land and building. The unrecorded interest owing as at 15 March 2014 is Sh.14,400.
5. The loan from the Co-operative society was obtained when Korir pledged his wholly owed farm as security. The farm is valued at Sh.45,000. There is no interest outstanding on his loan.
6. The interest on the loan from A Kariuki was to vary with profits, but since the business has been operating at loss, there is no interest due.
7. There is no interest outstanding on the loan from Barclays Bank.
8. W. Kuria is Korir's brother-in-law.
9. The value assets are estimated to be:

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

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

Required:

(a) A statement of affairs for Korir as at 15 March 2014 in good form (10 marks)

(b) A deficiency account. (8 marks)

(c) A detailed listing of the amounts you have included as unsecured preferential creditors. (2 marks)

QUESTION TWO

A creditor of Polepay Traders, a partnership owned by Peter Ole Lemsio and Patrick Ayimba, presented a petition in bankruptcy against the partnership on 1 April 2014. On 30 April 2014, the High Court made out a Receiving order against the partnership and the two partners.

The balance sheets of the partnership and the individual partners as at 30 April were as follows:

	Polepay	**Lemasio**	**Ayimba**		**Polepay**	**Lemasio**	**Ayimba**
Assets:	**Sh. '000'**	**Sh. '000'**	**Sh. '000'**	**Liabilities:**	**Sh. '000'**	**Sh. '000'**	**Sh. '000'**
Land and building	12,450			Bank overdraft	4,600		
Houses		5,500	4,800	Creditors	27,270	670	450
Plant & Equipment	14,600			Long-term loans	11,200	3,300	3,840
Furniture, etc,		650	400	Car loans		380	600
Inventory	19,600			Excess of assets			
Trade receivables	20,240			Over liabilities	24,000	15,990	15,550
Cash	180	90	140				
Investments		13,600	14,200				
Motor cars		500	900				
	67,070	20,340	20440		67,070	20,340	20,440

Additional information:

1. Lemasio and Ayimba have contributed equal amounts of capital to the partnership; always draw the same amount from the partnership and share profits and losses equally. The partners' capital included in their personal assets under the title investments,

2. The estimated realizable values of the assets stated above are as follows:

	Polepay	Lemasio	Ayimba
Assets:	**Sh. '000'**	**Sh. '000'**	**Sh. '000'**
Land and building	8,000		
Houses		4,000	3,500
Plant and Equipment	7,500		
Furniture		180	100
Inventory	13,500		
Trade receivables	13,100		
Other investments		700	1,000
Motor cars		250	300

3. The long term loan in the books of the partnership is secured on the partnership land and buildings. The long-term loan to the individual partners is secured on the individual partner's houses. The partnership overdraft was secured by a second mortgage on the partnership land and building and by the personal guarantee of Ayimba and the deposit of his investments. The car loans are secured on the partners' car individually.

4. Of the sectors of Polepay, Lemasio and Ayimba, preferential creditors amounted to Sh.20,000, Sh.590,000 and Sh.380,000, respectively, and represent amounts due for taxation.

Required:

Prepare statements of Affairs and Deficiency or surplus Accounts for the partnership and for the individual partners, using the format laid down in the Bankruptcy Act and showing the legal position. (20 marks)

QUESTION THREE

A trading company Endesha Ltd. has experienced severe financial difficulties in recent times and is currently insolvent. A voluntary winding up petition will soon be filed and management is considering either liquidation or reorganisation. The chief accountant has produced the following balance sheet as if the company were a going concern:

Balance Sheet as at 31 March 2014

	Sh. '000'		Sh. '000'
Ordinary share capital	100,000	Fixed assets:	
Retained earnings (deficit)	(64,000)	Land	100,000
	36,000	Building (NBV)	110,000
Long term liabilities:		Equipment (NBV)	80,000
Note payable (secured by		Intangible assets	15,000
lien on land and buildings)	200,000		305,000
		Investments in securities	15,000
Current liabilities:		Current assets:	
Creditors	60,000	Stocks	41,000
Accrued expenses	18,000	Debtors	23,000
Note payable (secured by	75,000	Prepaid expenses	3,000
stocks)		Cash at bank	2,000
	389,000		**389,000**

Additional information

1. The land and buildings are in the prime location and can be sold for 10% more than their book value. But the equipment may not get a buyer unless the price is reduced. It is expected to fetch only 40% of its current book value.
2. Administrative costs of Sh.21.5 million are projected if liquidation of the company does occur.
3. By spending Sh.5 million for repairs and marketing costs, stocks currently held can be sold for Sh.50 million.
4. Accrued expenses include salaries of Sh.13 million. Of this figure, one executive is owed a total of Sh.3 million but is the only employee whose amount due is in excess of the statutory limit. Payroll taxes withheld from salaries and wages but not yet remitted to the Kenya revenue Authority total Sh.3 million. However, company records currently show only Sh.1 million portion of this liability.

5. The investments reported on the balance sheet have appreciated in value since acquisition and are now worth Sh.20 million. Dividends of Sh.500,000 are currently due from these investments, but not yet recognised.
6. Interest of Sh.5,000,000 on the long-term liabilities has not been accrued for the current financial year.
7. Debtors are estimated to be collectible for Sh.12 million.
8. A refund of Sh.1 million will be received from the various prepaid expenses but the company's intangible assets have no resale value.

Required:

A statement of affairs in accordance with the requirements of the company's Act, 1948, for 31 March 2014. (20 marks)

QUESTION FOUR

Matatizo Ltd. went into voluntary liquidation on 30 November 2003. Its balance sheet as at that date was as follows:

	Sh.
Assets:	
Land and building	5,000,000
Plant and machinery	12,500,000
Patents	2,000,000
Stock	2,750,000
Sundry debtors	5,500,000
Cash at bank	1,500,000
Profit and loss account balance	5,625,000
	34,875,000
Equity and liabilities:	
Issued and subscribed capital	
100,000 10% cumulative preference shares of Sh.100 each, fully paid	10,000,000
50,000 equity shares of Sh.100 each, Sh. 75 paid	3,750,000

150,000 equity shares of Sh.100 each, Sh. 60 paid	9,000,000
15% debentures secured by floating charge	5,000,000
Interest outstanding on debentures	750,000
Creditors	6,375,000
	34,875,000

Additional information:

1. Preference dividends were in arrears for two years and the creditors included preferential creditors of Sh.760,000.

2. The assets were realized as follows:

	Sh.
Land and building	6,000,000
Plant and machinery	10,000,00 0
Patents	1,500,000
Stock	3,000,000
Sundry debtors	4,000,000

3. Liquidation expenses amounted to Sh.545,000. The liquidator is entitled to a commission of 3% on assets realized except cash
4. The final payments (including those relating to debentures) were made on 31 May 2014.

Required:

The liquidator's final statement of account as at 31 May 2014. (20 marks)

QUESTION FIVE

a) Discuss the procedure for winding up a firm in Kenya. (10 marks)

b) Discuss the consequences of winding a firm in Kenya. (10 marks)