# MACHAKOS UNIVERSITY

**University Examinations for 2018/2019 Academic Year**

**SCHOOL OF BUSINESS AND ECONOMICS**

**DEPARTMENT OF BANKING, ACCOUNTING & FINANCE**

**THIRD YEAR SPECIAL/SUPPLEMENTARY EXAMINATION FOR**

**BACHELOR OF COMMERCE**

**BAC 306: BANKRUPTCY AND REORGANISATION**

**DATE: 26/7/2019** **TIME: 2.00-4.00 PM**

**INSTRUCTIONS:** Attempt Question One and any other Two Questions

## QUESTION ONE

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 2001. On 30 April 2001, 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:

| **Assets:** | **Polepay Sh. '000'** | **Lemasio Sh. '000'** | **Ayimba Sh. '000'** | **Liabilities:** | **Polepay Sh. '000'** | **Lemasio Sh. '000'** | **Ayimba 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:

| Assets: | Polepay Sh. '000' | Lemasio Sh. '000' | Ayimba 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 are 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 TWO**

a) Explain the composition of the preferential debts in the liquidation process. (10 marks)

b) Explain five persons who may petition the winding up of a company (10 marks)

## QUESTION THREE

a) Explain five acts of bankruptcy on which a petition may be founded (5 marks)

(a) Hasara Ltd makes its accounts each year 31 October and has been trading at a loss. On 31 October 2002, a resolution for a voluntary liquidation was passed. The balance sheet as at that date was as follows.

| | Sh. '000' | Sh. '000' | Sh. '000' |
|---|---|---|---|
| **Non Current assets** | | | |
| Freehold property | | | 11,000 |
| Plant and machinery | | | 2,750 |
| | | | 13,750 |
| **Current assets:** | | | |
| Stock | | 8,750 | |
| Debtors | | 13,375 | |
| Cash | | 125 | |
| | | 22,250 | |
| **Current liabilities:** | | | |
| Bank overdraft | 3,750 | | |
| Creditors | 11,250 | | |
| Interest payable (5% debentures) | 500 | (15,500) | 6,750 |
| | | | 20,500 |
| **Paid up capital:** | | | |
| 10,000 10% cumulative preference shares of Sh.500 each fully paid | | | 5,000 |
| 25,000 Ordinary shares of Sh.500 each fully paid | | | 12,500 |
| 10,000 Ordinary shares of Sh.500 each. Sh.250 paid. | | | 2,500 |
| | | | 20,000 |
| Revenue reserves: profit and loss account | | | (9,500) |
| Non Current liabilities: | | | |
| 5% debentures | | | 10,000 |
| | | | 20,500 |

**Additional information:**

1. The debentures are secured by a floating charge on the asset and undertaking of the company.
2. The bank overdraft is secured by a fixed charge on the company's freehold property.
3. The preference shares carry a right to a fixed cumulative dividend of 10% per annum up to the date of liquidation and a repayment of Sh.500 per share in priority to all other classes of shares. No dividend has been paid on the preference shares for two years.
4. The creditors include:

| | Sh. '000' |
|---|---|
| Directors fees for one year | 1,000 |
| Rates for six months to 31 October 2002 | 125 |
| Manager's salary for October 2002 | |
| Wages for 15 employees | |
| Pay As You Earn (PAYE) | |

5. The assets realized the following amounts:

| | |
|---|---|
| Freehold property | 12,500 |
| Plant and machinery | 2,000 |
| Stock | 6,250 |
| Debtors | 12,250 |

6. The expenses of liquidation amount to Sh.125,000 and the liquidator's remuneration was fixed at Sh.500,000.

**Required:**

The liquidator's statement of account showing in order of priority, the payments made and the computation of any calls to be made. (15 marks)

**QUESTION FOUR**

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

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 defence 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:**

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

(b) Deficiency account as at 30 November 2003. (**10 marks**)

## QUESTION FIVE

a)Filisika Ltd. is insolvent and is in process of filing for relief under the provisions of the Bankruptcy Act. The company has no cash and its balance sheet currently shows creditors of Sh.48 million. An additional Sh.8 million is owed in connection with various expenses but these amounts have not yet been recorded. The company's assets with an indication of both book value and anticipated net realizable value as at 30 September 1999 as follows:

| | Book Value | Expected NRV |
|---|---|---|
| | Sh. '000' | Sh. '000' |
| Land | 80,000 | 75,000 |
| Buildings | 90,000 | 60,000 |
| Accumulated depreciation | (38,000) | - |
| Equipment | 110,000 | 20,000 |
| Accumulated depreciation | (61,000) | - |
| Investments | 10,000 | 18,000 |
| Stocks | 48,000 | 36,000 |
| Debtors | 31,000 | 9,000 |
| Other assets | 5,000 | - |
| | 275,000 | 218,000 |

**Additional information:**

1. Filisika Ltd. has three debentures payable, each with a difference maturity date:

- Debentures one due in 5 years – Sh.120 million, secured by a mortgage lien on Filisika's land and buildings.
- Debenture two due in 8 years – Sh.30 million secured by Filisika's investments.
- Debenture three due in 10 years – Sh.35 million, unsecured.

2. Of the creditors owed by Filisika Ltd. Sh.10 million represents salaries to employees. However, no individual is entitled to receive more than Sh.4,000. An additional Sh.3 million is included in this liability item that is due to the Kenya Government in connection with taxes.
3. The shareholders equity balance reported by the company at the current date is Sh.42 million: composed of ordinary share capital of Sh.140 million and a deficit of Sh.98 million.

4. If the company is liquidated, administrative expenses of approximately Sh.20 million would be incurred.

**Required:**

A statement of affairs and deficiency or surplus account for Filisika Ltd. to indicate the expected availability of funds if the company is ligidated as at 30 September 1999. (15 marks)

b) List and explain briefly the powers of liquidator (5 marks)