



**MASINDE MULIRO UNIVERSITY OF
SCIENCE AND TECHNOLOGY
(MMUST)**

MAIN/BUNGOMA/NAIROBI/WEBUYE CAMPUS

**UNIVERSITY EXAMINATIONS
2021/2022 ACADEMIC YEAR**

FOURTH YEAR SPECIAL/SUPPLEMENTARY EXAMINATIONS

**FOR THE DEGREE
OF
BACHELOR OF COMMERCE**

COURSE CODE: BCA 448

**COURSE TITLE: BANKRUPTCY & REORGANIZATION
ACCOUNTING**

DATE: TEUSDAY, 2ND AUGUST 2022 TIME: 2-4 PM

INSTRUCTIONS TO CANDIDATES

Answer QUESTION ONE and ANY OTHER TWO (2) questions

TIME: 2 Hours

MMUST observes ZERO tolerance to examination cheating

This Paper Consists of 3 Printed Pages. Please Turn Over.

QUESTION ONE (COMPULSORY)

- a) Insolvency Act (2015) seeks to accomplish three major objectives with respect to insolvent individuals and companies. Briefly explain these objectives **(6marks)**
- b) Financial ratios differ markedly between financially sound and insolvent companies. Describe commonly accepted financial indicators of impending business failure. **(6 marks)**
- c) An insolvent individual does not have to wait for bankruptcy proceedings to be brought against him/her. In light of this statement, briefly discuss four alternative procedures to bankruptcy. **(8marks)**
- d) An attendee at a Business failure and bankruptcy conference argues that Statement of Affairs is very similar to Statement of Financial position for a company. Do you agree with this statement? Briefly explain the grounds for agreement or disagreement. **(6 marks)**
- e) Distinguish between a Receiver and Liquidator in light of insolvent companies. **(4marks)**

SECTION B: ATTEMPT ANY TWO QUESTIONS**QUESTION TWO**

- a) Briefly explain the advantages of debt restructuring as an alternative to company liquidation **(4marks)**
- b) Hapa and Kule are in partnership and they filed for a bankruptcy petition on 31st December 2017. The following particulars were extracted from their books as at that date:

	Firm (sh)	Hapa (sh)	Kule(sh)
<u>Non-current and current Assets</u>			
Freehold land and Building	600,000	-	-
Motor vehicle	650,000	-	-
Machinery	40,000	100,000	120,000
Accounts receivable	500,000	-	-
Inventory	550,000	-	-
Kakuzi shares investment	-	250,000	80,000
Cash at bank	10,000	-	-
Capital contribution to the firm	-	300,000	200,000
<u>Capital and Liabilities</u>			
Bank overdraft	300,000	-	-
Long term loan	300,000	-	-
Accounts payable	1240,000	150,000	290,000
Preferential creditors	10,000	-	-
Capital: Hapa	300,000	-	-
Kule	200,000	-	-
Surplus	-	500,000	110,000

Additional information:

- The long term loan was secured by a second charge on buildings and on Kule's investments in Kakuzi shares
- The amounts expected to be realized were as follows;

	Firm (sh)	Hapa (sh)	Kule(sh)
Free hold land and Building	450,000	-	-
Motor vehicle	300,000	-	-
Machinery	15,000	60,000	80,000
Inventory	310,000	-	-

Accounts receivable	307,500	-	-
Kakuzi shares investment	-	200,000	30,000

Required:

Statement of affairs and deficiency account for the firm as at 31 December 2017. **(16 marks)**

QUESTION THREE

a) Mariam a newly appointed CEO of a young company is concerned with enhancing the success of the firm and is therefore keen on overcoming business failure Briefly explain to him six measures that a young company can take to minimize likelihood of insolvency **(8 marks)**

b) The following information was extracted from the books of GoodLuck ltd for the year ended 30th September 2017:

Assets

Free hold building	1880,000
Other non-current assets	8300,200

Capital and liabilities

Issued and fully paid 12% preference share capital	sh 1880,000
14,100 ordinary shares of sh 470 each, sh 446.50 paid	2679,000
Retained earnings	(1522,800)
Bank account	470,000
11% debenture	3760,000
Loan on mortgage	1504,000
Accounts Payable	1410,000

Additional information:

1. Mortgage was secured on buildings and debenture was secured by a floating charge on other non-current assets.
2. The administrator realized the assets for sh 5,546,000. Building was sold for sh 1692,000. Sh 2726,000 were received from the sale of Other non-current assets.
3. Liquidation costs amounted to sh 56,400 while liquidator remuneration was sh 23,500
4. Accounts Payable include sh 446,500 relating to preferential creditors
5. All transactions were concluded by 31st December 2016.

Required:

Liquidator's final statement of Account as at 31st December 2016 **(14 marks)**

QUESTION FOUR

Landmark Ltd has negotiated a capital re-organization scheme with its creditors. The statement of financial position for the year ended 31st December 2017 is as follows:

	Sh 000	sh 000
Land and buildings		2500
Plant and machinery		1000
Inventory		1000
Accounts receivable		<u>1500</u>
		<u>6000</u>
Debenture interest arrears		250
Accounts payable		1000
Bank overdraft		3000
Financed by:		
10% secured debenture		1250

I million authorized and issued 10% preference shares	1000
2 million authorized and issued sh 1 ordinary shares	2000
Retained earnings	(2500)
	<u>6000</u>

Additional information:

- Trade creditors are unlikely to agree to a reduction of their claims but are willing to supply the reconstructed company and continue to grant credit on normal terms.
- Preference shareholders would be willing to forego their dividend arrears and accept ordinary share capital.
- Debenture holders are prepared to agree on a reconstruction scheme on the following conditions: interest rate be raised from 10% to 15%p.a and they are given a fixed charge on land and buildings rather than on office building of the company. They are also willing to accept ordinary shares in lieu of sh 125,000 that is one of the 2 years interest in arrears.
- Debenture is secured on office building, whose net realizable value is sh 900,000. Other land and buildings are estimated to realize sh 1,900,000
- The net realizable value of plant and machinery is sh 500,000; inventory sh 750,000 and accounts receivable sh 1,425,000
- Preference dividends have not been paid for the last two years while the debenture interest arrears are for two years.
- The bank is prepared to agree to a reconstruction scheme provided that its debt is secured by a floating charge over assets, thus improving its position in relation to other creditors of the company. It would be willing to provide financing over the medium term.
- Directors are of the view that if the company can raise sh 1 million in rights issue, it would be able to commence trading successfully. Ordinary shareholders and debenture holders are willing to subscribe for new capital in the reconstructed firm.
- Costs of the reconstruction scheme would be sh 60,000 while in the absence of a satisfactory reconstruction scheme, the company would be have to be liquidated and would incur sh 295,000 as liquidation costs.

Required:

- Design a scheme of reconstruction acceptable to all parties **(12 marks)**
- Capital reduction account **(8 marks)**

QUESTION FIVE

- Acts of Bankruptcy that form the basis of bankruptcy proceedings against an insolvent person. Discuss **(6marks)**
- Bankrupt person has duties as outlined in the Insolvency Act 2015. Discuss duties of a bankrupt person. **(5 marks)**
- Briefly explain four reasons why a creditor would prefer liquidation as opposed to capital reorganization of an insolvent person **(4 marks)**
- Most companies that are put under receivership in Kenya remain in a state of receivership for too long. Discuss factors contributing to this scenario. **(5 marks)**