JARAMOGI OGINGA ODINGA UNIVERSITY OF SCIENCE AND TECHNOLOGY

SCHOOL OF HEALTH SCIENCES

UNIVERSITY EXAMINATION FOR THE DEGREE OF BACHELOR OF BUSINESS ADMINISTRATION WITH IT

4TH YEAR 2ND SEMESTER 2019/2020 ACADEMIC YEAR

MAIN CAMPUS

COURSE CODE: ABA 417

COURSE TITLE: Bankruptcy and Insolvency

EXAM VENUE: **STREAM: (BBA)**

DATE: **EXAM SESSION:**

TIME: 2 HOURS

Instructions:

1. **Answer ALL questions in section A and ANY other 2 questions in section B**
2. **Candidates are advised not to write on the question paper.**
3. **Candidates must hand in their answer booklets to the invigilator while in the examination room**

Instructions:

1. **Answer question 1 (compulsory) and any other TWO questions.**
2. **Candidates are advised not to write on the question paper.**
3. **Candidates must hand in their answer booklets to the invigilator while in the examination room.**

QUESTION ONE

Williamson & Company Ltd. was incorporated in 1988 with an issued share capital of 2,500,000 ordinary shares of Sh.10 each and 1,000,000 8% cumulative participating preference shares of Sh.10 each. All the shares were paid for in full.

In 1992, the company issued 2,500 10% debentures of Sh.1000 each. The terms of issue stipulate that each debenture is convertible into 75 ordinary shares of Sh.10 each on 31 December 2003 and those not converted will be redeemed at par on 31 December 2008.

On 1 March 1998, the company granted its directors options to take up 500,000 ordinary shares at a price of Sh.12 per share.

On 1 April 1999, the ordinary shares were split into shares of Sh.2.50 each and on 1 December 1999 a further 3,000,000 ordinary shares were issued at fair value to satisfy the purchase of certain business rights acquired.

On 2 December 1999, 200,000 of the above options were taken up when the fair value of the shares was Sh.6 each. The average fair value of the shares during the year was, Sh.5 each. The following information has been extracted from the consolidated income statements for the years ended 31 March 1999 and 31 March 2000.

	2000	**1999**
	Sh. '000'	**Sh. '000'**
Net operating income	19,800	18,410
Income from investments	420	360
Net income before taxation and extraordinary items	20,220	18,770
Taxation	(7,630)	(6,920)
Net income after taxation	12,590	11,850
Less: Minority interest	(1,270)	(1,440)
Profit attributable to members of the group	11,320	10,410
Extraordinary items	(2,000)	(1,500)
Profit after tax and extraordinary items	9,320	8,910
Dividends (Note 1)	(4,000)	(3,200)
Retained profits for the year	5,320	5,710
Retained profit brought forward	18,530	12,820

Retained profit carried forward	23,850	18,530
Note		
Dividends paid 31 March:		
On ordinary shares	3,200	2,400
On preference shares	800	800
	4,000	3,200

Required:

(a) Calculate the basic earnings per share figure to be disclosed in the published accounts of Williamson Company Ltd. for the years ended 31 March 1999 and 31 March 2000. (15 marks)

(b) Calculate the diluted earnings per share figure to be disclosed in the published accounts of Williamson Company Ltd. for the year ended 31 March 2000. Assume a tax rate of 32.5% (10 marks)

(c) Discuss the usefulness of the earnings per share figure. (5 marks)

QUESTION TWO

Japien Ltd. offered to acquire 75% of the issued share capital of Akwesi ltd. on 1 April 1999. The offer became final on 1 May 1999. The total coat of acquisition was Sh.177,000,000. The net assets of Akwesi Ltd. as at 1 April 1999 and 1 May 1999 were Sh.130,590,000 and Sh.137,560,000 respectively.

Japien Ltd. had acquired 25% of Midamba Ltd. many years ago. On 1 September 1999 it acquired the remainder of the share capital, the consideration of which was Sh.112,000,000. The net assets of Midamba Ltd. as at that date was Sh.74,000,000. Midamba Ltd. on 2 September 1999 acquired 40% of Bwombo Ltd. The consideration paid was Sh.28,980,000. The net assets of Bwombo Ltd. as at 1 January 1999 were Sh.55,500,000.The income statements of the four companies for the year ended 31 December 1999 were as follows:

	Japien Ltd.	Akwesi Ltd.	Midamba Ltd.	Bwombo Ltd.
	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'
Turnover	3,237,840	687,760	136,800	102,600
Cost of sales	2,238,624	489,312	92,160	69,120
Gross profit	999,216	198,448	44,640	33,480
Expenses	248,736	54,368	10,240	7,680
Operating profit	750,480	144,080	34,400	25,800
Dividend income	1,440	-	-	-
Interest income	4,800	2,000	-	-
Profit before tax	756,720	146,080	34,400	25,800
Taxation	269,600	61,000	15,600	11,700
Profit after taxation	487,120	85,080	18,800	14,100
Dividends				
Ordinary				
Interim	(22,000)	(960)	(480)	(270)
Final	(2,000)	(480)	(240)	(270)
Preference	(480)	-	-	-
Retained profit for the year	462,640	83,640	18,080	13,560

Additional information:

1. Interim dividends were paid by all companies on 1 July 1999.
2. Akwesi Ltd. had sold to Japien Ltd. in the post-acquisition period, machinery at Sh. 1,260,000. The machinery had coat Akwesi Ltd. Sh.1,500,000 on 1 January 1997. It is the group's policy to provide a full year's depreciation on machinery at the rate of 10% on cost in the year of purchase but not in the year of sale, and to carry group assets at their original cost to any number of the group. Any gain or loss on the sale of machinery was adjusted against expenses.
3. Profits are to be assumed to have accrued evenly throughout the year.

Required:

The consolidated income statement of the Japien group for the year ended 31 December 1999. A reconciliation schedule is required. **20 marks**

QUESTION THREE

(a) IAS 12 (revised) "Income Taxes" requires an enterprise to provide for deferred tax in full for all deferred tax liabilities with only limited expectations. The original IAS 12, and the equivalent Kenyan Accounting Standard, allowed an enterprise not to recognize deferred tax assets and liabilities where there was reasonable evidence that timing differences would not reverse for some considerable period ahead; this was known as the partial provision method.

The original IAS 12 did not refer explicitly to fair value adjustments made on a business combination and did not require an enterprise to recognize a deferred tax liability in respect of asset revaluations. The revised IAS 12 now requires deferred tax adjustments for these items and classifies them as temporary differences.

Required:

(i) Explain why the IASC decided to require recognition of the deferred tax liability for all temporary differences (with certain exceptions) rather than allowing the partial provision method. (5 marks)

(ii) Discuss the reasons why IAS 12 (revised) requires enterprises to provide for deferred taxation on revaluations of assets and fair value adjustments on business combination. (5 marks)

(b) Kakoyo Limited has the following balance sheet and tax bases at 30 June 2000, before providing for any deferred tax in the year to 30 June 2000.

	Carrying values		Tax bases	
	Sh. '000'	Sh. '000'	Sh. '000'	Sh. '000'
Non-current assets				
Buildings (Factory)		100,500		22,500
Plant and equipment		156,000		39,000
Investment in M Ltd.: cost		1,977		1,977
Long-term quoted investments		198,000		198,000
		456,477		
Current Assets	45,000		45,000	
Current liabilities.				
Trade payables	(40,500)		(40,500)	
Provision for repairs	(900)		(Nil)	
	(41,400)	3,600		
		460,077		
Capital and reserves.				
Equity capital		30,000		30,000
Revaluation reserve		73,500		-
Retained profit		298,047		-
Shareholders' funds		401,547		
Non-current liabilities				
Long-term loan	30,000		33,000	
Deferred tax (bal. b/l)	27,030		27,030	
		57,030		
Deferred income:				
Grant from World Bank		1,500		
		460,077		

1. Kakoyo Limited acquired 100% of the ordinary share capital of M limited on 30 June 2000. The net assets of M limited as on this day were as follows:

	Fair value Sh. '000'	Carrying value Sh. '000'	Tax value Sh. '000'
Buildings (Factory)	1,500	900	300
Plant and equipment	120	90	45
Inventory	372	342	342
Trade receivables	330	330	330
Current liabilities	(495)	(495)	(315)
	1,827	1,167	702

M limited does not carry a deferred tax liability in its accounts.

2. Kakoyo Limited's director decided to revalue Kakoyo Limited's buildings at Sh.150 million and the plant and equipment to Sh.180 million, investments were not to be revalued. Kakoyo Limited's buildings had cost Sh.135 million and the plant and machinery Sh.210 million.
3. The tax rate had changed from 35% to 30% in the current year.
4. During the year, the directors agreed to provide Sh.900,000 for future repairs to the buildings. The expense is allowable for tax when it is paid.
5. The grant from the World Bank is included as deferred income in the balance sheet and is not taxable.
6. Goodwill arising on acquisition is not an allowable expense for tax purposes. Since the subsidiary was acquired on 30 June 2000, no amortization has been charged in the financial statements.
7. Kakoyo Limited raised a long-term loan of Sh.33,000,000 during the year and recorded it net of transaction costs. The transaction costs of Sh.3,000,000 are allowable for tax in the year ended 30 June 2000.

Required:

Calculate the deferred tax expense for K Limited which would appear in the group financial statements under IAS 12 (revised) "Income Taxes" for the year ended 30 June 2000.

(10 marks)

QUESTION FOUR

Mr. Collins wishes to sell his minority shareholding of 3,000 Sh.10 shares in Zebra Crafts limited. Zebra Crafts Limited is a private company with an issued share capital of Sh.1,500,000.

The current shareholders and their shareholdings are as follows:

Shareholder	**Shareholding (shares)**
Mr. Athmany	73,500
Ms. Boiyon	36,000
Mr. Chewe	24,000
Ms. Daule	13,500
Mr. Collins	3,000

The income statements for the five years to 30 June 2000 are as follows:

Year ended 30 September	**1996**	**1997**	**1998**	**1999**	**2000**
	Sh. '000'	**Sh. '000'**	**Sh. '000'**	**Sh. '000'**	**Sh. '000'**
Sales	47,880	50,400	67,200	101,640	140,400
Cost of sales	(20,805)	(21,900)	(35,040)	(62,460)	(93,720)
Gross profit	27,075	28,500	32,160	39,180	46,680
Administration expenses	(10,260)	(10,800)	(12,000)	(14,400)	(16,800)
Distribution costs	(15,330)	(16,140)	(18,000)	(21,600)	(25,200)
Operating profit	1,485	1,560	2,160	3,180	4,680
Taxation	(456)	(480)	(720)	(1,080)	(1,630)
Profit after tax	1,029	1,080	1,440	2,100	3,050
Ordinary dividend	(250)	(270)	(288)	(300)	(315)
Retained profit	779	810	1,152	1,800	2,735

The gross dividend yield on quoted companies operating in the same business sector is 12%. You are advised that this yield should be increased to 18% to allow for lack of marketability. The rate of corporation tax should be taken to be 30% through the period being considered.

Required:

(a) Discuss the relevance of dividends in the valuation of Mr. Collins shareholding. Illustrate your answer from the data given. (5 marks)

(b) Explain the factors you would take into account when estimating the future dividends and when estimating the investor's required yield. (5 marks)

(c) Explain how your approach when valuing a minority interest could be influenced by the size of the shareholding, or the fact that the owner is a party related to other significant shareholders. (5 marks)

QUESTION FIVE

Legion Air Limited is a company incorporated in Kenya which operates throughout East, Central and Southern Africa. It is in the process of making an Initial Public Offering of its shares in the Nairobi Stock exchange.

The following information is provided:

1. The main revenue-earning asset is a fleet of Aircraft, each of which is registered in Kenya, and its other main source of revenue comes from the sale of holidays in the coastal region of Kenya. The directors are unsure as to how to identify business and geographical segments
2. The company also owns an aircraft maintenance subsidiary which carries out maintenance to its aircraft and third parties. Routine maintenance is charged by subsidiary at market price. However, for specialized work, since there is often no equivalent market price, the companies negotiate a price for the work.
3. The company has incurred an exceptional loss on the sale of several aircraft to the government of the Democratic republic of Congo. The loss occurred due to a fixed price contract which had been signed several years ago for the sale of second hand

aircraft; the contract was denominated in the currency of the Congo: the Congo currency had fallen in value substantially against the Kenya shilling.

4. In the year under consideration, the company decided to discontinue its holiday business due to competition in this sector. This plan had been approved by the board of directors and announced in the press.

5. The company owns 40% of the ordinary shares of Tanzania Tours Limited, an unquoted company incorporated in Tanzania, which specializes in flying tourists to game parks in Tanzania from Arusha and Dar-es-salaam. The investment is accounted for using the equity method of accounting and it is proposed to exclude the company's results and financial position from segment revenue and assets.

Required:

(a) Explain why the information content of financial statements is improved by the inclusion of segmental information on individual business segments (5marks)

(b) Discuss the implications of each of the above points for the determination of the segmental information required to be prepared and disclosed under IAS 14 (Revised) "Segment Reporting" and other relevant International Accounting Standards.

(15 marks)