

## CHAPTER 7

### DISSOLUTION OF PARTNERSHIP FIRM

S.NO.	TOPIC			
1.	Dissolution of partnership firm	As per 39 of the partnership act 1932, "Dissolution of the firm means dissolution of partnership among all the partners in the firm." Its means business of the firm ends. All the assets of the firm are disposed off and all outside Liabilities and partner capital are paid.		
2.	Mode of dissolution of firm	1. Dissolution by agreement 2. Compulsory Dissolution 3. On happening of an event like insolvency of a partner 4. Dissolution by notice 5. Dissolution by court		
3.	Dissolution of partnership V/S Dissolution of firm	BASIS	Dissolution of Partnership	Dissolution of firm
		1. End of business	The business of the firm continue	The business of the firm closed

		2. Settlement of assets & liabilities	Liabilities are reassessed and new balance sheet is opened	Assets are realized and liabilities are paid off.
		3. Economic relationship	Economic relationship between the partners are changed	Economic relationship between the partners are to end.
		4. Court's intervention	No intervention of the court can be dissolved by mutual agreement	A firm can be dissolved by the court's order.
		5. Closer of books and accounts	Books of accounts of the firm need not to be closed.	Books of accounts of the firm are closed.
		6. Effect	It may or may not dissolution of firm	It necessarily in dissolution of partnership.

4.	SETTLEMENT OF ACCOUNTS	<p>As per section 48 of the partnership act 1932, the following rules shall apply.</p> <p>1. Treatment of losses: losses including deficiencies of capital, shall be paid :- (i) first out of profit, (ii) next out of capital and (iii) if necessary, by the partners individually in the profit sharing ratio.</p> <p>2. Application of assets: Assets of the firm shall be applied in the following manner.</p> <p>(i) In paying firm's debts to the third party.</p> <p>(ii) In paying each partner proportionately what is due to him on a/c of loan(i.e. partner's loan)</p> <p>(iii) In paying each partner proportionately what is due to him on a/c of capital</p> <p>(iv) The residue, if any shall be divided among the partners in their profit sharing ratio.</p>
5.	PRIVATE DEBTS V/S FIRM'S DEBTS	<p>SEC 49 Of the act applied as follows:</p> <p>(i) Firms property is applied first for settling the firms debts, surplus if any can be utilized for payment of their private debts up to received share.</p> <p>(ii) Private property is applied first for private debts then towards firms liability.</p>

6.	ACCOUNTING TREATMENT ON DISSOLUTION OF FIRM	Following accounts are prepared to close the books.(i) realization A/c (ii) partner's capital A/c (iii)partner's loan A/c (iv) bank A/c
7.	REALISATION Account	It is nominal A/c opened at the time of dissolution of a firm to ascertain profit and loss from realization of assets and payment of outsider's liabilities which may be transferred to partner's capital A/c in the profit sharing ratio.
8.	SETTLEMENTS OF ASSETS	(a) Fictitious assets such as advertisement suspense, preliminary expenses etc, directly transferred to partner's capital A/c in their profit sharing ratio. (b) Unrecorded assets must be realized and shown credit side of the realization A/c
9.	SETTLEMENT OF LIABILITIES	(a) All outside liabilities must be paid off even if nothing is stated for their payment. (b) Unrecorded liabilities also paid through cash or settled by unrecorded assets or settling recorded assets. (c) Contingent liabilities discounting of B/R become liability must be settled or paid.
10.	Settlement of creditors through a recorded assets	In this case no entry in the books of A/c. if part payment is made in asset in cash , then the entry will be made for cash payment only.

11.	REALISATION EXPENSES	<p>(i) If nothing is mentioned then paid by the firm.</p> <p>(ii) In case realization exp. are born by partner, clear indication should be regarding the payment there of.</p>
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#### PREPARATION OF REALISATION ACCOUNT

The following Journal Entries are passed:

##### Journal

Date	Particulars	L.F.	Cr. (₹)	Dr. (₹)
	Realisation Dr. To sundry Assets A/c (Being assets transferred to realisation A/c)			

#### Note:

1. Cash and Bank balance are not transferred to Realisation Account.
2. Assets (tangible and intangible) are transferred to Realisation Account at their Gross Value
3. Fictitious Asset such as Debit balance of Profit and Loss Account or Advertisement Suspense Account etc. are not transferred to Realisation Account. These are directly debited to partners' capital accounts in their profit sharing ratio by passing following entry:

Date	Particulars	L.F.	Dr.(Rs.)	Cr.(Rs)
	Partner's capital A/c Dr. To Profit and Loss A/c To Advertisement Suspense A/c (Being balance of losses transferred to capital accounts)			

### For Closing Liabilities Accounts

#### Journal

Date	Particular	L.F.	Dr.(Rs)	Cr.(Rs.)
	Sundry Liabilities A/c Dr. To Realisation A/c (Being sundry liabilities transferred to Realisation A/c)			

1. Only third parties' liabilities/outside liabilities are transferred to Realisation A/c
2. Balance of Partner's Loan Account is not transferred to Realisation Account. Separate accounts are opened to settle such liabilities.
3. Undistributed profits and reserves are also not transferred to Realisation A/c. These are directly credited to partners' capital accounts in their profit sharing ratio by passing the following entry:

#### Journal

Date	Particulars	L.F.	Dr.(₹)	Cr. (₹)
	Profit and loss A/c Dr. General reserves A/c Dr. Reserve fund A/c Dr. Contingency Reserve A/c Dr. To Partner's Capital A/c's (Being balance of undistributed profits transferred to capital accounts)			

Provident Fund is a liability of the firm towards employees and hence it is transferred to Realisation A/c.

- If any liability is expected to arise against any fund or reserve e.g., Workmen's Compensation Fund, then an amount equal to such liability is transferred to Realisation A/c and balance, if any, distributed among the partners in their profit-sharing ratio by passing the following entry.

#### Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Workmen's Compensation Fund A/c      Dr.			
	To Realisation A/c (Liability)			
	To Partner's Capital A/c (Balance if any)			
	(Being liability against workmen's compensation fund transferred to Realisation A/c and balance distributed among partners)			

**Example:** Workmen's Compensation Fund shown in the liability side of Balance Sheet is Rs. 50,000. At the time of dissolution liability against this fund is estimated at Rs. 30,000. Pass necessary Journal Entry:

#### Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Workmen's Compensation Fund A/c      Dr.		50,000	
	To Realisation A/c			30,000
	To A's Capital A/c			10,000
	To B's Capital A/c			10,000
	(Being liability against workmen's compensation fund transferred to Realisation A/c and balance distributed among partners)			

C. For Realisation of assets (whether recorded or unrecorded)

(a) When assets are sold for cash

Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Cash/ Bank A/c Dr.			
	To Realisation A/c			
	(Being assets sold for cash)			

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(b) When assets are taken over by any partner

Journal

Date	Particulars	L.F.	Dr. (₹)	Cr. (₹)
	Partner's Capital A/c Dr.			
	To Realisation A/c			
	(Being assets taken over by any partner)			

(c) When assets are taken over by any creditor in part of full payment of his dues:

I. In case of Full Settlement:

- (i) NO ENTRY is passed for the transfer of assets to the creditor.
- (ii) NO ENTRY is passed for the payment to creditor

II. In case of Part Settlement:

- i. NO ENTRY is passed for the transfer of assets to the creditor.
- ii. The agreed amount of asset is deducted from the claims of the creditors and the balance is paid to him.



D. For Payment of Liabilities

(a) When liabilities are paid in cash

Journal

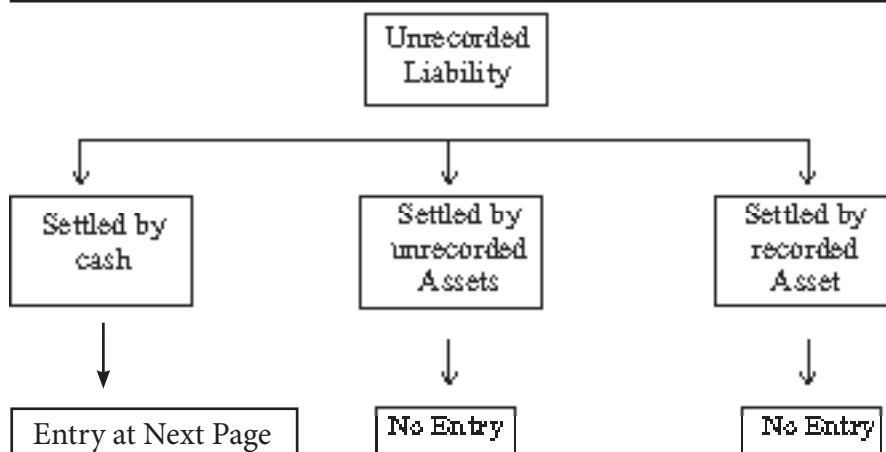
Date	Particulars	L.F.	Dr.( <sup>o</sup> )	Cr. ( <sup>o</sup> )
	Realisation A/c <span style="float: right;">Dr.</span>			
	To Cash/ Bank A/c			
	(Being liabilities paid in cash)			

(b.) When liabilities are taken over by any partner

Journal

Date	Particulars	L.F.	Dr.(Rs.)	Cr. (Rs.)
	Realisation A/c <span style="float: right;">Dr.</span>			
	To Partner's capital A/c			
	(Being liabilities taken over by a partner)			

Note: If nothing is stated regarding the settlement of any outside liability, then it should be assumed that the amount equal to book value is paid.



Journal

Date	Particular	Dr. Rs.	Cr. Rs.
	Realisation A/c Dr.		
	To cash A/c		
	(Being cash paid for unrecorded liability)		

**PREPARATION OF PARTNERS' LOAN ACCOUNT**

If a partner has given any loan to firm, his loan will be paid

- \* After payment of all the outside liabilities: but
- \* Before making any payment to partners on account of capital

Journal

Date	Particulars	L.F.	Dr.(₹)	Cr. (₹)
	Partner's loan A/c Dr.			
	To Cash/ Bank A/c			
	(Being loan of a partner paid)			

Partner's Loan A/c

Dr.

Cr.

Particulars	Rs	Particulars	Rs
To Cash/Bank A/c	—	By Balance b/d	—
	—		—

If the firm has given a loan to any partner then such loan account will show a debit balance and will appear on the asset side of Balance Sheet of the firm. Such loan accounts are settled through partner's capital account by passing the following entry:

Journal

Date	Particulars	L.F.	Dr.(₹)	Cr. (₹)
	Partner's Capital A/c <span style="float: right;">Dr.</span>			
	To Partner's Loan A/c			
	(Being loan of a partner transferred to his Capital A/c)			

**Distinction between Revaluation Account and Realisation Account**

Basis of Difference	Revaluation Account	Realisation Account
Purpose	It is prepared to show assets and liabilities in the books at their revised values.	It is prepared to ascertain profit or loss from sale of assets and repayment of Liabilities.
When to be prepared	It is prepared at the time of change in profit sharing ratio among the existing partner, admission, retirement and death of a partner.	It is prepared at the time of dissolution of a firm.
Preparation of Account	This account may be prepared at a number of times during the life of a firm.	This account is prepared once during the life of a firm.

Content	This account records only those assets and liabilities whose book values have been changed.	This account records all assets (except cash, fictitious assets etc.) and all outside liabilities.
Result	A Firm continues its business even after the preparation of revaluation account.	The business activities of a partnership firm comes to an end after preparation of realisation account

### Practical Problem

Q1. Following is the Balance Sheet of X and Y, who share profits and losses in the ratio of 4:1, as at 31st March, 2015

#### BALANCE SHEETS on 31st March, 2015

Liabilities	Rs	Assets	Rs
Sundry Creditors	8,000	Bank	20,000
Bank Overdraft	6,000	Debtors	17,000
X's Wife Loan	8,000	Less : Provision	(2,000)
Y's Loan	3,000	Stock	15,000
Investment Fluctuation fund	5,000	Investments	25,000
Capital		Buildings	25,000
X	50,000	Goodwill	10,000
Y	40,000	Profit and Loss A/c	10,000
	1,20,000		1,20,000

The firm dissolved on the above date and the following arrangement was decided upon:

- (i) X agreed to pay off his wife's loan.
- (ii) Debtors of Rs. 5,000 proved bad.
- (iii) Other assets realised-Investment 20% less; and Goodwill at 60%
- (iv) One of the creditors for Rs. 5,000 was paid only ₹ 3,000
- (v) Buildings were auctioned for Rs. 30,000 and auctioneer's commission amounted to Rs. 1,000.
- (vi) Y took over part of Stock at Rs. 4,000 (being 20% less than the book value. Balance stock realised 50%.
- (vii) Realisation expenses amounted to Rs. 2,000.

Prepare Realisation A/c, Partner's Capital A/cs and Bank A/c

Realisation Account

Dr.

Cr.

Particulars	Rs.	Particulars	Rs.
To Goodwill	10,000	By Investment Fluctuation Fund	5,000
To Buildings	25,000	By Provision for Doubtful Debts	2,000
To Investments	25,000	By Creditors	8,000
To Stock	15,000	By Bank overdraft	6,000
To Debtors	17,000	By X's Wife Loan	8,000
To X's Capital A/c (X's wife loan)	8,000	By Bank A/c (Asset realised)	
To Bank A/c (Bank overdraft)	6,000	Debtors 12,000	
To Bank A/c (Creditors) (3000+3000)	6,000	Investment 20,000	
To Bank A/c (Expenses on Realisation)	2,000	Goodwill 6,000	
To Bank A/c (auctioneer Commission)	1000	Buildings 30,000	
		Stock <u>5,000</u>	73,000
		By Y's Capital A/c (Stock)	4,000
		By Loss transferred to:	
		X's Capital A/cs 7,200	
		Y's Capital A/cs <u>1,800</u>	9,000
	1,15,000		1,15,000

Y's Loan A/c

Dr.

Cr.

Particulars	Rs.	Particulars	Rs.
To Bank A/c	3,000	By balance b/d	3,000
	3,000		3,000

Partner's Capital A/cs

Dr.

Cr.

Particulars	Rs.	Rs.	Particulars	Rs.	Rs.
To Profit and Loss A/c	8,000	2,000	By Balance b/d	50,000	40,000
To Realisation A/c (Assets taken)	—	4,000	(Cr. Balance)		
To Realisation A/c (Loss on Realisation)	7,200	1,800	(By Realisation A/c	8,000	—
To Bank A/c (Excess cash paid)	42,800	32,200	Liabilities taken)		
	58,000	40,000		58,000	40,000

Bank A/c

Dr.

Cr.

Particulars	Rs.	Particulars	Rs.
To Balance b/d (Cash at Bank)	20,000	By Balance b/d (Bank Overdraft)	6,000
To Realisation A/c (Assets Realised)	73,000	By Realisation A/c (Liabilities Paid)	1,000
		By Realisation A/c	6,000

		By Realisation A/c (Exp. Paid)	2,000
		By Y's Loan A/c (Partner's Loan Paid)	3,000
		By X' Capital A/c	42,000
		By Y's Capital A/c	32,200
	20,000		93,000

Q. Pass the necessary journal entries on the dissolution of a firm in the following cases:

- Dharama, a partner, was appointed to look after the process of dissolution at a remuneration of ₹ 12,000 and he had to bear the dissolution expenses. Dissolution expenses ₹ 11,000 were part by the Bharma.
- Jay a partner was to look after the process of dissolution and for this work he was allowed a remuneration of ₹ 7,000 agreed to bear all dissolution expenses. Actual expenses ₹ 6000 were pound from firm's Bank A/c.
- Realisation expenses ₹ 12000 born by the partner Deepa. These expenses were paid by Deepa by drawing cash from the firm. She was allowed commission ₹ 10,000 for process of dissolution.
- Dev, a partner, agreed to do the work of dissolution for ₹ 7500. He took away stock for his commission.
- A debtor of ₹ 8,000 already transferred to realization account agreed to pay the realization expenses of ₹ 78,00 in full settlement.
- Realisation expenses amounted to ₹ 15,000 out of this ₹ 12000 were to be born by 'A' a partner and the balance by firm.



**Solution:**

**Journal**

Date	Particular	L.F.	Dr. Amount (₹)	Cr. Amount (₹)
(1)	Realisations A/c To Dharam's capital A/c (Being remuneration allowed to partner to carry out dissolution)	Dr.	12,000	12,000
(2)	(i) Realisation A/c To Jay's capital A/c (Being the remunerable all out to partner for bear realisation expenses)	Dr.	7,000	7,000
	(ii) Jay's capital A/c To Bank A/c (Being the expenses paid by firm on behalf partner)	Dr.	6,000	6,000
(3)	(i) Realisation A/c To Deepa's capital A/c (Being the commission paid for realisation expenses to Deepa)		10,000	10,000
	(ii) Deepa's capital A/c To cash A/c (Being the cash is drawn for payment of realisation expenses by Deepa)		12,000	12,000
(4)	No Entry			
(5)	No Entry			
(6)	A's capital A/c Realisation A/c To Bank A/c (Being the payment of realization expenses by partner 'A' and Balance by firm)	Dr. Dr.	12,000 3,000	15,000

Q.5. Pass Journal entries for the following transactions in the book of the firm on its dissolution:

- Bills receivable of Rs. 20000 discounted with the bank is dishonoured as drawee was declared insolvent and 30% amount is received in cash from him.
- 100 shares of Bajaj Auto Ltd. acquired at a cost Rs. 3,600 had been written off from the books. These were valued at Rs. 12 par share, and were divided among partner's A and B in 2 : 1.
- Mr. Verma, a creditor to whom Rs. 6,000 are due, accepted office equipment at ₹ 4,000 and the balance paid to him by cash.
- Debtors of ₹ 5,00,000 and provision for doubtful debts of Rs. 20,000 transferred to realisation account. On dissolution bad debts were Rs. 1,00,000 and remaining debtors realised at 30% discount.

- e) Loan owed by B towards firm is Rs. 30,000. It was decided by the firm that B will pay to the creditor Rs. 25,000 in settlement of his loan.
- f) The firm had borrowed Rs. 35,000 from Rashmi, a partner. The firm got dissolved; Rashmi decided to take furniture against the payment of her loan.

Date	Particulars	L.F.	Amount (₹)	Amount (₹)
	(a) Cash A/c Dr. To Realisation A/c (Being 30% realized from drawer)		6,000	6,000
	Realisation A/c Dr. To Bank A/c (Being full amount paid to Bank)		20,000	20,000
	(b) As capital A/c Dr B's Capital A/c Dr. To Realisation A/c (Being shares taken by A and B)		800 400	12,000
	(c) Realisation A/c Dr To cash A/c (Being Net ₹2000 paid to Mr. Verma)		2,000	2,000
	(d) Cash A/c Dr To Realisation A/c (Being 70% realised from Debtors)		2,80,000	2,80,000
	(e) Realisation A/c Dr To B's Loan A/c (Being B's loan transferred)		30,000	30,000
	(f) Rashmi's Loan A/c Dr To Realisation A/c (Being loan settled by providing furniture)		35,000	35,000