

Chapter 5 Part – A

DissolutionOf a Partnership Firm

Dissolution of a firm : As per Indian Partnership Act, 1932 : “**Dissolution firm means termination of partnership among all the partners of the firm**”

When a firm is dissolved, the business of the firm terminates. All the assets the firm are disposed off and all outsiders' liabilities and partners' loan and partner capital are paid.

Dissolution of Partnership : **Dissolution of Partnership refers to terminal of old partnership agreement (i.e., Partnership Deep) and a reconstruction the firm.**

It may take place on

- Change in profit sharing ratio among the existing partner:
- Admission of a partner; and
- Retirement of Death of partner.

It may or may not result into closing down of the business as the remount partners may decide to carry on the business under a new agreement.

Types of dissolution of firms: A Partnership firm can be dissolved in any the following ways:

(A)Without the intervention of the court:

- (1)** When all partners agree to dissolve the firm (Sec. 40);
- (2)** Compulsory Dissolution (Sec. 41)
 - (i)** When all or except but one partner of the firm become insolvent
 - (ii)** When business of the firm become unlawful.

(3) On the happening of any of the following events: (Sec. 42)

(i) On the insolvency of a partner.

(ii) On the fulfillment of the objective of the firm for which the firm was formed.

(iii) On the expiry of the (period) for which the firm was formed.

(4) By Notice (Sec. 43) : When the duration of the partnership firm is a fixed and it is at will of the partners. Any partner by giving notice other partners can dissolve the firm.

(B) Dissolution by order of the court (Sec. 44) : A court on application by a partner may order the dissolution of the firm under the following circumstances:

(1) When a partner has become of unsound mind.

(2) When a partner has become permanently incapable of performing his duties as a partner.

(3) When a partner is found guilty of misconduct that may harm the partnership.

(4) When a partner consistently and deliberately commits breach of partnership agreement.

(5) When a partner transfers whole of his interest in the business firm to a third party, without the consent of existing partners.

(6) When the court is satisfied that the partnership firm cannot be carried on except at a loss.

(7) When the court finds that the dissolution of firm is justified and equitable.

ACCOUNTING TREATMENT OF DISSOLUTION

On dissolution of a firm, the following accounts are opened to close the books of the firm .

· Realisation Account;

· Partner's Loan Account;

· Partner's Capital Accounts; and

· Cash or Bank Account.

Realisation Account : It is nominal account opened on the dissolution of a firm **to ascertain the profit or loss on realization of assets and payment of outsiders liabilities.** This account is closed by transferring the balance (i.e., profit or loss on realization) to partner's capital accounts.

PREPARATION OF REALISATION ACCOUNT

The following Journal Entries are passed :

A. For Closing Assets Accounts:

Realisation A/cDr.

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 to their Gross Value
3. Fictitious Asset such as Debit balance of Profit and Loss Account of Advertisement Suspense's Account etc. are not transferred to Realisation Account. These are directly debited to partners' capital accounts in their profit sharing ratio by passing the following entry.

Partner's capital A/cDr.

To Profit and Loss A/c

To Advertisement Suspense A/c

(Being Balance of losses transferred to capital accounts)

4. **Provision** against assets such as Provision for Depreciation of Provision for Bad & Doubtful debts etc. are transferred to Realisation Account by passing a Separate entry:

Provision's for Bad Debts A/cDr.

Provision's for Depreciation A/cDr.

Investment Fluctuation Fund A/cDr.

Machinery Replacement Reserve A/cDr.

To Realisation A/c

(Being Provision & Reserves Against Assets transferred to Realisation Account)

B. For Closing Liabilities Accounts:

Sundry Liabilities A/cDr.

To Realisation A/c

(Being sundry liabilities transferred to Realisation A/c)

Note :

1. Only third parties liabilities/outside liabilities are transferred to Realisation A/c
2. Balance of Partner's Loan Accounts are 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.

Profit and Loss A/cDr.

General Reserves A/cDr.

Reserve fund A/cDr.

Contingency Reserve A/cDr.

To Partner's Capital A/cs

(Being balance of undistributed profits transferred to capital accounts)

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

*5. 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 balance, if any, distributed among the partners in their profits-sharing ratio by passing the following entry.

Workmen's Compensation Fund A/CDr.

To Realisation A/c(Liability)

To Partners' Capital A/cs(Balance, if any)

(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

Cash/Bank A/cDr.

To Realisation A/c

(Being assets sold for cash)

b. When assets are taken over by any partner.

Partner's Capital A/cDr.

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 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 its creditors and the balance is paid to him.

Note :

1. The realized value of each asset must be given at the time of dissolution.

D. For Payment of Liabilities

a. When liabilities are paid in cash

Realisation A/cDr.

To Cash/Bank A/c

(Being liabilities paid in cash)

b. When liabilities are taken over by any partner

Realisation A/cDr.

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.

E. For Realisation Expenses

a. When expenses are paid by firm and borne by firm:

Realisation A/cDr.

To Cash/Bank A/c

(Being realization expenses paid in cash).

b. When expenses are paid by any partner and borne by firm :

Realisation A/cDr.

To Partner's Capital A/c

(Being realization expenses paid by a partner).

c. When expenses are paid by firm (on behalf of any partner) and borne by a partner.

Partner's Capital A/cDr.

To Cash/Bank A/c

(Being realization expenses paid on behalf of partner).

e. When a partner is paid a fixed amount for bearing realization expenses then: Actual expenses are not be considered;

ii. Realization A/cDr. (With Fixed Amount)

To Partner's Capital A/c

(Being realization expenses paid by a partner)

f. When expenses are paid by one partner and borne by another partner;

Partner's Capital A/cDr. (Who borne the expenses)

To Partner's Capital A/c (Who pays the expenses)

(Being realization expenses paid by one partner and borne by another partner).

In case the realization expenses are borne by a partner, clear indication should be given regarding the payment there of.

F. For Closing Realisation Account

a. When Realization A/c Discloses profit (in case total of credit side is more than the total of

debit side)

Realisation A/cDr.

To Partner's Capital A/cs

(Being profit on realization transferred to partners' capital A/cs)

b. When Realisation A/c discloses loss (in case total of debit side is more than the total of credit side)

Partners' Capital A/cDr.

To Realisation A/c

(Being loss on realization transferred to partners capital A/cs)

FORMAT OF REALISATION ACCOUNT

Realization A ccount

Particulars	(Rs.)	Particulars	(Rs.)
To sundry Assets A/c (Excluding cash or bank balance. Fictitious assets. Dr. balance of P & Lac, Dr. balance of partner's Capital/current A/cs, Loans to partners)		By Sundry Liabilities A/c (Excluding Cr. Balance of P & L A/c, Reserves, Partners' Capital/Current A/cs, Loan from partner and Bank Overdraft)	
To Cash/Bank A/c (Amount paid for discharging Liabilities-recorded and unrecorded)		By provision on any Assets A/c (Such as provision for Depreciation, Provision for Doubtful Debts, Joint Life Policy Reserve etc.)	
To Cash Bank A/c (Expenses on Realisation)		By Cash/Bank A/c (Amount received on realization of assets-recorded and unrecorded)	

To Partner's Capital A/cs (Liabilities taken over by a Partner commission payable to him or any expenses payable to him)		By Partners' Capital A/c (Assets taken over by a partner recorded or unrecorded)	
To Partner' Capital A/cs (For transferring profit on Realisation)		By partners' Capital A/cs (For transferring loss on Realisation)	

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

Partner's Loan A/cDr.

To Cash/Bank A/c

(Being loan of a partner paid)

Partner's Loan A/c

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 debti 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:

Partner's Capital A/c Dr.

To Partner's Loan A/c

(Being loan to partner transferred to his Capital A/c)

Preparation of partner capital Accounts

After the Transfer of

- Undistributed profits and reserves
- Profit on Realisation
- Any liability taken over by any partner

And

- Undistributed losses and fictitious assets
- Loss on realization
- Any assets taken over by any partner

The balance of partners' capital A/cs are closed in the following manner

a. For making final payment to a partner (if total of credit side is more than the total of debit side)

Partner's Capital A/c Dr.

To Cash/Bank A/c

(Being excess paid to partner in cash)

b. For any amount received from a partner against debit balance in his capital account.

Cash/Bank A/c Dr.

To Partner's Capital

(Being cash brought in by any partner)

Partner's Capital A/c

Particulars	(Rs.)	Particulars	(Rs.)
-------------	-------	-------------	-------

To Balance A/c (Dr. Balance)		By balance bid (Cr. Balance)	
		By General Reserve A/c	
To Profit and Loss A/c		By Profit and Loss A/c	
To Advertisement Suspense A/c		By workmen's	
To Realisation A/c		Compensation Fund	
(Assets taken)		By Realisation A/c	
To Realisation A/c		(Liabilities taken)	
(Loss on Realisation)		By Realisation A/c	
To Cash/Bank A/c		(Profit on Realisation)	
(Excess cash paid)		By Cash/Bank A/c Cash brought in	

Preparation of Cash or Bank Account

This account is prepared at the end closed last of all. This account helps to verification of the arithmetically accuracy of accounts as both sides of this account must be equal.

Note: If cash and bank balance both are given in the Balance Sheet, one A/c to prepared, either a Cash A/c or a Bank A/c If Cash A/c is opened, an entry of with drawing the bank balance is made:

Cash A/c Dr.

To Bank A/c

(Being cash withdrawn from Bank)

If Bank A/c is opened, an entry for depositing the cash into bank is passed.

Bank A/c Dr.

To Cash A/c

(Being cash deposited into Bank)

Cash/Bank A/c

--	--	--	--

Particulars	(Rs.)	Particulars	(Rs.)
To Balance A/c (Cash in Hand or Cash at Bank)		By balance bid (Bank overdraft)	
To Realisation A/c (Assets Realisation)		By Realisation A/c (Liabilities Paid)	
To Partner' Capital A/cs (Cash brought in by partner)		By Realisation A/c (Realisation Expenses Paid)	
		By Partner's Loan A/c (Partner's Loan Paid)	
		By Partner's Capital A/cs (Excess cash paid to partner)	

Distinction between Revaluation Account Realisation Account

Basic 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 on 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	A firm comes to an end after preparation of realization

	revaluation account.	account
--	----------------------	---------

PREPARATION OF MEMORANDUM BALANCE SHEET

If a balance sheet on the date of dissolution is not given in the question, there is always advisable to prepare Memorandum Balance Sheet on the date of dissolution to ascertain the amount of balancing figure.

Note

- In the absence of any other information “Sundry Assets” should be treatment as balancing figure on the **assets side of Balance Sheet**.
- If the balance of Partners’ Capital A/cs are not given as on the date on dissolution, first we will find the balance of partners’ capital accounts as on the date of dissolution by **recasting the capital accounts**.
- When “Sundry Assets” are given in the question and nothing is specified about the difference on the asset side of Balance Sheet, the different should be treated as **Dr. balance of Profit and Loss A/c**.

Some common mistakes committed by students

- Entries for assets or liabilities taken by partners
- Dissolution Expenses
- Realisation of unrecorded assets
- Payment of Unrecorded Liabilities
- Treatment of Fictitious Assets

Due care should be taken while showing the effect of above mentioned items.