

CHAPTER - 4

Dissolution of Partnership Firm

❖ **Meaning of Dissolution of Partnership Firm**

It implies winding-up of a partnership firm and the business of the partnership firm is discontinued. It is carried by selling off assets of the business and paying off all the liabilities. It implicitly implies dissolution of partnership (deed) as well as dissolution of the partnership firm.

❖ **Difference Between Dissolution of Partnership and Dissolution of Partnership Firm**

Basis of Difference	Dissolution of Partnership	Dissolution of Partnership firm
Meaning	It means change in the partnership deed (or the agreement) among the partners.	It means that the business is wound up and the firm is dissolved.
Discontinuation	Business is not discontinued.	Business is discontinued, as the firm is dissolved.
Closure of Books of Accounts	Books of accounts are not closed forever, as there is only change in the existing agreement between the partners.	Books of accounts are closed, as the business is discontinued.
Assets and Liabilities	In this case, the assets and liabilities are revalued.	In this case, all the assets are sold off in order to pay the liabilities of the business.
Role of Court	There is no intervention by the court.	Dissolution of a partnership firm may be done with the consent of the court.
Nature	It is voluntary in nature.	It may be voluntary (as per the discretion of the partners) or compulsory (as per the order of the court).
Effect	It may or may not involve dissolution of the firm.	It necessarily involves dissolution of both the partnership as well as of the partnership firm.

❖ **Difference Between Realisation and Revaluation**

Basis of Difference	Realisation Account	Revaluation Account
Meaning	It records the sale of various assets and payment of various liabilities.	It records the effect of revaluation of assets and liabilities on the eve of admission, retirement, death and change in the profit sharing ratio.
Time	Prepared at the time of dissolution of firm.	It is prepared when admission/retirement/death or change in profit sharing ratio takes place.
Objective	To ascertain profit or loss on realisation of assets and payment of liabilities.	To find out profit or loss on revaluation of assets and liabilities.

Amount	Assets and liabilities are shown at their book-value.	Increase or decrease in the value of assets and liabilities are shown in this account.
Records	All assets and liabilities are recorded here.	Only those assets and liabilities are recorded here whose values have changed over a period of time.
Effect	All accounts of assets and liabilities are closed.	No account is closed on revaluation of assets and liabilities.

❖ **Realisation Account**

Realisation Account			
Dr.		Cr.	
Particulars	Amount Rs	Particulars	Amount Rs
<i>Individual Assets</i> (Excluding Cash/Bank, fictitious assets, Debit balance of P & L A/c, partner Capital A/c, Deferred Revenue Expenditure A/c, Current A/c, Loan to Partner) Land and Building Furniture Plant and Machinery* Debtors/Book Debts* Freehold Property Bills Receivables Joint Life Policy Goodwill Equipments Marketable Securities Investments Stock Prepaid Expenses Outstanding Incomes Provision for Discount on Creditors		<i>Individual Liabilities</i> (Excluding Partner Capital Account, Reserves, P & L A/c, Current A/c, Partner's Loan, Bank Overdraft) Provisions for Doubtful Debts Machinery Replacement Reserve Provisions for Bad Debts Provisions for Depreciation Notes Payable Partner's Wife's or Husband's Loan Joint Life Policy Fund [#] Creditors Bills Payable Long-term Loans Investment Fluctuation Fund [#] Mortgaged Loans Loans and Advances from External Parties Income earned in advance Outstanding Expenses Provision for taxation/ Taxation Reserve Employee Provident Fund Depreciation Reserve	

<i>Realisation of Liabilities</i> Cash/ Bank (if liabilities paid-off in cash/cheque)ψ Partner's Capital A/c (if liabilities paid by partner) Cash/Bank/Partner's Capital A/c (if unrecorded liabilities paid in cash/bank/ paid by Partner) Partner's Capital A/c (If Remuneration paid by firm to partner to carry out Realisation work) Cash/Bank A/c (if Realisation expenses are borne and paid by firm) Profit on Realisation ** A's Capital/Current A/c – B's Capital/Current A/c – C's Capital/Current A/c – 		<i>Realisation of Assets</i> Cash/Bank (if assets sold-off for cash/cheque) Partner's Capital A/c (if assets taken over by partner) Cash/Bank/Partner's Capital A/c (if unrecorded asset sold for cash/bank/ taken over by Partner) Loss on Realisation ** A's Capital/Current A/c – B's Capital/Current A/c – C's Capital/Current A/c – 	

* At its Gross Value (given in the inner column of the Balance Sheet of the question)

Investment Fluctuation Fund (IFF), Joint Life Fund (JLF) is transferred to the credit side of the Realisation Account, if and only if, Investments and Joint Life Policy appear on the Assets side of the Balance Sheet. Else, the funds (IFF and JLF) are transferred to the credit side of the Partner's Capital Account.

ψ The external liabilities such as, Creditors, Outsider's Loan, Bills Payables, Long-term Loans, etc., should be paid-off either in cash or through cheque, even if the question is silent about their repayment.

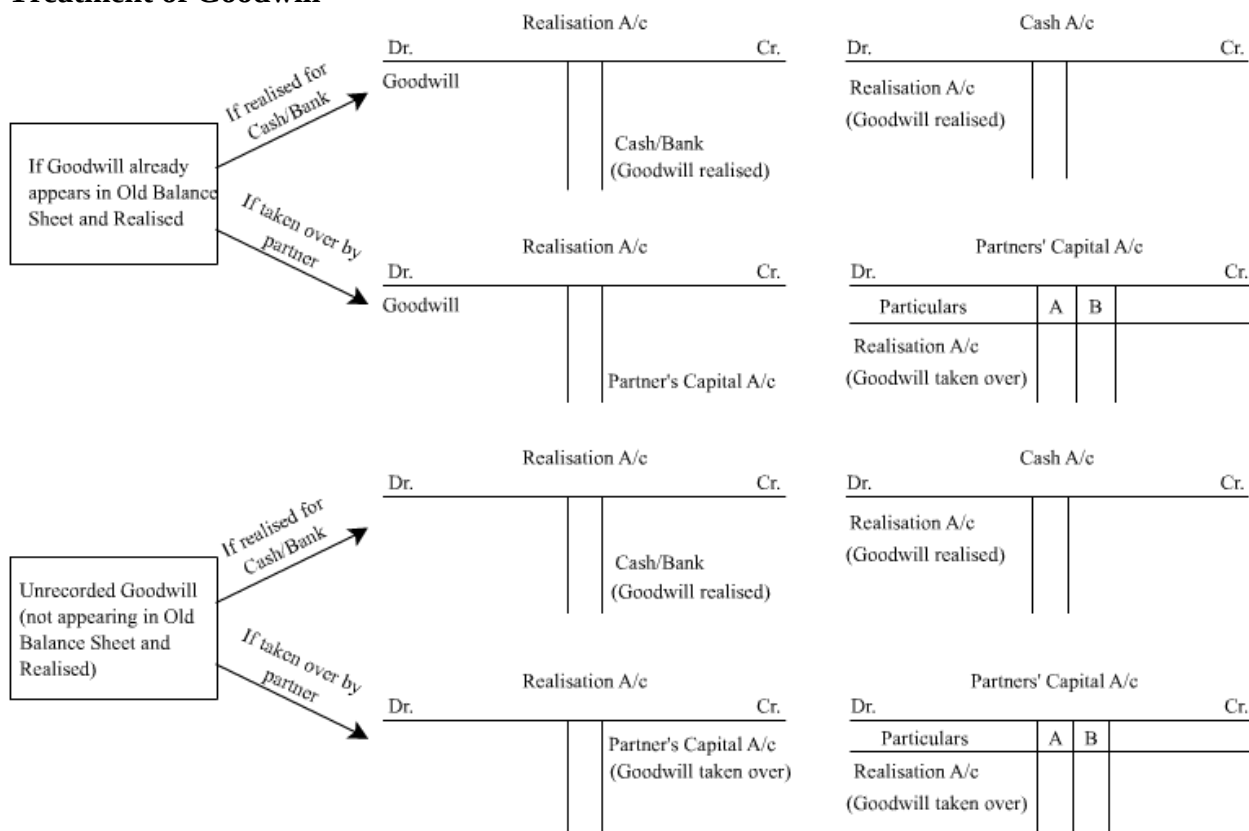
** If credit side > debit side, then Realisation Profit is credited to the Partner's Capital A/c in Old Ratio.

** If credit side < debit side, then Realisation Loss is debited to the Partner's Capital A/c in Old Ratio.

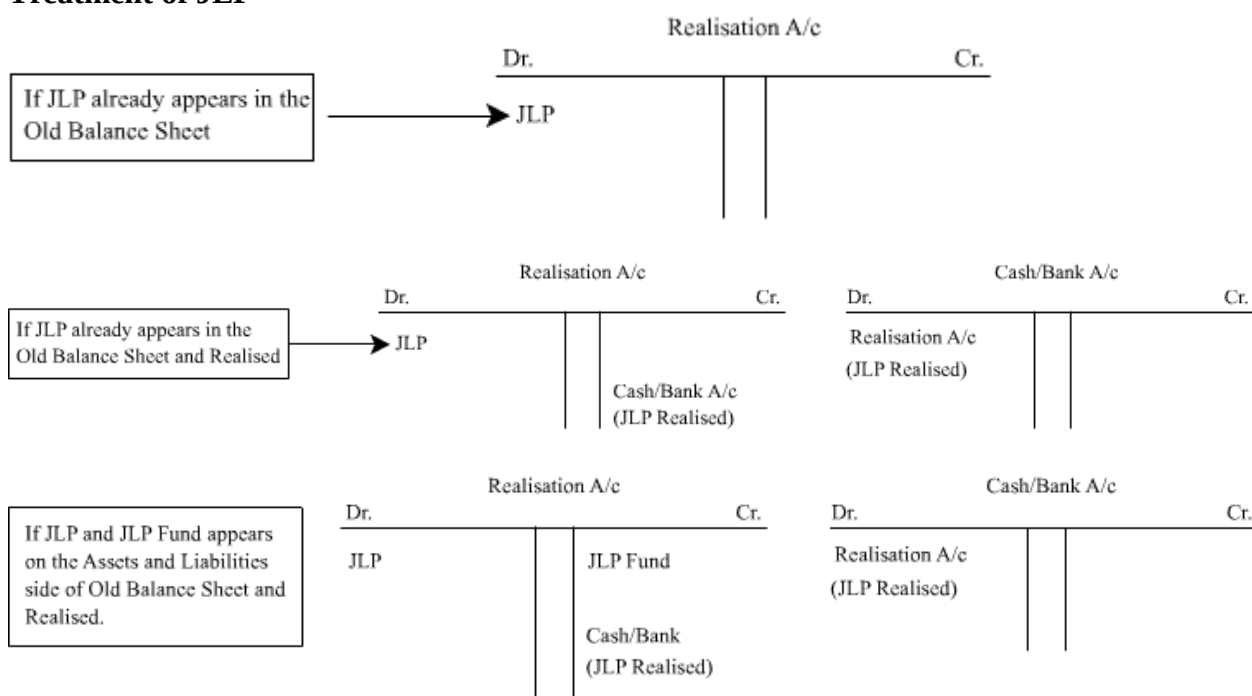
NOTE: The items such as IFF, JLF, Machinery Replacement Reserve, Provisions for Doubtful Debts, Provisions for Bad Debts, Provisions for Depreciation, Provision for taxation/ Taxation Reserve, Employee Provident Fund, Depreciation Reserve, Outstanding Incomes, Income Earned in advance, etc. will not be repaid as other liabilities because these are not actual liabilities.

❖ Accounting Treatment of Some Important Items

• Treatment of Goodwill



• Treatment of JLP



Partners' Capital A/c				
Dr.				Cr.
	Particulars	A	B	C
	JLP Fund (Credited in Old ratio)			

If JLP Fund appears but JLP does not appears in the Old Balance Sheet.

- Treatment of Workmen Compensation Fund and Contingency Reserve**

Case 1: If Workmen Compensation Fund (WCF) appears in the Old Balance Sheet and no related adjustment is given, then WCF will be credited with the whole amount to the Partner's Capital Account in their profit sharing ratio. It will not be transferred to the credit side of the Realisation Account.

Case 2: If WCF appears in the Old Balance Sheet and related adjustment is given, then WCF will be closed by transferring it to the credit side of the Realisation A/c with the amount with which the claim arose. Further, it will also be transferred to the debit side of the Realisation Account with the same amount of the claim arose. The excess amount will be credited to the Partner's Capital A/c in their old profit sharing ratio.

For example: If WCF appears in the Balance Sheet with Rs 10,000 and the related adjustment of Rs 4,000 is given, then

Realisation Account			
Dr.			Cr.
Particulars	Amount Rs	Particulars	Amount Rs
<i>Liabilities Realised</i> Cash/Bank (Workmen Compensation Fund)	4,000	Workmen Compensation Fund	4,000

Partners' Capital Account							
Dr.							Cr.
Particulars	A	B	C	Particulars	A	B	C
				WCF *	2,000	2,000	2,000

* The excess amount of Rs 6,000 (Rs 10,000 – Rs 4,000) is distributed among the partners in their profit sharing ratio of 1:1:1.

❖ Realisation Expenses

The following are the different situations for the Realisation Expenses

- **Case 1:** If paid by Firm and borne by Firm

Realisation A/c Dr.
To Cash/Bank A/c

- **Case 2:** If paid by *Firm* and borne by *Partner*

Partner's Capital A/c Dr.
To Cash/Bank A/c

- **Case 3:** If paid by *Partner* and borne by *Firm*

Realisation A/c Dr.
To Partner's Capital A/c

- **Case 4:** If paid by Partner and borne by Partner
No Entry

- **Case 5:** If a partner (say Mohan) agrees to bear realisation expenses (say actual expenses Rs 15,000) for a certain amount of remuneration (say Rs 2,000), then the Journal entry will be same as of the Case 3, but the amount in the Journal entry will be of the remuneration amount given to the partner (i.e. of Rs 2,000) and not of the actual expenses.

Realisation A/c	Dr.	2,000	
To Mohan's Capital A/c			2,000

- **Case 6:** If realisation expenses (say Rs 20,000) is to be bear by both firm (say Rs 6,000) as well as by the partner (say Rs 14,000), but the expenses are to be paid by the partner, then the Journal entry of only Rs 6,000 will be passed as the remaining amount of Rs 14,000 is borne and paid by the partner.

Realisation A/c	Dr.	6,000	
To Partner's Capital A/c			6,000

- Case 7:** If a partner (say Rohit) agrees to carry out all realisation work for an agreed certain remuneration (say Rs 15,000) and realisation expenses (of Rs 10,000) is to be borne by the firm, then the following Journal entries are passed.

Realisation A/c	Dr.	15,000	
To Rohit's Capital A/c			15,000
(Remuneration to Rohit for carrying out realisation work)			

Realisation A/c	Dr.	10,000	
To Cash/Bank A/c			10,000
(Realisation expenses of Rs 10,000 paid and borne by firm)			

NOTE: If nothing is mentioned about who is paying and who is bearing the realisation expenses, for example, 'Realisation expenses amounted to Rs 6,000', then it is assumed that the realisation expenses are paid and borne by firm itself, i.e. **Case 1**.

❖ Partner's Loan Account

Partner's Loan Account is not closed by transferring its balance to the credit side of the Realisation Account. In fact a separate account is prepared namely, Partner's Loan Account. This account is closed by paying cash/bank to the partner.

Partner's Loan Account

Dr.		Cr.	
Particulars	Amount Rs	Particulars	Amount Rs
Cash/Bank	-	Balance b/d	-
	-		-

❖ Partners' Capital Account

Partners' Capital A/c

Dr.							Cr.
Particulars	A	B	C	Particulars	A	B	C
Profit and Loss (Debit Balance)	—	—	—	Balance B/d	—	—	—
Deferred Revenue	—	—	—	General Reserve/ Reserve Fund	—	—	—
Expenditure (Advertisement Expenditure)				Profit and Loss (Credit Balance)	—	—	—
Realisation Loss	—	—	—	Realisation Profit	—	—	—
Assets (If taken over by Partners)	—	—	—	Liabilities (If taken paid- off by Partners)	—	—	—
Cash/Bank- Realisation Expenses (if expenses are paid by firm and borne by partner)	—	—	—	Realisation- Remuneration (paid by firm to partner to carry out Realisation work)	—	—	—
				Workmen's Compensation Fund*	—	—	—

				Investment Fluctuation Fund*	—	—	—
				Contingency Reserve*	—	—	—
Cash/Bank- Final Payment (If Cr. Side > Dr. side)	—	—	—	Cash/Bank- Deficiency in Capital (If Dr. side > Cr. Side)	—	—	—

❖ **Cash/Bank Account**

Cash/Bank Account

Dr.		Cr.	
Particulars	Amount Rs	Particulars	Amount Rs
Balance b/d		Realisation (Liabilities Paid-off)	
Realisation A/c (All Assets realised)		Realisation (Expenses)	
Cash A/c [#] (for deposit of cash into bank)		Partner's Capital	
		A's Capital -	
		B's Capital -	
		C's Capital -	-
		Partner's Loan- Repayment	
	**		**

**** Equality ensures arithmetical accuracy of the solution.**

[#] If both Cash as well as Bank balances are given in the question, then either of the two can be prepared. In such case, an additional entry is passed for deposit of cash into bank, if Bank Account is prepared, i.e. debited to the Bank Account (or an additional entry is passed for withdrawal of cash from bank, if Cash Account is prepared, i.e. debited to the Cash Account).