

Class 12

Accountancy

CHAPTER – 4

**DISSOLUTION
OF A PARTNERSHIP FIRM**

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Dissolution of a Firm

According to Section 39 of the Indian Partnership Act, 1932, Dissolution of a firm means the dissolution of partnership between all the partners and no business is being carried out afterwards.



Dissolution of Partnership
Vs
Dissolution of Firm



Differences between Dissolution of partnership and Dissolution of a firm

BASIS	DISSOLUTION OF PARTNERSHIP	DISSOLUTION OF FIRM
1. Meaning	Economic relation between the partners change	Partnership between all the partners of a firm comes to an end.
2. Termination	The business is not terminated	The business of the firm is completely closed.
3. Court's intervention	No court intervention	Court may intervene and order for dissolution of firm.

Differences between Dissolution of partnership and Dissolution of a firm

BASIS	DISSOLUTION OF PARTNERSHIP	DISSOLUTION OF FIRM
4. Settlement	Assets and liabilities are revalued and new balance sheet is prepared	Assets are sold, liabilities are paid off and balance utilized towards settlement of partners.
5. Closure of Books	Books of accounts are not closed	All books of accounts are closed.
6. Settlement of Assets and Liabilities	Assets and liabilities are revalued	Assets are sold and liabilities are paid off.

Dissolution of Partnership

Dissolution of partnership changes the existing relationship between partners but the firm may continue its business as before



Dissolution of Partnership may take place in any of the following ways:

1. Change in profit sharing ratio among partners.
2. Admission of a new partner.
3. Retirement of a partner.
4. Death of a partner.
5. Insolvency of a partner.
6. Completion of the venture.
7. Expiry of the period of partnership.



Modes of Dissolution of a Firm

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Modes of Dissolution of a Firm

1. Dissolution by Agreement (Sec. 40):

A partnership firm may be dissolved when:

- a) All the partners give consent for dissolution.
- b) As per the contract between partners.



Modes of Dissolution of a Firm

2. Compulsory Dissolution (Sec.41)

A firm is dissolved compulsorily in the following cases:

- a. Where all the partners or all except one become insolvent or insane.
- b. Where the business becomes illegal.
- c. Where all the partners except one decide to retire from the firm.
- d. Where all the partners or all except one partner die.



INSOLVENT

Modes of Dissolution of a Firm

3. Due to Contingencies (Sec. 42)

In the absence of an agreement to the contrary, a firm will be dissolved in the following cases:

- a) On the expiry of the term of the firm.
- b) On the death of a partner.
- c) On the adjudication of a partner as insolvent.
- d) On the completion of the venture for which the firm was constituted.



Modes of Dissolution of a Firm

4. Dissolution by Notice (Sec. 43)

In case of a partnership at will, the firm may be dissolved by any partner giving a notice in writing to all the other partners of his intention to dissolve the firm

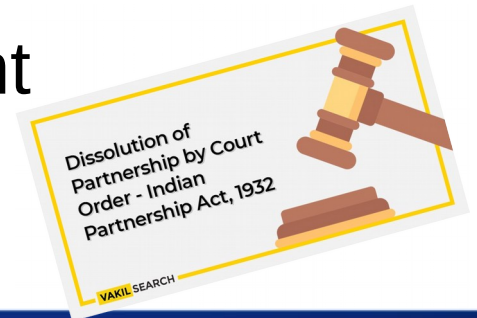


Modes of Dissolution of a Firm

5. Dissolution by Court (Sec. 44)

A court may order a partnership firm to be dissolved in case of a suit by a partner in the following cases:

- a) Where a partner becomes of unsound mind.
- b) Where a partner becomes permanently incapable of performing his duties as a partner.
- c) Where a partner commits wilful or persistent (continuous) breaches of agreement.



Modes of Dissolution of a Firm

5. Dissolution by Court (Sec. 44)

Where a partner's conduct is likely to adversely affect the business of the firm.

- d)** Where a partner transfers whole of his interest in the firm to a third party without the consent of the other partners.
- e)** Where the business of the firm cannot be carried on except at a loss.
- f)** Where the court regards dissolution to be just and equitable.

SETTLEMENT OF ACCOUNTS

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SETTLEMENT OF ACCOUNTS

At the time of dissolution, the firm stops its business and has to settle its accounts

For this, it disposes off all the assets for satisfying all the claims (liabilities) against it



SETTLEMENT OF ACCOUNTS

Section 48 of the Partnership Act provides the following rules in the mode of settlement of accounts between the partners:

1. Loss to be paid first out of profits, next out of capital and lastly by the partners individually in their profit sharing ratio.



SETTLEMENT OF ACCOUNTS

2. All the assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner and order:

- (a) Realisation expenses.
- (b) Payment of outside liabilities of the firm, ie; creditors, loans, bank overdraft, bills payable, loans from partner's relatives etc.
- (c) Repayment of loans from partners.
- (d) Repayment of capital contributed by the partners.
- (e) Any surplus left is distributed among all the partners in their profit sharing ratio.

Firms Debts and Private Debts

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Firms Debts and Private Debts

- a) The resources of the firm shall be utilized to pay off the firm's creditors and if any surplus left out can be applied to pay off the creditors of a partner.
- b) The individual property of a partner must be applied first for satisfying his private debts and any surplus is made available to settle the firm's debts.



Accounting Treatments

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Accounting Treatments

When a firm is dissolved, the books of accounts are to be closed and profit or loss on realizing the assets and discharge of liabilities are to be calculated



For this, a **Realisation Account** is prepared, by which assets are realized and liabilities are paid off.

Accounting Treatments

Assets may be realized at more or less than the book values

Profit or loss on realisation is transferred to partners' capital accounts in their profit sharing ratio



Partners with debit balance in their capital account should bring necessary cash and partners having credit balance in their capital accounts are paid off

Accounting Treatments

Loan from a partner – It is not transferred to the realization account, but it is paid directly through the loan account itself.



This is because partner's loan must be repaid before making payment of capitals

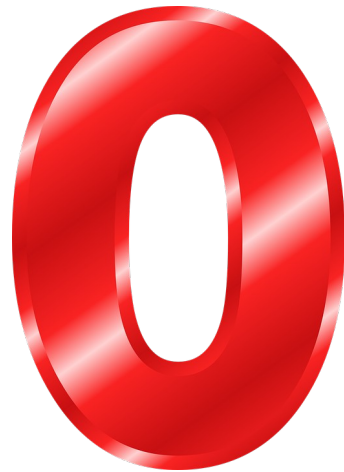
Accounting Treatments

Loan from the wife of a partner – It is transferred to the realization account as it is an outside liability.



Accounting Treatments

Cash / Bank Accounts – After making all the settlement it will be automatically closed.



Cash & Bank A/c Balance = 0



Journal Entries on Dissolution of a Firm

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Journal Entries on Dissolution

1 (a) Transfer of Assets

All assets other than cash, bank and the fictitious assets are closed by transfer to the debit of Realisation Account at their gross book values.



Realisation Account Dr
To Assets Account (individually)

1. Transfer of Assets

Note – 1. Fictitious Assets are those assets which are having no marketable values but they are treated only for the sake of convenience, they have existence merely in name, eg. Prepaid expenses, Preliminary expenses, deferred revenue expenses etc.

Note – 2. Sundry debtors should be transferred at its full value without deducting the provision for doubtful debts, if any.

Journal Entries on Dissolution

1 (b). Provisions

All the provisions against the assets are closed by transfer to the Realisation account

Provision for doubtful debts	Dr
Provision for depreciation	Dr
Joint Life Policy Reserve	Dr
Contingency Reserve	Dr
To Realisation Account	

Journal Entries on Dissolution

2. Transfer of liabilities

All liabilities to outsiders (external liabilities) are closed by transfer to realisation account at the book value

(Sundry Creditors, Bills Payable, Bank O/d, Outstanding Expenses, Partner's Wife's loan etc.)

Liabilities (Individually) A/c Dr
To Realisation Account



Journal Entries on Dissolution

4. Assets taken over by a partner

Partner's Capital account Dr
To Realisation Account



Journal Entries on Dissolution

5. Payment of liabilities:

Realisation Account **Dr**
To Cash / Bank



Journal Entries on Dissolution

6. Partner discharge the external liabilities

If a partner agrees to discharge the liabilities to outsiders:

Realisation Account Dr
To Partner's capital account



Journal Entries on Dissolution

7. Settlement of creditor through transfer of assets

- a) When a creditor accepts partly assets and partly cash, only the cash payment is recorded.

Realisation Account Dr
To Cash / Bank



Only the cash payment is recorded. Why?

It is so because, the liability due to the creditor has already been transferred to the credit of Realisation Account and the Assets taken over by the creditor is also transferred to the debit of Realisation account, but the cash account is not transferred

The debit of assets cancels the credit of corresponding liability in the realisation account and the payment of balance will be made in cash

Therefore, the cash payment is only recorded.

Journal Entries on Dissolution

7. Settlement of creditor through transfer of assets

- c) When a creditor accepts assets as full and final settlement, ie; the amount due to him and the value of asset is the same:

No Entry



Journal Entries on Dissolution

8. Realisation expenses

a) For payment of realisation expense:

Realisation Account Dr
To Cash / Bank



Journal Entries on Dissolution

8. Realisation expenses

b) If a partner meets the expenses on realisation of assets and liabilities:

Realisation Account Dr
To Partner's capital account



Journal Entries on Dissolution

8. Realisation expenses

c) When a partner has agreed to undertake the dissolution work for an agreed remuneration and he bears all the realization expenses, in such a situation;

i) For payment of agreed remuneration to that partner:

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



Journal Entries on Dissolution

8. Realisation expenses

c) ii) If the partner himself pays the realization expenses:

No Entry.....



Journal Entries on Dissolution

8. Realisation expenses

c) iii) If payment of realization expenses is made by the firm:

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



Journal Entries on Dissolution

9. Unrecorded Assets

For realization of any unrecorded assets including goodwill, if any:

Bank A/c Dr
To Realisation A/c

Unrecorded

Journal Entries on Dissolution

10. Unrecorded Liability

For settlement of unrecorded liability:

Realisation A/c Dr
To Bank A/c



Unrecorded

Journal Entries on Dissolution

11. To close the realisation account:

a) If it is profit on realisation account:

Realisation A/c Dr
To Partners' capital account

Realisation A/c

Journal Entries on Dissolution

11. To close the realisation account:

b) If it is loss on realisation account:

Partners' Capital A/c Dr
To Realisation A/c

Realisation A/c

Journal Entries on Dissolution

12. Other items on the liability side of Balance Sheet

Reserve fund and credit balance of P&L Account are transferred to the partners' capital accounts directly

Reserve fund / General Reserve A/c	Dr
P & L Account	Dr
To Partners' Capital Account	

Reserve Fund

Journal Entries on Dissolution

13. Fictitious Assets

To transfer fictitious assets, if any, to partners' capital accounts in their profit sharing ratio:

Partners' Capital A/c (individually) Dr

To Fictitious Assets A/c



Journal Entries on Dissolution

14. Partner's Loan

For payment of loans due to partners

Partners' Loan A/c Dr

To Bank A/c

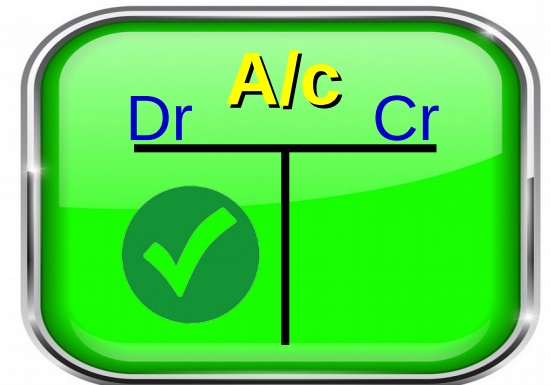
Journal Entries on Dissolution

15. Final Settlement

For settlement of partners' accounts:

- a) If the partner's capital account shows a debit balance, he brings in necessary cash:

Cash / Bank Dr
 To Partners' Capital A/c



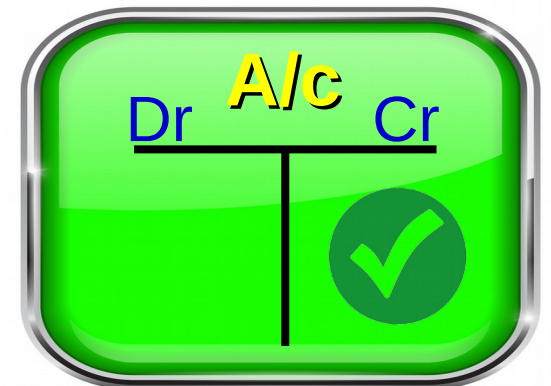
Journal Entries on Dissolution

15. Final Settlement

For settlement of partners' accounts:

- b) If partner's capital account shows a credit balance, he withdraws that amount

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



Final Settlement

The aggregate amount finally payable to the partners must be equal to the amount available in bank and cash accounts

Thus, all accounts of a firm are closed in case of dissolution

Some Tips for the Preparation of Realisation A/c

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Some Tips for the Preparation of Realisation A/c



If nothing is mentioned regarding the realization of an asset, it is assumed that the same asset is realized in full



Some Tips for the Preparation of Realisation A/c



If payment regarding any liability is not mentioned,
it is assumed that it is paid in full



Some Tips for the Preparation of Realisation A/c



Joint life policy on the assets side of the balance sheet is taken along with other assets to the debit side of realization account



Joint life insurance policy

Some Tips for the Preparation of Realisation A/c



Joint life policy reserve on the liability side of the balance sheet may be taken along with all other outside liabilities to the credit side of realization account



Reserve Fund for Joint life policy

Some Tips for the Preparation of Realisation A/c



If some specific funds like Investment fluctuation fund, Workmen's compensation fund, Joint life policy fund etc. are given they should be credited to realization account

This is because some losses or liabilities are attached to such funds

But general purpose funds such as general reserve, reserve fund etc. are directly credited to capital accounts of partners

Some Tips for the Preparation of Realisation A/c



Provident fund is usually transferred to the credit side of realization account like other liabilities and it should be paid off through realization account (debit side)





Differences between Revaluation Account and Realization Account

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Revaluation Account Vs. Realization Account

1

Revaluation Account

Prepared to ascertain the variation in the values of the assets and liabilities of the firm

Realization Account

Prepared to ascertain the net profit or loss on the sale of assets or discharge of liabilities

Revaluation Account Vs. Realization Account

2

Revaluation Account

It comprises of only those assets and liabilities which are revalued

Realization Account

All the assets and liabilities are realised

Revaluation Account Vs. Realization Account

3

Revaluation Account

Prepared at the time of
reconstitution

Realization Account

At the time of dissolution

Revaluation Account Vs. Realization Account

4

Revaluation Account

It can be prepared at various events during the life of the firm

Realization Account

It can be prepared only once, i.e. when the firm is dissolved

Revaluation Account Vs. Realization Account

5

Revaluation Account

Based on the difference in the book value and the revalued amount of assets and liabilities

Realization Account

Based on the book value of assets and liabilities

Revaluation Account Vs. Realization Account

6

Revaluation Account

Balance is transferred to the capital accounts of old partners

Realization Account

Balance is transferred to the capital accounts of all partners

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THANK
YOU

The image features the words "THANK YOU" rendered in a playful, 3D style. Each letter is a separate, brightly colored block with a white, sans-serif font. The top row consists of five blocks: 'T' (purple), 'H' (blue), 'A' (red), 'N' (yellow), and 'K' (green). The bottom row consists of three blocks: 'Y' (green), 'O' (blue), and 'U' (yellow). The blocks are arranged in a slightly staggered, descending line from left to right, giving a sense of depth and movement. The background is a plain, bright white.