

DISSOLUTION OF A PARTNERSHIP FIRM

25.1 INTRODUCTION

A partnership firm comes to an end when all partners or all except one become insolvent, or the business of the firm becomes illegal or when all partners agree to dissolve the firm because they think that there is no possibility of running the business on profit in future. At this stage the accounts of the firm are settled. Assets are realised, liabilities are paid out and whatever is due to or from the partners is settled. This process of settlement requires proper maintenance of records. This lesson focuses on the maintenance of accounting records at the time of dissolution of the partnership firm.

25.2 OBJECTIVES

After going through this lesson, you will be able to:

- state the meaning of dissolution of partnership firm;
- distinguish between dissolution of partnership and dissolution of firm;
- record the disposal of assets and payment of liabilities through accounting vouchers and journal entries;
- prepare Realisation A/c, Partners' Capital A/cs and Bank and /or Cash A/c;
- illustrate the treatment of unrecorded assets and liabilities;
- settle the accounts of the partners and close the books of the firm.

25.3 MEANING OF DISSOLUTION OF PARTNERSHIP FIRM

When a firm decides to close down its business, it is said to be dissolved. All its business activities come to an end. The following are the circumstances under which a firm is dissolved:

- i) When all partners agree to dissolve the firm.
- ii) When all partners or all except one become insolvent.
- iii) When the business of the firm becomes illegal.
- iv) In the case of partnership at will, when one partner gives the necessary notice.
- v) When the court dissolves the firm under the circumstances mentioned below:
 - (a) When a partner becomes of unsound mind.
 - (b) When a partner becomes permanently incapable of doing partnership work but this will not apply if the partner is dormant or sleeping.
 - (c) When a partner is guilty of practices harming the partnership.
 - (d) When a partner transfers his interest in the firm to a third person – such a partner cannot ask for dissolution of the firm.
 - (e) When the court is satisfied that the firm cannot run except at a loss.
 - (f) When a court deems it proper to dissolve the firm.

Distinction Between Dissolution of Partnership and Dissolution of Firm

You have already studied that on Admission, Retirement and Death of a partner, old partnership comes to an end but the firm continues its business under a new agreement. When a firm decides to wind up its business under any of the circumstances mentioned as one, it is dissolved. Dissolution of a firm is different from the dissolution of a partnership. Dissolution of a firm means complete closure of the business activities of a firm while dissolution of a partnership means a reconstitution of the firm due to a admission, retirement and death of a partner. It entails a change in partnership agreement also.

INTEXT QUESTIONS 25.1

A. Fill in the blanks with appropriate word or words:

- (i) When a firm closes down its business, it is said to be _____
- (ii) Dissolution of partnership means a _____ of the firm due to admission, retirement and death of a partner.
- (iii) The firm is compulsorily _____ when all partners except one become insolvent.
- (iv) Dissolution of a _____ is different from dissolution of _____.
- (v) If the partnership is at will, the partnership firm may be dissolved by giving _____ by any partner.

B. The following statements pertain either to dissolution of partnership or dissolution of partnership firm. Write 'A' if it pertains to dissolution of partnership or 'B' if it pertains to dissolution of partnership firm.

- (i) The court ordered to close down a business because the partners were dealing in smuggled goods, it is a case of dissolution.
- (ii) There is change in profit-sharing ratio of the partners of a firm, it is a case of dissolution.
- (iii) When a new partner is admitted into the partnership firm, it is a case of dissolution.
- (iv) When all partners except one expired, it is a case of dissolution.

25.4 TREATMENT OF ASSETS AND LIABILITIES AT THE TIME OF DISSOLUTION OF PARTNERSHIP FIRM

When the firm decides to discontinue the business, it becomes necessary for it to settle the Accounts. All the assets (except cash and bank balances) of the firm are to be disposed or realised. Out of the sale proceeds, the outsiders' liabilities are settled first. Then the partners' loan is paid off and finally all the partners are paid whatever is due to them.

The private property of the partners, after settling private debts, can also be used for paying the firms' liabilities.

In order to ascertain profit or loss on realisation of assets and payment of liabilities, an account is prepared which is called **Realisation Account**.

Steps in Preparation of Realisation Account

The following steps are required for preparing the Realisation Account:

- (i) All assets except cash in hand or at bank are transferred to Realisation Account at their book values. For this purpose, we prepare a transfer voucher as follows:

Transfer Voucher

Voucher No.		Name of the Firm	Date: _____
			Amount Rs.
Debit	Realisation A/c		
Credit	Various Assets A/c (Being assets a/cs transferred to Realisation A/c)		
Sd/- Manager			Sd/- Accountant

If the journal entry is to be passed for the above accounting voucher, it will be as under:

Particulars	Dr. Amount Rs.	Cr. Amount Rs.
Realisation A/c Dr. To Various Assets A/c (Being assets A/cs transferred to Realisation A/c)		

Note: This will close the accounts of the various assets except Cash A/c and Bank A/c.

- (ii) All external liabilities (except partner's loan) are transferred to the Realisation account by preparing the following Transfer voucher:

The various external liabilities are Creditors, Bills Payable, Bank overdraft, Partner's wife's loan, etc.

Transfer Voucher

Voucher No.		Name of the Firm	Date: _____
		Amount Rs.	
Debit	External Liabilities Accounts		
Credit	Realisation Account (Being all external liabilities transferred to Realisation A/c)		
Sd/- Manager		Sd/- Accountant	

If the journal entry is to be passed for the above accounting voucher, it will be as under:

Particulars	Dr. Amount Rs.	Cr. Amount Rs.
External Liabilities A/c Dr. To Realisation A/c (Being external liabilities transferred to Realisation A/c)		

Note: This will close the accounts of external liabilities transferred.

(iii) On realisation (cash sale) of asset, a credit voucher is prepared as follows:

CREDIT VOUCHER

Voucher No.		Name of the Firm	Date: _____
		Amount Rs.	
Credit	Realisation A/c (Being the assets realised)		
Sd/- Manager		Sd/- Accountant	

If the journal entry is to be passed for the above accounting voucher it will be as under:

Particulars	Dr.	Cr.
	Amount	Amount
	Rs.	Rs.
Cash / Bank A/c Dr. To Realisation A/c (Being the assets realised)		

- (iv) If a partner takes over an asset, his capital account will be debited and the realisation account credited by the amount agreed to by the other partners. The following transfer voucher will be prepared for this:-

TRANSFER VOUCHER

Voucher No.		Name of Firm	Date: _____
			Amount Rs.
Debit	Partner's Capital A/c		
Credit	Realisation A/c (Being an asset taken over by a partner at an agreed value)		
Sd/- Manager		Sd/- Accountant	

If the journal entry is to be passed for the above accounting voucher, it will be as under:

Particulars	Dr.	Cr.
	Amount	Amount
	Rs.	Rs.
Partner's Capital A/c Dr. To Realisation A/c (Being an asset taken over by a partner at an agreed value)		

- (v) On payment of external liabilities, a debit voucher will be prepared, debiting Realisation A/c by the actual amount paid.

If the journal entry is to be passed for the above accounting voucher it will be as under:

Particulars	Dr. Amount Rs.	Cr. Amount Rs.
Realisation A/c Dr. To Partner's Capital A/c (Being a liability taken over by a partner)		

(vii) The expenses incurred on dissolution will be debited to the Realisation Account. The following Debit Voucher is prepared :

DEBIT VOUCHER

Received	Name of the Firm		Date: _____
	Voucher No.	Amount Rs.	
	Debit Realisation A/c (Being the realisation expenses paid)		
STAMP	Sd/- Manager	Sd/- Accountant	

If the journal entry is to be passed for the above accounting voucher, it will be as under:

Particulars	Dr. Amount Rs.	Cr. Amount Rs.
Realisation A/c Dr. To Cash/Bank A/c (Being the realisation expenses paid)		

If the realisation expenses are paid by the firm but are to be borne by a partner, a debit voucher will be prepared as follows:

DEBIT VOUCHER

Received STAMP	Name of Firm		Date: _____
	Voucher No.		Amount Rs.
	Debit	Partner's Capital A/c (Being the realisation expenses borne by the partner paid by the firm)	
Sd/- Manager		Sd/- Accountant	

If the journal entry is to be passed for the above accounting voucher, it will be as under:

Particulars	Dr. Amount Rs.	Cr. Amount Rs.
Partner's Capital A/c Dr. To Cash/Bank A/c (Being realisation expenses paid by firm, borne by partner)		

Similarly, if realisation expenses are borne by the firm but are paid by a partner, the following transfer voucher is prepared:

TRANSFER VOUCHER

Name of Firm		Date: _____
Voucher No.		Amount Rs.
Debit	Realisation A/c	
Credit	Partner's Capital A/c (Being realisation expenses borne by the firm paid by the partner)	
Sd/- Manager		Sd/- Accountant

If the journal entry is to be passed for the above accounting voucher, it will be as under:

Realisation A/c Dr. To Partner's Capital A/c (Being realisation expenses borne by the firm paid by a partner).	
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- (viii) At this stage, Realisation A/c should be prepared to ascertain profit or loss on dissolution. In case it shows profits, Realisation A/c will be debited and partners' Capital A/cs will be credited in their profit sharing ratio. However, the loss will be debited to the Capital A/cs of partners' in their profit sharing ratio and credited to the Realisation A/c.

The Following transfer voucher is prepared:

In case of profit on realisation:

TRANSFER VOUCHER

Voucher No.		Name of the Firm	Date: _____
		Amount Rs.	
Debit	Realisation A/c		
Credit	Partner's Capital A/c (Being profit on realisation divided among partners in their profit sharing ratio)		
Sd/- Manager		Sd/- Accountant	

In case of loss on realisation

TRANSFER VOUCHER

Voucher No.		Name of the Firm	Date: _____
		Amount Rs.	
Debit	Partners' Capital A/c		
Credit	Realisation A/c (Being loss on Realisation transferred to partners' capital A/c in their profit sharing ratio)		
Sd/- Manager		Sd/- Accountant	

If the journal entry is to be passed for the above accounting voucher, it will be as under:

In case of profit on Realisation

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Realisation A/c Dr. To Partner's Capital A/c (Being profit on Realisation transferred to partners' capital account in their profit sharing ratio)		

In case of Loss on Realisation:

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Partners' Capital A/c Dr. To Realisation A/c (Being loss on realisation transferred to partners' capital accounts in their profit sharing ratio)		

Preparation of Realisation A/c

The accounting vouchers and the journal entries pertaining to the disposal of assets and payment of liabilities are posted to the Realisation A/c in the ledger as under:

Realisation A/c

Particulars	Amount Rs.	Particulars	Amount Rs.
To Various Assets A/c (except Cash/Bank)		By Various External Liabilities A/c	
To Cash/Bank A/c (payment of external liabilities)		By Cash/Bank A/c (amounts realised on sale of various assets)	
To Partner(s)' Capital A/c (if any liability is paid)		By Partner(s)' Capital A/c (if any asset is taken over)	
To Cash/Bank A/c (expenses on realisation paid by the firm)		By Partners' Capital A/c (in case of loss on dissolution).	
To Partner's Capital A/c (expenses on realisation borne by firm but paid by a partner)			
To Partners' Capital A/c (in case of profit on dissolution).			

Some other Adjustments on dissolution

There are some accounting items which require special attention on dissolution. Some such important items are:

- (i) Partner's Loan;
- (ii) Reserves and/or Undistributed profits;
- (iii) Unrecorded assets and liabilities;
- (iv) Loss shown on asset side, i.e., Dr. Balance of Profit and Loss A/c.

(i) Partner's Loan —

If a partner's loan appears under liability side of the Balance Sheet, it will be paid off by preparing a debit voucher debiting the loan account as follows:

DEBIT VOUCHER

Received _____ STAMP	Voucher No.	Name of Firm	Date: _____	Amount Rs.
	Debit	Partner's Loan A/c (Being partner's loan paid off)		
	Sd/- Manager	Sd/- Accountant		

If the journal entry is to be passed for the above accounting voucher it will be as under:

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Partner's Loan A/c Dr. To Cash/Bank A/c (Being partner's loan paid off)		

(ii) Reserves and Undistributed profits —

Any free reserve or undistributed profit in the books of the firm will be credited to the capital A/cs of the partners in the profit sharing ratio and debited to the Reserve Account through the following transfer voucher:

TRANSFER VOUCHER

Name of the Firm		Date: _____
Voucher No.		Amount Rs.
Debit	Reserve/Undistributed Profit A/c	
Credit	Partner's Capital A/c (Being reserves or undistributed profit transferred to partners' Capital A/c in the profit sharing ratio)	
Sd/- Manager		Sd/- Accountant

If the journal entry is to be passed for the above accounting voucher it will be as under:

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Reserves/Undistributed Profit A/c Dr. To Partners' Capital A/c (Being reserves or undistributed profit transferred to partners' capital A/cs in their profit sharing ratio)		

(iii) Treatment of unrecorded Assets and/or Liabilities

Sometimes, there may be some assets that have already been written off completely in the past and, thus, do not appear in the Balance sheet but physically they still exist. For example, an old typewriter which is still in working condition though its book value is zero. Similarly, there may be some liabilities which do not appear in the Balance Sheet but actually they are still there. For example, on dissolution a bill under discount was dishonoured and had to be taken up by the firm.

The amount realised from the sale of an unrecorded asset is debited to the Cash/Bank A/c. and credited to Realisation A/c. The credit voucher for this is prepared in the following way:

CREDIT VOUCHER

Voucher No. _____		Date: _____
		Amount Rs.
Credit	Realisation A/c (Being cash realised due to unrecorded asset)	
Sd/- Manager		Sd/- Accountant

A journal entry for the above credit voucher will be passed as under:

Particulars	Dr. Amount Rs.	Cr. Amount Rs.
Cash/Bank A/c Dr. To Realisation A/c (Being cash realised due to unrecorded assets.)		

On the payment made for an unrecorded Liability, Realisation account is debited and Cash/Bank account is credited.

The following debit voucher is prepared :

DEBIT VOUCHER

Received	Voucher No. _____	Date: _____
		Amount Rs.
	Debit	Realisation A/c (Being unrecorded liability paid)
STAMP	Sd/- Manager	Sd/- Accountant

The following journal entry is passed for the above Debit Voucher:

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Realisation A/c Dr. To Cash/Bank A/c (Being payment made for unrecorded liability)		

If any unrecorded asset is taken over by a partner, that partner's capital Account is debited and the Realisation Account will be credited. The following Transfer Voucher is prepared :

TRANSFER VOUCHER

Voucher No.	Name of the Firm	Date: _____
		Amount Rs.
Debit	Partners' Capital A/c	
Credit	Realisation A/c (Being unrecorded assets taken over by partner).	
Sd/- Manager		Sd/- Accountant

The journal entry for the above accounting voucher is as:

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Partners' Capital A/c Dr. To Realisation A/c (Being unrecorded asset taken over by a partner)		

Similarly, in case an unrecorded liability is taken over by a partner his Capital A/c is credited and the Realisation A/c will be debited.

The following journal entry is passed for the above accounting voucher:

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Realisation A/c Dr. To Partner's Capital A/c (Being the unrecorded liability taken over by partner)		

If a transfer voucher is to be prepared for the above, it will be as under:

TRANSFER VOUCHER

Name of Firm		Date: _____
Voucher No. _____		Amount Rs.
Debit	Realisation A/c	
Credit	Partners' Capital A/c (Being an unrecorded Liability taken over by partner)	
Sd/- Manager		Sd/- Accountant

iv) **Loss shown on asset side, i.e., Dr. Balance of Profit and Loss A/c**

If Balance Sheet shows a debit balance of Profit and Loss A/c on asset side, it will be debited in the Capital A/cs of partners in their profit sharing ratio.

The following transfer voucher is prepared for the above:

TRANSFER VOUCHER

Name of the firm		Date: _____
Voucher No. _____		Amount Rs.
Debit	Partners' Capital A/cs	
Credit	Profit and Loss A/c (Being debit balance of profit and Loss A/c transferred to Capital A/cs of partners in their profit sharing ratio)	
Sd/- Manager		Sd/- Accountant

If the journal entry is to be passed for the above accounting voucher it will be as under:

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Partners' Capital A/cs Dr To Profit and Loss A/c (Being debit balance of Profit and Loss A/c transferred to Partners' Capital A/cs in their profit sharing ratio)		

Illustration 1

The following is the Balance Sheet of M/S Bela & Co. as at 31st March, 1996

Balance Sheet

Liabilities	Amount (Rs.)	Assets	Amount (Rs.)
A's Capital	5,000	Freehold property	8,000
B's Capital	4,000	Investments	2,000
C's Capital	3,000	Book debts	1,000
Sundry Creditors	2,000	Cash at Bank	3,000
P& L A/c	1,500	Stock	1,500
	15,500		15,000

The partnership firm was dissolved on the above date. A took over the investments at the agreed value of Rs.1,900. Cash realised was : Freehold property Rs.9,000, Book debts Rs.900 and stock Rs.1,400. The creditors were paid at a discount of 5%. The expenses of realisation came to Rs.200.

Prepare accounting vouchers and journalise the same. Also prepare Realisation A/c, Capital A/cs and Bank A/c.

Solution (i)

M/s Bela & Co.		Date 31.3.96
Voucher No.		Amount Rs.
Debit	Realisation A/c	12,500
		12,500
Credit	Freehold property A/c	8,000
	Investment A/c	2,000
	Sundry Debtors A/c	1,000
	Stock A/c	1,500
	(Being various assets except cash or Bank transferred to Realisation A/c)	12,500
Sd/- Manager		Sd/- Accountant

(ii)

M/s Bela & Co.		Date 31.3.96
Voucher No.		Amount Rs.
Debit	Sundry Creditors A/c	2,000
		2,000
Credit	Realisation A/c	2,000
	(Being creditors transferred at book figure)	2,000
		2,000
Sd/- Manager		Sd/- Accountant

(iii)

M/s Bela & Co.		Date 31.3.96
Voucher No.		Amount Rs.
Credit	Realisation A/c	11,300
	(Being the amount realised from assets	
	Freehold property 9,000	
	Book Debts 9,00	
	Stock <u>1,400</u>	
	<u>11,300</u>	11,300
Sd/- Manager		Sd/- Accountant

(iv)

M/s Bela & Co.		
Voucher No.		Date 31.3.96 Rs.
Debit	A's Capital A/c	1,900
		1,900
Credit	Realisation A/c (Being investment taken over by A at the agreed value of Rs.1,900)	1,900
		1,900
Sd/- Manager		Sd/- Accountant

(v)

Stamp	Received	M/s Bela & Co.		
		Voucher No.	Date 31.3.96 Rs.	
		Debit	Realisation A/c (Being the payment for expenses of realisation)	200
				200
		Sd/- Manager	Sd/- Accountant	

(vi)

Stamp	Received	M/s Bela & Co		
		Voucher No.....	Date 31.3.96 Rs.	
		Debit	Realisation A/c (Being the payment to creditors at 5% less than the book value)	1,900
				1,900
		Sd/- Manager	Sd/- Accountant	

(vii)

M/s Bela & Co.		Date 31.3.96
Voucher No.		Rs.
Debit	Realisation A/c	600
		600
Credit	A's Capital A/c	200
	B's Capital A/c	200
	C's Capital A/c	200
	(Being profit on realisation transferred)	600
Sd/- Manager		Sd/- Accountant

(viii)

M/s Bela & Co.		Date 31.3.96
Voucher No.		Rs.
Debit	Profit & Loss A/c, 1,500	1,500
Credit	A's Capital A/c	500
	B's Capital A/c	500
	C's Capital A/c	500
	(Being P&L A/c balance transferred to Capital Accounts equally)	1,500
Sd/- Manager		Sd/- Accountant

(ix)

M/s Bela & Co		Date 31.3.96	
Voucher No.....		Rs.	
Received	Debit	A's Capital A/c	3,800
		B's Capital A/c	4,700
		C's Capital A/c	3,700
		(Being the partners given the same due to them)	12,200
Stamp	Sd/- Manager		Sd/- Accountant

OR

JOURNAL ENTRIES:

Date	Particulars	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
1996 March 31	Realisation Account Dr To Freehold property A/c To Investment A/c To Sundry Debtors A/c To Stock A/c (Being various assets except cash at bank transferred to Realisation Account at Book values)		12,500	8,000 2,000 1,000 1,500
"	Sundry Creditors Dr To Realisation A/c (Being the creditors transferred to Realisation a/c at book values)		2,000	2,000
"	Bank A/c Dr To Realisation A/c (Being the amount realised from assets: Freehold property 9,000 Book Debts 900 Stock <u>1,400</u>)		11,300	11,300
"	A's Capital A/c Dr To Realisation A/c (Being the investments taken over by A at the agreed value of Rs.1,900)		1,900	1,900
"	Realisation Account Dr To Bank A/c (Being the payment of expenses of realisation)		200	200
"	Realisation Account Dr To Bank A/c (Being the payment made to creditors at 5% less than the book value)		1,900	1,900
"	Realisation Account Dr To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being profit on realisation transferred to capital accounts equally since no profit sharing ratio is mentioned)		600	200 200 200

Date	Particulars	L.F.	Dr. Amount Rs.	Cr. Amount Rs.
1996 March	Profit and Loss A/c To A's Capital A/c To B's Capital A/c To C's Capital A/c (Being the P&L A/c balance transferred to capital a/cs equally)	Dr	1,500	500 500 500
"	A's Capital A/c B's Capital A/c C's Capital A/c To Bank A/c (Being the payment to the partners of the sums due to them)	Dr Dr Dr	3,800 4,700 3,700	12,200

Realisation A/c

Particulars	Amount (Rs)	Particulars	Amount (Rs)
To Freehold property	8,000	By Sundry Creditors	2,000
To Investment A/c	2,000	By Bank A/c	
To Sundry Debtors	1,000	-Freehold property	9,000
To Stock A/c	1,500	-Book Debts	900
To Bank A/c (Exp.)	200	-Stock	1,400
To Bank A/c (Creditors)	1,900	By A's Capital A/c	1,900
To Profit on Realisation A's Capital 200 B's Capital 200 C's Capital 200	600		
	15,200		15,200

Dr.		A's Capital A/c		Cr.	
Particulars	Amount (Rs)	Particulars	Amount (Rs)	Particulars	Amount (Rs)
To Relisation A/c	1,900	By Balance b/d	5,000		
To Bank A/c	3,800	By Realisation A/c	200		
		By P&L A/c	500		
	5,700		5,700		

Dr.		B's Capital A/c		Cr.	
Particulars	Amount (Rs)	Particulars	Amount (Rs)		
To Bank A/c	4,700	By Balance b/d	4,000		
	/	By Realisation A/c	200		
		By P&L A/c	500		
	4,700		4,700		

Dr.		C's Capital A/c		Cr.	
Particulars	Amount (Rs)	Particulars	Amount (Rs)		
To Bank A/c	3,700	By Balance b/d	3,000		
	/	By Realisation A/c	200		
		By P&L A/c	500		
	3,700		3,700		

Dr.		Bank A/c		Cr.	
Particulars	Amount (Rs)	Particulars	Amount (Rs)		
To Balance b/d	3,000	By Realisation A/c	200		
To Realisation A/c	11,300	By Realisation A/c	1,900		
	/	By A's Capital A/c	3,800		
		By B's Capital A/c	4,700		
		By C's Capital A/c	3,700		
	14,300		14,300		

INTEXT QUESTIONS 25.2

A. Given below are certain statements. Some of these statements are True and Some of these statements are false. Write 'T' against true statements and 'F' against false statements.

- i) Whenever the constitution of a partnership changes, the old firm continues to exist.

ii) In the absence of a partnership deed, the partnership is dissolved.

- iii) After the Realisation A/c is prepared, no other account will show any balance.
- iv) On the dissolution of the firm, first creditors and wages outstanding etc. have to be paid.
- v) Partners continue business after dissolution of a firm.

25.5 SETTLEMENT OF PARTNER'S ACCOUNTS AND PREPARATION OF BANK A/C

(A) After all above entries are made the capital Account of any partner may show a debit balance at this stage. The partners will bring cash equal to this debit balance. For this, the following credit voucher should be prepared:

CREDIT VOUCHER

Voucher No.	Name of Firm	Date: _____
		Amount Rs.
Credit	Partners' Capital A/c (Being cash brought in equal to the debit balance in their a/cs)	
Sd/- Manager		Sd/- Accountant

If the journal entry is to be passed for the above accounting voucher, it will be as under :

Particulars	Dr. Amount (Rs.)	Cr. Amount (Rs.)
Cash A/c/Bank A/c Dr. To Partner's Capital A/c (Being cash equivalent to the debit balance in this A/c brought in by the partners)		

Illustration 2

M/s Sita Bros. had the following Balance Sheet as on Dec.31, 1993, when the firm was dissolved.

Liabilities	Amount (Rs)	Assets	Amount (Rs)
Creditors	3,400	Cash	2,500
Capitals		Debtors	6,200
X's Capital	12,000	Car	1,200
Y's Capital	9,000	Machinery	6,000
Z's Capital	6,000	Stock	3,700
		Tools	800
		Building	10,000
	30,400		30,400

Profits were shared in the ratio of 3:2:1 respectively among X, Y, Z.

Assets realised as under:

Stock	Rs. 4,000
Tools	Rs. 500
Machinery	Rs. 7,800
Building	Rs. 8,400
Car	Rs. 2,500
Goodwill	Rs. 6,000
Debtors	Rs. 5,900

There was an unrecorded liability for Tax for Rs.272 which was paid. There was an unrecorded asset valued at Rs.300, which was handed over to X for Rs.200.

Journalise the above, prepare accounting Vouchers, Realisation A/c, Capital A/cs, and Cash A/c.

Solution

JOURNAL ENTRIES

Sl. No.	Particulars	Dr. Amount Rs.	Cr Amount Rs.
1.	Realisation A/c Dr To Debtors To Stock To Tools To Car To Machinery. To Building (Being all the assets transferred to Realisation A/c)	27,900	6,200 3,700 800 1,200 6,000 10,000
2.	Creditors A/c Dr To Realisation A/c (Being Crs. transferred to Realisation A/c)	3,400	3,400
3.	Cash A/c Dr To Realisation A/c (Being the Assets realised)	29,100	29,100
4.	Realisation A/c Dr To Cash A/c (Being the creditors settled at a discount of Rs.72)	3,328	3,328
5.	Cash A/c Dr To Realisation A/c (Being the goodwill valued)	6,000	6,000
6.	X's Capital A/c Dr. To Realisation A/c (Being the unrecorded assets taken over by X for Rs.200)	200	200
7.	Realisation A/c Dr To Cash A/c (Being unrecorded liability paid)	272	272

	Liabilities	Amount (Rs)	Assets	Amount (Rs)
8.	Realisation A/c To X's Capital To Y's Capital To Z's Capital (Being profit on realisation transferred to partner's capital account in the ratio 3:2:1)	Dr	7,200	3,600 2,400 1,200
9.	X's Capital A/c Y's Capital A/c Z's Capital of A/c To Cash A/c (Being the payment of what was due to partners)		15400 11400 7,200	34,000

Accounting Vouchers

(i) TRANSFER VOUCHER

Voucher No.	Name of Firm	Date: _____
		Amount Rs.
Debit	Realisation A/c	27,900
		27,900
Credit	Debtors	6,200
	Stock	3,700
	Tools	800
	Car	1,200
	Machinery	6,000
	Buildings	10,000
	(Being the assets transferred to Realisation A/c)	
		27,900
Sd/- Manager		Sd/- Accountant

(ii) TRANSFER VOUCHER

Voucher No.		Name of the Firm	Date: _____
			Amount Rs.
Debit	Creditors		3,400
			3,400
Credit	Realisation A/c (Being creditors transferred to Realisation A/c)		3,400
			3,400
Sd/- Manager		Sd/- Accountant	

(iii) DEBIT VOUCHER

Received _____	Voucher No.		Name of the Firm	Date: _____
				Amount Rs.
	Debit	Realisation A/c (Being the creditors settled at a discount of Rs.72)		3,328
				3,328
STAMP	Sd/- Manager		Sd/- Accountant	

(iv) CREDIT VOUCHER

Voucher No.		Name of the Firm	Date: _____
			Amount Rs.
Credit	Realisation A/c (Being the Assets realised)		29,100
			29,100
Sd/- Manager		Sd/- Accountant	

(v) TRANSFER VOUCHER

Voucher No.		Name of the Firm	Date: _____	Amount Rs.
Debit	X's Capital A/c			200
				200
Credit	Realisation A/c (Being unrecorded asset taken over by X for Rs.200)			200
				200
Sd/- Manager			Sd/- Accountant	

(vii) DEBIT VOUCHER

Received _____ STAMP	Voucher No.		Name of the Firm	Date: _____	Amount Rs.
		Debit	Realisation A/c (Being unrecorded liability paid)		
				272	
Sd/- Manager			Sd/- Accountant		

TRANSFER VOUCHER

Voucher No.		Name of the Firm	Date: _____	Amount Rs.
Debit	Realisation A/c			7,200
				7,200
Credit	X's Capital A/c			3,600
	Y's Capital A/c			2,400
	Z's Capital A/c			1,200
		(Being profit on Realisation transferred to partners' Capital A/cs in 3:2:1 ratio)		7200
Sd/- Manager			Sd/- Accountant	

DEBIT VOUCHER

Received	Name of the Firm		Date: _____
	Voucher No. _____		Amount Rs.
	Debit	X's Capital A/c Y's Capital A/c Z's Capital A/c (Being Payment made to partners for which was due to them)	15,400 11,400 7,200
			34,000
STAMP	Sd/- Manager	Sd/- Accountant	

Realisation A/c

Dr.		Cr.	
Particulars	Amount (Rs)	Particulars	Amount (Rs)
To Debtors	6,200	By Creditors	3,400
To Stock	3,700	By Cash:	
To Tools	800	Stock	4,000
To Car	1,200	Tools	500
To Machinery	6,000	Machinery	7,800
To Building	10,000	Building	8,400
To Cash A/c (creditors paid)	3,328	Car	2,500
To Cash A/c (unrecorded liability)	272	Debtors	5,900
To X's Cap 3,600		By Goodwill <u>6000</u>	35,100
Y's Cap 2,400		By X's Capital A/c	200
Z's Cap 1,200	7,200		
	38,700		38,700

Dr.				Capital A/cs				Cr.			
Particulars	X Rs.	Y Rs.	Z Rs.	Particulars	X Rs.	Y Rs.	Z Rs.				
To Realisation A/c	200	-	-	By Balance b/d	12,000	9,000	6,000				
				By Realisation A/c	3,600	2,400	1,200				
To Cash A/c	15,400	11,400	7,200								
	15,600	11,400	7,200		15,600	11,400	7,200				

Dr.		Cash A/c		Cr.	
Particulars	Amount (Rs)	Particulars	Amount (Rs)		
To Balance b/d	2,500	By Realisation A/c	3,328		
To Realisation A/c	35,100	By Realisation A/c	272		
		By X's Capital 15,400			
		By Y's Capital 11,400			
		By Z's Capital <u>7,200</u>			
			34,000		
	<u>37,600</u>		<u>37,600</u>		

INTEXT QUESTIONS 25.3

- A. Which of the following is an unrecorded asset:
- Debt written off as bad but are likely to be recovered;
 - Goodwill of the firm written off;
 - Machine disposed off;

- (iv) A valuable antique piece of furniture completely written off.
- (v) Patents appearing in the Balance Sheet.

B. Which of the following will be treated as unrecorded liability?

- (i) Damages claimed by the bank because of default in the loan repayment.
- (ii) A dispute settled against the firm.
- (iii) Creditors for stock purchased.
- (iv) A Bills payable dishonoured
- (v) Bank Overdraft.

5.6 WHAT YOU HAVE LEARNT

When the business of a partnership firm is closed permanently, dissolution of a partnership firm takes place.

Dissolution of a firm means a complete and permanent closure of the business of the firm, while dissolution of a partnership means a reconstitution of the firm which entails a change in partnership agreement.

For the dissolution of a firm, Realisation A/c is prepared to dispose of assets (other than cash and bank) and payment of liabilities.

The following steps are taken for the preparation of Realisation A/c:

- (i) All assets (except cash and bank) are transferred to the debit side of Realisation A/c at their book value.
- (ii) All external liabilities (except partner's loan) are transferred to the credit side of Realisation A/c at their book value.
- (iii) Realisation A/c is credited by the amount realised on assets. And if an asset is taken over by a partner, partner's capital A/c is debited and Realisation A/c is credited.
- (iv) On payment of external liabilities, Realisation A/c is debited. Similarly, if an external liability is taken over by a partner, his/her capital A/c is credited and Realisation A/c is debited.
- (v) Expenses incurred on dissolution are debited to Realisation A/c. If dissolution expenses are borne by a partner, partner's capital A/c is credited and Realisation A/c is debited.

(vi) Loss or Profit shown by Realisation A/c is transferred to partner's capital A/cs in their profit-sharing ratio and thereby Realisation A/c is closed.

5. Treatment of unrecorded assets and liabilities:

If an unrecorded asset is realised then cash A/c is debited and Realisation A/c is credited. When a payment is made for unrecorded liability, Realisation A/c is debited and cash A/c is credited.

If an unrecorded asset is taken over by a partner, partner's capital A/c is debited and Realisation A/c is credited. Similarly, on taking over an unrecorded liability by a partner, his/her capital A/c is credited and Realisation A/c is debited.

6. Settlement of Partners' Capital A/cs:

After making all entries relating to partner's A/cs, these A/cs may show — (a) debit balance, or (b) credit balance. If a partner A/c shows a debit balance, then the partner has to bring cash equal to the amount of the debit balance to make up the deficiency. If a partner A/c shows a credit balance, such amount is paid to the partner.

25.7 TERMINAL QUESTIONS

1. Answer the following questions in one sentence :
 - (i) What is meant by dissolution of a firm?
 - (ii) Why is Realisation Account prepared ?
 - (iii) In what ratio do partner's share profit or loss on realisation?
 - (iv) What journal entry will you pass when the firm pays actual realisation expenses on behalf of a partner who has to bear the expenses ?
2. Distinguish between dissolution of partnership firm and dissolution of partnership.
3. Under what circumstances can the court dissolve the partnership firm?
4. Explain the accounting treatment of unrecorded Assets and Liabilities at the time of dissolution of a partnership firm.
5. How will the external liabilities be met if firm's resources are insufficient ?

6. M/S B.K. Bros. had the following Balance Sheet as on Dec.31, 1997, when the partnership was dissolved.

Liabilities	Amount (Rs)	Assets	Amount (Rs)
Capitals			
A	10,000	Land & Building	40,000
B	20,000	Machinery	30,000
C	40,000	Furniture	5,000
General Reserve	15,000	Stock	10,000
B's Loan A/c	5,000	Debtors	6,000
Creditors	6,000	Cash	5,000
	96,000		96,000

The partners share the profits in the ratio of 5:3:2. Land and Buildings were sold for Rs.45,000. Machinery was disposed off for Rs.28,000. Furniture was taken over by C for Rs.3,000. Stock realised Rs.9,000 and debtors were realised at 5% discount. Expenses on Realisation were Rs.500.

Prepare :

- (a) necessary Accounting Vouchers.
- (b) necessary Journal Entries.
- (c) Realisation Account, Cash Account and partners' capital Accounts.

7. M/s Roopak Stores Balance Sheet as on December 31, 1997 was as follows:

Balance Sheet

Liabilities	Amount (Rs)	Assets	Amount (Rs)
Capital			
X	25,000	Machinery	50,000
Y	50,000	Furniture	20,000
		Stock	15,000
Profit & Loss A/c	20,000	Debtors	18,000
Creditors	10,000	Cash	2,000
	1,05,000		1,05,000

They decided to dissolve the firm on the above date. The assets realised are as follows:

Machinery Rs.45,000, Furniture Rs. 18,000, Stock Rs.16,000 and Debtors 10% less. Creditors net claim was reduced to Rs.9,000. There was an unrecorded liability of Rs.2,100, which was taken over by X. An unrecorded asset was sold for Rs.2,800. The expenses of realisation amounted to Rs.800 which were paid by the firm but borne by Y.

Close the books of the firm and prepare:

- (i) necessary accounting Vouchers
- (ii) necessary Journal Entries.
- (iii) Realisation Account, Cash Account, X's Capital A/c and Y's Capital Account.

8. A, B, and C were partners sharing profits in the ratio of 2:2:1. On Jan. 1, 1995, their Balance Sheet was as follows:

Liabilities	Amount (Rs)	Assets	Amount (Rs)
Sundry Creditors	12,000	Cash at Bank	12,200
General Reserves	5,000	Debtors	8,000
Capital A/cs		Stock	6,000
A 15,000		Furniture	2,000
B 12,000		Buildings	22,000
C <u>6,000</u>	33,000		
	<u>50,000</u>		<u>50,000</u>

The Firm was dissolved on that date, the assets realised as under:

Debtors	7,000
Stock	5,000
Furniture	1,000
Buildings	25,000

The creditors were settled for Rs.11,000. It was found, however, that there was a liability for Rs.3,000 for damages.

Prepare Realisation A/c, Cash A/c and Partners' Capital A/c.

9. Vinod, Vijay and Venkat are partners sharing profits in the ratio of 3:2:1. They decide to dissolve their firm on 31-12-1996, the date on which their Balance Sheet stood as under:

Balance Sheet

Liabilities	Amount (Rs)	Assets	Amount (Rs)
Creditors	1,70,000	Bank	35,000
Bills Payable	1,20,000	Stock	1,98,000
Vinod's Loan	53,000	Debtors 1,50,000	
		Less: Prov. 10,000	1,40,000
General Reserves	60,000	Joint Life Policy	40,000
Capitals:			
Vinod 2,50,000		Machinery	3,30,000
Vijay 1,10,000			
Venkat <u>80,000</u>	4,40,000	Furniture	1,00,000
	<u>8,43,000</u>		<u>8,43,000</u>

The Following additional information is given:

- (i) The Joint Life Policy is taken by Vinod at Rs.50,000.
- (ii) Assets realised as follows:

Stock	Rs.1,75,000
Debtors	Rs.1,45,000
Furniture	Rs. 68,000
Machine	Rs.3,03,000
- (iii) Expenses on realisation amounted to Rs.20,000.

The expenses of dissolution amounted to Rs.1,000 which had to be paid.

Prepare Realisation A/c, the Capital Accounts of the Partners and the Bank A/c.

25.8 ANSWERS TO INTEXT QUESTIONS

25.1

- A. (i) dissolved (ii) reconstitution
(iii) dissolved (iv) firm; partnership
(v) notice
- B. i. B ii. A iii. A iv. B

25.2

- i) T ii) F iii) F iv) T v) F

25.3

- (A) i, iv
(B) i, ii