CBSE Quick Revision Notes and Chapter Summary
Class-12 Accountancy
Chapter 6 – Dissolution of Partnership Firm

Introduction

As per Indian Partnership Act, 1932: "Dissolution of firm means termination of partnership among al the partners of the firm". When a firm is dissolved, the business of the firm terminates. Al the assets of the firm are disposed off and al outsiders' liabilities and partners' loan and partners capitals are paid. Dissolution of Partnership: Dissolution of Partnership refers to termination of old partnership agreement (i.e., Partnership Deed) and a reconstruction of the firm. It may take place on Change inprofit sharing ratio amongthe existing partner; – Admission of a partner; and – Retirement or Death of a partner. It may or may not result into closing down ofthe business as the remaining partner may decide to carry on the business under a new agreement

Meaning of Dissolution of Partnership Firm

According to Section 39 of Indian Partnership Act 1932 , The dissolution of partnership between all the partners of a firm is called " dissolution of the firm". A firm may be dissolved with the consent of all the partners or in accordance with a contract between the partners.
Students must understand that there is difference between dissolution of partnership and dissolution of firm.

Basis	Dissolution of Firm	Dissolution of Partnership
Meaning	Dissolution of partnership between all the partners in the firm	Change in the present agreement
Effect on business	Business is Closed down	Business is continued by the remaining partners
Effect on accounts	All Accounts Books are closed	Accounts Books are not closed
Dissolution by court	Dissolution of firm may be ordered by court in some cases	Dissolution of Partnership is not ordered by the court
Calculation of profit or loss	Assets are realized and liabilities are paid by preparing realization account and profits are distributed among the partners	Assets are revaluated and liabilities are reassessed by preparing Revaluation account. Profit or loss calculated is posted to the partners capital account.

Modes of Dissolution

1.Dissolution by agreement : A firm may be dissolved with the consent of all the partners or in accordance with a contract between the partners. (Section 40)

2.Compulsory Dissolution - A firm is dissolved

a) by the adjudication of all the partners or of all partners but one as insolvent or,

b) By the happening of any event which makes it unlawful for the business of the firm to be carried on or for the partners to carry it on in partnership. (Section 41)

3. Dissolution on the happening of certain contingencies -

Subject to contract between the partners a firm is dissolved -

a) If constituted for a fixed term, by the expiry of that term

b) If constituted to carry out one or more adventures or undertakings by the completion thereof.

c) by the death of a partner.

d) by the adjudication of a partner as an insolvent. (Section 42)

4.Dissolution by notice of partnership at will –

(1) Where the partnership is at will the firm may be dissolved by any partner giving notice in writing to all the other partners of his intention to dissolve the firm.

(2) The firm is dissolved as from the date mentioned in the `notice as the date of dissolution or, if no date is so mentioned, as from the date of the communication of the notice. (Section 43)

5. Dissolution by the Court. At the suit of a partner, the Court may dissolve a firm on any of the following grounds, namely:

a) A partner has become of unsound mind

b) A partner has become permanently incapable of performing his duties as partner.

c) A partner is found guilty of misconduct

d) Breach of Agreement by partner

e) A Partner transfer his right

f) That the business of the firm cannot be carried on save at a loss.

g) On any other ground which renders it just and equitable that the firm should be dissolved.

Main Activities at the time of Dissolution

1. Settlement of Accounts [Section 48]

In setting the accounts of a firm after dissolution, the following rules shall, subject to agreement by the partners, be observed.

a) Losses, including deficiencies of capital, shall be paid first out of profits, next out of capital and, lastly, if necessary, by the partners individually in the proportion in which they were entitled to share profits. [Section 48 (a)]

b) 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:-

i) In paying the debts of the firm to third parties.
ii) In paying to each partner rateably what is due to him from the firm for advances as distinguished from capital:
iii) in paying to each partner rateably what is due to him on account of capital and.
iv) The residue, if any shall be divided among the partners in the proportions in which they were entitled to share profits. [Section 48 (b)]

2. Payment of Firm's Debts and Private Debts [Section 49]

Where there are joint debts due from the firm, and also separate debts due from any partner, the property of the firm shall be applied in the first instance in payment of the debts of the firm, and if there is any surplus, the separate property of any partner shall be applied first in the payment of his separate debts and the surplus (if any) in the payment of the debts of the firm.

Distinction Between Firms Debts and Private Debts

Basis	Firm's Debts	Private Debts
Meaning	Amounts payable by the firm or liabilities of the firm is known as Firms debts	These debts are personal debts and are not recorded in the books of the firm
Who will pay	All partners are responsible for the debts of the firm	Only particular partner is responsible for his debts
Use of property to pay the debts	Property of the firm shall be applied first to pay the debts of the firm. Only excess of partners property may be applied to pay the debts of the firm	Private property shall be applied first to pay his personal debts. Only excess of firms property may be applied to pay the personal debts

Accounting Treatment at the time of Dissolution of firm

At the time of Dissolution of a firm , all the assets of the firm are sold or Realized , and all liabilities are paid off. In such a case Realization account is prepared to realize the assets and to pay off the liabilities, balance if any , is treated as profit/loss and distributed to the partners. Students must remember that Partners capital accounts are closed in this situation. In place of Balance Sheet only cash/Bank account is prepared. Following accounts are prepared at the time of Dissolution of firm :

Preparation of Realisation Account

Realisation Account is a nominal account. The main purpose of this account is to calculate the profit or loss after realising the assets and paying the liabilities. Transfer All the assets (except

Cash/Bank and fictitious assets) on the debit side of Realisation account from the balance sheet and show the realize value on the credit side of realization account. Transfer all the liabilities (outsider) on the credit side of realization account and pay them on the debit side of realization account. Do not transfer capitals of the partners and accumulated reserve and profit etc.

Main Journal entries:

1. When assets are transferred to the Realisation Account :
   Realisation A/c Dr.
   To Sundry Assets A/c

2. When Provisions of related assets are transferred to realisation A/c :
   Provision for doubtful debts A/c Dr.
   Provision for Depreciation A/c Dr.
   To Realisation A/c

3. When Assets are realized :
   Cash/bank A/c Dr.
   To Realisation A/c

4. When liabilities are transferred to the Realisation Account :
   Sundries Liabilities A/c Dr.
   To Realisation A/c

5. When Liabilities are paid :
   Realisation A/c Dr.
   To Cash/Bank A/c

6. When Asset is taken over by the partner :
   Partners Capital A/c Dr.
   To Realisation A/c

7. When Liability taken over by the partner :
   Realisation A/c Dr.
   To Partners capital A/c

8. When unrecorded Assets are realized :
   Cash/bank A/c Dr.
   To Realisation A/c

9. When unrecorded liabilities are realized :
   Realisation A/c Dr.
   To Cash /Bank A/c

10. When Realisation expense are paid :

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

11. When Realisation expenses are paid by the partner :

    Realisation A/c Dr.
        To Partners capital A/c

12. When bank overdraft is paid :

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

13. When realization profit is transferred to the partners :

    Realisation A/c Dr.
        To partners capital A/c

If there is loss on realization Account following entry should be recorded :

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

Complete Proforma of Realisation Account :

Particulars	Amount	Particulars	Amount
To Sundry Assets :	--	By Sundries Liabilities	--
Land and Building		(Only outsiders liabilities)	
Plant and Machinery		By Provision on Assets	--
Furniture		By Cash/Bank (assets realized)	--
Debtors		By Cash/Bank	--
Bills Receivable etc.		(unrecorded Asset)	
To Cash/Bank (Liability paid)	--	By Partners capital A/c	--
To Partners capital A/c	--	(Asset taken by partner)	
(liability taken by partner)		By Partners capital A/c	--
To Cash/Bank (Realisation Exp.)	--	(Loss transfer to partners if	
To Partners Capital A/c's	--	any)	
(profit Transfer to partners)			

Partners Loan Account : -

Students must remember that partners loan will not take place in realization account and partners capital account , A separate account (Loan A/c) is to be prepared for this purpose.

Partners Capital Account

Students must remember that partner's capital accounts not only show the capital balance but current account balance in capital accounts at the time of dissolution. All Reserve and profit etc. should be recorded in the partner's capital account. Profit/loss calculated in realization account will be transferred to the partner's capital account. If any asset is taken over by the partner, it will take place on the debit side of partner's capital accounts. If any liability is taken over by the partner, it will be shown on the credit side of partner's capital accounts.

Partners Capital A/c

Particulars	A	B	Particulars	A	B
To Realisation A/c (Loss on Realisation)	xxxx	xxxx	By balance b/d	xxxx	xxxx
			By General Reserve		
To Realisation A/c (Asset taken over)	xxxx	xxxx		xxxx	xxxx
			By P/L A/c		
To Bank A/c (final Payment)	xxxx	xxxx	By Realisation A/c (Profit on realization)	xxxx	xxxx
			By Realisation A/c (Liability taken over)	xxxx	xxxx

Preparation of Bank A/c : Students must remember that we do not prepare Balance sheet at the time of dissolution of firm , instead of preparing Balance Sheet , we prepare Cash/Bank Account. All cash realized are shown on the debit side of cash/Bank account and all cash payments are shown on the credit side of Cash/Bank A/c.

Difference Between Revaluation Account and Realisation Account

Basis	Revaluation Account	Realisation Account
Meaning	Revaluation accounts is related with the revaluation of assets and re-assessment of liabilities	Realisation Account is prepared to realize the assets and to pay the liabilities.
Objective	Main purpose is to record the fluctuating values of assets and liabilities and to calculate the profit or loss on revaluation	Main purpose is to calculate the profit/loss after realizing the assets and payment of liabilities.
Need	Revaluation account is needed at the time of admission and retirement or death of a partner.	Realisation Account is needed when dissolution takes place.

Result	Profit or loss calculated in Revaluation account is distributed among the old partners only.	Profit or loss calculated in Realisation Account is distributed among the all the partners

Treatment of Realisation Expenses :

Case 1 : - If Realisation Expenses are paid by the firm :

Realisation A/c Dr.
To Cash/Bank A/c
(Being Realisation expenses paid by the firm)

Case 2 : - When Realisation expenses are paid by the partner :

Realisation A/c Dr.
To Partner's Capital A/c
(Being Realisation expenses paid by a partner)

Note : Students must remember that these expenses are paid by the partner on the behalf of the firm Because this is not the duty of partner to pay the realization expense in this case.

Case 3 : - When expenses for realization are paid by the firm but borne by the partner :

Partner's capital A/c Dr.
To Cash/Bank A/c
(Being expense by paid by firm and borne by partner)

Case 4 : - When Expenses for realization are paid by the partner and borne by partner :

No Entry in this case

Reason : According to Business Entity concept Business and Businessman both are separate entity and we record only business transactions.

Case 5 : - When actual expenses are borne by the partner and he is compensated by the firm through a fixed amount :

- ❖ When partner is compensated with the fixed amount by the firm :
  Realisation Account A/c Dr.
  To Partner's Capital A/c
  (Being Compensation or commission/Remuneration of partner is due)

- ❖ When expenses are paid by the firm on behalf of a partner :
  Partner's Capital A/c Dr.
  To Cash/Bank A/c
  (Being expenses paid by the firm on behalf of partner)

Remember : These expenses are paid by the firm , but if paid by the partner 2nd entry

Should not be recorded .

Note :

If cash and bank balance (or Bank Overdraft) both are given in the Balance Sheet, only one A/c is prepared, either a Cash A/c or a Bank A/c. If Cash A/c is opened, an entry for withdrawing 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. BankA/c Dr. To Cash A/c
(Being cash deposited into Bank)

Preparation of Memorandum Balance Sheet

Sometimes Balance sheet is not given in the question, this is the case where capitals of partner's and liabilities are given but the value of sundry assets is missing. To calculate the value of sundry assets we prepare a balance sheet which is called Memorandum Balance sheet.