



Dissolution of a Partnership Firm

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CHAPTER

1. **Meaning of Dissolution** : Dissolution means breaking-up or extinction i.e., discontinuance of existing relationship among the partners.



2. **Dissolution of Partnership** : It changes the existing relationship between partners but the firm may continue its business as before.
3. **Dissolution of a firm**:Dissolution of the firm means dissolution of partnership among all the partners in the firm. In such a case the business of the firm also comes to an end.
4. **Modes of Dissolution of Partnership firm**
 - (i) Dissolution by mutual agreement
 - (ii) Compulsory dissolution
 - (iii) Dissolution by notice
 - (iv) On the happening of an event
 - (v) Dissolution by court



5. **Settlement of Accounts in Case of Dissolution of firm** (Section 48) In settling the accounts of a firm after dissolution, the following rules subject to the agreement by the partners, shall be observed
 - (i) Treatment of losses : losses including deficiencies of capital shall be paid in the following manner
 - (a) First out of Profits
 - (b) Next out of capital
 - (c) Lastly, if necessary, by the partners individually in their profit sharing ratio. [Section 48 (a)]
 - (ii) Application of Assets : The assets of the firm, including any sum contributed by the partners to make up deficiencies, shall be applied in the following manner
 - (a) First to pay firm's debts to the third Parties, i.e., outside parties.
 - (b) Then to pay loans from partners.
 - (c) Then to pay capitals of partners.
 - (d) Lastly the surplus (if any) shall be distributed among the partners in their profit sharing ratio. [Section 48 (b)]

6. **Treatment of Firm's Debts and Private Debts (Section 49):** Where both the debts of the firm and private debts of a Partner co-exist, the following rules, as stated in Section 49 of the Act, shall apply
- (i) Firm's property is applied first in payment of firm's debts and if there is any surplus, then the share of each partner is applied in the payment of his private debts or paid to him.
 - (ii) Partner's private property is applied first in payment of his private debts and the surplus (if any) in payment of firm's debts if the firm's liabilities exceed the firm's assets.
7. **Accounting Treatment on Dissolution** : Following accounts are opened in the books of the firm
- (i) Realisation Account
 - (ii) Partners' Capital Account
 - (iii) Partners's Loan Account
 - (iv) Cash/Bank Account
8. **Realisation Account:** It is opened on the dissolution of a firm. It is a nominal account. It is prepared to determine the or los on the realization of assets and payment of liabilities.

Dr.	Realization Account		Cr.
Particulars	Amt (Rs.)	Particulars	(Amt (Rs.)
To sundry Assets A/c [Excluding cash, bank, fictitious asset, accumulated losses,, debit balance of partners' partners' capital/current A/c, loans to partner (s)]	By sundry Liabilities A/c [Excluding partners' capital, loan from partner (s), reserve, accumulated profit etc.]	....
To Provision on any Liability A/c	By Provision on Any Assets A/c	....
To Bank/Cash A/c (Amount Paid for discharging liabilities)	By Bank/Cash A/c (amount received on realization of assets)	....
To Bank/Cash A/c (Expenses on realization)	By Bank/Cash A/c (Amount received from unrecorded assets)	....
To Partners' capital/current A/c (Liability taken over by a partner or remuneration/commission paid to him or any expenses beared by him)	By Partner's capital A/c (Assets taken over by a partner recorded or unrecorded)	....
To Partners' Capital/Current A/c (Profit on realization)*	By Partners' capital/Current A/c (Loss on realization)*

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9. Partners' Capital Account

Dr.		Partners' Capital Account		Cr.	
Particulars	X(Rs.)	Y(Rs.)	Particulars	X(Rs)	Y(Rs)
To Balance b/d (Debit balance)	By balance b/d (credit balance)	....	...
To Profit and Loss A/c	By General Reserve A/c	...	....
To advertisement Expenditure A/c	By Profit and Loss A/c	....	...
To Realisation A/c (assets taken over)	By Workmen's Compensation fund A/c	....	...
To Realisation A/c (Loss on realization)	By Realization A/c (Liabilities taken over)	....	...
To Cash/Bank A/c (Excess cash paid)	By Realization A/c (Profit on realization)	....	....
	By Cash/Bank A/c (Cash brought in)	....	....

10. Partners' Loan Account: Partners' loan will be paid after all outside liabilities are paid.

The following journal entry is passed

Partner's Loan A/c

Dr.

To Cash/Bank A/c

11. Cash/Bank Account

Dr.		Cash/Bank Account		Cr.	
Particulars	Amt (Rs)	Particulars	Amt (Rs)		
To Balance b/d (debit balance)	By Balance b/d (Bank overdraft)			
To Profit and Loss A/c	By Realization A/c (Liabilities paid)			
To Advertisement Expenditure A/c	By Realization A/c (Realization expenses paid)			
To Realisation A/c (Assets taken over)	By Partner's loan A/c (Partner's loan paid)			
To realization A/c (Loss on realization)	By partner's			
To cash/Bank A/c (Excess cash paid)					

12. Preparation of Memorandum Balance Sheet:Memorandum balance sheet is prepared for calculating the missing figures of various assets or various liabilities. Sometimes, the total value of sundry assets is not given. However, the value realized from the assets is given, the partners' capital and other liabilities are also given. In that case sundry assets have to be ascertained by preparing the old balance sheet. The amount of capital and other liabilities are added. The sum total amount of assets.

LAT Classes