Dissolution of Partnership Firm

Objective

After going through this lesson, you shall be able to understand the following concepts.

- Dissolution of a Partnership Firm
- Ways of Dissolution of a Partnership Firm
- Difference between Dissolution of Partnership Firm and Partnership

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. As per the Section 39 of Partnership Act, 1932, dissolution of partnership between all the partners of a firm is called dissolution of partnership firm. It involves winding up of business, disposal of assets and paying off the liabilities and distribution of any surplus or borne of loss by the partners of the firm.

Difference Between Dissolution of Partnership and Dissolution of Partnership Firm

According to the Partnership Act, 1932, there is difference between *dissolution of partnership* and *dissolution of a partnership firm*. Whenever a partner is admitted, retired or died, it leads to the dissolution of a partnership. In other words, due to the admission, retirement and death of a partner the old partnership gets dissolve however; the firm continues the operation of its business as per the new deed and terms. That is, dissolution of partnership implies mere change in the partnership relationship among the partners. On the other hand, dissolution of a partnership firm implies discontinuation of the business of the partnership firm. It implies a winding up the firm and discontinuation of its business. Thus, dissolution of partnership firm implies an end of the contractual relationship among all the partners.

Important Note- Dissolution of a partnership firm automatically leads to the dissolution of partnership but dissolution of partnership can not results into the dissolution of a firm.

The below mentioned points will further highlight the difference between dissolution of partnership and dissolution of a 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	Books of accounts are not closed	Books of accounts are closed, as the

Accounts	forever, as there is only change in the existing agreement between the partners.	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.

Ways of Dissolution of a Partnership Firm

From the above points we are now through with the concept of the dissolution of a partnership firm. Now, let us understand different ways in which a partnership firm may be dissolved as prescribed in the Partnership Act of 1932.

(i) *Dissolution by Mutual Agreement-* A partnership firm is a result of a contractual relationship between the partners. It means it arises from a contract. Therefore, a partnership firm can be dissolved:

a. with the consent of all the partners of the firm, or
b. with the contract between all the partners

(ii) *Compulsory Dissolution-* The below mentioned are the two situations in which a partnership firm may be compulsorily dissolved.

a. *Insolvency of Partners*- When all the partners or all the partners except one become insolvent, it leads to the dissolution of a partnership firm
b. *Unlawful Business*- The happening of an event or any change in the government policies that makes the business of the firm unlawful, the partnership firm gets dissolved automatically.

(iii) *Dissolution due to Happening of Certain Contingencies-* Dissolution of a firm may also take place due to the happening of some contingent events. For this, there should be a partnership agreement among the partners of a firm. Some of the such events are explained below.

a. *Expiry of Period*- If a partnership firm is formed for a specific period of time then on the expiry of such period, dissolution of a firm takes place.
b. *Specific Purpose*- When a partnership firm is formed for a specific purpose, the dissolution of firm takes place on the completion of that particular purpose.

c. *Death of Partner/s*- If the partnership deed provides that due to the death of a partner/partners, partnership firm will get dissolve, then on the death of a partner/s, the firm gets dissolve.
d. *Insolvency of Partner/s*- A partnership firm may also get dissolve in case partner/s becomes insolvent.

(iv) *Dissolution by Notice*- When the partnership firm is at will and any of the partner of a firm wants to dissolve the firm, then he/she can do so by giving a notice in writing to all the other partners expressing his/her intention to dissolve the firm.

(v) *Dissolution by Order of a Court-* Sometimes, the court may also issue orders to dissolve the partnership firm. The situations in which such orders could be passed by the court are as follows.

a. *Insanity of a Partner*- When any partner of a firm becomes insane and lunatic.
b. *Incapacity of a Partner*- In case a partner becomes permanently incapable of performing his/her duties, the firm may be asked to discontinue its business by the court.
c. *Misconduct of a Partner*- When a partner is found guilty of misconduct and affects the business activities, the firm may be dissolved.
d. *Repeatedly Violation of Terms*- When a partner repeatedly breaks the terms of the partnership agreement, the court in such a case may order to dissolve the firm.
e. *Transfer of Interest*- When a partner of a firm transfers his/her interest to the third party without obtaining the consent of other co-partners, then the court may order to dissolve the firm.
f. *Continuous and Persistent Losses*- If a business persistently incurs losses, then the court in this situation may issue an order to the partners to dissolve the firm.

Besides these above mentioned circumstances, a partnership firm may also be dissolved if the court at any stage finds dissolution of the firm to be justified and inevitable.

***Example*:** State whether the following statements are True or False. If false, then justify it with appropriate reason.

a. Change in agreement among the of partners without discontinuing business is called dissolution of old partnership
b. In case of dissolution of a partnership firm, Revaluation Account is prepared to record the disposal of assets and payment of liabilities
c. Dissolution of partnership firm is possible only when the business of the partnership becomes unlawful.
d. Change in profit sharing ratio among partners is a part of dissolution of partnership.

Solution

a. True

b. False- In case of dissolution of a partnership firm, Realisation Account is prepared to record the disposal of assets and payment of liabilities.

c. False- There can be several other reasons to dissolve the partnership firm such as, expiry of agreement, in case of partners becoming permanently incapable of performing duties, etc.

d. True

Settlement of Accounts and Accounting Treatment

Objective

After going through this lesson, you shall be able to understand the following concepts.

- Settlement of Accounts
- Firm's Debts and Private Debts
- Journal Entries for Realisation of Assets and Liabilities
- Difference between Realisation and Revaluation Account

Settlement of Accounts

As we know that dissolution of partnership firm implies that the business of the firm is wound-up and no business activities can be further carried out by the firm. This implies that the firm need to settle the accounts of all the external liabilities and make final payment to its partners. In order to do so, generally firm applies its assets. That is, a firm sells its assets to pay-off the liabilities.

In this regard, the Section 48 of the Partnership Act, 1932 provides the following rules for the purpose of settlement of accounts.

(A) Application of Assets

Amount received from realisation (or sale) of the assets of a firm shall be used in the following order.

i. At first, all the external liabilities and expenses should be paid.
ii. Out of the balance amount, all the loans and advances forwarded by the partners should be paid.
iii. Then, the amount due on account of capital of each partner should be paid off.
iv. If still any balance remains (after paying above), then it should be distributed among all the partners in their profit sharing ratio.

(B) Treatment of Losses

In case of loss and any deficiencies of capital, it should be paid in the following order:.

i. First these should be adjusted against firm's profits.
ii. Then, against the total capital of the firm
iii. If still there exists any loss or deficiency, then it shall be borne by the partners individually from their private property in their profit sharing ratio.

Firm's Debts and Private Debts

Firm's debts means the debts which are incurred/borrowed by a firm from outsiders, whereas, private debts are the debts which are incurred/borrowed by the partners in their own name from any other person. It may be possible that the firm have both, its own debts i.e. firm's debts as well as private debts.

In such a case, the mentioned below rule of Section 49 of Partnership Act should be followed to pay off these debts.

i. Amount realised from the assets of a firm shall be first used to pay-off the debts and liabilities of the firm (i.e. firm's debts) and if there remains any balance amount, then it should be utilised to pay-off the private debts of the concerned partners.
ii. Similarly, any amount realised from the sale of the private assets of a partner shall be first used to pay off his/her private debts and if there remains any balance amount, then it should be utilised to pay off the firm's debt.

Difference Between Firm's Debts and Private Debts

The following are some points of difference between the firm's debts and private debts.

Basis of Difference	Firm's Debts	Partner's Private Debts
Meaning	It refers to those debts that are borrowed against the name of the firm.	It refers to those debts that are borrowed personally by the partner.
Liability	All the partners of the firm are jointly and separately liable for the firm's debt.	The concerned partner is personally liable for his private debts.
Settlement of debts by private assets	If the firm's debt exceeds the firm's assets, then private assets of the partners may be utilised to pay back the firm's debt, if only the partner's private assets exceed his/her own private debts.	Private debts are settled against the partner's private assets. Subsequently, if any surplus exists then this may be utilised to settle the firm's debts.
Settlement of debts by firm's assets	Firm's debts are settled against the firm's assets. Subsequently, if any surplus exists, then this is distributed among the partners.	After paying off firm's debts, the surplus of firm's assets, if any is distributed among the partners. The personal share of the partner in this surplus can be utilised to settle his/her own private debts.

Accounting Treatment

In case of dissolution of a firm the following accounts are to be prepared.

1. Realisation Account
2. Partner's Loan Account
3. Partners' Capital Account
4. Cash/Bank Account

Realisation Account

As we know that in case of dissolution of a partnership firm, the business is wound-up and all the books of accounts are closed. Also, assets are sold in order to pay-off all liabilities. Thus, in order to record the transactions related to sale of assets and discharge of all liabilities, Realisation Account is prepared. It is a nominal account. The main motive to prepare Realisation Account is to ascertain the profit or loss due to the realisation of assets and liabilities. Any realisation profit or loss is distributed (or borne) by the partners in their profit sharing ratio.

Difference Between Realisation Account and Revaluation Account

In the chapters of Admission, Retirement and Death of a partner, we learnt about the Revaluation Account. But in the chapter of Dissolution, we will learn about Realisation Account. While Revaluation Account records the revaluation of assets and liabilities, on the other hand, Realisation Account records the value realised for the assets and liabilities. With this basic difference between the two, let us understand some more differences between the two in the following tabular form.

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.

Accounting Treatment of Assets and Liabilities- in case of Dissolution

For Transfer of Assets

All the assets of a firm including goodwill, joint life policy, etc. (except cash, bank and fictitious assets) are transferred to the debit side of the Realisation Account at their book value. The Journal entry to record this is given below.

Journal Entry

Realisation A/c	Dr.
To Assets A/c (Individually)	

Important Notes

Note 1 ***It should be kept in mind that Debtors are transferred to the debit side of the Realisation Account at its gross value. Any provision for debtors shall be transferred to its credit side.***

In the similar manner, other assets of the firm shall also be recorded at their gross value if there is any provision or reserve against such asset.

For example- Debtors are appearing on the Assets side of a Balance Sheet at Rs 15,000 (in the inner column) and the Provision for Doubtful Debts is appearing at Rs 3,000. Here, the Gross Value of the Debtors is amounted to Rs 15,000, which shall be transferred to the Debit Side of the Realisation Account. The Provision for Doubtful Debts i.e. Rs 3,000 will be transferred to the credit side of the Realisation Account.

Note 2 ***Fictitious Assets (such as preliminary expenses) or Accumulated Losses (such as Debit balance of Profit and Loss Account) are not transferred to the Realisation Account. Such assets shall be transferred to the Partner's Capital Accounts in their profit sharing ratio.*** The Journal entry for this is;

Partner's Capital A/c	Dr.
To Fictitious Assets A/c	

Note 3 ***Cash or Bank Balance are also not transferred to the Realisation Account. It shall be recorded in the Cash/Bank Account as its opening balance.*** This is because only those assets are transferred to the Realisation Account, which can be realised and can be converted into cash or bank. In another way round, only those assets are transferred to the Realisation Account that have the probability of either losing values (depreciation, such as machinery, etc.) or gaining values (appreciation, such as buildings, goodwill, etc.), when they are sold or realised. However; the values of Cash and Bank remain steady and it is less probable that the values of Cash and Bank will change over a period of time. Hence, these balances are not transferred to Realisation Account.

For Transfer of Liabilities

All the liabilities of a firm including Partner's Wife Loan and Partner's Husband Loan are external liabilities, therefore are transferred to the credit side of the Realisation Account. The Journal entry to record this is;

Journal Entry

External Liabilities A/c (individually)	Dr.
To Realisation A/c	

Note: Partners' Loan and Partners' Capital Balances are not transferred to Realisation Account. In fact, these are transferred to Partners' Loan Account and Partners' Capital Account respectively.

Transfer of Accumulated Profits and Reserves

The balance of accumulated profits and reserves (such as General Reserve, Reserve Fund, etc.) appearing on the Liabilities Side of the Balance Sheet are not transferred to the Realisation Account. This is because these are mere provisions and not the actual liabilities. Such reserves are prepared to insulate the business from the unforeseen circumstances and future conditions. Therefore, such reserves are transferred to the credit side of the Partners' Capital Account in their profit sharing ratio.

Realisation of Assets

Assets can be realised (sold-off) mainly in three ways, namely either in cash, bank or taken over by any partner. When assets are realised in cash or in bank, then the following Journal entry is passed.

Journal Entry

If ***Asset*** realised in ***Cash/Bank***	If ***Asset*** taken over by ***Partner***
Cash A/c or Bank A/c Dr. To Realisation A/c (Assets sold for cash) *{at Realised value}*	Partner's Capital A/c Dr. To Realisation A/c (Assets taken over by partner) *{at Agreed value}*

Realisation of Liabilities

Similar to the assets, liabilities can also be realised (paid-off) in three ways, namely either in cash, bank or taken over by any partner. When liabilities are paid in cash or in bank, then the following Journal entry is passed.

If ***Liability*** paid in ***Cash/Bank***	If ***Liability*** paid by ***Partner***
Realisation A/c Dr. To Cash A/c or Bank A/c (Liabilities paid in cash)	Realisation A/c Dr. To Partner's Capital A/c (Liabilities paid-off by partner)

'Treatment of Unrecorded Assets and Liabilities

Unrecorded Assets are those assets the value of which are not shown in the books of accounts. But it may happen that at the time of dissolution, these assets are sold off as scraps or taken over by any partner. These assets are recorded in the Realisation Account only if they are realised (either in cash, bank or taken over by any partner). The Journal entry to record the sale of unrecorded asset is;

*When the **Unrecorded Assets** are Sold for **Cash***	*When the **Unrecorded Assets** are Taken Over by the **Partner***
Cash A/c or Bank A/c Dr. To Realisation A/c (Unrecorded assets sold for cash)	Partner's Capital A/c Dr. To Realisation A/c (Unrecorded assets taken over by partner)

Unrecorded Liability are those liabilities which are not recorded in the books of accounts. Similar to the unrecorded assets, these unrecorded liabilities are also to realised (or paid-off) either in cash, bank or taken-over by any partner. The following Journal entry is passed when unrecorded liabilities are realised.

*When the **Unrecorded Liabilities** are Paid-off in **Cash***	*When the **Unrecorded Liabilities** are Paid-off by **Partner***

Realisation A/c Dr. To Cash A/c or Bank A/c (Unrecorded liability paid in cash)	Realisation A/c Dr. To Partner's Capital A/c (Unrecorded liability paid-off by partner)

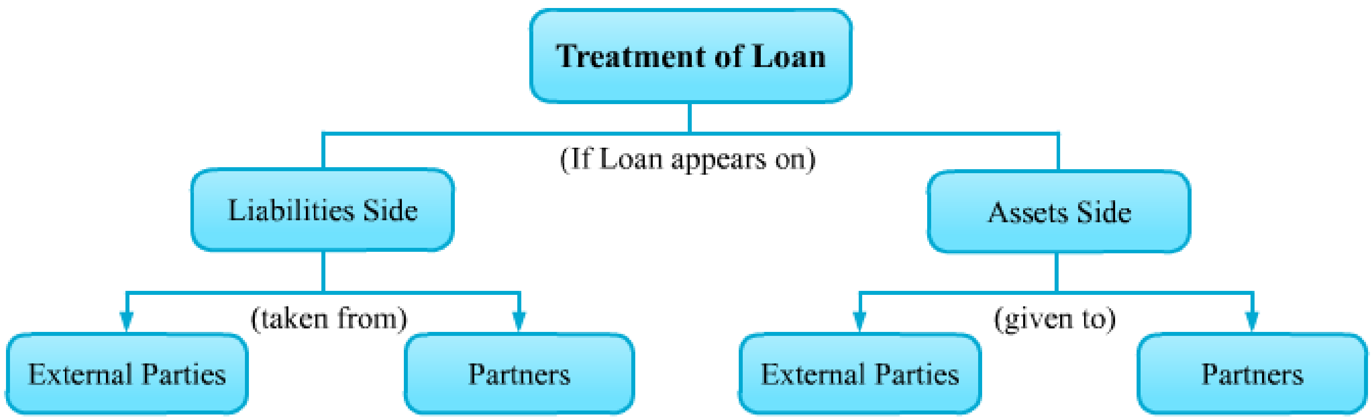
For Transfer of Profit or Loss on Realisation

After the completion of realisation process, there may be either loss or profit. The loss incurred or profit earned on realisation of assets and liabilities are to borne (or distributed) among the partners in their profit sharing ratio. The following Journal entries are passed in case of profit and loss.

In case of Profit on Realisation	*In case of Loss on Realisation*
Realisation A/c Dr. To Partner's Capital A/c	Partner's Capital A/c Dr. To Realisation A/c

Settlement of Loan

Loan may appear both on the Liabilities side as well as on the Assets side of a firm's balance sheet. The different situations of loan in case of dissolution is presented in the following diagram.



Summary of Accounting Treatment of Loan in case of Dissolution of Partnership Firm

If Loan Appears on the ***Liabilities Side*** of the Balance Sheet	
Loan from External Parties (It implies that the firm has ***taken*** loan from the external party)	*Loan from Partners* (It implies that the firm has ***taken*** loan from its partners)
For Closing Loan from External Party A/c Dr. To Realisation A/c	***For Closing*** Transferred to the credit side of Partner's Loan Account (*prepared separately*) as '**Balance b/d**'

(External Party's loan transferred to Realisation Account) ***At the time of Repayment of Loan*** Realisation A/c Dr. To Cash/Bank A/c (External Party's Loan paid-off)	***At the time of Repayment of Loan*** Loan from Partner A/c Dr. To Cash/Bank A/c (Loan from Partner paid-off in cash or through cheque)
If Loan Appears on the ***Assets Side*** of the Balance Sheet	
Loan to External Parties (It implies that the firm has ***given*** loan to the external party)	*Loan to Partners* (It implies that the firm has ***given*** loan to its partners)
For Closing Realisation A/c Dr. To Loan to External Party's A/c (Loan to External Party transferred to Realisation Account) ***At the time of Realisation of Loan (receiving payment)*** Cash/Bank A/c Dr. To Realisation A/c (Received amount of loan given to external party)	***For Closing*** Transferred to the debit side of Partner's Capital Account as 'Loan to Partner' Loan to Partner A/c Dr. To Partners' Capital A/c (Loan to Partner transferred to Partners' Capital Account) ***At the time of Realisation of Loan (receiving payment)*** The final payment to the partner will be made after adjusting the loan amount from him/her. This means that the final balance to the partner calculated as total of credit side – total of debit side, will automatically be net of partner's loan, when partner's loan is shown on the debit side.

***Example*:** Pass the Journal entries for the following transaction at the time of winding up of firm.

(a) Closing balances of assets at the time of winding-up: Land and Building Rs 1,00,000, Goodwill Rs 20,000, Plant and Machinery Rs 40,000, Sundry Debtors Rs 20,000, Stock Rs 15,000, Cash in Hand Rs 2,000

(b) Closing balances of liabilities at the end time of winding-up, Bank loan Rs 20,000, Partners' loan Rs 5,000, Sundry Creditors Rs 8,000

(c) Land and Building realised Rs 1,20,000, Plant and Machinery Rs 15,000, Partner took over Sundry Debtors Rs 20,000 and Stock Rs 12,000

(d) Realisation expenses Rs 200, Loan paid Rs 20,000

(e) Partners accepted Sundry Creditors Rs 6,000

(f) Unrecorded typewriter sold for Rs 1,200

(g) Sundry Creditors Rs 20,000 discharged at 10% discount

Solution

Journal Entries

Date	Particulars		L.F.	Debit Amount Rs	Credit Amount Rs
(a)	Realisation A/c	Dr.		1,95,000	
	To Land and Building A/c				1,00,000
	To Goodwill A/c				20,000
	To Plant and Machinery				40,0000
	To Sundry Debtors				20,000
	To Stock				15,000
	(Assets transferred to Realisation account)				
(b)	Bank Loan A/c	Dr.		20,000	
	Sundry Creditors A/c	Dr.		8,000	
	To Realisation A/c				28,000
	(Liabilities transferred to Realisation Account)				
(c)	Bank A/c	Dr.		1,35,000	
	To Realisation A/c				1,35,000
	(Plant and Machinery; Land and Building realised)				
	Partners Capital A/c	Dr.		32,000	
	To Realisation A/c				32,000
	(Stock and Sundry Debtors took over by partners)				
(d)	Realisation A/c	Dr.		20,200	
	To Bank A/c				20,200
	(Loan and Realisation expenses paid)				
(e)	Realisation A/c	Dr.		6,000	
	To Partners Capital A/c				6,000
	(Creditors took over by partners)				
(f)	Bank A/c	Dr.		1,200	

	To Realisation A/c			1,200
	(Unrecorded typewriter sold)			
(g)	Realisation A/c Dr.		18,000	
	To Bank A/c			18,000
	(Creditors Rs 20,000 paid at 10% discount)			

Format of Realisation A/c, Realisation Expenses, Partner's Loan A/c

Objective

After going through this lesson, you shall be able to understand the following concepts.

- Realisation Account and its Format
- Cases of Realisation Expenses
- Partner's Loan Account

Realisation Account

In the previous chapter, we learnt how the accounts of assets and liabilities are closed by transferring their balances to the Realisation Account. In this chapter, we will learn how to prepare Realisation Account.

Procedure to Prepare Realisation Account

The following are the various steps involved in preparation of Realisation Account.

1. First of all, all the assets (except Cash, Bank, Loan to a Partner, Fictitious Assets such as, Preliminary Expenses, Deferred Revenue Expenditure, Debit balance of Profit and Loss Account, etc.) are transferred to the ***Debit side*** of the Realisation Account.

2. Secondly, all the liabilities (except Bank Overdraft, Partner Capital Account, Reserves, Credit balance of Profit and Loss Account, Partner's Loan, General Reserve, Reserve Fund, etc.) are transferred to the ***Credit side*** of the Realisation Account.

3. Then, if assets are realised for cash or bank, then it is shown on the ***Credit side*** of the Realisation Account as Cash/Bank A/c. On the other hand, if any asset is taken-over by any of the partners, then it is shown on the ***Credit side*** of the Realisation Account as Partner's Capital Account for example, C's Capital A/c.

4. Similarly, if liabilities are paid-off in cash or bank, then it is shown on the ***Debit side*** of the Realisation Account as Cash/Bank A/c. On the other hand, if any liability is paid-off by any of the partners, then it is shown on the ***Debit side*** of the Realisation Account as Partner's Capital Account for example, B's Capital A/c.

5. For realisation of Unrecorded Assets in cash or in bank (or taken-over by partner), then it is shown on the ***Credit side*** as Cash/Bank A/c (or Partner's Capital A/c).

6. Similarly, for paying-off Unrecorded Liabilities in cash or in bank (or paid-off by partner), then it is shown on the ***Debit side*** as Cash/Bank A/c (or Partner's Capital A/c).

7. It should be remembered that it may happen that some of the liabilities remained unpaid and the question is also silent about their realisation. In such case, these unrealised liabilities are to be paid-off before closing the Realisation Account.

8. In the similar manner, if nothing is specified in the question regarding the realisation of the assets, then any one of the following practices may be adopted.

    - It is either assumed that such assets have not realised for any amount. That is, the assets have remained unrealised. **OR**
    - It is assumed that the assets have been realised at their book value.
    - ***(Students may adopt any of these two practices for realisation of assets- in absence of information regarding realisation of assets. However, as the first practice is more popular and is in fashion, so throughout the chapter of dissolution, we have adopted the first practice only).***

9. Lastly, if the total of the debit side exceeds the total of the credit side, then it is regarded as Realisation Loss and is transferred to the Debit Side of the Partners' Capital Account in their profit sharing ratio. On the other hand, if the total of the debit side is short of the total of the credit side, then it is regarded as Realisation Profit and is transferred to the Credit Side of Partners' Capital Account in their profit sharing ratio.

Format of Realisation Account

Realisation Account

Dr. **Cr.**

Particulars	**Amount Rs**	**Particulars**	**Amount Rs**
Individual Assets (Excluding Cash/Bank, Fictitious Assets, Debit balance of P & L A/c, Partners' Capital A/c, Deferred Revenue Expenditure A/c, Current A/c, Loan to Partner)		***Individual Liabilities*** (Excluding Partner Capital Account, Reserves, P & L A/c, Current A/c, Partner's Loan, Bank Overdraft)	
Land and Building		Provisions for Doubtful Debts	
Furniture		Machinery Replacement Reserve	
Plant and Machinery*		Provisions for Bad Debts	
Debtors/Book Debts*		Provisions for Depreciation	
Freehold Property		Notes Payable	
Bills Receivables		Partner's Wife's or Husband's Loan	

Joint Life Policy		Joint Life Policy Fund#	
Goodwill		Creditors	
Equipments		Bills Payable	
Marketable Securities		Long-term Loans	
Investments		Investment Fluctuation Fund#	
Stock		Mortgaged Loans	
Prepaid Expenses		Loans and Advances from External Parties	
Outstanding Incomes		Income earned in advance	
Provision for Discount on Creditors		Outstanding Expenses	
		Provision for taxation/ Taxation Reserve	
		Employee Provident Fund	
		Depreciation Reserve	
Realisation of Liabilities		***Realisation of Assets***	
Cash/ Bank (if liabilities paid-off in cash/cheque)♣		Cash/Bank (if assets sold-off for cash/cheque)	
Partner's Capital A/c (if liabilities paid by partner)		Partner's Capital A/c (if assets taken over by partner)	
Cash/Bank/Partner's Capital A/c (if unrecorded liabilities paid in cash/bank/ paid by Partner)		Cash/Bank/Partner's Capital A/c (if unrecorded asset sold for cash/bank/ taken over 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 **		Loss on Realisation **	
A's Capital/Current A/c –		A's Capital/Current A/c –	
B's Capital/Current A/c –		B's Capital/Current A/c –	
C'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 Policy Fund (JLPF) 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 JLPF) are transferred to the credit side of the Partner's Capital Account.

♣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:

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

2. *We know that for Liabilities even if the question is silent about their repayments, we have to settle them. However, for Assets, if the question is silent regarding their realisation, then we have two alternative treatments- either to realise such assets at their book-value or to assume that such assets have not been realised at all. Generally, the second alternative is preferred. Therefore, it is advisable to the students to follow the second alternative.*

***Example*:** A and B are partners sharing profits and losses in the ratio 3 : 2. On March 31, 2012 their balances was as:

Balance Sheet

Liabilities		Amount Rs	Assets		Amount Rs
Capital A/c			Goodwill		5,000
A	40,000		Land and Building		35,000
B	30,000	70,000	Plant and Machinery		22,000
General Reserve		4,000	Stock		10,000
A's Loan		3,000	Sundry Debtors	12,000	
Mrs. B's Loan		1,500	*Less*: Provision for Bad debts	500	11,500
Sundry Creditors		12,000	Bills Receivable		6,000
Bills Payable		2,000	Cash at Bank		3,000
		92,500			92,500

On April 01, 2012, the partners decided to dissolve the firm. The realisation of assets and liabilities took place in the following manner.

a. Assets realised: Land and Building for Rs 40,000, Plant and Machinery for Rs 15,000 and Stock for Rs 17,000.

b. All sundry debtors were taken-over by A at the book value.
c. Sundry Creditors accepted Bills Receivable remaining creditors paid for Rs 3,000
d. B accepted his wife loan
e. Bills Payable paid for Rs 1,800 and Realisation expenses amounted to Rs 400.

Prepare Realisation Account.

Solution

Realisation Account

Dr. Particulars		Amount Rs	Particulars		**Cr.** Amount Rs
Goodwill		5,000	Mrs. B's Loan		1,500
Land and Building		35,000	Sundry Creditors		12,000
Plant and Machinery		22,000	Bills Payable		2,000
Stock		10,000	Provision for Bad debts		500
Sundry Debtors		12,000	Bank:		
Bills Receivable		6,000	Land and Building	40,000	
			Plant and Machinery	15,000	
B's Capital (wife loan)		1,500	Stock	17,000	72,000
Bank:			A's Capital (Debtors)		12,000
Sundry Creditors	3,000				
Bills Payable	1,800				
Realisation Expenses	400	5,200			
Profit transferred to Capital Accounts					
A	1,980				
B	1,320	3,300			
		1,00,000			1,00,000

***<u>Working Notes</u>*:**

1. Bills Receivable Rs 6,000 accepted by creditors have not been shown in Realisation Account because balance of Bills Receivable has already been transferred to Realisation Account

2. Profit on Realisation

$$A\text{'s share} = 3{,}300 \times \frac{3}{5} = \text{Rs}1{,}980$$

$$B\text{'s share} = 3{,}300 \times \frac{2}{5} = \text{Rs}1{,}320$$

Treatment of Realisation Expenses

Realisation expenses refer to those expenses which are incurred to carry out the realisation work. These expenses are recorded on the debit side of the Realisation Account. However; there arises differences in the treatment of the realisation expenses in case these are borne (who bears the expenses) and paid (who actually pays the amount) by two different parties. It may happen that the bearer of these expenses may not be payer of the expenses. The following are the different situations of realisation expenses.

Case-1 When expenses are paid by firm and borne by firm.
Case-2 When expenses are paid by firm and borne by partner.
Case-3 When expenses are paid by partner and borne by firm.
Case-4 When expenses are paid by firm and borne by partner.

Case 1: If expenses are paid by ***Firm*** and are borne by ***Firm***	
Realisation A/c To Cash/Bank A/c	Dr.
Case 2: If expenses paid by ***Firm*** and borne by ***Partner***	
Partner's Capital A/c To Cash/Bank A/c	Dr.
Case 3: If expenses paid by ***Partner*** and borne by ***Firm***	
Realisation A/c To Partner's Capital A/c	Dr.
Case 4: If expenses paid by ***Partner*** and borne by ***Partner***	
No Entry	

Case 5: If a partner (say Mohan) *agrees to bear* the realisation expenses (say actual realisation expenses of Rs 15,000) for a certain amount of remuneration (say Rs 2,000), then the Journal entry will be same as that 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 (Rs 15,000).

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

Besides the above cases, there may be following additional cases that are being asked in the questions.

Case 6: If realisation expenses (say of Rs 20,000) are to be borne by firm (for Rs 6,000) and also by a partner (for Rs 14,000), but the expenses are paid by the partner, then the Journal entry of only Rs 6,000 will be passed. This is because the remaining amount of Rs 14,000 is borne and paid by the partner **(Case-4)**.

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

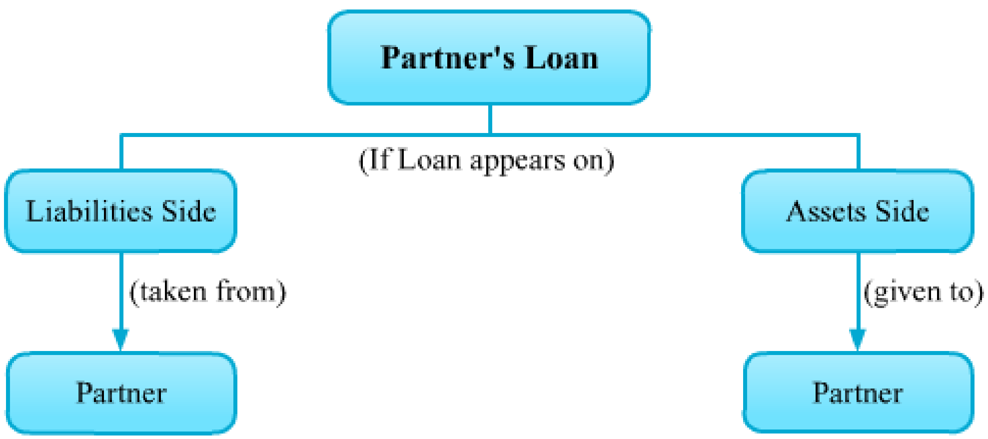
Case 7: If a partner (say Rohit) *agrees to carry out all* realisation work for an agreed certain remuneration (say Rs 15,000) and *realisation expenses* (of Rs 10,000) is *to be borne by the firm*, then the following Journal entries are passed.

Realisation A/c Dr. To Partners' (Rohit's) Capital A/c (Remuneration to Rohit for carrying out realisation work)	15,000	 15,000
Realisation A/c Dr. To Cash/Bank A/c (Realisation expenses of Rs 10,000 paid and borne by firm)	10,000	 10,000

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 the firm itself, i.e. Case 1.

Partner's Loan Account

Partner's Loan may appear both on the Liabilities side as well as on the Assets side of the Balance Sheet.



When Partner's Loan Appears on the Liabilities Side- It implies that the partner has given loan to the firm and it is a liability for the firm. At the time of dissolution of the firm, the loan provided by the partner has to be paid back by the firm after the settlement of all the external liabilities. In this case, partner's loan is transferred to the credit side of the Partner's Loan Account (that is prepared separately) as 'Balance b/d'. It should be noted that partner's loan is not transferred to the Realisation Account. At the time of repayment of the loan amount to the partner, Cash/Bank Account is debited in the Partner's Loan Account.

Format of Partner's Loan Account

Partner's Loan Account

Cr.

Particulars	**Amount Rs**	**Particulars**	**Amount Rs**
Cash/Bank**	-	Balance b/d	-

** It will also be shown on the credit side of the Cash/Bank Account as 'Partner's Loan Account-Paid'

When Partner's Loan Appears on the Assets Side- It implies that the firm has given loan to its partner and it is an asset for the firm. In this case, the partner's loan is transferred to debit side of the Partner's Capital Account. The final payment to the partner is made net of the loan amount.

If Partner's Loan Appears on the ***Liabilities Side*** of the Balance Sheet	If Partner's Loan Appears on the ***Assets Side*** of the Balance Sheet
Loan from Partner (It implies that the firm has ***taken*** loan from its partner)	*Loan to Partner* (It implies that the firm has ***given*** loan to its partner)
For Closing Transfer to the credit side of Partner's Loan Account (*prepared separately*) as '**Balance b/d**' ***At the time of Repayment of Loan*** Partner's Loan A/c Dr. To Cash/Bank A/c (External Party's Loan paid-off)	***For Closing*** Transfer to the debit side of Partner's Capital Account as 'Loan to Partner' Partner's Capital A/c Dr. To Partner's Loan A/c (Loan to Partner transferred to Partners' Capital Account) ***At the time of Realisation of Loan (receiving payment)*** The final payment to the partner will be made after adjusting the loan amount from him/her. This means that the final balance to the partner calculated as total of credit side – total of debit side, will automatically be net of partner's loan, when partner's loan is shown on the debit side.

Note: *It should be noted that in neither of the two cases, partner's loan is transferred to the Realisation Account.*

Treatment of JLP, IFF, Goodwill, Workmen Compensation Fund

Objective

After going through this lesson, you shall be able to understand the following concepts.

- Treatment of Goods and Services Tax (GST)
- Treatment of Goodwill
- Treatment of Investment Fluctuation Fund (IFF)
- Treatment of Workmen Compensation Fund and Contingency Reserves

Treatment of Goods and Services Tax (GST)

Goods and Services Tax (GST) has integrated several taxes like sales tax, VAT, Excise, etc., into one common tax for the entire nation. As we have studied in detail in the previous grade, GST was introduced on 1st July, 2017 with this motive.

GST is applicable on a partnership firm if it has been registered under the same and will have to duly comply with it even during its dissolution by paying taxes on the assets sold, etc. GST registration for a partnership firm is either voluntary or mandatory depending on the annual turnover of the firm and the place of business. So, let's try to understand these cases before going into the treatment of GST.

Jurisdiction of Business	Annual Turnover	GST Registration
Same state of business except certain Northeastern States, Jammu & Kashmir & Himachal Pradesh.	Exceeds Rs. 20 Lakhs	Mandatory
Same state of business only for Arunachal Pradesh, Assam, Himachal Pradesh, J&K, Meghalaya, Manipur, Nagaland, Sikkim, Tripura and Uttarakhand.	Exceeds Rs. 10 Lakhs	Mandatory
Inter-state export/supply of services	Exceeds Rs. 20 Lakhs	Mandatory
Inter-state export/supply of goods	Value of goods ranging from Rs. 1 to any value	Compulsory/ Mandatory for all.
• Supply of goods through e-commerce portal. • Supply of goods via export • You are a service provider, agent for registered person,		

casual taxable person, Input service distributer, TDS/TCS deductor, e-commerce operator, online information and database retrieval provider supplying services from outside India to a non-registered person in India. • You are registered under any of the previous Indirect taxes (Sales Tax, VAT, etc.) irrespective of the turnover.		Mandatory in all these cases

Note: *In all the other cases not mentioned above, a partnership can register under the GST voluntarily.*

We already know by now that, the liability of the partners is unlimited in case of a partnership firm. Therefore, if a firm is liable to pay any GST tax then all its partners shall be jointly and severally liable (i.e. all partners liable together) to pay the amount due.

Journal Entry:

i. **In case of same state GST due for sale of an asset to a Partner at the time of dissolution:**

Date	Particulars	L.F.	Dr.(Rs.)	Cr.(Rs.)
	Partner's Capital A/c Dr To Realisation A/c To Output CGST A/c To Output SGST A/c (Being asset taken over by a Partner, CGST & SGST charged)			

i. **In case of same state GST due for sale of an asset to an outsider at the time of dissolution:**

Date	Particulars	L.F.	Dr.(Rs.)	Cr.(Rs.)

	Bank A/c Dr To Realisation A/c To Output CGST A/c To Output SGST A/c (Being asset sold, CGST & SGST charged)			

i. **In case of same state GST applicable on realisation expenses:**

Date	Particulars	L.F.	Dr.(Rs.)	Cr.(Rs.)
	Realisation Expenses A/c Dr Input CGST A/c Dr Input SGST A/c Dr To Bank A/c (Being the realization expenses paid along with CGST and SGST)			

i. **In case of depositing Output GST after setting it off against Input GST:**

Date	Particulars	L.F.	Dr.(Rs.)	Cr.(Rs.)
	Output CGTS/Output SGST Dr To Input CGST/Input SGST To Bank A/c (Being Output GST deposited after setting it off against Input GST)			

Note: *In case of inter-sate GST, it will be charged to IGST A/c (Integrated GST) instead of CGST A/c and SGST A/c. Also, Output IGST A/c will be set off against Input IGST A/c.*

Let's understand this with the help of a comprehensive example given below.

Comprehensive Example:

Example: X, Y and Z were partners in a firm sharing profits and losses in the ratio of 5:3:2. Due to constant internal clashes, they decided to dissolve the firm with effect from 1st April, 2018 on which date the Balance Sheet of the firm was:

Balance Sheet as at 1st April, 2018

Liabilities	Rs.	Assets	Rs.
Capital A/cs:		Plant and Machinery	2,50,000
X 2,00,000		Furniture	40,000
Y 1,00,000		Car	80,000
Z 50,000	3,50,000	Stock-in-Trade	35,000
Sundry Creditors	1,50,000	Sundry Debtors	75,000
		Cash at Bank	20,000
	5,00,000		5,00,000

The following information is given:

i. Plant and Machinery of book value Rs. 1,00,000 was taken over by X at an agreed value of Rs. 1,20,000 and the remaining machinery realised Rs. 85,000.

ii. Furniture realised Rs. 60,000.

iii. Car was taken over by Y for Rs. 60,000.

iv. Sundry debtors included a bad debt for Rs. 2,000 and the rest was realised in full.

v. Stock realised 20% above their book value.

vi. A creditor for Rs. 20,000 was untraceable and other creditors accepted payment allowing a 15% discount.

vii. Realisation expenses paid to an agency carrying out the dissolution process Rs. 6,000.

viii. Sale of Plant and Machinery, Furniture, Car, Stock and Realisation expenses are subject to levy of CGST and SGST @ 9% each.

Pass the Journal entries; prepare Realisation Account, CGST and SGST Accounts, Bank Account, and Partner's Capital Accounts for the above.

Answer:

JOURNAL				
Date	**Particulars**	**L.F.**	**Dr.(Rs.)**	**Cr.(Rs.)**
	Realisation A/c Dr. To Plant & Machinery A/c To Furniture A/c To Car A/c To Stock-In-Trade A/c To Sundry Debtors A/c (Being assets transferred)		4,80,000	 2,50,000 40,000 80,000 35,000 75,000
	Sundry Creditors A/c Dr. To Realisation A/c (Being liabilities transferred)		1,50,000	 1,50,000
	X's Capital A/c Dr. To Realisation A/c To Output CGST A/c To Input SGST A/c (Being machinery taken over by X, CGST AND SGST charged @ 9% each)		1,41,600	 1,20,000 10,800 10,800
(iv)	Bank A/c Dr. To Realisation A/c To Output CGST A/c To Input SGST A/c (Being balance machinery sold, CGST and SGST charged@9% each)		1,00,300	 85,000 7,650 7,650
	Bank A/c Dr. To Realisation A/c To Output CGST A/c To Input SGST A/c		70,800	 60,000 5,400 5,400

	(Being furniture sold, CGST and SGST charged@9% each)			
	Y's Capital A/c Dr. To Realisation A/c To Output CGST A/c To Input SGST A/c (Being car taken over by Y, CGST and SGST charged @ 9% each)		70,800	 60,000 5,400 5,400
	Bank A/c Dr. To Realisation A/c (Being debtors realised)		73,000	 73,000
	Bank A/c Dr. To Realisation A/c To Output CGST A/c To Input SGST A/c (Being stock sold, CGST and SGST charged @ 9% each)		49,560	 42,000 3,780 3,780
	Realisation A/c Dr. To Bank A/c (Being Creditors paid)		1,10,500	 1,10,500
	Realisation A/c Dr. Input CGST A/c Dr. Input SGST A/c Dr. To Bank A/c (Being realisation expenses paid along with CGST and SGST @ 9% each)		6,000 540 540	 7,080
	Output CGST A/c Dr. To Input CGST A/c To Bank A/c		33,030	 540 32,490

	(Being the output CGST deposited after setting off Input CGST)			
	Output SGST A/c Dr. To Input SGST A/c To Bank A/c (Being the output SGST deposited after setting off Input SGST)		33,030	 540 32,490

Dr. **Output CGST A/c** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Input CGST A/c	540	By X' Capital A/c	10,800
To Bank A/c (Balancing Figure)	32,490	By Bank A/c	7,650
		By Y's Capital A/c	5,400
		By Bank A/c	3,780
		By Bank A/c	5,400
	33,030		33,030

Dr. **Output SGST A/c** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Input SGST A/c	540	By X' Capital A/c	10,800
To Bank A/c (Balancing Figure)	32,490	By Bank A/c	7,650
		By Y's Capital A/c	5,400
		By Bank A/c	3,780
		By Bank A/c	5,400
	33,030		33,030

Dr. **Input CGST A/c** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Bank A/c	540	By Output CGST A/c	540

Dr. **Input CGST A/c** Cr.

Particulars	Rs.	Particulars	Rs.
To Bank A/c	540	By Output SGST A/c	540

Dr. **Realisation A/c** Cr.

Particulars	Rs.	Particulars	Rs.
To Sundry Assets A/c: Plant & Machinery A/c 2,50,000 Furniture A/c 40,000 Car A/c 80,000 Stock-In-Trade A/c 35,000 Sundry Debtors A/c 75,000	4,80,000	By Sundry Creditors A/c	1,50,000
To Bank A/c: Sundry Creditors 1,10,500 85% of(Rs. 1,50,000 -20,000) Expenses 6,000	1,16,500	By X's Capital A/c (Machinery taken over)	1,20,000
		By Bank A/c (Furniture)	60,000
		By Bank A/c (Machinery sold)	85,000
		By Y' Capital A/c (Car taken over)	60,000
		By Bank A/c (Debtors realised)	73,000
		By Bank A/c (Stock sold)	42,000
		By Loss Transferred to: X's Capital A/c 3,250 Y's Capital A/c 1,950 Z's Capital A/c 1,300	6,500
	5,96,500		5,96,500

Dr. **Partner's Capital A/c** Cr.

Particulars	X(Rs.)	Y(Rs.)	Z(Rs.)	Particulars	X(Rs.)	Y(Rs.)	Z(Rs.)
To Realisation A/c (Machinery)	1,20,000			By balance b/d	2,00,000	1,00,000	50,000

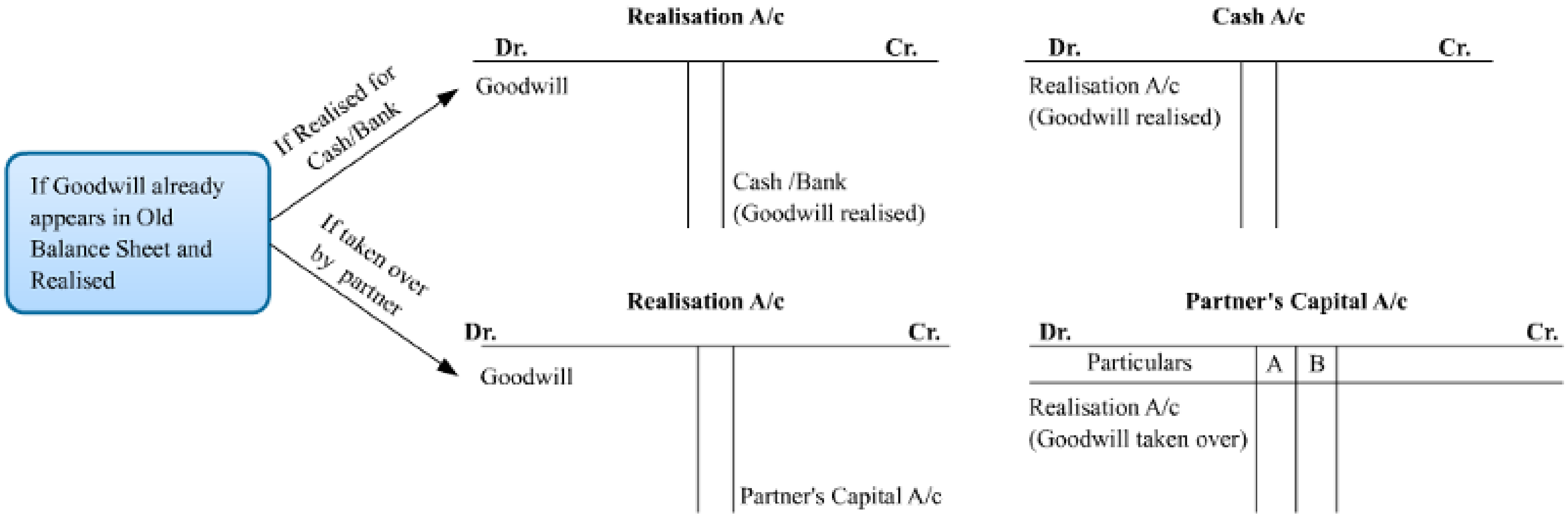
To Output CGST A/c	10,800						
To Output SGST A/c	10,800						
To Realisation A/c (car taken over)		60,000					
To Output CGST A/c		5,400					
To Output SGST A/c		5,400					
To Realisation A/c (loss)	3,250	1,950	1,300				
To Bank A/c (Final Payment)	55,150	27,250	48,700				
	2,00,000	1,00,000	50,000		2,00,000	1,00,000	50,000

Dr. **Bank A/c** **Cr.**

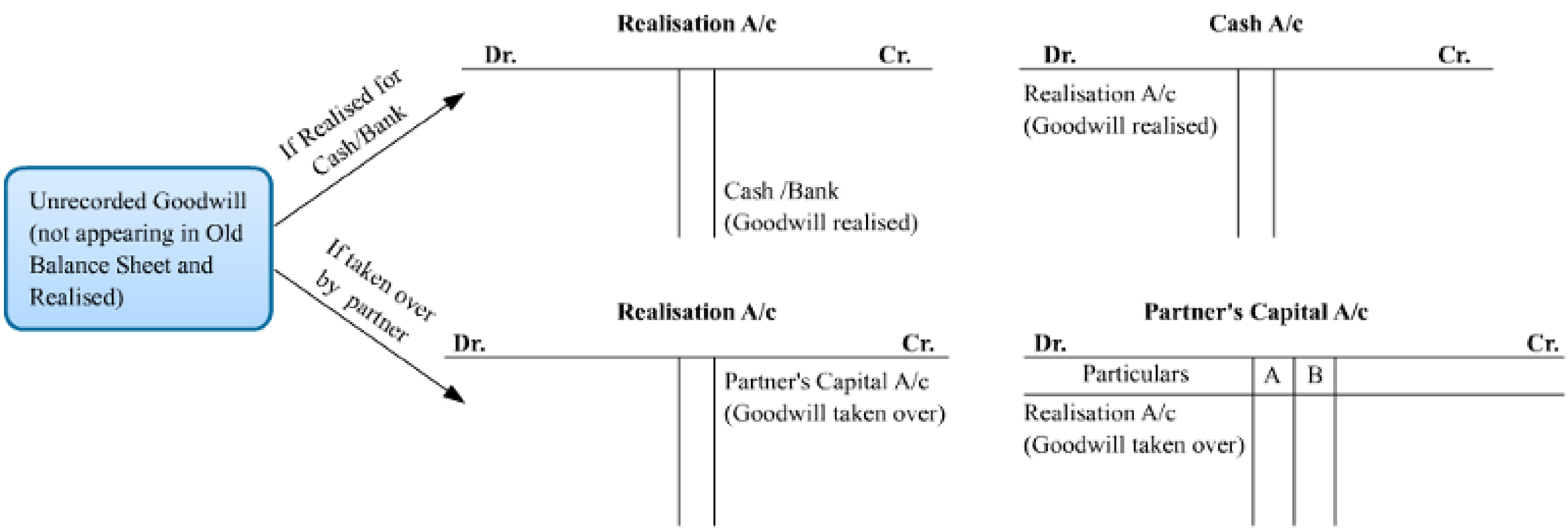
Particulars	Rs.	Particulars	Rs.
To balance b/d	20,000	By Realisation A/c	1,10,500
To Realisation A/c	85,000	By X's Capital A/c	55,150
To Output CGST A/c	7,650	By Y's Capital A/c	27,250
To Output SGST A/c	7,650	By Z's Capital A/c	48,700
To Realisation A/c	73,000	By Realisation A/c	6,000
To Realisation A/c	42,000	By Input CGST A/c	540
To Output CGST A/c	3,780	By Input SGST A/c	540
To Output SGST A/c	3,780	By Output CGST A/c (CGST deposited)	32,490
To Realisation A/c	60,000	By Output SGST A/c (SGST deposited)	32,490
To Output CGST A/c	5,400		
To Output SGST A/c	5,400		
	3,13,660		3,13,600

Treatment of Goodwill

In case of dissolution, goodwill is transferred to the Debit side of the Realisation Account like any other assets. If any amount is realised from the goodwill (either in cash or taken-over by partner), then it is credited to the Realisation Account and also shown on the debit side of the Cash/Bank A/c (or Debit side of Partners' Capital Account, if taken by partner) with the realised amount.



In case of unrecorded goodwill, no goodwill appears on the Assets side of the given Balance Sheet, so goodwill is not transferred to the Realisation Account. However; if any amount is realised for the unrecorded goodwill (either in cash or taken-over by partner), then it is credited to the Realisation Account and also shown on the debit side of the Cash/Bank A/c (or Debit side of Partners' Capital Account, if taken by partner) with the realised amount.



Treatment of Investment Fluctuation Fund (IFF)

The treatment of IFF is almost same as that of the JLP Fund. IFF is transferred to the credit side of the Realisation Account, if and only if, Investments appear on the Assets side of the given Balance Sheet. Else, IFF is transferred to the credit side of the Partner's Capital Account.

Treatment of Workmen Compensation Fund and Contingency Reserves

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

Case 2a*:** If WCF appears in the Old Balance Sheet and related adjustment is given (such that claim is ***less than fund balance), then WCF will be closed by transferring it to the credit side of the Realisation A/c to the extent of claim. Further, the payment against the claim will also be shown on the debit side of the Realisation Account. The excess amount will be credited to the Partner's Capital A/c in their old profit sharing ratio.
***<u>Example</u>*:** If WCF appears in the Balance Sheet with Rs 10,000 and the related adjustment of Rs 4,000 is given.

Realisation Account

Dr. **Cr.**

Particulars	Amount Rs	Particulars	Amount Rs
		Workmen Compensation Fund	4,000
Liabilities Realised			
Cash/Bank (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.

Case 2b*:** If WCF appears in the Old Balance Sheet and related adjustment is given (such that claim is ***more than the fund balance), then whole of WCF will be closed by transferring it to the credit side of the Realisation A/c. Further, the payment against the claim will also be shown on the debit side of the Realisation Account. In this case, there is no excess amount and therefore nothing will be credited to the Partner's Capital A/c.

Example: If WCF appears in the Balance Sheet with Rs 10,000 and the related adjustment of Rs 14,000 is given, then

Realisation Account

Dr.			Cr.
Particulars	**Amount Rs**	**Particulars**	**Amount Rs**
		Workmen Compensation Fund	10,000
Liabilities Realised			
Cash/Bank (Workmen Compensation Fund)	14,000		

Note: The treatment for WCF and contingency reserve is exactly the same.

Partners' Capital A/c and Cash and Bank A/c

Objective

After going through this lesson, you shall be able to understand the following concepts.

- Partner's Capital Account in case of Dissolution
- Cash or Bank Account in case of Dissolution

Introduction

After preparing Realisation Account and Partner's Loan Account, the next step is to prepare Partners' Capital Account. Partners' Capital Account is prepared in the same manner as it is in case of Admission, Retirement and Death of a partner. However, the basic difference is that while in the previous chapters, Partners' Capital Account was prepared to ascertain the closing capital balances of the partners to be shown in the New Balance Sheet, whereas, in the chapter of Dissolution, this account is prepared to ascertain the final amount to be paid-off to the partners.

Procedure to Prepare Partners' Capital Account

The following are the various steps involved in the preparing Partners' Capital Account at the time of dissolution.

1. First of all, the opening balance of capital is shown on the credit side of the Partners' Capital Account as 'Balance b/d'. In case, if the capital balance of any of the partners appears on the Assets side of the Balance Sheet (in the question), then it is shown on the debit side of the Capital Account as 'Balance b/d'.

2. Then, Realisation Profit is transferred to the Credit side and in case of loss, it is transferred to the Debit side of the capital account.

3. Thirdly, we need to transfer reserves such as, *General Reserve, Reserve Fund, Investment Fluctuation Fund*, Workmen Compensation Fund* (see NOTE)*, *Machinery Replacement Reserve, Credit Balance of P & L, Provisions for Depreciation, Provision for taxation/ Taxation Reserve, Depreciation Reserve, etc.* are transferred to the credit side of the capital account in their profit sharing ratio.

4. Similarly, losses such as *Debit Balance of P & L A/c, Deferred Revenue Expenditure, Advertisement Suspense Account, etc.* are transferred to the debit side of the capital accounts in the profit sharing ratio.

5. If any of the partners has taken-over any of the assets, then it is shown on the Debit side and if any liability is paid-off by any partner, then it is shown on the credit side of the capital account.

6. Realisation Expenses, if paid by partner and borne by firm, then it is shown on the debit side of the capital account.

7. Finally, if the total of the credit side exceeds the total of the debit side, then it is shown as 'Cash/Bank A/c' on the Debit side (implies the final payment to the partners). On the contrast, if the total of the debit side exceeds the total of the credit side, then it is shown as 'Cash/Bank A/c' on the Credit side (implying the deficiency in funds and is to be brought in by the partners).

8. If the Partners' Capital Account shows a debit balance (Dr. Side > Cr. Side), then it is also shown on the debit side of the Cash Account or Bank Account. On the other hand, if the Partners' Capital Account shows a credit balance (Cr. Side > Dr. Side), then it is shown on the credit side of the Cash Account or Bank Account. The following are the Journal entries to record the treatment of Debit balance and Credit Balance.

If partner's capital account shows a ***Debit Balance***	If the partner's capital account shows a ***Credit Balance***
Bank/Cash A/c Dr. To Partner's Capital A/c (Cash brought in by the partner)	Partner's Capital A/c Dr. To Bank/Cash A/c (Cash paid to the partners)

* ***NOTE- After considering the various cases related to WCF, IFF and JLP in the previous chapter.***

Format of 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 Expenditure (Advertisement Expenditure)	-	-	-	General Reserve/ Reserve Fund	-	-	-
Realisation Loss	-	-	-	Profit and Loss (Credit Balance)	-	-	-
Assets (If taken over by Partners)	-	-	-	Realisation Profit	-	-	-
Cash/Bank- Realisation Expenses (if expenses are paid by partner and borne by firm)	-	-	-	Liabilities (If taken paid-off by Partners)	-	-	-
Cash/Bank- Final Payment (If Cr. Side > Dr. side)	-	-	-	Realisation- Remuneration (paid by firm to partner to carry out Realisation work)	-	-	-
				Workmen's Compensation Fund	-	-	-
				Investment Fluctuation Fund	-	-	-
				Contingency Reserve	-	-	-
				Cash/Bank- Deficiency in Capital (If Dr. side > Cr. Side)	-	-	-

Bank or Cash Account

The final step in the question of Dissolution is to prepare Bank or Cash Account (after the Partners' Capital Accounts). Although, we have prepared Cash Account or Bank Account in the chapters of Admission, Retirement and Death but in case of Dissolution, the Cash/Bank Account has a different implication. This account is the final account. That is, if the balance of Debit side and the Credit side of the Cash/Bank Account matches, then it is assumed that the solutions is correct (arithmetically accurate). The matching of the balances of both sides implies that the firm is left with zero amount of balance, that is, it has paid all its liabilities and the firm does not owe any amount to anybody.

Which Account to be Prepared- Cash Account or Bank Account?

If in the question, both Cash as well as Bank balances are given, then either of the two can be prepared. That is, either the Cash Account or the Bank Account is to be prepared. If students wish to prepare Bank Account, then an additional entry is passed for depositing cash balance into bank. This is shown as 'Cash A/c' on the Debit side of the Bank Account. Similarly, if students wish to prepare Cash Account, then an additional entry is passed to withdraw cash from the bank. This is shown as 'Bank A/c' on the debits side of the Cash Account.

Procedure to Prepare Cash/Bank Account

The following are the various steps involved in the preparation of Cash Account or Bank Account.

1. First of all, the opening balance of Cash/Bank (as given in the Balance Sheet of the question) is transferred to Debit side of the Cash/Bank Account. In case, the question specifies Bank Overdraft, then it is shown on the Credit side of the Cash/Bank Account.

2. All the assets that were realised for cash or bank are shown on the Debit side and all the liabilities that were realised for cash or bank are shown on the Credit side.

3. Realisation Expenses (paid by firm) are shown on the Credit side.

4. If the Partners' Capital Account is showing a debit balance (Dr. Side > Cr. Side) after all the adjustments, then it is also shown on the Debit side of the Cash Account or Bank Account. On the other hand, if the Partners' Capital Account shows a credit balance (Cr. Side > Dr. Side) after all the adjustments, then it is shown on the Credit side of the Cash Account or Bank Account.

5. For repayment of Partner's Loan, it is shown on the Credit side of the Cash/Bank Account.

6. Finally, the total of debit side and the total of the credit side of the Cash/Bank Account should match.

Format of Cash or Bank Account

Cash/Bank Account

Dr.				**Cr.**
Particulars	**Amount Rs**	**Particulars**		**Amount Rs**
Balance b/d	-	Balance b/d (Bank Overdraft)		-
Realisation A/c (All Assets realised)	-	Realisation A/c (Liabilities Paid-off)		
		Realisation A/c (Expenses)		-
Cash A/c# (for deposit of cash into bank) OR Bank A/c (for withdrawal of cash from Bank)	-	Partner's Capital A/c		
		A's Capital A/c	-	
		B's Capital A/c	-	

		C's Capital A/c	-	-
		Partner's Loan A/c - 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).

Memorandum Balance Sheet

Balance sheet as we know is a statement (i.e. prepared at a certain point of time) listing all assets and liabilities of the firm. It is prepared using the equation:

Capital + Liabilities = Assets

Sometimes, at the time of dissolution of the firm, the balance sheet is not given. But as it constitutes a vital part of the Final accounts we thus prepare a Memorandum Balance Sheet wherein, following the above equation we arrive at the missing figure which is usually our Sundry Assets. The term sundry assets is used instead of any specific asset because the type of asset cannot be determined with certainty hence the name.

However, sometimes it may happen that the Sundry assets are given in the question then in that case cash is our balancing figure.

If, cash is given and the two sides do not match then in that case depending on the side of the balance sheet accumulated profit or loss becomes our balancing figure.

Once, the memorandum balance sheet has been completed we prepare the realisation account same as under a normal case.

Example: Rima and Rekha are partners in a firm sharing profits and losses in the ratio of 3:2. They have mutually agreed to dissolve the firm as on 31st March, 2018. On the date of dissolution, Rima' Capital was Rs. 1,20,000 and Rekha's capital was Rs. 13,500. Bills Payable amounted to Rs. 22,460 and Cash Rs. 3,560. Remaining Assets realised Rs. 1,00,000 and expenses on account of dissolution were Rs. 1,180. Both Rima and Rekha are solvent.

You are required to prepare Balance Sheet of the firm as at the date of the dissolution and also necessary accounts to close the books of the firm, showing final adjustment of cash between the partners.

Answer:

Memorandum Balance Sheet as at 31st March, 2018

Liabilities	Rs.	Assets	Rs.
Capital		Cash	3,560
Rima 1,20,000		Sundry Assets (Balancing Figure)	1,52,400
Rekha 13,500	1,33,500		
Bills Payable	22,460		
	1,55,960		**1,55,960**

Dr. **Realisation Account** **Cr.**

Particulars	Rs.	Particulars	Rs.
To Sundry Assets A/c	1,52,400	By Cash A/c- Assets Realised	1,00,000
To Cash A/c- Dissolution Expenses	1,180	By Bills Payable A/c	22,460
To Cash A/c – Bills Payable settled	22,460	By Loss Transferred to:	53,580
		Rima's Capital A/c 32,148 Rekha's Capital A/c 21,432	
	1,76,040		**1,76,040**

Dr. **Partner's Capital A/c** **Cr.**

Particulars	Rima (Rs.)	Rekha (Rs.)	Particulars	Rima (Rs.)	Rekha (Rs.)
To Revaluation A/c- Loss	32,148	21,432	By balance b/d	1,20,000	13,500
To Cash A/c- Final Payment	87,852		By Cash A/c- Cash brought in		7,932
	1,20,000	**21,432**		**1,20,000**	**21,432**

Dr. **Cash A/c** **Cr.**

Particulars	Rs.	Particulars	Rs.
To balance b/d	3,560	By Realisation A/c- Dis. Expenses	1,180
To Realisation A/c – Assets Realised	1,00,000	By Realisation A/c- Bills Payable	22,460
To Rekha's Capital A/c	7,932	By Rima's Capital's A/c	87,852

	1,11,492		**1,11,492**