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Dissolution of Firm

Learning objectives :

After going through this Chapter you will be able to :

- Understand the meaning of dissolution of firm and dissolution of partnership and differentiate between the two.
- Learn the process of constructing Realisation Account on dissolution of firm.
- Know accounting entries on firm's dissolution and prepare necessary ledger accounts.
- Learn accounting for insolvency of one or all partners applying Garners V/s Murray Rule or not applying this rule.

Meaning of dissolution of Firm

According to section 39 of Indian Partnership Act, 1932, "termination of partnership among all partners is called dissolution of the firm".

When partnership among all the partners is terminated, it is called dissolution of firm. On the dissolution of firm, the assets of the firm are sold and liabilities are paid off and out of the remaining amount, if any, the accounts of the partners are settled.

Meaning of Dissolution of Partnership

Dissolution of partnership denotes termination of relationship of a partner with all the remaining partners. Under such a case the business of the firm is not closed and remaining partners, if they like, may continue the business of the firm.

Example :

On the death, insolvency or retirement of a partner or on expire of a specified time, the partnership is dissolved, but firm may or may not be dissolved, which depends upon the partnership agreement. Thus, dissolution of partnership is not the dissolution of the firm. After dissolution of partnership, the firm can continue its business. But dissolution of the firm is the dissolution of partnership. On dissolution of firm, all the activities of business are closed.

The firm and partnership both are dissolved under the following cases :

1. When all the partners make an agreement to dissolve the firm.
2. When all the partners or all except one is declared insolvent.
3. When business of the firm became illegad.
4. In case of partnership at will, one partner has notified the other partners to terminate or close the business.
5. When the court issues orders for the termination of firm.

Modes of Dissolution

Circumstances of Dissolution of a Partnership Firm : According to section 40 to 44 of Indian Partnership Act the firm is dissolved under the following circumstances.

1. **Dissolution by Agreement-** Partners may dissolve the firm by agreement at any time.

2. **Compulsory Dissolution-** The firm is compulsorily dissolved under the following **circumstances**-
   (i) If the business of the firm has become illegal.
   (ii) If any partner of the firm is citizen of enemy country.
   (iii) If all or all but one partners are declared insolvent.
   (iv) If the maximum number of partners in a firm has become more than 50 (20 in banking business) in an ordinary business.
3. **Dissolution by Notice-** If partnership is at will, by giving a notice of dissolution by any partner to others.
4. **Dissolution by court-** On application by a partner, the court may issue orders for dissolution of the firm-
   (i) Where a partner has become of unsound mind,
   (ii) Where a partner has become in any way permanently incapable of performing his duties as a partner,
   (iii) Where a partner is guilty of misconduct,
   (iv) Where a partner willfully commits breach of agreement relating to management of the of affairs of the firm,
   (v) Where a partner has, in any way, transferred the whole of his interest in the firm,
   (vi) Where the business of the firm cannot be carried on except at a loss, and
   (vii) Where the court is satisfied as to the grounds, which render the firm to dissolve.

(5) **Dissolution on the happening of certain contingencies-** Under this, happening of the following events may render the firm dissolved-
   (i) Where a partnership is for a specified time, on the expiry of such time,
   (ii) Where a partnership is formed to do a certain work, the firm is dissolved soon after the completion of that work.
   (iii) On the death of any partner.
   (iv) On declaration of insolvency of any partner by the court.

Difference between Dissolution of Partnership and Dissolution of Firm

Basis of Difference	Dissolution of Partnership	Dissolution of Partnership Firm
(1) Meaning	Partnership is an agreement between two or more persons to carry on legal business, any change in the agreement will cause dissolution of partnership.	Dissolution of partnership firm denotes closure of partnership business where all business activities are discontinued.
(2) Circumstances	Partnership is dissolved when a new partner is admitted, or on retirement or death of a partner and change in profit sharing ratio or any other such reason.	Dissolution of partnership firm is either by agreement among the partners or by the intervention of court.
(3) Continuance of Business	When partnership is dissolved, the firm may continue the business under the same name.	On dissolution of the firm, business activities can not be continued.
(4) Termination	On termination of partnership, partnership firm is not closed.	On termination of the partnership firm closure of business is compulsory.

Settlement of Accounts on Dissolution

Section 48, 49 and 55 of Indian partnership Act specify the mode of settlement of accounts on the dissolution of a partnership firm. These are as follows :

(A) All the amount of loss and deficiency of capital, if any, shall be first paid, out of profits, next out of capital and lastly, if necessary, will be realized from the partners in their profit sharing ratio.

(B) Amount realised from the sale of assets and the amount brought in by the partners shall be applied in the following manner-

(i) Payment to secured creditors.

(ii) Payment to outside debts of the firm ratably.

(iii) Out of the remaining amount, the loan advanced by partners will be paid off ratably.

(iv) There after the balance of the partner's capital accounts will be paid off.

(v) If some amount remains, it will be divided among the partners in their profit sharing ratio.

On dissolution of the firm, out of sale proceeds of assets received first of all outside debts will be paid off. Remaining amount will utilized in paying partner's loans and lastly in returning the capitals of the partners. Private debts of partners are paid out of their private assets. After making payment to private debts, if some surplus remains, the same shall be used for making payment to firm's debts. (sec. 49).

Provisions of section 48 of Indian partnership Act, 1932 relating to settlement of accounts at the time of dissolution:

(1) All losses including the deficiency of capital shall be paid off as under:-

- (a) First of out of profits,
- (b) Then out of Capitals,
- (c) In the end, if necessary, the partners will bring the amount in their respective profit sharing ratio.

(2) All the assets of the firm including the cash brought in by the partners will be used as under:-

(a) In paying all the debts of the firm including the loan given by spouse of the partner.

(b) In returning capital of the partners ratably.

(3) If there any balance remains, it will be distributed by the partners in their profit sharing ratio.

In other words it can be summerised that the balance available will be used in the following order-

- (a) For payment of expenses incurred in selling assets and disposing off the liabilities.
- (b) Outside creditors or debts including that of the spouse shall be paid off.
- (c) For paying partners loans.
- (d) For returning capital of partners.
- (e) After all the above liabilities from (a) to (d) are paid off and some amount remains in balance, it will be distributed by the partners in their profit sharing ratio. (Sec.48).

Accounting Procedure on Dissolution of firm

From the date of dissolution, usual business activities are closed and the working of disposing of assets and payment of liabilities, commences. The following accounts are opened in order to meet the above procedure :

(i) Reallsation Account (ii) Bank/Cash Account.

(iii) Partners Capital Accounts (iv) Other necessary Accounts.

Realisation Account : On the dissolution of the firm, the assets of the firm are sold and from the amount realized out of this the liabilities of the firm are paid off. For this purpose one specific account is opened, which is known as Realisation Account. This account is of nominal nature. The purpose of opening this account is to find out the amount of profit or loss on realizing sale proceeds of assets and payment of liabilities.

Except balance of Cash or Bank Account, Partners Loan Accounts, Reserves and undistributed Profits, Partners current Account, etc., rest all assets and liabilities are transferred to Realisation Account. Sale proceeds of assets, assets taken over by partners, payment of liabilities and expenses of realization are all recorded in this Account. The balance of this Account shows profit or loss on realization, which is divided by the partners in profit sharing ratio and recorded in partner's capital or current accounts.

Difference between Realisation Account and Revaluation Account

Basis of Difference	Realisation Account	Revaluation Account
(1) Object or Purpose	Realisation A/c is opened to record realisation of assets and payment of liabilities on dissolution of the firm.	Revalutation A/c is opened to record increase or decrease in the value of assets and liabilities at the time of admission, retirement or death of a partner.
(2) Compulsion	On dissolution of the firm Realisation Account is compulsurily opened.	On the change in organisation of firm revalution account may not be opened, even then the amount of profit or loss can be ascertained.
(3) Time of Preparation	This account is opened at the time of dissolution of the firm to close books of accounts.	At the time of reorganisation, if firm continues its business, this account is opened.
(4) Expenses	At the time of dissolution, some expenses are incurred in realising assets and paying liabilities, which are called realisation exp-enses. These are debited to realisation A/c.	At the time of reorganisation of firm revaluation of assets and liabilities is done by firm's accountant, so expenses are required to be incurred.
(5) Entries	The balances of all assets except cash and bank balance are transferred to Realisation A/c on debit side. On the credit side balances of all external liabilities, except -reserves, undistributed profits and capital and current accounts of partners and their loan account are transferred to its credit side	In this account on debit side only reduction in the value of assets and increase in liabili-ties are recordes and on credit side only increase in the value of Assets and decrease in liabilities are recorded.

Accounting Entries Regarding Dissolution

1. For transfer of Assets (except Cash and Bank balance)

   Realisation A/c Dr.

   To Sundry Assets A/c (By name)

   (Being assets transferred at their book values)

2. When Liabilities are transferred (expect Partners Capital, Current General Reserve, Profit & Loss Account, Reserve Fund and Loan Accounts)

   Sundry Liabilities A/c Dr. (By name with the amount given in Balance Sheet)

   To Realisation A/c

   (Being balances of liabilities transferred)

3. When assets are sold for cash

   Cash/Bank A/c Dr. (With the amount of sale price of assets)

   To Realisation A/c

   (Being Cash realised from sale of Assets)

4. When assets is taken over by a partner

   Partner's Capital A/c Dr. (With the amount of agreed value by partners)

   To Realisation A/c

   (Being assets taken over by the partner)

5. When liabilities transferred are paid off

Realisation A/c Dr. (With the amount of payment)

To Cash/Bank A/c

(Being liabilities paid in cash/ by cheque)

6. When some of the liability is taken over by a partner

Realisation A/c Dr. (With the amount of agreed value by partners)

To Partner's Capital A/c

(Being liability taken over by a partner)

7. When realisation expenses paid off

Realisation A/c Dr. (With the amount of actual payment)

To Cash/Bank A/c

(Being reailsation expenses paid off)

8. When Realisation A/c depicts credit Balance (Profit)

Realiastion A/c Dr. (Amount of profit in profit sharing ratio)

To Partner's Capital A/c

(Being profit on realization distributed)

9. When Realisation A/c shows debit balance (loss)

Partner's Capital A/c Dr. (Amount of Loss on Profit sharing Ratio)

To Realisation A/c

(Being loss on realization transferred)

10. When a partner pays realisation expenses

Realisation A/c Dr. (Actual amount paid by partner)

To Partner's Capital A/c

(Being expenses paid by the partners)

Note: If a partner undertakes the responsibility for payment of realisation expenses personally, no entry will be passed in the books of the firm for the payment of these expenses.

11. When a partner acts as an agent for realisation of assets, the entry for his commission.

Realisation A/c Dr. (With the amount of commission/remuneration payable)

To Particular Partner's Capital A/c

(Being commission allowed to a partner)

Importance Note: Sometimes, liabilities are not transferred to Realisation A/c. Under such a case, liabilities are paid off directly. In case if there is any profit or loss, the amount of such profit or loss only will be transferred to Realisation A/c.

12. The entry will be as under :

Sundry Liabilities A/c Dr. (Book value of liabilities)

Realisation A/c Dr. (Excess payment amount)

To Cash/Bank A/c (Actual amount paid)

(Being liabilities paid off and loss transferred)

13. When liabilities are discharged for amount less than book value :

Sundry Liabilities A/c Dr. (Book value of liabilities)

To Cash/Bank A/c (Amount actual payment)

To Realiastion A/c (Profit transferred)

(Being liabilities disposed and profit transferred)

Notes:

(1) The following items, which are on assets side of Balance Sheet are not transferred to Realisation Account :

Cash and bank balance, balance (Dr.) of profit & loss A/c, deferred revenue expenses (directly transferred to partner's capital accounts in profit sharing ratio except cash and bank balance)

(2) The item on Liabilities side of Balance Sheet such as partner's capital or/and current account balances, Partner Loan A/c, General Reserve, credit for Balance of Profit & Loss A/c, other undistributed profits are not transferred to Realisation Account. But except for capital and current account, and partners loan, remaining a/cs are directly transferred to partners capital accounts in their profit sharing ratio.

(3) Partner's private assets are first used to meet their personal liabilities and excess if any may be used for making payment to firm's obligations, in case partner's capital account shows debit balance or firm's assets are less than firm's liabilities.

(4) When nothing is given in the question for payment to external creditors it should be assumed that the same are discharged at book value.

(5) When realisation value of an asset is not given, it should be regarded as valueless.

14. When partner's loan are discharged

Partner's Loan A/c	Dr.	(Amount paid, normal book value)
To Cash/Bank A/c		

(Being partner's loan paid off)

15. When undistributed profit are distributed

General Reserve A/c	Dr.	(Book Value)
Reserve Fund A/c	Dr.	(Book Value)
Profit & Loss A/c	Dr.	(Book Value)
To partner's Capital Accounts		(Profit sharing ratio)

(Being undistributed profit, distributed)

16. When there is any undistributed loss given :

Partner's Capital A/c	Dr.	(Profit sharing ratio)
To Profit & Loss A/c		(Book Value)

(Being undistributed loss transferred)

17. When deficiency in capital is brought in by a partner

Cash/Bank A/c	Dr.	(With the amount of cash brought)
To partner Capital A/c		

(Being shortage of capital brought in cash)

18. Balance of Capital Accounts of Partners when paid off

Partner's Capital A/c	Dr.	Balances
To Cash/Bank A/c		Amount paid

(Balance of capital with drawn)

Important Note:

After passing aforesaid entries the Cash/Bank A/c will be closed automatically.

(1) Assets and liabilities not shown in Balance Sheet

(a) Some assets with physical presence do not appear in Balance Sheet since they were completely written off. But some amount is realized on their sales, because the same are in useable condition. The following entry will be passed :

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

(Being amount realized from sale of assets)

(b) Some of the liabilities not appearing in Balance Sheet are also to be disposed of, for example bills discounted and dishonoured, amount payable under guarantee or a legal case in pending, etc. When payment of such liabilities is made, the following entry will be passed :

Realisation A/c Dr.

To Cash/Bank A/c

(Contingent liabilities paid off)

(2) When an asset not shown in Balance Sheet is utilized in paying the debts not shown in Balance Sheet, no entry is required to be passed.

(3) Similarly if an asset, which is shown in Balance Sheet is given away to creditors, which is also shown in Balance Sheet, in part or full payment of his dues, no entry will be passed.

(4) When an asset not recorded in Balance Sheet is used for payment to recorded debt, no entry will be passed. But if some dues still remain to be discharged; the entry for this payment will be passed.

(5) When a recorded asset is used for passing unrecorded debts, no entry is passed in books.

Treatment of Goodwill on Dissolution :

(i) If goodwill appears in Balance Sheet, it is transferred to Realisation A/c as other assets are transferred.

(ii) If goodwill is not appearing in Balance Sheet, it is not to be valued.

(iii) If some amount is realized from goodwill, debit Cash/Bank A/c and credit Realisation A/c.

(iv) If goodwill is taken over by a partner, Capital A/c of said partner will be debited and Realisation A/c will be credited.

(v) If nothing is mentioned in the question regarding its realiastion, the value of goodwill is treated as zero.

Important : If nothing is mentioned in the question regarding payment of external debts, it must be assumed that they are paid in full.

Instructions for Treatment of Different Reserves on Dissolution

S.No.	Name of Reserve	Transfer to Realisation A/c	Transfer to Partner's Capital A/c
1.	Worksmen Compensation Fund	If there is any claim against it.	If there is no claim against it.
2.	Investment Fluctuation Fund	In case investment fluctuation fund exists in the Balance Sheet.	In case, there is no investment fluctuation fund in Balance Sheet.
3.	Joint Life Policy Reserve	If Joint life policy A/c appears on asset side of Balance Sheet.	If Joint Life Policy Account does not appear in Balance Sheet.
4.	Plant Replacement Fund	-	When machine or plant A/c does not appear on asset side of Balance Sheet
5.	Contingent Fund	-	Always transfer to partner's Capital Accounts.

Specimen of Realisation Account

Particulars	Amount (₹)	Particulars	Amount (₹)
To Sundry Assets A/c (at Book Value)		By Sundry Liabilities (at Book Value)	
Buildings		Creditors	
Machinery		B/P	
Furniture		Bank Loan	
Stock		Other Liabilities	
Debtors		By Bank Account	
Other Assets		(Realisation value of Assets)	
To Bank A/c (Realisation Exp. paid)		By Partners Capital A/c	

To Bank A/c (Creditor B/P and other Liabilities Paid) To Partners Capital A/c (Liabilites taken over) To Bank A/c (Premium paid) To Partner's Capital or Current A/c (if Profit) (BF)		(Assets taken over by partners) By Partner's Loan A/c (Discount on his loan) By Partner's Capital or current A/c (If Loss) (BF)	

Bank or Cash Account : On its debits side, balance of cash or bank (opening), amount received from sale of assets, and amount brought in by partners will be written. On its credit side payment for debts and expenses along with the payment made to partners loan and their capital accounts are shown. When cash and bank both accounts appear in the Balance Sheet only one account should be shown and the balance of other account should be transferred to the account opened.

Partner's Capital Accounts : On credit side write balances of capitals, credit balance of partner's current **a**ccount, share of profit on **r**ealization, the amount of liability taken over by him, share in **r**eserve and other undistributed profit and deficiency of capital brought in by him are recorded. On its debits side write debit balance of capital/current account share of loss on realisation, amount of assets taken over by him (agreed value), share of undistributed Losses etc.

Other Necessary Accounts : Partner's loan accounts, partner's current accounts. Reserves and undistributed profits accounts undistributed losses A/c and deficiency A/c, if all partners become insolvent etc., may be required to be opened at the time of dissolution.

Illustration 1 :

Tarun and Varun decided to dissolve the firm. The Balance Sheet as at 31 Dec. 2015 was as follows :

Balance Sheet As on 31 Dec., 2015

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors		Cash in hand	10,000
B/P	1,20,000	Debtors	1,00,000
G/R	20,000	Stock	4,00,000
Varun's Loan	30,000	Furniture	10,000
Capital :	1,10,000	Machinery	2,80,000
Tarun 400000		Buildings	80,000
Varun 200000	6,00,000		
	8,80,000		**8,80,000**

They distributed profit equally. Assets were realized as follows : Debtor's ₹ 84,000, stock ₹ 3,60,000, Machinery ₹ 2,24,000, Buildings ₹ 1,20,000 and paid to Creditors at 5% discount in full settlement. Realisation expenses ₹ 6000 paid. Prepare necessary journal entries and accounts.

Journal

Date	Particulars	L.F.	Amount (₹) Dr.	Amount (₹) Cr.
2015 31 Dec.,	Realisation A/c Dr.		8,70,000	
	To Stock A/c			4,00,000
	To Debtors A/c			1,00,000
	To Furniture A/c			10,000

	To Machinery A/c			2,80,000
	To Building A/c			80,000
	(Balance transfer to Realisation A/c)			
	Creditor's A/c Dr.		1,20,000	
	B/P A/c Dr.		2,000	
	To Realisation A/c			1,40,000
	(Balance transfer to Realisation A/c)			
	Cash A/c Dr.		7,88,000	
	To Realisation A/c			7,88,000
	(Realised from assets)			
	Realisation A/c Dr.		1,34,000	
	To Cash A/c			1,34,000
	(Liabilities paid)			
	Realisition A/c Dr.		6,000	
	To Cash A/c			6,000
	(Realisation expenses paid)			
	Tarun's Capital A/c		Dr.	41,000
	Varun's Capital A/c Dr.		41,000	
	To Realisation A/c			82,000
	(Realisation loss transferred)			
	General Reserve A/c Dr.		30,000	
	To Tarun's Capital A/c			15,000
	To Varun's Capital A/c			15,000
	(General Reserve distributed)			
	Varun's Loan A/c Dr.		1,10,000	
	To Cash A/c			1,10,000
	(Loan paid)			
	Tarun's Capital A/c Dr.		3,74,000	
	Varun's Capital A/c Dr.		1,74,000	
	To CashA/c			5,45,000
	(Final payment made)			

Realisation A/c

Date	Particulars	Amount (₹)	Date	Particulars	Amount (₹)
2015	To Debtors A/c	1,00,000	2015	By Creditor's A/c	1,20,000
Dec., 31	To Stock A/c	4,00,000	Dec., 31	By B/P A/c	20,000
	To Furniture A/c	10,000		By Cash A/c	7,88,000
	To Machinery A/c	2,80,000		Debtors 84,000	
	To Building A/c	80,000		Stock 3,60,000	
Dec., 31	To Cash A/c	1,34,000		Machinery 2,24,000	
	Creditor's 1,14,000			Buildings 1,20,000	
	B/P 20,000			By Capital A/c	82,000
Dec., 31	To Cash A/c (Expenses)	6,000		Tarun's 41,000	
				Varun's 41,000	
		10,10,000			**10,10,000**

Partner's Capital A/c

Particulars	Tarun (₹)	Varun (₹)	Particulars	Tarun (₹)	Varun (₹)
To Realisation A/c	41,000	41,000	By Balance b/d	4,00,000	2,00,000
To Cash A/c	3,74,000	1,74,000	By General Reserve	15,000	15,000
(Final Payment B/F)					
	4,15,000	**2,15,000**		**4,15,000**	**2,15,000**

Varun's Loan A/c

Particulars	Varun (₹)	Particulars	Varun (₹)
To Cash A/c	1,10,000	By Balance b/d	1,10,000
	1,10,000		1,10,000

Cash A/c

To Balance b/d	10,000	By Realisation A/c (Liablities paid)	1,34,000
To Realisation A/c	7,88,000	By Realisation A/c (Expenses)	6,000
(Sundry Assets)		By Varun's Loan A/c	1,10,000
		By Tarun's Capital A/c	3,74,000
		By Varun's Capital A/c	1,74,000
	7,98,000		**7,98,000**

Illustration 2 :

M/s A and B dissolove the firm on 31 Dec., 2012. The Balance Sheet was as follows :

Liabilities	Amount (₹)	Assets	Amount (₹)
Trade Creditors	5000	Cash in Hand	900
B's Loan	8000	Furniture	600
General Reserve	1800	Book Debts	4000
Capital A 10,000		Stock in Trade	1600
B 5,000	15000	Investment	4000
A's Current A/c	3600	Land & Buildings	21000
		Goodwill	500
		B's Current A/c	800
	33,400		**33,400**

B took furniture at 2/3 of its value. Book – debts realized at 5%, stock sold for ₹1000 and a loss on sale of buildings ₹3000. Investments taken by A at 90% of its book value. A typewriter costing ₹ 1000, which was not shown in the books, realized from ₹ 500. Creditors are paid at 10% discount. A paid realiastion expenses ₹ 800.

Make necessary journal entries and accounts to close the books of firm.

Journal

Date	Particulars	L/F	Amount (₹) Dr.	Amount (₹) Cr.
2012	Realisation A/c Dr.		31,700	
Dec., 31	To Furniture A/c			600

Date	Particulars		L.F.	Dr.	Cr.
	To Book Debt A/c				4,000
	To Stock in Trade A/c				1,600
	To Investment A/c				4,000
	To Land & Building A/c				21,000
	To Goodwill A/c				500
	(Assets transferred to realisation A/c)				
Dec., 31	Trade Creditor's A/c	Dr.		5,000	
	To Realisation A/c				5,000
	(Liabilities transferred to realisation A/c)				
Dec., 31	Cash A/c	Dr.		21,500	
	To Realisation A/c				21,500
	(Realised from assets)				
	Realisation A/c	Dr.		4,500	
	To Cash A/c				4,500
	(Creditor paid off)				
Dec., 31	A's Current A/c	Dr.		3,600	
	B's Current A/c	Dr.		400	
	To Realisation A/c				4,000
	(Partners took the assets)				
Dec., 31	Realisation A/c	Dr.		800	
	To A/s Current A/c				800
	(Realisation expenses paid by A)				
Dec., 31	A's Current A/c	Dr.		3,250	
	B's Current A/c	Dr.		3,250	
	To Realisation A/c				6,500
	(Realisation loss transferred)				
Dec., 31	B's Loan A/c	Dr.		8,000	
	To Cash A/c				8,000
	(B's Loan Paid off)				
Dec., 31	General Reserve A/c	Dr.		1,800	
	To A's Current A/c				900
	To B's Current A/c				900
	(General reserve transferred)				
Dec., 31	B's Capital A/c			Dr.	3,550
	To B's Current A/c				3,550
	(Balance of Current A/c transferred)				
Dec., 31	A's Capital A/c	Dr.		1,550	
	To A's Current A/c				1,550
	(Balance on Current A/c transferred)				
Dec., 31	A's Capital A/c	Dr.		8,450	
	B's Capital A/c	Dr.		1,450	
	To Cash A/c				9,900
	(Balance of Capital A/c paid off)				

Realisation A/c

Particulars	Amount (₹)	Particulars		Amount (₹)
To Furniture A/c	600	By Trade Creditors		5,000
To Book Debt's A/c	4,000	By Cash A/c		21,500
To Stock A/c	1,600	Book Debt	2000	
To Investment A/c	4,000	Stock	1000	
To Land & Buildings A/c	21,000	Land & Buildings	18000	
To Goodwill A/c	500	Typewriter	500	
To Cash A/c (Creditor's)	4,500	By A's Current A/c		3,600
To A's Current A/c	800	By B's Current A/c		400
		By Current A/c		6,500
		A 3250		
		B 3250		
	37,000			**37,000**

Partner's Capital A/c

Particulars	A ₹	B ₹	Particulars	A ₹	B ₹
To Current A/c	1,550	3,550	By Balance b/d	10,000	5,000
To Cash A/c	8,450	1,450			
	10,000	**5,000**		**10,000**	**5,000**

Partner's Capital A/c

Particulars	A ₹	B ₹	Particulars	A ₹	B ₹
To Balance b/d	-	800	By Balance b/d	3,600	-
To Realisition A/c	3,250	3,250	By General Reserve	900	900
To Realisition A/c	3,600	400	By Realisation A/c	800	-
			By Capital A/c	1,550	3550
	6,850	**4,450**		**6,850**	**4,450**

Cash A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	900	By Realisation A/c	4,500
To Realisation A/c	21,500	By B's Loan A/c	8,000
		By A's Capital A/c	8,450
		By B's Capital A/c	1,450
	22,400		**22,400**

llustration 3 :

X, Y and Z started partnership business on 1st January, 2013. They decided to distribute profit and loss in the ratio of 5:3:2. They invested capital ₹ 80,000, ₹ 60,000 and ₹ 40,000 respectively. In partnership dead there was a provision for 5% interest on capital withdrawal ₹ 12,000, ₹ 16,000 and ₹ 8,000 respectively. Profit for 2013, was ₹ 40,000 before charging interest on capital. The relations between partners were not good. Hence, they decided to dissolve the firm on 31st December, 2013. From the sale of assets ₹ 1,60,000 is realised and cash was ₹ 13,000. Creditors were ₹ 48,000, it was paid off at a discount of 10 percent. Reserves were ₹ 3,000. Realisation expenses paid ₹ 1800.

Prepare necessary ledger accounts to close the books of the firm.

Solution :

Profit & Loss Appropriation Account For the year ending 31 Dec., 2013

To Interest on Capital			By Net Profit	40,000
X	4,000	9,000		
Y	3000			
Z	2000			
To Capital Account		31,000		
X	15,500			
Y	9,300			
Z	6,200			
		40,000		**40,000**

Partner's Capital A/c

Particulars	X ₹	Y ₹	Z ₹	Particulars	X ₹	Y ₹	Z ₹
To Drawings	12,000	16,000	8,000	By Balance b/d	80,000	60,000	40,000
To Balance c/d	87,500	56,300	40,200	By Interest on Capital	4,000	3,000	2,000
				By P & L App. A/c	15,500	9,300	6,200
	99,500	72,300	48,200		99,500	72,300	48,200
To Realisation	29,500	17,700	11,800	By Balance b/d	87,500	56,300	40,200
To Cash A/c	59,500	39,500	29,000	By Reserve A/c	1,500	900	600
	89,000	**57,200**	**40,800**		**89,000**	**57,200**	**40,800**

Memorandum Balance Sheet as on 31 Dec., 2013

Liabilities		Amount (₹)	Assets	Amount (₹)
Creditors		48,000	Cash	13,000
Reserve		3,000	Sundry Assets (B/F)	2,22,000
Capital		1,84,000		
X	87,500			
Y	56,300			
Z	40,200			
		2,35,000		**2,35,000**

Realisation A/c

Particulars	Amount (₹)	Particulars		Amount (₹)
To Sundry Assets	2,22,000	By Creditor A/c		48,000
To Cash A/c (Creditor's)	43,200	By Cash A/c (Sundry Assets)		1,60,000
To Cash A/c (Real. Exp.)	1800	By Capital A/c		59,000
		X	29,500	
		Y	17,700	
		Z	11,800	
	2,67,000			**2,67,000**

Cash A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	13,000	By Realisation A/c	43,200
To Realisation A/c	1,60,000	By Realisation A/c	1,800
		By X Capital A/c	59,500
		By Y Capital A/c	39,500
		By Z Capital A/c	29,000
	1,73,000		**1,73,000**

Illustration 4 :

A, B and C are partners sharing profit and losses in the ratio of 3 : 1 : 1. They decided to dissolve their partnership on 31st March, 2010, on which date their Balance Sheet was as under :

Balance Sheet as on 31 March, 2010

Liabilities			Amount (₹)	Assets		Amount (₹)
Creditors			6,000	Cash		3,200
Loan			1,500	Debtors	24,200	
Capital				Less : PBD	1,200	23,000
	A	27,500		Stock		7,800
	B	10,000		Furniture		1,000
	C	7,000	44,500	Sundry Assets		17,000
			52,000			**52,000**

It was decided : (1) A takes furniture for ₹800 and debtors of book value ₹20,000 for ₹ 17,200 and agreed to pay ₹ 6,000 to creditors (2) B takes stock for ₹ 7,000 and some of sundry assets for ₹ 7,200. This amount is 10% less than book- value. (3) C takes remaining sundry assets at 90% of book value less ₹ 100 discount and also agrees to make payment of firm's loan with interest. Interest on loan is ₹ 30, which is not recorded in books (4) Expenses of dissolution amounted to ₹ 270. Rest of debtors sold to a debt collection agency for 50% of book value. Prepare necessary Ledger Accounts to close the books of the firm.

Solution :

Realisation A/c

Particulars			Amount (₹)	Particulars	Amount (₹)
To Sundry Assets				By Creditors	6,000
	Debtor	24,200		By Loan	1,500
	Stock	7,800		By Provision for Bad debts	1,200
	Furniture	1000		By A's Capital A/c (800+17200)	18,000
	Sundry Assets	17,000	50,000	By B's Capital A/c	14,200
To A's Capital (Creditors)			6,000	(Stock 7000+S. Assets 7200)	
To C's Capital A/c (1500+30)				By C's Capital A/c (S. Assets 8000)	8,000
Loan & Interest			1,530	By Cash A/c (Debtor 50% of 4200)	2,100
To Cash A/c (Exp.)			270	By Partners Capital A/c (Loss)	6,800
				A 4080, B 1360, C 1360	
			57,800		**57,800**

Partner's Capital A/c

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To Realisation	18,000	14,200	8,000	By Balance b/d	27,500	10,000	7,000
To Realisation	4080	1360	1,360	By Realisation	6,000	-	1,530
To Cash A/c	11,420	15,560	-	By Cash A/c	-	5,560	830
	33,500	15,560	9,360		33,500	15,560	9,360

Cash A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	3,200	By Realisation A/c	270
To Realisation A/c	2,100	By A's Capital A/c	11,420
To B's Capital A/c	5,560		
To C's Capital	830		
	11,690		**11,690**

Important Notes : Value of Assets of ₹ 7,200 = 7,200 x 100/90 = ₹ 8,000. Thus the value of Sundry Assets taken over by C = ₹ 17,000 – 8,000 = ₹ 9,000 x 90% = ₹ 8,100 – 100 = ₹ 8,000

Insolvency of Partners

After passing entries regarding dissolution of the firm in capital accounts of the partners, it is possible that Capital Accounts of one or more partners may show debit balance. In case, such partner is solvent, he will bring the debit balance of his Capital Account in the firm. But if such partner has been adjudged as insolvent, he will not be in a position to bring his deficiency in the firm. Deficiency of Capital of such partner will be borne by solvent partners.

Before the year 1903, deficiency of insolvent partner used to be borne by solvent partners in profit sharing ratio. But in that year the court of England awarded a decision in the case of **Garner v/s Murray**. According that decision, solvent partners have to bear the loss due to insolvency of a partner in the Capital Ratio. The details of this case are sunder :

Facts of Garner v/s Murray Case

Garner, Murray and Wilkinson were partners in a firm sharing profits and loss equally. The firm was dissolved on 30th June, 1900, when assets were sold and liabilities were disposed off. After this, the Balance Sheet of the firm was as under :

Liabilities	Amount (₹)	Assets	Amount (₹)
Capitals :		Cash / Bank	1,916
Garner	2,500	Deficiency of Wilkmson's Capital	263
Murray	314	Realisation Loss	635
	2,814		**2,814**

Wilkinson was declared insolvent and nothing could be realized from his private estate. His total liability for the firm was for 263 + 1/3 of ₹ 635 = 475. The problem before the court was about the distribution of this deficiency by Garner and Murray.

Decision awarded in the case : In accordance with the decision awarded by the court that solvent partners shall bear the insolvency loss in the ratio of their Capitals just before firm's dissolution. This decision was awarded on the ground that realisation loss is not a business loss or this loss is different from business loss.

Interpretation of the case : On the basis of decision awarded in the case following two points are to be noted :

(1) The loss of Insolvency of a partner shall be borne by solvent partners in the ratio of their respective Capitals.

(2) Solvent partners shall bring their share of loss on realisation in cash.

Ratio of Capital refers to the balances of Capital standing in the Balance Sheet just prior to dissolution.

Example : If Balance Sheet of the firm is prepared on 31st December every year, then for the ratio, balances of Capitals will be taken standing in Balance Sheet as on 31st December, just before dissolution. It is applicable in case of fixed Capitals.

When Capital Accounts are fluctuating, then adjustment in Capitals will be made for the amount of undistributed profit & losses appearing in the Balance Sheet just before dissolution. Thus the ratio of adjusted Capitals will be material for this purpose.

Note : In the absence of clear instructions in question, it should be solved applying the provisions of Garner V/s Murray case.

When Garner V/S Murray case not applicable

Nothing has been provided in Indian Partnership Act, 1932 as regards the applicability of Garner V/S Murray Rule. As such deficiency of insolvent partner should be borne by solvent partners in their respective profit sharing ratio.

Illustration 5:

Deepak, Kapil and Bharat are partners sharing profit in 3 : 2 : 1 ratio. Their Balance Sheet as on 31-3-2014 was as follows :

Balance Sheet as on 31st March, 2014

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	1,40,000	Cash	24,000
B/P	1,00,000	Debtors	1,20,000
General Reserve	54,000	Stock	1,80,000
P & L A/c	18,000	Buildings	3,84,000
Capital		Capital : Bharat	24,000
Deepak 2,64,000			
Kapil 1,56,000	4,20,000		
	7,32,000		**7,32,000**

The firm was dissolved on that date. Building and Stock were sold for ₹ 5,28,000. Realisation expenses amounted to ₹ 6000. Debtors worth ₹ 3,000 were declared as bad. Creditors were paid in full. Bharat was declared Insolvent and ₹ 5,100 only could be recovered from his private estate.

Prepare Realisation A/c and Partner's Capital Accounts. Apply Garner V/S Murray Rule, assuming that solvent partners do not bring their share of loss on realisation in cash.

Realisation A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Debtors A/c	1,20,000	By Creditors A/c	1,40,000
To Stock A/c	1,80,000	By B/P	1,00,000
To Buildings A/c	3,84,000	By Cash A/c (Assets Realised)	6,45,000
To Cash A/c		Building - 5,28,000	
Creditors 1,40,000		Debtor's - 1,17,000	
B/P 1,00,000	2,40,000	By Partners Capital A/c	45,000
To Cash A/c (Realisation Exp.)	6000	D 22,500, K-15,000, B- 7500	
	9,30,000		**9,30,000**

Partner's Capital A/c

Particulars	Deepak ₹	Kapil ₹	Bharat ₹	Particulars	Deepak ₹	Kapil ₹	Bharat ₹
To Balance b/d	-	-	24,000	By Balance b/d	2,64,000	1,56,000	-
To Realisation	22,500	15,000	7,500	By Cash A/c	-	-	5,100
To Bharat Capital	9000	5,400	-	By General Reserve	27,000	18,000	9,000
To Cash A/c	2,68,500	1,59,600	-	By P&L A/c	9,000	6,000	3,000
				By Deepak Capital	-		9,000
				By Kapil Capital	3,00,000		5,400
	3,00,000	1,80,000	31,500		3,00,000	1,80,000	31,500

Working Note : Deficiency of Bharat's Capital ₹ 14,000 will be borne by Deepak and Kapil in their Capital Ratio (3,00, 000 : 1,80,000) or 5 : 3, assuming that their Capitals are fluctuating. This ratio has been ascertained as under:-

Ascertainment of Capital Ratio

Particulars	Deepak ₹	Kapil ₹
Capital	2,64,000	1,56,000
+ General Reserve	27,000	18,000
+ P&L A/c	9000	6000
	3,00,000	1,80,000

Cash A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	24,000	By Realisation A/c (Creditors)	1,40,000
To Realisation A/c	6,45,000	By Realisation A/c (B/P)	1,00,000
To Bharat Capital A/c	5,100	By Realisation A/c (Exp.)	6000
		By Deepak Capital	2,68,500
		By Kapil Capital	1,59,600
	6,74,100		**6,74,100**

Illustration 6 :

A, B and C sharing profit in 5 : 3 : 2 respectively are partners in a firm. The Balance Sheet of the firm at the date of dissolution on 31st December, 2013 was as under :

Balance Sheet as on 31 March, 2013

Liabilities	Amount (₹)	Assets	Amount (₹)
Bills Payable	40,000	Cash at Bank	8000
Creditors	1,00,000	Bill's Receivable	32,000
Capital :		Debtor's	1,40,000
A 80,000		Capital of C	60,000
B 40,000	1,20,000	Stock	20,000
	2,60,000		**2,60,000**

A was appointed to realise the assets and distribute the amount on dissolution who was to be given 5% as remuneration on the amount collected from Bills Receivable, Stock and Debtors. He furnished following information for realization of Assets- B/R ₹30,000, Debtors ₹1,20, 000 and Stock ₹ 50,000. Creditors were paid ₹ 94,000 in full payment. The amount of B/R was paid in full. Realisation expenses amounted to ₹ 4,000. C was declared insolvent and ₹ 4,000 only could be realized from his private estate.

Prepare Realisation A/c and Partner's Capital Accounts assuming that Garner V/S Murray rule is applicable and solvent partners will bring cash for their respective share of loss on realisation.

Solution :

Realisation A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Bill Receivable A/c	32,000	By Bill Payable A/c	40,000
To Debtors A/c	1,40,000	By Creditors A/c	1,00,000
To Stock A/c	60,000	By Cash A/c	
To Cash A/c		B/R 30,000	
Creditors 94,000		Debtors 1,20,000	
B/R 40,000	1,34,000	Stock 50,000	2,00,000
To Cash A/c (Realisation Expenses)	4000	By Partners Capital A/c (Loss)	
To A's Capital (Remuneration)	10,000	A - 20,000	
		B - 12,000	
		C - 8000	40,000
	3,80,000		**3,80,000**

Partner's Capital A/c

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To Balance b/d	-	-	20,000	By Balance b/d	80,000	40,000	-
To Realisation	20,000	12,000	8000	By Realisation	10,000	-	-
To C's Capital	16,000	8,000		By Cash A/c	20,000	12,000	4000
To Cash A/c	74,000	32,000		By A's Capital	-	-	16000
				By B's Capital	-	-	8000
	1,10,000	**52,000**	**28,000**		**1,10,000**	**52,000**	**28,000**

Cash A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	8000	By Realisation A/c	1,34,000
To Realisation A/c	2,00,000	By Realisation A/c	4000
To A's Capital A/c	20,000	By A's Capital A/c	74,000
To B's Capital A/c	12,000	By B's Capital A/c	32,000
To C's Capital A/c	4000		
	4,00,000		**4,00,000**

Illustration 7:

A, B and C are equal partners. Their capital as on 31st March, 2014 were ₹ 2,40,000, ₹ 1,20,000 and ₹ 40,000 respectively. It was decided to dissolve the firm on this date. Amount realized from the sale of different assets was ₹ 1,64,000. Realisation expenses incurred were ₹ 4,000. C was declared insolvent and a sum of ₹ 0.40 in a rupee was realised from his private estate. Prepare necessary ledger accounts to close the books of the firm.

Solution :

Balance Sheet as on 31 March, 2014

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital A/c	4,00,000	Sundry Assets (B.F.)	4,00,000
A 2,40,000			
B 1,20,000			
C 40,000			
	4,00,000		**4,00,000**

Realisation A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Sundry Asset's	4,00,000	By Cash A/c (Assets Realised)	1,64,000
To Cash A/c (Exp.)	4000	By Partners Capital A/c	2,40,000
		A 80,000	
		B 80,000	
		C 80,000	
	4,04,000		**4,04,000**

Partner's Capital A/c

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To Realisation	80,000	80,000	80,000	By Balance b/d	2,40,000	1,20,000	40,000
To C's Capital	16,000	8000	-	By Cash A/c	80,000	80,000	16,000
To Cash A/c	2,24,000	1,12,000	-	By A's Capital			16,000
				By B's Capital			8000
	3,20,000	**2,00,000**	**80,000**		**3,20,000**	**2,00,000**	**80,000**

Cash A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Realisation A/c	1,64,000	By Realisation A/c	4000
To A's Capital A/c	80,000	By A's Capital A/c	2,24,000
To B's Capital A/c	80,000	By B's Capital A/c	1,12,000
To C's Capital A/c	16,000		
	3,40,000		**3,40,000**

Liability of Minor Partner in case of Insolvency of Partners on Dissolution of firm

According to the provision of Indian partnership Act, the liability of a minor partner is limited to the capital employed by him along with the profit earned. As regards the payment to firm's debts, only his capital in the firm may be used. His private estate is not liable for firm's dues. In case, if all the partners of the firm (other than minor) become insolvent even then minor's private estate is not liable to meet firm's debts though, his private estate may be capable to meet them.

Illustration 8 :

A, B and C are partners sharing profit in 3:2:1 ratio. They decided to dissolve the firm on 31st December, 2014, on which date their Balance Sheet was as under :

Balance Sheet as on 31 March, 2014

Liabilities	Amount (₹)	Assets	Amount (₹)
A's Capital A/c	25,000	Cash	600
B's Capital A/c	15,000	Sundry Assets	36,000
		C's Capital Overdrawn	3400
	40,000		**40,000**

Amount realized from sale of assets ₹30,000. C became insolvent and only ₹ 1,200 could be collected from his private estate. Prepare necessary ledger accounts to close the books of the firm assuming that the Garner V/s Murray rule is not applicable.

Realisation A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Sundry Assets	36,000	By Cash A/c (Assets Realised)	30,000
		By Partners Capital A/c	6,000
		A 3000	
		B 2000	
		C 1000	
	36,000		**36,000**

Partner's Capital A/c

Particulars	A ₹	B ₹	C ₹	Particulars	A ₹	B ₹	C ₹
To Balance b/d	-	-	3400	By Balance b/d	25,000	15,00	-
To Realisation	3000	2000	1000	By Cash A/c	-	-	1200
To C's Capital	1920	1280	-	By A's Capital	-	-	1920
To Cash A/c	20,080	11,720	-	By B's Capital	-	-	1280
	25,000	**15,000**	**4,400**		**25,000**	**15,000**	**4,400**

Cash A/c

Particulars	Amount (₹)	Particulars	Amount (₹)
To Balance b/d	600	By A's Capital A/c	20,080
To Realisation A/c	30,000	By B's Capital A/c	11,720
To C's Capital A/c	1,200		
	31,800		**31,800**

Summary

- **Dissolution of Firm and Partnership :** (1) When all partners enter into agreement to dissolve the firm, (2) When all partners leaving one are declared insolvent, (3) When business of the firm become illegal, (4) when the partner, in case of partnership at will, given notice to all to dissolve the firm, (5) When court has issued orders for dissolution.
- **Types of dissolution :** (1) Dissolution by agreement, (2) Compulsory dissolution, (3) dissolution by giving notice, (4) dissolution by the court, (5) Dissolution on the happening of certain contingence.
- **Accounts to be prepared on dissolution :** (1) Realisation Account, (2) Bank/Cash Account, (3) Partner's Capital Accounts, (4) Other necessary accounts.

- **Garner V/s Murray Rule :** According to this decision, deficiency of insolvent partner is borne by solvent partners in the ratio of their capital balances on the date of dissolution. Excluding all transactions related to dissolution, remaining solvent partners bear the loss in their capital ratio.

Glossary

- **Dissolution of Firm :** Termination of partnership among all partners.
- **Dissolution of Partnership :** Only partnership is dissolved, firm is not dissolved.
- **Realisation Account :** This Account is opened on dissolution in which all assets and liabilities are transferred. Assets are realized and payment of liabilities is done through this account. Profit or Loss of this account on dissolution is divided in profit sharing ratio of partners.
- **Garner V/s. Murray :** These are names of two partners in a firm in England. The decision awarded by court propounding the famous rule on distribution of deficiency of a partner who becomes insolvent by the solvent partners.

Questions for Exercise

Multiple Choice Questions :

1. At the time of dissolution of the firm balance of bad debts account is transferred to :
   (a) Debtors A/c (b) Bad debts A/c
   (c)Realisation's A/c (d) Capital a/c
2. On the dissolution of partnership firm, losses will be charged first :
   (a) Out of profit (b) From Partner's Loan A/c
   (c) From Partner's Capital A/c (d) From Partner's Personal resources
3. On the dissolution of firm, to close goodwill account, it is transferred to :
   (a) Revaluation's A/c (b) Partner's Capital A/c
   (c) Realisation A/c (d) Profit & Loss A/c
4. In which ratio, capital deficiency of an insolvent partners is distributed among solvent partners, when Garner vs. Murray Rule applies :
   (a) Profit – Loss Ratio (b) Opening Capital Ratio
   (c) Capital ratio before charging dissolution profit or loss (d) Equal Ratio
5. When Garner vs. Murray Rule applies, realization loss will be borne by the partner's in :
   (a) Equal Ratio (b) Profit & Loss Ratio
   (c) Capital Ratio (d) None of the above

Very Short Answer Type Questions :

1. On the dissolution of the firm, from debtors worth ₹ 50,000 realised ₹ 45,000. Make necessary journal entry at the time of dissolution of the firm.
2. What was name of insolvent partner in Garner V/s. Murray case? In which ratio his loss was distributed.
3. What is Realisation account?
4. What is dissolution of partnership firm?
5. What is the sequence for payment at the time of dissolution of firm?
6. What do you mean by dissolution of firm by court order?
7. At the time of dissolution capitals of the partners of the firm were ₹ 20,000, liabilities ₹ 15,000 and cash balance ₹ 1000; Amount realized from sundry assets ₹ 9,000. What is loss on realization?
   Answer: ₹ 25,000

Short Answer Type Questions :

1. Explain the Garner V/s. Murray rule.

2. “There is a difference between dissolution of partnership and dissolution of firm”. Explain this statement.
3. A, B and C's profit sharing ratio is 1 : 2 : 2. Before debiting realization loss partners capitals balances are ₹ 3000 (Dr.) ₹ 6000 (Cr.) and ₹ 2000 (Cr.) respectively and realization loss ₹ 5000. A became insolvent, give journal entry for distributing the deficiency of A.
4. Himi and Shreekant are partners. As 31st March, 2012 their Capita wasl ₹ 1,00,000 and ₹ 50,000 and creditors were ₹ 30,000. On that date firm dissolved and realization value of assets is ₹ 90,000. Prepare Realisation Account on dissolution.
5. In which circumstances compulsory dissolution happens?
6. State the modes of dissolution of partnership firm.
7. How capital accounts are closed on dissolution of partnership firm?
8. State any two circumstances under which partnership is deemed to be dissolved.
9. State the rules of preparation of realization account on dissolution of partnership firm.
10. State any two grounds on which a court can pass orders for dissolution of a firm.
11. Kapil one of the partner, agreed to take over the creditor’s of ₹ 25,000 for ₹ 22,000. Pass necessary journal entry at time of dissolution of the firm.

Essay Type Questions :

1. What is difference between realization account and revaluation account?
2. Under what circumstances a firm may be dissolved?
3. What do you mean by the Garner vs. Murray rule. How it is applied in case of fixed capital method and fluctuating capital method. Explain.
4. Explain the method of accounting for settlement of accounts at the time of dissolution.

Answers of Multiple Choice Questions

Question No.	(1)	(2)	(3)	(4)	(5)
Answer	C	A	C	C	B

Numerical Questions :

1. Ramesh, Naresh and Mahesh are partners in a firm sharing profit and losses in the ratio of 3 : 2 : 1. They decided to dissolved partnership firm on 31st December, 2014, on which date the Balance Sheet of the firm stood as follows :-

Balance Sheet as on 31st December, 2014

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	20,500	Cash in Hand	6000
Mrs. Ramesh Loan	8000	Debtors	9000
Joint Life Policy fund	20,000	Joint Life Policy	14,000
Capital		Investment	20,000
Ramesh 50,000		Stock	8000
Naresh 10,000	60,000	Machinery	40,000
		Mahesh Capital A/c	11,500
	1,08,500		**1,08,500**

The following transactions took place on dissolution :

(1) Joint life Policy was surrendered for ₹15,000. (2) Ramesh took Investments for ₹ 17,500 and agreed to discharge his wife’s Loan. (3) Ramesh took stock for ₹ 7,500 and debtors worth ₹ 5000 for ₹ 4,000, (4) Machine was sold for ₹ 50,000 and Debtors (remaining) realized 50% of book value. (5) realization expenses amounted to ₹ 1,000.

(6) ₹ 3,000 were realized from the sale of investments, which were not recorded in books. Give necessary journal entries to close the books of the firm and also prepare necessary ledger accounts.

Answer: Profit on Realisation ₹ 27,000.

2. Gopesh and Rakesh were partners sharing profit equally. They decided to dissolve the firm. The following was their Balance sheet as on 31st December, 2014 :-

Balance Sheet as on 31st December, 2014

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	30,000	Bank	20,000
General Reserve	20,000	Debtors	40,000
Capital		Stock	20,000
Gopesh 44,000		Furniture	8000
Rakesh 44,000	88,000	Plant & Machinery	50,000
	1,38,000		**1,38,000**

Realisation from the assets was as under: (1) Gopesh took Plant Machinery and furniture for 10% less than book value, (2) Rakesh took stock and goodwill for ₹ 35,000 and ₹ 37,000 were realized from Debtors. (4) Creditors were paid at a discount of 5%. Give necessary journal entries to close the books of the firm and prepare necessary accounts.

3. X, Y and Z are partners sharing profit in 2:2:1 ratio. Partners decided to dissolve the firm on 31st March, 2010, on which date Balance Sheet was as follows:-

Balance Sheet as on 31st March, 2010

Liabilities	Amount (₹)	Assets		Amount (₹)
Creditors	2500	Cash at Bank		4500
General Reserve	5000	Debtors	6500	
Current A/c X	2500	Less P.F.B. & D.D.	500	6000
Current A/c Y	1500	Stock		5000
Capital		Investments		5000
X 10,000		Furniture		4000
Y 5000		Plant & Machinery		6000
Z 5000	20,000	Current A/c Z		1000
	31,500			**31,500**

₹10,000 was realized from Plant & Machine, ₹ 6,000 from furniture, full amount from debtors and ₹ 4,000 from stock. Investments were taken over by Z at book value. Creditors were paid at 10% discount and expenses of realization were ₹ 100. An assets of the value of ₹ 550 was not recorded in books, which was taken by X for ₹ 450. There was a liability of ₹ 100, which was not entered in books. Close the books of the firm and prepare necessary ledger accounts.

Answer: Profit on realization ₹ 2,500.

4. Tanu and Manu sharing profits in 3 : 1 ratio are partners in a firm. They agreed to dissolve the firm. The assets of the firm (expect cash ₹ 2,000) realized ₹ 1,08,500. The liabilities on the date of dissolution were as under: creditors ₹ 40,000, Capital Tanu ₹ 1,00, 000 (Cr.), Manu's Capital A/c ₹ 10,000 (Dr.), Profit & Loss A/c ₹ 8,000 (Dr.), Realisation Expenses ₹ 1,000. It was ascertained that an investment worth ₹ 2,000 was not recorded in the books, which was taken by a creditor for ₹ 1,500. Remaining creditors were paid ₹ 36,500 in full settlement. Prepare Realisation Account, Partner's Capital Accounts and Cash Account.

Answer: Loss on Realisation ₹ 9,000.

5. Ram, Rahim and Karim sharing Profit in 2 : 2 : 1 ratio are partners in a firm. They decided to dissolve the firm on 31st March, 2012, on which date their Balance Sheet was as under:-

Balance Sheet as on 31st March, 2012

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	4,000	Cash in Hand	4,000
Capital		Debtors 2600	
Ram 10,000		Less – P.F.B.D. 600	2,000
Rahim 4000		Stock	4,000
Karim 2000	16,000	Fixtures and other Assets	10,000
	20,000		**20,000**

The assets were realised as under :- Fixtures and other Assets ₹ 9,000, Stock ₹ 4,520, Debtors ₹ 1,800, Creditors were paid off ₹ 3,800 in full settlement. Realisation expenses incurred ₹ 120. Prepare necessary accounts to close the books of the firm.

Answer : Less on Realisation : ₹ 600.

6. The following Balance Sheet reveals the position of M/s. Rakesh and Deepak as on 31st December, 2017.

Balance Sheet as on 31st December, 2017

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	1,900	Stock	3,600
General Reserve	1,000	Book Debts	6,000
Capital		Furniture	200
Rakesh 5,500		Plant & Machinery	900
Deepak 4,000	9,500	Profit & Loss A/c	1,700
	12,400		**12,400**

Book debts were realised at a discount of 7 ½%, stock was sold for ₹ 3,000, Plant & Machine for ₹ 700 and furniture for ₹ 250. Partners share profits and losses equally. Prepare necessary accounts on dissolution.

Answer: Loss on Realisation ₹ 1,200.

7. X, Y and Z are partners in a firm sharing profit and loss in the ratio of 4 : 3 : 3. On 31st December, 2015 it was decided to dissolve the firm on which date their Balance Sheet was as under:-

Balance Sheet as on 31st December, 2015

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	80,000	Cash	6,000
Capital		Debtors 90,000	
X 80,000		Less : P.F B.D. 5,000	85,000
Y 60,000	1,40,000	Stock	1,20,000
		Z Overdrawn	9, 000
	2,20,000		**2,20,000**

Y was appointed to realise the assets and amount so collected to be distributed. He will get 5% of the amount collected from stock and debtors and he will bear all expenses. Y reports about his collection as under: ₹ 96,000 was realised from stock and ₹ 72,000 from debtors and creditors were paid of ₹ 76,000 in full settlement. ₹ 1,000 was paid to an outstanding creditor not appearing in Balance Sheet.

Z was declared Insolvent and only ₹ 7,720 could be collected from his private estate. Apply the Garner V/s. Murray rule. Prepare Realisation A/c, Partners' Capital Accounts and Cash Account to close the books of the firm.

8. A, B and C are partners sharing profits and losses in the ratio of 5 : 3 : 2 respectively. The business was dissolved on 31st March, 2008, on which date the Balance Sheet of the firm was as under:-

Balance Sheet as on 31st March, 2008

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	2,00,000	Cash at Bank	10,000
Capital		Debtors	90,000
A 20,000		Stock	1,20,000
B 80,000		Motor Car	20,000
C 40,000	1,40,000	Machinery	1,00,000
	3,40,000		**3,40,000**

Amount realised from the sale of Machinery ₹ 50,000 and stock ₹ 38,000. B took over Motor car for ₹ 24,000. ₹ 40,000 was realised from Debtors. Deficiency of Capital of any partner will be borne by other partners in their profit sharing ratio. A was declared as insolvent and nothing could be realised from his estate. Prepare necessary accounts on dissolution.

Answer : Loss on Realisation ₹ 1,80,000.

9. The partnership between Ram and Shyam was dissolved on 31st March, 2010. Ram's Capital was ₹ 17,000 and Shyam's ₹ 3,000. Shyam owed ₹ 2,000 to the firm and the firm owed ₹ 10,000 to Ram and ₹ 20,000 was payable to Sundry Creditors. The books of the firm showed cash and furniture of ₹ 300 and ₹ 1,200 respectively. Profits and Losses were to be divided in the ratio of 2 : 1. The assets representing the above liabilities realised ₹ 40,000 (Other than cash, furniture and ₹ 2,000 payable by Shyam). Ram took furniture at an agreed price of ₹ 800. Liabilities were discharged at book value. Realisation expenses incurred were ₹ 200. Prepare Balance Sheet before the date of dissolution and necessary Accounts to close the books on dissolution.

Answer: Loss on Realisation ₹ 7,100.

10. The Balance Sheet of Ram, Shyam and Mohan on 31st March, 2014 was as follows:-

Balance Sheet as on 31st March, 2014

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	40,000	Cash at Bank	12,000
General Reserve	30,000	Debtors	20,000
Capital		Stock	40,000
Ram 50,000		Plant & Machinery	40,000
Shyam 30,000	80,000	B/R	20,000
		Mohan Capital overdrawn	18,000
	1,50,000		**1,50,000**

Mohan was declared insolvent and could contribute only ₹4,000. The firm was dissolved and the amount realised from assets was: Sundry Debtors ₹ 15,000, B/R ₹ 14,000, Stock ₹ 32,000, Plant & Machinery ₹ 28,000, realization expenses ₹ 5,000. Prepare Accounts to close firm's books.

Answer : Realisation A/c Loss ₹ 36,000.

11. A, B and C are equal partners in a firm. The Balance Sheet as on 31st March, 2012 was as under:-

Balance Sheet as on 31st March, 2012

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	90,000	Cash	10,000
Capital		Debtors	1,10,000
A 10,000		Stock	60,000
B 60,000		Goodwill	20,000
C 40,000	1,10,000		
	2,00,000		**2,00,000**

The firm was dissolved on the above mentioned date. A becomes insolvent. ₹ 80,000 was realised from firm's debtors and ₹ 50,000 from stock. Creditors were paid ₹ 86,000 in full satisfaction. Realisation expenses amounted to ₹ 4,000. A could not bring anything for his deficiency. Prepare Realisation A/c, Partner's Capital Accounts and Cash Account.

Answer: Loss on Realisation ₹ 60,000.

12. Kapil, Bharat, Vivek and Bhavesh are equal partners. The firm was dissolved on 31st March, 2006 on which date Balance Sheet was as follows:-

Balance Sheet as on 31st March, 2006

Liabilities	Amount (₹)	Assets	Amount (₹)
Creditors	16,000	Debtors	50,000
Bank overdraft	4,000	Stock	30,000
Capital		Kapil Capital overdrawn	20,000
Vivek 60,000		Bharat Capital overdrawn	10,000
Bhavesh 30,000	90,000		
	1,10,000		**1,10,000**

Amount realised from debtors 20% less than book value and from stock ₹ 4,000. Doubtful debts were of ₹ 2,000 which was not mentioned in Balance Sheet was discharged for ₹ 1,600. A became insolvent and only ₹ 6,000 could be realised from him. Realisation expenses amounted to ₹ 4,800. The Garner V/S Murray Rule is applied. Prepare necessary ledger accounts to close the books of the firm.

Answer: Loss on Realisation ₹ 42,400.

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