



## Revision Notes for CBSE Class 12 Accountancy Chapter 4, Dissolution of a Firm

### When does Dissolution of a Partnership takes place?

Dissolution of a partnership takes place under following circumstances:

- Change in existing profit sharing ratio among partners
- Admission of a new partner
- Retirement of a partner
- Death of a partner
- Insolvency of a partner
- Completion of the venture, if partnership is formed for that
- Expiry of the period of partnership, if partnership is for a specific period of time

### When does Dissolution of a Partnership Firm take place?

Dissolution of a partnership firm takes place by the following methods:

- The firm gets dissolved through an agreement with the consent of all the partners by a contract between the partners
- The firm has to be dissolved compulsorily when all the partners or all but one partner, become insolvent, rendering them incompetent to sign a contract, when the business of the firm becomes illegal or when some event has taken place which makes it unlawful for the partners to carry on the business of the firm in partnership, e.g., when a partner who is a citizen of a country becomes an alien enemy because of the declaration of war with his country and India.
- If contingencies such as the following takes place: if constituted for a fixed term, by the expiry of that term, if constituted to carry out one or more ventures, by the completion thereof, by the death of a partner or by the adjudication of a partner as an insolvent.
- If the dissolution is at will the firm can be dissolved if a partner submits a notice in writing to the rest of the partners
- There is an intervention from court if the partner becomes insane, becomes permanently incapable of performing his duties as a partner, when a partner is guilty of misconduct which is likely to adversely affect the business of the firm, when a partner persistently commits breach of partnership agreement, when a partner has transferred the whole of his interest in the firm to a third party, when the business of the firm cannot be carried on except at a loss, or when, on any ground, the court regards dissolution to be just and equitable.

### Difference Between Dissolution of a Partnership and Dissolution of a Firm

| Dissolution of a Partnership  | Dissolution of a Partnership Firm                         |
|---|---|
| The business can continue, it does not get terminated.              | The business gets terminated                              |
| Assets and Liabilities are revalued a new balance sheet is prepared | Assets and Liabilities are sold and paid off respectively |
| No intervention of court. It gets dissolved mutually                | It is dissolved by court's order                          |
| Economic relationship between partners continues                    | Economic relationship between partners comes to an end    |
| Closure of books is not required                                    | The balance books are closed                              |

### Settlement of Accounts

While settling the accounts on dissolution of a partnership firm, Section 48 of the Indian Partnership Act implies that:

- **Treatment of Losses-** The losses have to be paid firstly out of profits of the firm, secondly out of the capital of partners, and lastly by partners individually in their profit sharing ratio.

- **Application of Assets-** The assets of the firm will be utilised in paying the debts of the firm to the third parties, in paying each partner proportionately what is due to him/her from the firm for advances as distinguished from capital (i.e. partner's loan), in paying to each partner proportionately what is due to him on account of capital and the residue, if any, shall be divided among the partners in their profit sharing ratio.
- **Private Debts and Firm's Debts-** The property of the firm shall be applied first in the payment of debts of the firm and then the surplus, if any, shall be divided among the partners as per their claims, which can be utilised for payment of their private liabilities and the private property of any partner shall be applied first in payment of his private debts and the surplus, if any, may be utilised for payment of the firm's debts, in case the firm's liabilities exceed the firm's assets.

#### **Accounting Treatment (Journal Entries)**

At the time of dissolution of a partnership firm, the company's accounts have to be settled for which a realisation account is prepared in which the net profit or loss of the company is calculated and then distributed among the partners in their profit sharing ratio. Various journal entries to be made in different situations are presented below:

- **For transfer of assets**
- **For transfer of liabilities**
- **For sale of assets**
- **For an asset taken over by a partner**
- **For payment of liabilities**
- **For a liability which a partner takes responsibility to discharge**
- For settlement with the creditor through transfer of assets when he asks payment in parts
- when a creditor accepts an asset whose value is more than the due amount
- For payment of realisation expenses
- For agreed remuneration to such partner who agrees to undertake the dissolution work
- *For realisation of any unrecorded assets including goodwill, if any*
- *For settlement of any unrecorded liability*
- *For transfer of profit and loss on realisation*
- *For settlement of loan by a firm to a partner*
- *For transfer of accumulated profits in the form of general reserve to partners' capital accounts in their profit sharing ratio*
- *For transfer of fictitious assets, if any, to partners' capital accounts in their profit sharing ratio*
- *For payment of loans due to partners*
- *For settlement of partners' accounts*

#### **What is a Realisation Account?**

The Realisation Account is prepared to record the transactions relating to sale and realisation of assets and settlement of creditors. Any profit or loss arising out of this process is shared by partners in their profit sharing ratio. Partners' accounts are also settled and the Cash or Bank account is closed.