

MEANING OF KEY TERMS USED IN THIS CHAPTER

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| 1. Dissolution of Firm | Dissolution of the firm means business of the firm ends and the firm is dissolved. Assets of the firm are sold and liabilities are paid. In effect, economic relationship among the partners comes to an end. |
| 2. Dissolution of Partnership | It means change in economic relationship among partners of the firm but the firm continues its business. In other words, there is dissolution of partnership whenever a partnership is reconstituted, viz., admission, retirement, death or insolvency of a partner. |
| 3. Firm's Debts | Firm's Debts means the debts owed by the firm to outsiders. |
| 4. Private Debts | Private Debts means debts owed by a partner to any other person. |
| 5. Realisation Account | It is the account to which assets owned by the firm and liabilities owed to outsiders are transferred at the time of firm's dissolution. Amounts realised from assets and payments of liabilities are recorded in this account. The balance is Gain (Profit) or Loss on realisation of assets and settlement of liabilities. |
| 6. Unrecorded Assets | Assets which are not recorded in the books (Balance Sheet) of the firm but exist are called unrecorded assets . |
| 7. Unrecorded Liability | Liability which is not recorded in the books of the firm but payable is known as unrecorded liability . |

CHAPTER SUMMARY

- **Dissolution of a partnership between all the partners of a firm is called Dissolution of the Firm:** In case of dissolution of a firm, the business of the firm is closed, assets are realised and liabilities are paid.
- **Dissolution of partnership refers to the change in the existing relations of the partners:** The firm continues its business. It may take place on admission/retirement/death/insolvency of a partner or change in the profit-sharing ratio.

Settlement of Accounts (Section 48)

- **Treatment of Losses:** Losses including deficiencies of capital are to be paid in the following order:
 - (i) First out of profits of the firm;
 - (ii) Then out of capitals of the partners;
 - (iii) Lastly by partners individually in their profit-sharing ratio. [Section 48(a)]
- **Application of Assets:** Assets of the firm, including any sum contributed by the partners to meet the deficiencies of capital are applied in the following order:
 - (i) In paying firm's debts to the third parties;
 - (ii) In paying to each partner rateably what is due to him on account of loans and advances;
 - (iii) In paying to each partner rateably what is due to him on account of capital; and
 - (iv) The surplus, if any, is distributed among the partners in their profit-sharing ratio. [Section 48(b)]

Treatment of Firm's Debts and Private Debts (Section 49)

- (a) Firm's property is applied first towards the payment of firm's debts; then the surplus, if any, is applied towards the payment of partner's private debts to the extent to which the concerned partner is entitled to share in the surplus; and
- (b) Partner's private property is applied first in payment of his private debts and the surplus, if any, in payment of firm's debts if the firm's liabilities exceed the firm's assets.
- Loan to partner by the firm is received from him in cash. Meaning thereby, it is *not* transferred to his Capital Account.
- **Closing of Firm's Books:** Firm's books are closed by preparing the following accounts:
 - (i) Realisation Account; (ii) Loan by Partners Accounts; (iii) Loan to Partners Accounts (iv) Partners' Capital Accounts; and (v) Bank or Cash Account.

- **Realisation Account:** It is prepared on dissolution of a firm. The object or purpose of preparing the account is to determine gain (profit) or loss on realisation of assets and payment of liabilities.

Accounting Entries Relating to Realisation Account

Transfer of assets (except cash and bank balances)	Realisation A/c To Sundry Assets A/c	...Dr.	[At book value]
Transfer of liabilities (except partners' loan, capital and undistributed profits)	Sundry Liabilities A/c To Realisation A/c	...Dr.	[At book value]
Sale of assets	Bank/Cash A/c To Realisation A/c	...Dr.	[At selling price]
Assets taken over by a partner	Concerned Partner's Capital A/c To Realisation A/c	...Dr.	[At agreed value]
Assets taken over by a Partner against Payment of his Loan	Partner's Loan A/c To Realisation A/c To Realisation A/c	...Dr.	[With Loan Amount] [Agreed Value] [Loan Amount /less Agreed Value]
Sale of unrecorded asset	Bank/Cash A/c To Realisation A/c	...Dr.	[Amount received on sale]
Payment of liabilities	Realisation A/c To Bank/Cash A/c	...Dr.	[Amount of payment]
Any liability taken over by a partner	Realisation A/c To Concerned Partner's Capital A/c	...Dr.	[At agreed value]
Payment of realisation expenses paid by the firm	Realisation A/c To Bank/Cash A/c	...Dr.	[Amount of payment]
Payment of unrecorded liability (which did not appear in the Balance Sheet)	Realisation A/c To Bank/Cash A/c	...Dr.	[Amount of payment]
Payment of realisation expenses by any partner on firm's behalf	Realisation A/c To Concerned Partner's Capital A/c	...Dr.	[Amount of payment]
Credit balance of Realisation Account Gain(Profit)	Realisation A/c To Partners' Capital A/cs	...Dr.	[In profit-sharing ratio]
Debit balance of Realisation Account (Loss)	Partners' Capital A/cs To Realisation A/c	...Dr.	[In profit-sharing ratio]

Points to Remember

- An Asset (e.g., Debtors) against which a provision or reserve exists, is transferred to Realisation Account at its gross value.
- *Fictitious asset* like debit balance of Profit & Loss Account or Deferred Revenue Expenditure is *not transferred to Realisation Account*. It is debited to Partners' Capital Accounts in their profit-sharing ratio.
- Balance of *Partners' Capital Accounts/Current Accounts* are not transferred to *Realisation Account*.
- Balance of *Partners' Current Accounts* are transferred to respective Partners' Capital Accounts.
- Loan provided by the firm to the partner is received in cash or through cheque and transferred to Cash/Bank Account.
- Balance of *Realisation Account* means gain (profit) (if it has credit balance) and loss (if it has debit balance) on *realisation*.
- Gain (Profit) or Loss on *realisation* is transferred to Partners' Capital Accounts in the profit-sharing ratio.
- Balance at Bank is not transferred to Realisation Account.
- **If the question is silent about the realisation of any intangible asset**, it is assumed that such asset has not realised any amount.
- **If the question is silent about the realisation of any tangible asset**, it is assumed that such asset has been realised at its book value.
- **If the question is silent about the payment of a liability**, it is paid.