Unit 6: DISSOLUTION OF FIRM AND LLP

CH 10E

"Don't be pushed around by the Fears in your Mind. Be led by the Dreams in your Heart."

TOPIC 1A: DISSOLUTION

DISSOLUTION

A partnership is dissolved or comes to an end on:

- expiry of the term for which it was formed or completion of the venture for which it was entered into
- death of a partner
- insolvency of a partner.

However, the partners or remaining partners (in case of death or insolvency) may continue to do the business. In such case there will be a new partnership but the firm will continue. When the business comes to an end then only it will be said that the firm has been dissolved

A firm stands dissolved in the following cases:

- The partners agree that the firm should be dissolved
- All partners except one become insolvent
- The business becomes illegal
- In case of partnership at will, a partner gives notice of dissolution and
- The court orders dissolution

The court has the option to order dissolution of a firm in the following circumstances:

(a) Where a partner has become of unsound mind;
(b) Where a partner suffers from permanent incapacity;
(c) Where a partner is guilty of misconduct of the business;
(d) Where a partner persistently disregards the partnership agreement;
(e) Where a partner transfers his interest or share to a third party;
(f) Where the business cannot be carried on except at a loss; and
(g) Where it appears to be just and equitable.

SETTLEMENT OF ACCOUNTS (Section 48 of the Partnership Act)

A. Treatment of Losses: Losses including deficiencies of capital are paid,
   - → first out of profits,
   - → next out of capital and,
   - → lastly, if necessary, by the partners individually in their PSR.

B. Application of Assets: The assets of firm, including any sums contributed by the partners to make up deficiencies of capital have to be applied in the following manner and order:
   - → paying the debts of the firm to third parties;
   - → pay off loans from partners.
   - → pay off capitals of partners.
   - → Any surplus to be divided among the partners in their PSR.

Dissolution before expiry of a fixed term

A partner who, on admission, pays a premium to the other partners with a stipulation that the firm will not be dissolved before the expiry of a certain term, will be entitled to a suitable refund of premium or of such part as may be reasonable, if the firm is dissolved before the term has expired.

No claim in this respect will arise if:

(1) the firm is dissolved due to the death of a partner;
(2) the dissolution is mainly due to the partner's (claiming refund) own misconduct; and
(3) the dissolution is in pursuance of an agreement containing no provision for the return of the premium or any part of it.

The amount to be repaid will be such as is reasonable having regard to the terms upon which the admission was made and to the length of period agreed upon and that already expired. Any amount that becomes due will be borne by other partners in their profit- sharing ratio.

Distinction Between Dissolution of Partnership & Dissolution of Firm

S. No.	Dissolution of Partnership	Dissolution of Partnership Firm
1	Refers to the discontinuance of the relation between the partners of firm.	Implies that entire firm ceases to exist, including the relation among all partners
2	There can be change in PSR or admission/death/retirement of a partner	Dissolution of partnership firm occurs
3	In event of dissolution of the partnership, the business continues as usual, but the partnership is reconstituted.	In event of the dissolution of the firm, the business ceases to end.
4	There is no intervention by the court.	Court has inherent power to intervene. By its order, a firm can be dissolved.
5	Economic relationships among partners may remain same or change.	Economic relationship among partners comes to an end.
6	Assets and liabilities are revalued. New balance sheet is prepared	Assets are sold and realized. Liabilities are paid off.
7	Revaluation account is prepared	Realization account is prepared.
8	Assets and liabilities are revalued after winding up of the existing partnership.	Assets and liabilities are settled on winding up of a firm.
9	Books of accounts are not closed.	Books of accounts are closed.

WINDING UP OF A LIMITED LIABILITY PARTNERSHIP (LLP)

The winding up of a LLP may be either voluntary or by the Tribunal and LLP, so wound up may be dissolved.

Winding up of a LLP may be initiated by Tribunal if:

- The LLP wishes to wind up;
- The LLP has less than 2 partners for more than 6 months;
- The LLP is unable to pay its debts;
- The LLP has not acted in the interest of the sovereignty and the integrity of India;
- The LLP has failed to submit with the statements of accounts and solvency or the LLP annual returns for more than five consecutive financial years with the Registrar;
- The Tribunal thinks that it is Just and Equitable that the LLP should be wound up.

The Central Government may make rules for the provisions in relation to winding up and dissolution of LLP.

ACCOUNTING ENTRIES: BOOKS OF FIRM

1. Transfer of Assets to Realisation Account

Realisation A/c Dr. To Sundry Assets A/c

- By Name of Individual Assets
- To be transferred at *BOOK VALUE*
- Do not transfer the following.
    - Fictitious Assets
    - P & L debit balance
    - Cash & Bank balance
    - Current & Capital Account debit balance
- If any asset is having corresponding provision, then gross value to be transferred.

2. Transfer of Outsider's Liabilities to Realisation Account

Liabilities A/c Dr. To Realisation A/c

- By Name of Individual Liabilities
- To be transferred at *BOOK VALUE*
- Do not transfer the following
    - Partner's capital & current account balances
    - Reserves and surplus
    - Partner's Loan
- Any provision appearing on asset side is to be debited in this entry

3. Realisation of All Assets (whether recorded or unrecorded)

When assets are sold for cash	Cash/Bank A/c Dr. To Realisation Account
When assets are taken away by the partners	Partner's Capital A/c Dr. To Realisation Account
When assets are given away to any of the creditors towards his dues	No Entry

4. Discharge of Outsider's Liabilities (whether recorded or unrecorded)

When the liabilities are discharged in cash	Realisation Account Dr. To Cash/Bank A/c
When any of the partners agree to discharge the liability	Realisation Account Dr. To Partner's Capital A/c

5. Realisation Expenses:

When expenses are paid by the firm on its own behalf	Realisation Account Dr. To Cash/Bank A/c
When expenses are paid by a partner on firm's behalf	Realisation Account Dr. To Partner's Capital A/c
When any of the partners agree to do dissolution work for an agreed remuneration	Realisation Account Dr. To Partner's Capital A/c
When expenses are paid by a partner who has to bear such expenses	No Entry
When expenses are paid by firm on behalf of a partner who has to bear such expenses	Partner's Capital A/c Dr. To Cash/Bank A/c

6. Payment of Partner's Loan /Advance

Partner's Loan A/c Dr. To Capital A/c (Only to the extent of Dr. Balance in Capital A/c) To Cash/Bank A/c

7. Ascertainment of Profit/Loss on Realisation A/c & Transfer in Profit Sharing Ratio (PSR)

A: If Profit	B: If Loss
Realisation A/c Dr. To All Partner's Capital A/c	All Partner's Capital A/c Dr. To Realisation A/c

8. Transferring Accumulated Profits/Reserves & Losses to Partner's Capital Account in PSR

For Transfer of Accumulated Profits & Reserves
General Reserves A/c Dr. P&L A/c Dr. To All Partner's Capital A/c *Reverse entry to be passed in case of Accumulated Losses*

Realisation Account

To Sundry Assets (Individually at Book value) Cash & Bank ✗ Losses ✗ Adv. to partner Current/Capital (Dr. Bal.) ✗		By Sundry Liabilities (Outsider) (Individually at Book value) Capital/Current A/c ✗ Reserves & Profits ✗ Partner's Loan A/c ✗	
To Cash & Bank / Partner's Capital A/c (Paid value) (Taken over value) [Including unrecorded Liabilities/ Dissolution Expenses]		By Cash & Bank / Partner's Capital A/c (Realised value) (Taken over value) [Including unrecorded Assets]	
To Profit tfd. to Partner's cap. A/c (B.f.) (PSR)		By Loss tfd. to Partner's cap. A/c (B.f.) (PSR)	

NOTES:

1) Debtors & Provision for Doubtful Debts

Balance Sheet

Liabilities		Assets	
		Debtors 50000 - Provision for Doubtful debt (3000)	47000

Realisation A/c

To Debtors	50000	By Provision for Doubtful Debt	3000

2) Treat Goodwill just like any other normal asset.

Transfer Goodwill to Realisation A/c by passing entry:

Realisation A/c – Dr.

To Goodwill A/c

3) If any asset is assigned for settlement of liability

Only transfer to Realisation A/c with no further effect.

Balance Sheet

Liabilities		Assets	
Creditors	100000	Stock	80000

Realisation A/c

To Stock	80000	By Creditors	100000

4) Question is silent on payment of liabilities & realisation of assets.

For Liabilities: Full payment is made.

For Assets: Depends on nature & value of asset.

Option 1: Assume full value realised.

Option 2: Assume Nil value realised

[Eg. Goodwill, Prepaid Expenses, etc.]

TOPIC 1B: INSOLVENCY OF PARTNER

CONSEQUENCES OF INSOLVENCY OF A PARTNER

1. The partner adjudicated as insolvent ceases to be a partner on the date on which the order of adjudication is made.
2. The firm is dissolved on the date of the order of adjudication unless there is a contract to the contrary.
3. The estate of insolvent partner is not liable for any act of firm after the date of order of adjudication
4. The firm cannot be held liable for any acts of insolvent partner after the date of order of adjudication.

LOSS ARISING FROM INSOLVENCY OF A PARTNER

When a partner is unable to pay his debt due to the firm he is said to be insolvent & share of loss is to be borne by other solvent partners as per decision: English case of Garner vs Murray
According to this decision, solvent partners have to bear the loss due to insolvency of a partner and have to categorically put that the normal loss on realisation of assets to be borne by all partners (including insolvent partner) in the profit sharing ratio but a loss due to insolvency of a partner has to be borne by the solvent partners in the capital ratio.
The provisions of the Indian Partnership Act are not contrary to Garner vs. Murray rule. However, if the partnership deed provides for a specific method to be followed in case of insolvency of a partner, the provisions as per deed should be applied.

Insolvency of Partner
[GARNER vs MURRAY]

1) Deficiency / Shortage on account of insolvency of partner to be borne by remaining (other) solvent partners (having credit balance) in their last agreed capital ratio

2) Realisation loss to be brought in cash by all the solvent partners (including Dr. Balance)

Last Agreed Capital Ratio
(upto the date of dissolution of firm)

Fixed capital → Ratio of Fixed capital

Fluctuating Capital →

Capital Balances in B/s	xx
± Effect of Reserves, Profits & Losses	xx
	xx

Capital Ratio on Insolvency

- If they are maintaining capitals at fixed amounts then all adjustments regarding their share of profits, interest on capitals, drawings, interest on drawings, salary etc. are done through Current Accounts, which may have debit or credit balances and insolvency loss is distributed in the ratio of fixed capitals.
- But if capitals are not fixed and all transactions relating to drawings, profits, interest, etc., are passed through Capital Accounts then Balance Sheet of the business should not exhibit Current Accounts of partners & capital ratio will be determined after adjusting all reserves

& accumulated profits, all drawings, all interest on capitals & on drawings to the date of dissolution but before adjusting profit or loss on Realisation Account.

- If some partner is having a debit balance in his Capital Account and is not insolvent then he cannot be called upon to bear loss on account of the insolvency of other partner.

Non Applicability of Garner vs Murray

1. When the solvent partner has a debit balance in the capital account. Only solvent partners will bear the loss of capital deficiency of insolvent partner in their capital ratio. If incidentally a solvent partner has a debit balance in his capital account, he will escape the liability to bear the loss due to insolvency of another partner.
2. When the firm has only two partners.
3. When there is an agreement between the partners to share the deficiency in capital account of insolvent partner.
4. When all the partners of the firm are insolvent.

Insolvency of all Partners

- When the liabilities of the firm cannot be paid in full out of the firm's assets as well as personal assets of the partners, then all the partners of the firm are said to be insolvent. Under such circumstances don't transfer creditors (Outsider Liabilities) to Realisation A/c.
- Creditors (Outsider Liabilities) may be paid the amount available including the amount contributed by the partners in the ratio of their outstanding amount.

TOPIC 2: PIECEMEAL DISTRIBUTION

Generally, the assets sold upon dissolution of partnership are realised only in small instalments over a period of time. In such circumstances, the choice is either to distribute whatever is collected or to wait till the whole amount is collected. Usually, the first course is adopted. In order to ensure that the distribution of cash among the partners is in proportion to their interest in the partnership concern either of the two methods described below may be followed for determining the order in which the payment should be made.

PIECEMEAL DISTRIBUTION
(Instalments)

Sequence of Distribution:

1) Provide for Dissolution/Realisation Expenses (Estimated)
(Actual Amount decided in last instalment)

2) Outsider Liabilities [If >1, distribute in o/s Amount ratio until they are fully paid]

3) Partner's Loan

4) Partner's capital* → Highest Relative capital Method
→ Maximum loss Method

*	
Capital Balances	xx
+ Reserves & Surplus	xx
- P&L A/c (Dr.)	(xx)
- Loan to Partner	(xx)
	xx

ASSIGNMENT QUESTIONS

TOPIC 1A: NORMAL DISSOLUTION

Question 1 *(ICAI Study Material)* *Pg no._____*

P, Q and R are partners sharing profits and losses as to 2:2:1. Their Balance Sheet as on 31st March, 2023 is as follows:

Liabilities	₹	Assets	₹
Partners' Capitals:		Plant and Machinery	1,08,000
P	1,20,000	Fixtures	24,000
Q	48,000	Stock in trade	60,000
R	24,000	Sundry debtors	48,000
Reserve Fund	60,000	Cash in hand	60,000
Creditors	48,000		
	3,00,000		**3,00,000**

They decided to dissolve the business. The following are the amounts realized:

	₹
Plant and Machinery	1,02,000
Fixtures	18,000
Stock	84,000
Sundry debtors	44,400

Creditors allowed a discount of 5% and realization expenses amounted to ₹ 1,500. There was an unrecorded asset of ₹ 6,000 which was taken over by Q at ₹ 4,800. A bill for ₹ 4,200 due for GST was received during the course of realization and this was also paid. Prepare:

(i) Realisation account.
(ii) Partners' capital accounts.
(iii) Cash account.

Question 2 *Pg no._____*

X, Y and Z were in partnership sharing profits and losses in the ratio of 3:2:1 respectively. They decided to dissolve the partnership firm on 31.3.2020, when the Balance Sheet of the firm appeared as under:

Balance Sheet of the firm as on 31.3.2020

Liabilities	₹	Assets	₹
Sundry Creditors	8,50,500	Plant and Machinery	15,95,700
Bank Overdraft	9,09,675	Furniture	96,975
Joint Life Policy Reserve	3,98,250	Stock	3,55,050
Loan from Mrs. X	2,25,000	Sundry Debtors	8,01,000
Capital Accounts:		Joint Life Policy	3,98,250
X	6,30,000	Commission Receivable	2,10,825
Y	3,37,500	Cash in Hand	73,125
Z	1,80,000		
	35,30,925		35,30,925

The following details are relevant for dissolution:

(i) The joint life policy was surrendered for ₹ 3,48,750.
(ii) X took over plant and machinery for ₹ 13,50,000.
(iii) X also agreed to discharge bank overdraft and loan from Mrs. X.
(iv) Furniture and stocks were divided equally between X and Y at an agreed valuation of ₹ 5,40,000.

(v) Sundry debtors were assigned to firm's creditors in full satisfaction of their claims.
(vi) Commission receivable was received in time.
(vii) A bill discounted was subsequently returned dishonoured and proved valueless ₹ 46,125 (including ₹ 750 noting charges).
(viii) X paid the expenses of dissolution amounting to ₹ 27,000.

You are required to prepare:
(i) Realisation Account (ii) Partners' Capital Accounts and (iii) Cash Account.

Question 3 *(ICAI Study Material) / (RTP Nov 2021)* *Pg no._____*

P and Q were partners sharing profits equally in LLP. Their Balance Sheet as on March 31, 2023 was as follows:

Liabilities		Amount	Assets	Amount
Capitals:			Bank	30,000
P	1,00,000		Debtors	25,000
Q	50,000	1,50,000	Stock	35,000
Creditors		20,000	Furniture	40,000
Q's current account		10,000	Machinery	60,000
Reserves		15,000	P's current account	10,000
Bank overdraft		5,000		
		2,00,000		2,00,000

The firm was dissolved on the above date:
P took over 50% of the stock at 10% less on its book value, and the remaining stock was sold at a gain of 15%. Furniture and Machinery realized for ₹ 30,000 and ₹ 50,000 respectively; There was an unrecorded investment which was sold for ₹ 25,000; Debtors realized 90% only and ₹ 1,245 were recovered for bad debts written off last year; There was an outstanding bill for repairs which had to be paid for ₹ 2,000.
You are required to prepare Realization Account, Partners' capital accounts (including transfer of current account balances) and Bank Account in the books of the firm.

TOPIC 1B: INSOLVENCY OF PARTNER

Question 4 *(ICAI Study Material)* *Pg no._____*

A, B, C and D sharing profits in the ratio of 4:3:2:1 decided to dissolve their partnership on 31st March 2023 when their balance sheet was as under:

Liabilities		₹	Assets	₹
Creditors		15,700	Bank	535
Employees Provident Fund		6,300	Debtors	15,850
Capital Accounts:			Stock	25,200
A	40,000		Prepaid Expenses	800
B	20,000	60,000	Plant & Machinery	20,000
			Patents	8,000
			C's Capital A/c	3,200
			D's Capital A/c	8,415
		82,000		82,000

Following information is given to you :-
1. One of the creditors took some of the patents whose book value was ₹ 5,000 at a valuation of ₹ 3,200. Balance of the creditors were paid at a discount of ₹ 400.
2. There was a joint life policy of ₹ 20,000 (not mentioned in the balance sheet) and this was surrendered for ₹ 4,500.

3. The remaining assets were realised at the following values:- Debtors ₹ 10,800; Stock ₹ 15,600; Plant and Machinery ₹ 12,000; and Patents at 60% of their book-values. Expenses of realisation amounted ₹ 1,500.

D became insolvent and a dividend of 25 paise in a rupee was received in respect of the firms claim against his estate. Prepare necessary ledger accounts.

Question 5 *(ICAI Study Material)* *Pg no.*_____

P, Q and R were partners sharing profits and losses in the ratio of 3 : 2 : 1, no partnership salary or interest on capital being allowed. Balance sheet on 30th June, 2023 is as follows:

Liabilities	₹	Assets	₹
Fixed Capital		Fixed Assets:	
P- 20,000		Trademark	40,000
Q- 20,000		Freehold Property	8,000
R- 10,000	50,000	Plant and Equipment	12,800
Current Accounts:		Motor Vehicle	700
P- 500		Current Assets:	
Q- 9,000	9,500	Stock	3,900
Loan from P	8,000	Trade Debtors 2,000	
Trade Creditors	12,400	Less: Provision (100)	1,900
		Cash at Bank	200
		R's Current Account	400
		Profit and Loss Account	12,000
	79,900		79,900

On 1st July, 2023 the partnership was dissolved. Motor Vehicle was taken over by Q at a value of ₹ 500 but no cash passed specifically in respect of this transaction. Sale of other assets realised the following:

	₹
Trademark	Nil
Freehold Property	7,000
Plant and Equipment	5,000
Stock	3,000
Trade Debtors	1,600

Trade Creditors were paid ₹ 11,700 in full settlement of their debts. The costs of dissolution amounted to ₹ 1,500. The loan from P was repaid, P and Q were both fully solvent and able to bring in any cash required but R was forced into bankruptcy and was only able to bring 1/3 of the amount due. You are required to show:

(a) Cash and Bank Account,
(b) Realisation Account, and
(c) Partners Fixed Capital Accounts (after transferring Current Accounts' balances).

Question 6 *(RTP May 2023)* *Pg no.*_____

P, Q and R are sharing profits and losses in the ratio 5:3:2. Due to finding of frauds committed by R during the year, it was decided to dissolve the partnership on 31st March, 2022. As on 31st March, 2022 their Balance Sheet was as under:

Equity & Liabilities	Amount (₹)	Assets	Amount (₹)
Partner's Capital A/c		Plant & Machinery	6,00,000
P	4,50,000	Stock	4,27,500
Q	4,50,000	Investments	1,45,000
R	-	Debtors	2,10,000
General reserve	1,20,000	Cash	72,500

Trade creditors	2,35,000	R's Capital	75,000
Bills payable	1,00,000		
Mrs. Q's loan	1,75,000		
Total	15,30,000	Total	15,30,000

Additional information are given as under:

a) During the year R sold Investments costing of ₹ 45,000 at ₹ 56,000 and the said funds were transferred to his personal account. This transaction was not recorded in the firm's books.

b) A cheque for ₹ 30,000 was received from debtor, not recorded in the books and was misappropriated by R.

c) A Trade creditor agreed to takeover stock of the book value of ₹ 25,000 at ₹ 26,500. The rest of the Trade creditors were paid off at a discount of 2%.

d) The bills payable were settled at a discount of 2%.

e) The expenses of dissolution amounted to ₹ 15,900.

f) The other assets realized were as follows:

Plant & Machinery	5% above the book value
Stock	Rest of the stock realized at a loss of ₹ 15,000
Investments	Rest of investments were sold at a profit of ₹ 5,600
Debtors	Rest of the debtors were realized at a discount of 12%.

g) Q agreed to takeover loan of Mrs. Q of ₹ 1,75,000.

h) The realizable value of R's private assets would only be ₹ 20,000.

Applying the principles laid down in Gamer vis. Murray, prepare Realization Account, Cash Account and Partner's Capital Accounts.

Question 7

Pg no._____

Neptune, Jupiter, Venus and Pluto had been carrying on business in partnership sharing profits and losses in the ratio of 3 : 2 : 1 : 1. They decide to dissolve the partnership on the basis of the following Balance Sheet as on 30th April, 2020:

Liabilities		₹	Assets		₹
Capital Accounts			Capital Accounts		
Neptune	1,00,000		Venus	10,000	
Jupiter	60,000	1,60,000	Pluto	12,000	22,000
General Reserve		56,000	Premises		1,20,000
Capital Reserve		14,000	Furniture		40,000
Sundry Creditors		20,000	Stock		1,00,000
Mortgage Loan		80,000	Debtors		40,000
			Cash		8,000
		3,30,000			3,30,000

(i) The other assets realized as follows:

Debtors	24,000
Stock	60,000
Furniture	16,000
Premises	90,000

(ii) Expenses of dissolution amounted to ₹ 4,000.

(iii) Further creditors of ₹ 12,000 had to be met.

(iv) General Reserve unlike Capital Reserve was built up by appropriation of profits.

You are required to draw up the Realisation Account, Partners' Capital Accounts and the Cash Account assuming that Venus became insolvent and nothing was realised from his private estate. Apply the principles laid down in Garner vs Murray.

Question 8 *(ICAI Study Material)* *Pg no._____*

M/s X, Y and Z who were in partnership sharing profits and losses in the ratio of 2:2:1 respectively, had the following Balance Sheet as at December 31, 2023:

Liabilities	₹	Assets	₹
Capital: X 29,200		Fixed Assets	40,000
Y 10,800		Stock	25,000
Z 10,000	50,000	Book Debts 25,000	
Z's Loan	5,000	Less: Provision (5,000)	20,000
Loan from Mrs. X	10,000	Cash	1,000
Sundry Trade Creditors	25,000	Advance to Y	4,000
	90,000		90,000

The firm was dissolved on the date mentioned above due to continued losses. After drawing up the balance sheet given above, it was discovered that goods amounting to ₹ 4,000 have been purchased in November, 2023 and had been received but the purchase was not recorded in books.

Fixed assets realised ₹ 20,000; Stock ₹ 21,000 and Book Debt ₹ 20,500. Similarly, the creditors allowed a discount of 2% on the average. The expenses of realisation come to ₹ 1,080. X agreed to take over the loan of Mrs. X. Y is insolvent, and his estate is unable to contribute anything. Give accounts to close the books; work according to the decision in Garner vs. Murray.

Question 9 *(ICAI Study Material)* *Pg no._____*

Amal and Bimal are in equal partnership. Their Balance Sheet stood as under on 31st March, 2023 when the firm was dissolved:

Liabilities	₹	Assets	₹
Creditors A/c	4,800	Plant & Machinery	2,500
Amal's Capital A/c	750	Furniture	500
		Debtors	1,000
		Stock	800
		Cash	200
		Bimal's drawings	550
	5,550		5,550

The assets realised as under:

Plant & Machinery	1,250
Furniture	150
Debtors	400
Stock	500

The expenses of realisation amounted to ₹ 175. Amal's private estate is not sufficient even to pay his private debts, whereas Bimal's private estate has a surplus of ₹ 200 only.

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

TOPIC 2: PIECEMEAL DISTRIBUTION

Question 10 *(ICAI Study Material) / (RTP May 2019) (Similar)* *Pg no._____*

A partnership firm was dissolved on 30th June, 2023. Its Balance Sheet on the date of dissolution was as follows:

Liabilities		₹	Assets	₹
Capital Accounts			Cash	10,800
A	76,000		Sundry Assets	1,89,200

B	48,000			
C	36,000	1,60,000		
Loan A/c – B		10,000		
Sundry Creditors		30,000		
		2,00,000		2,00,000

The assets were realized in instalments and the payments were made on the proportionate capital basis. Creditors were paid ₹ 29,000 in full settlement of their account. Expenses of realization were estimated to be ₹ 5,400 but actual amount spent was ₹ 4,000. This amount was paid on 15th September.

Draw up a statement showing distribution of cash, which was realized as follows:

	₹
On 5th July, 2023	25,200
On 30th August, 2023	60,000
On 15th September, 2023	80,000

The partners shared profits and losses in the ratio of 2 : 2 : 1. Prepare a statement showing distribution of cash amongst the partners by 'Highest Relative Capital' method.

Question 11 *Pg no._____*

Amar, Akbar and Antony are in partnership. The following is their Balance Sheet as at March 31, 2020 on which date they dissolved their partnership. They shared profit in the ratio of 5:3:2.

Liabilities	₹	Assets	₹
Creditors	80,000	Plant and machinery	60,000
Loan A/c – Amar	20,000	Premises	80,000
Capital A/cs -		Stock	60,000
Amar	1,00,000	Debtors	1,20,000
Akbar	30,000		
Antony	90,000		
	3,20,000		3,20,000

It was agreed to repay the amounts due to the partners as & when the assets were realised.

	₹
April 15, 2020	60,000
May 1, 2020	1,46,000
May 31, 2020	94,000

Prepare a statement showing how the distribution should be made under maximum loss method.

Question 12 *(ICAI Study Material)* *Pg no._____*

A, B & C are partners sharing profits & losses in ratio 5:3:2. Their capitals were 9,600, 6,000 and 8,400 respectively. After paying creditors, the liabilities and assets of the firm were:

	₹		₹
Liability for interest on loans from:		Investments	1,000
Spouses of partners	2,000	Furniture	2,000
Partners	1,000	Machinery	1,200
		Stock	4,000

The assets realised in full in the order in which they are listed above. B is insolvent. Prepare statement showing distribution of cash as & when available, applying maximum possible loss procedure.

PRACTICE QUESTIONS

MULTIPLE CHOICE QUESTIONS

1) Partnership could be dissolved because of
   (a) Death of a partner.
   (b) Insolvency of a partner.
   (c) Either (a) or (b).

2) On the dissolution of partnership, profit or loss on realization of assets and liabilities should be divided among partners
   (a) In the ratio of their capitals.
   (b) In the same ratio in which they share profits.
   (c) Equally.

3) An unrecorded asset realized at the time of dissolution is credited to
   (a) Realization account.
   (b) Revaluation account.
   (c) Capital accounts.

4) A liability taken over by a partner at the time of dissolution is credited to
   (a) Profit and loss account.
   (b) Partners' capital accounts.
   (c) Realization account

5) Realization account is a
   (a) Nominal account.
   (b) Real account.
   (c) Personal account.

6) Which of the following method/methods is adopted to ensure that distribution of cash among partners is in proportion to their interest in partnership?
   (a) Maximum loss method.
   (b) Highest relative capital method.
   (c) Either (a) or (b).

ANSWERS MCQs

1 (c) 2 (b) 3 (a) 4 (b) 5 (a) 6 (c)

TRUE / FALSE

State with reasons, whether the following statements are true or false:

1) Books of accounts are closed in dissolution of partnership.
2) On the dissolution of a partnership, firstly, the assets of the firm are realized. Then the amount realized, is applied first towards repayment of liabilities to outsiders.
3) In event of the dissolution of the firm, the business ceases to end. In event of dissolution of the partnership, the partnership is reconstituted and the business discontinues.
4) Expenses of dissolution on realization of assets are credited to the Realization Account.
5) Revaluation Account is prepared at the time of dissolution of partnership but Realization Account is prepared at the time of dissolution of partnership firm.

Solution

1) False: Books of accounts are not closed in dissolution of partnership but are closed in case of dissolution of partnership firm.
2) True: On the dissolution of a partnership, firstly, the assets of the firm, are realized. Then the amount realized, is applied first towards repayment of liabilities to outsiders and loans taken from partners; afterwards, the capital contributed by partners is repaid.
3) True: In event of the dissolution of the firm, the business ceases to end. However, in event of dissolution of the partnership, the business continues as usual, but the partnership is reconstituted.
4) False: Expenses of dissolution on realization of assets are debited to the Realization Account.
5) True: Revaluation Account is prepared at the time of dissolution of partnership but Realization Account is prepared at the time of dissolution of partnership firm.

HOMEWORK QUESTIONS

TOPIC 1A: NORMAL DISSOLUTION

Question 1 (ICAI Study Material) Pg no.______

X, Y, and Z are partners of the firm XYZ and Co., sharing Profits & Losses in the ratio of 4: 3: 2. Following is the Balance Sheet of the firm as on 31st March, 2023.

Liabilities	₹	Assets	₹
Partner's Capital:		Fixed Assets	5,00,000
X	4,00,000	Stock	3,00,000
Y	3,00,000	Debtors	5,00,000
Z	2,00,000	Cash in Hand	10,000
General Reserve	90,000		
Sundry Creditors	3,20,000		
	13,10,000		13,10,000

Partners of the firm decided to dissolve the firm on the above-said date.
Fixed assets realized ₹ 5,20,000 & book debts ₹ 4,40,000. Stocks were valued at ₹ 2,50,000 and it was taken over by partner Y. Creditors allowed discount of 5% and the expenses of realization amounted to ₹ 6,000. You are required to prepare:
(i) Realization account; (ii) Partners capital account; and (iii) Cash account.

Question 2 (ICAI Study Material) / (RTP Nov 2020) (Similar) Pg no.______

Amit, Sumit and Kumar are partners sharing profit and losses in the ratio 2:2:1. The partners decided to dissolve the partnership on 31st March, 2023 when their Balance Sheet was as under:

Liabilities	Amount	Assets		Amount
Capital Accounts:		Land & Building		1,35,000
Amit	55,200	Plant & Machinery		45,000
Sumit	55,200	Furniture-		25,500
General Reserve	61,500	Investments		15,000
Kumar's Loan A/c	15,000	Book Debts	60,000	
Loan from D	1,20,000	Less: Prov. for bad debts	(6,000)	54,000
Trade Creditors	30,000	Stock		36,000
Bills Payable	12,000	Bank		13,500
Outstanding Salary	7,500	Capital withdrawn: Kumar		32,400
	3,56,400			3,56,400

The following information is given to you:

(i) Realisation expenses amounted to ₹ 18,000 out of which ₹ 3,000 was borne by Amit.

(ii) A creditor agreed to takeover furniture of book value ₹ 12,000 at ₹ 10,800. The rest of the creditors were paid off at a discount of 6.25%.

(iii) The other assets realized as follows:

Furniture - Remaining taken over by Kumar at 90% of book value
Stock - Realised 120% of book value
Book Debts - ₹ 12,000 of debts proved bad, remaining were fully realized
Land & Building - Realised ₹ 1,65,000
Investments - Taken over by Amit at 15% discount

(iv) For half of his loan, D accepted Plant & Machinery and ₹ 7,500 cash. The remaining amount was paid at a discount of 10%.

(v) Bills payable were due on an average basis of one month after 31st March, 2023, but they were paid immediately on 31st March @ 6% discount "per annum".

Prepare the Realisation Account, Bank Account and Partners Capital Accounts in the books of partnership firm.

Question 3 *Pg no.____*

W paid ₹ 70,000 as premium to other partners of the firm at the time of his admission to the firm, with a condition that it will not be dissolved before expiry of five years. The firm is dissolved after three years. W claims refund of premium. Explain -

(1) List the criteria for the calculation of the amount of the refund.

(2) Also explain any two conditions when no claim in this respect will arise.

TOPIC 1B: INSOLVENCY OF PARTNER

Question 4 *Pg no.____*

Kamal, Kishor, Mohan, and Sohan, were partners sharing profits and losses in the ratio of 3:3:2:2. Following was balance sheet as on 31st March, 2020 on which date firm was dissolved

Liabilities		₹	Assets		₹
Capital Accounts			Capital Accounts		
Kamal	30,000		Mohan	24,000	
Kishor	22,500	52,500	Sohan	9,000	33,000
Trade creditors		23,250	Trade debtors	24,000	
Kamal's loan		15,000	Less: Provision	(750)	23,250
			Inventories		15,000
			Cash at bank		3,000
			Furniture and fixture		6,000
			Trademarks		10,500
		90,750			90,750

The assets realised were as follows: trade debtors ₹ 16,500; inventories ₹ 12,000; furniture and fixture ₹ 1,500; trade mark ₹ 6,000; trade creditors were settled at ₹ 23,000. Also there was a joint life insurance policy for ₹ 45,000. This was surrendered for ₹ 4,500. Expenses of realisation amounted to ₹ 750. 'Mohan' was insolvent, but ₹ 5,550 were recovered from his estate. You are required to show the following accounts in the book of partnership firm:

(a) Realisation account;

(b) Cash account;

(c) Partners' capital accounts.

Question 5 *Pg no.____*

A, V, R and S are partners in a firm sharing profits and losses in the ratio of 4 : 1 : 2 : 3. The following is their Balance Sheet as at 31st March, 2020:

Liabilities		₹	Assets		₹
Sundry Creditors		6,00,000	Sundry Debtors	7,00,000	
Capital Accounts:			Less: Doubtful Debts	(1,00,000)	6,00,000
A	14,00,000		Cash in hand		2,80,000
S	6,00,000	20,00,000	Stocks		4,00,000
			Other Assets		6,20,000
			Capital Accounts:		
			V	4,00,000	
			R	3,00,000	7,00,000
		26,00,000			26,00,000

On 31st March, 2020, the firm is dissolved and the following points are agreed upon:
(a) A is to takeover sundry debtors at 80% of book value.
(b) S is to takeover the stocks at 95% of the value.
(c) R is to discharge sundry creditors.
(d) Other assets realise ₹ 6,00,000 and the expenses of realisation come to ₹ 60,000.
(e) V is found insolvent and ₹ 43,800 is realised from his estate.
Prepare Realisation Account , Partner's Capital Accounts & Cash A/c. The loss arising out of capital deficiency may be distributed following the decision in Garner vs Murray.

Question 6 *(ICAI Study Material)* Pg no.______

'Thin', 'Short' and 'Fat' were in partnership sharing profits and losses in the ratio of 2:2:1. On 30th September, 2023 their Balance Sheet was as follows :

Liabilities	₹	Assets	₹
Capital Accounts:		Premises	50,000
Thin 80,000		Fixtures	1,25,000
Short 50,000		Plant	32,500
Fat 20,000	1,50,000	Stock	43,200
Current Accounts:		Debtors	54,780
Thin 29,700			
Short 11,300			
Fat (Dr.) (14,500)	26,500		
Sundry Creditors	84,650		
Bank Overdraft	44,330		
	3,05,480		3,05,480

'Thin' decides to retire on 30th September, 2023 and as 'Fat' appears to be short of private assets, 'Short' decides that he does not wish to take over Thin's share of partnership, so all three partners decide to dissolve the partnership with effect from 30th September, 2023. It then transpires that 'Fat' has no private assets whatsoever.
The premises are sold for ₹ 60,000 and the plant for ₹ 1,07,500. The fixtures realize ₹ 20,000 and the stock is acquired by another firm at book value less 5%. Debtors realise ₹ 45,900. Realisation expenses amount to ₹ 4,500. The bank overdraft is discharged and the creditors are also paid in full. You are required to write up the following ledger accounts following the rules in Garner vs. Murray:

(i) Realisation Account;
(ii) Partners' Current Accounts;
(iii) Partners' Capital Accounts showing the closing of the firm's books

Question 7 *(CA Inter Nov 2019) (15 Marks)* Pg no.______

G, S & J were partners sharing profits and losses in the ratio of 4:3:2, no partnership salary or interest on capital being allowed. Their Balance Sheet as on 31.3.2019 is as follows:

Liabilities	Amount	Assets	Amount
Partners' Fixed capital accounts		Fixed assets:	
G	24,000	Goodwill	48,000
S	24,000	Land	9,600
J	12,000	Plant & Machinery	15,360
Partners' current accounts:		Motor Car	840
G	600	Current assets:	
S	10,800	Stock	4,680
J	(480)	Trade debtors 2,400	
Loan from G	9,600	Less: Provision (120)	2,280

Trade creditors	14,880	Cash at bank	240
		Miscellaneous losses:	
		Profit & loss	14,400
	95,400		95,400

On 1st April, 2019, the partnership was dissolved. Motor car was taken over by G at a value of ₹ 600, but no cash was given specifically in respect of this transaction. Sale of other assets realized the following amounts:

Particulars	Amount
Goodwill	Nil
Land	8,400
Plant & Machinery	6,000
Stock	3,600
Trade Debtors	1,920

Trade creditors were paid ₹ 14,040 in full settlement of their debts. The cost of dissolution amounted to ₹ 1,800. The loan from G was repaid; G and S both were fully solvent and able to bring in any cash required but J was forced into bankruptcy and was only able to bring 1/2 of the amount due. You are required to prepare: (Applying Garner Vs. Murray rule.)

(i) Cash & Bank account
(ii) Realization account, and
(iii) Partners' Fixed Capital Accounts (after transferring current accounts balances)

Question 8 *(RTP Nov 2019) / (RTP Nov 2023) (Similar)* *Pg no._____*

P, Q, R and S are sharing profits and losses in the ratio 3 : 3 : 2 : 1. Frauds committed by R during the year were found out and it was decided to dissolve the partnership on 31st March, 2020 when their Balance Sheet was as under:

Liabilities	₹	Assets	₹
Capital Accounts:		Building	1,90,000
P	1,50,000	Stock	1,30,000
Q	1,50,000	Investments	50,000
R	-	Debtors	70,000
S	60,000	Cash	30,000
General reserve	40,000	R	40,000
Trade creditors	80,000		
Bills payable	30,000		
	5,10,000		5,10,000

Following information is given to you:

(i) A cheque for ₹ 7,000 received from debtor was not recorded in books and & misappropriated by R
(ii) Investments costing ₹ 8,000 were sold by R at ₹ 11,000 and the funds transferred to his personal account. This sale was omitted from the firm's books.
(iii) A creditor agreed to take over investments of the book value of ₹ 9,000 at ₹ 13,000. The rest of the creditors were paid off at a discount of 5%.
(iv) The other assets realized as follows:

	₹
Building	110% of book value
Stock	1,20,000
Investments	The rest of investments were sold at a profit of ₹ 7,000
Debtors	The rest of the debtors were realized at a discount of 10%

(v) The bills payable were settled at a discount of ₹ 500.
(vi) The expenses of dissolution amounted to ₹ 8,000.

(vii) It was found out that realization from R's private assets would only be ₹ 7,000.
Prepare Realisation Accounts, Cash Account and Partner's Capital Account.

Question 9 *(CA Inter May 2022) (15 Marks)* Pg no.______

Ajay, Vijay and Sanjay have been in partnership for a number of years, sharing profits and losses in the ratio 7:7:4 as a wholesale stationer running business under the name "AVS Traders". On 31st March,2021, it was found that some frauds were committed by Sanjay during the year 2020-2021. So, it was decided to dissolve the partnership business on 31st March,2021 when their Balance sheet stood as under:

Balance Sheet as at 31st March,2021

Liabilities	Amount (₹)	Assets	Amount (₹)
Capital accounts:		Building	1,90,000
Ajay 1,80,000		Inventory	1,30,000
Vijay 1,80,000	3,60,000	Investments	50,000
General Reserve	36,000	Trade Debtors	70,000
Trade Creditors	80,000	Cash & Bank	26,000
Bills payables	30,000	Sanjay's Capital (overdrawn)	40,000
	5,06,000		5,06,000

Additional Information:

(i) Following frauds were committed by Sanjay:
1) Investments costing ₹8,000 were sold by Sanjay at ₹ 11,000 and the funds were transferred to his personal account. This sale was omitted from firm's books.
2) A cheque for ₹ 7,000 received from trade debtors was not recorded in the books and was misappropriated by Sanjay.

(ii) A trade creditor agreed to take over investments of the book value of ₹ 9,000 at ₹ 13,000. The rest of the trade creditors were paid off at a discount of 10%.

(iii) Other assets were realized as follows:

Inventory	₹ 1,20,000
Building	110% of book value
Investments	The rest of the investments were sold at a profit of ₹ 7,000
Trade Debtors	The rest of the trade debtors were realised at a discount of 10%

(iv) The Bills payables were settled at a discount of, ₹500.

(v) The expenses of dissolution amounted to ₹8,060.

(vi) It was found out, that realisation from Sanjay's private assets would be ₹ 7,000.

You are required to prepare
1. Realisation Account
2. Cash & Bank Account
3. Partners' Capital Accounts.

Question 10 Pg no.______

P, Q, R and S had been carrying on business in partnership sharing profits & losses in the ratio of 4:3:2:1. They decided to dissolve the partnership on the basis of following Balance Sheet as on 30th April, 2020:

Liabilities	₹	Assets	₹
Capital Accounts		Capital Accounts	
P 1,68,000		R 25,000	
Q 1,08,000	2,76,000	S 18,000	43,000
General reserve	95,000	Land & building	2,46,000

Capital reserve	25,000	Furniture & fixtures	65,000
Sundry creditors	36,000	Stock	1,00,000
Mortgage loan	1,10,000	Debtors	72,500
		Cash in hand	15,500
	5,42,000		5,42,000

(i) The other assets realized as follows:

Land & building	2,30,000
Furniture & fixtures	42,000
Stock	72,000
Debtors	65,000

(ii) Expenses of dissolution amounted to ₹ 7,800.
(iii) Further creditors of ₹ 18,000 had to be met.
(iv) R became insolvent and nothing was realized from his private estate.

Applying the principles laid down in Garner Vs. Murray, prepare the Realisation Account, Partners' Capital Accounts and Cash Account.

Question 11 *(RTP May 2022)* *Pg no._____*

The firm of M/s OM has 4 partners A, B, C & D and as on 31st March, 2021, its Balance Sheet stood as follows:

Liabilities	₹	Assets	₹
Capital Accounts:		Land	50,000
A	2,00,000	Building	2,50,000
B	2,00,000	Office Equipment	1,25,000
C	1,00,000	Computers	70,000
Current Accounts:		Debtors	4,00,000
A	50,000	Stock	3,00,000
B	1,50,000	Cash at Bank	75,000
C	1,10,000	Other Current Assets	22,600
Loan from NBFC	5,00,000	Current A/c:	
Current Liabilities	70,000	D	87,400
	13,80,000		13,80,000

The partners have been sharing profits & losses in the ratio of 4:4:1:1. It has been agreed to dissolve the firm on 01.04.2021 on the basis of the following understanding:

a) The following assets are to be adjusted to the extent indicated with respect to the book values: Land 200%, Building 120%, Computers 70%, Debtors 95%, Stocks 90%.
b) In case of loan the lenders are to be paid at their insistence a prepayment premium of 1%.
c) D is insolvent & no amount is recoverable from him. His father C, however agrees to bear 50% of his deficiency. The balance of the deficiency is agreed to be apportioned according to law.
d) The assets are realized at the agreed (adjusted) values.

Assuming that the realization of the assets and discharge of liabilities is carried out immediately, show the Bank Account, Realization Account & the Partner's Capital Accounts (including Current Accounts).

Question 12 *(CA Inter May 2019)/ (CA Inter Dec 2021)/ (CA Inter May 2023) (5 Marks)* *Pg no._____*

State the circumstances when Garner V/s Murray rule is not applicable.

TOPIC 2: PIECEMEAL DISTRIBUTION

Question 13 Pg no._____

The firm of Omega was dissolved on 31.3.2020, at which date its Balance Sheet stood as:

Liabilities	₹	Assets	₹
Creditors	2,00,000	Fixed Assets	45,00,000
Bank Loan	5,00,000	Cash and Bank	2,00,000
L's Loan	10,00,000		
Capital			
L	15,00,000		
M	10,00,000		
S	5,00,000		
	47,00,000		47,00,000

Partners share profits equally. A firm of Chartered Accountants is retained to realise the assets and distribute the cash after discharge of liabilities. Their fees which include all expenses is fixed at ₹ 1,00,000. No loss is expected on realisation since fixed assets include valuable land and building. Realisations are:

	₹
I (including Cash & Bank)	5,00,000
II	15,00,000
III	15,00,000
IV	30,00,000
V	30,00,000

The Chartered Accountant firm decided to pay off the partners in 'Higher Relative Capital Method'. Prepare a statement showing distribution of cash with necessary workings.

Question 14 *(ICAI Study Material)* Pg no._____

Following is Balance Sheet of A,B,C on 31st Dec, 2022 when they decided to dissolve partnership

Liabilities	₹	Assets	₹
Creditors	2,000	Sundry Assets	48,500
A's Loan	5,000	Cash	500
Capital Accounts:			
A	15,000		
B	18,000		
C	9,000		
	49,000		49,000

The assets realised the following sums in instalments:

	₹
I	1,000
II	3,000
III	3,900
IV	6,000
V (includes saving in expenses 100)	20,100
	34,000

The expenses of realisation were expected to be ₹ 500 but ultimately amounted to ₹ 400 only. Show how at each stage the cash received should be distributed between partners. They share profits in the ratio of 2:2:1. Show by Maximum Loss Method.

Question 15 *(CA Inter Nov 2019) (5 Marks)* *Pg no.*_____

AD, BD & SD are partners sharing profits and losses in the ratio of 5:3:2. There capitals were ₹13,440, ₹8,400, ₹11,760 respectively. Liabilities and assets of the firm are as under:

Liabilities:	Amount
Trade creditors	2,800
Loan from partners	1,400
Assets of the firm:	
Patent	1,400
Furniture	2,800
Machinery	1,680
Stock	5,600

The assets realized in full in the order in which they are listed above. BD is insolvent. You are required to prepare a statement showing the distribution of cash as and when available, applying maximum possible loss procedure.