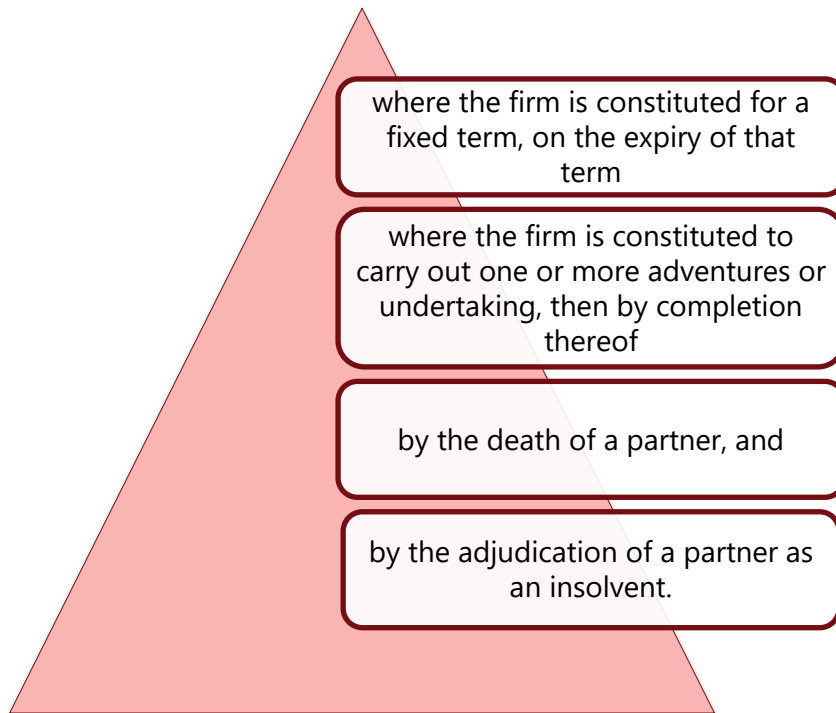
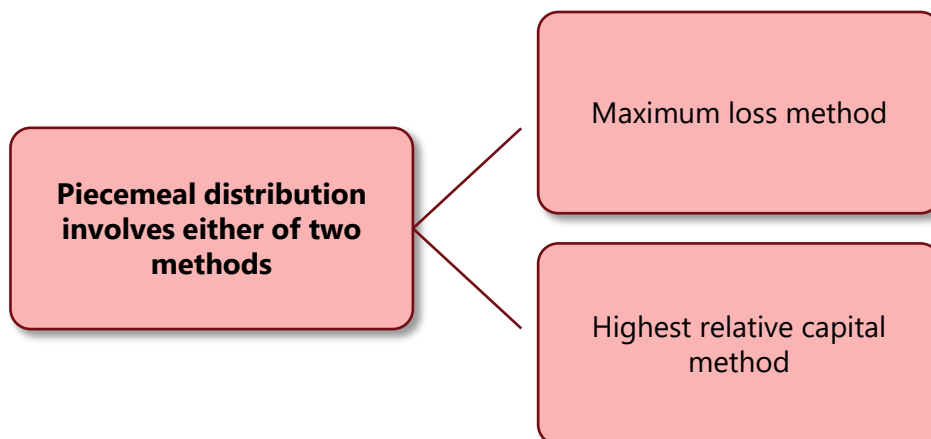


UNIT - 6: DISSOLUTION OF PARTNERSHIP FIRMS AND LLPs

LEARNING OUTCOMES

After studying this unit, you would be able to:

- ◆ Go through the circumstances in which a partnership is dissolved.
- ◆ Understand that on the dissolution of a partnership all assets are sold out and all liabilities are discharged. Learn the accounting technique relating to the disposal of assets and payment of liabilities.
- ◆ Learn how to settle the partner's claims in case of surplus and how to raise money from partners in case of a deficit.
- ◆ Deal with piecemeal distribution to partners of the amount realized from assets net of liabilities.
- ◆ Winding up of a Limited Liability Partnership (LLP)

UNIT OVERVIEW**Circumstances leading to Dissolution of Partnership****Methods of piecemeal distribution**



6.1 INTRODUCTION

Apart from the readjustment of rights of partners in the share of profit by way of change in the profit-sharing ratio and admission of a new partner or for retirement/death of a partner, another important aspect of partnership accounts is how to close books of accounts in case of dissolution. In this Unit, we will discuss the circumstances leading to the dissolution of a partnership firm and accounting treatment necessary to close its books of accounts. Also, we will discuss the special problems relating to the insolvency of partners and the settlement of the partnership's liabilities.



6.2 CIRCUMSTANCES LEADING TO DISSOLUTION OF PARTNERSHIP

A partnership is dissolved or comes to an end on:

- the expiry of the term for which it was formed;
- 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 a 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:

A firm stands dissolved in the following cases:				
(i) The partners agree that the firm should be dissolved;	(ii) All partners except one become insolvent;	(iii) The business becomes illegal;	(iv) In case of partnership at will, a partner gives notice of dissolution; and	(v) 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.



6.3 CONSEQUENCES OF DISSOLUTION

On the dissolution of a partnership, firstly, the assets of the firm, including goodwill, 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 and, if there is still a surplus, it is distributed among the partners in their profit-sharing ratio.

Conversely, after payment of liabilities of the firm and repayment of loans from partners, if the assets of the firm leftover are insufficient to repay in full the capital contributed by each partner, the deficiency is borne by the partners in their profit-sharing ratio.

According to the provisions contained in section 48 of the Partnership Act, upon dissolution of the partnership, the mutual rights of the partners, unless otherwise agreed upon, are settled in the following manner:

- (a) Losses including deficiencies of capital are paid, first out of profits, next out of capital, and, lastly, if necessary, by the partners individually in the proportion in which they are entitled to share profits.
- (b) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital have to be applied in the following manner and order:
 - (i) in paying the debts of the firm to third parties;
 - (ii) in paying to each partner rateably what is due to him from the firm in respect of advances as distinguished from capital;
 - (iii) in paying to each partner what is due to him on account of capital; and

- (iv) the residue, if any, to be divided among the partners in the proportion in which they are entitled to share profits.

Distinction between Dissolution of Partnership and Dissolution of Partnership Firm

Dissolution of Partnership	Dissolution of Partnership Firm
Dissolution of a partnership refers to the discontinuance of the relation between the partners of the firm.	Dissolution of the firm implies that the entire firm ceases to exist, including the relation among all the partners.
There can be change in profit sharing ratio or admission/death/retirement of a partner.	Dissolution of partnership firm occurs.
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.
There is no intervention by the court.	Court has the inherent power to intervene. By its order, a firm can be dissolved.
Economic relationships among partners may remain same or change.	Economic relationship among partners comes to an end.
Assets and liabilities are revalued. New balance sheet is prepared.	Assets are sold and realized. Liabilities are paid off.
Revaluation account is prepared.	Realization account is prepared.
Assets and liabilities are revalued after winding up of the existing partnership.	Assets and liabilities are settled on winding up of a firm.
Books of accounts are not closed.	Books of accounts are closed.

6.3.1 Dissolution before the 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 the period agreed upon and that already expired. Any amount that becomes due will be borne by other partners in their profit-sharing ratio.



6.4 CLOSING OF PARTNERSHIP BOOKS ON DISSOLUTION

To close books of accounts of Partnership Firm. We need to transfer all the assets and liabilities to Realization Account. Given below is the specimen of the Realization Account.

Specimen of Realization Account

Particulars	₹	Particulars	₹
To Sundry Assets (Excluding Cash/Bank, Debit Balance of P&L A/c, Partners' Current, Capital, and Loan A/cs)		By Sundry Liabilities (Excluding Credit Balance of P&L A/c, Partners' Current, Capital, and Loan A/c)	
To Bank/Cash (expenses for realization)		By Provision on Assets	
To Bank/Cash A/c (Amount paid for liabilities and unrecorded liabilities)		By Bank/Cash A/c (Amount realized from assets and unrecorded assets)	
To Partners' Capital A/cs (Expenses or Liabilities paid by partners)		By Partners' Capital A/cs (Assets taken over by partners)	
To Partners' Capital A/cs (Profit on realization distributed among partners in profit sharing ratio)		By Partners' Capital A/cs (Loss on realization distributed among partners in profit sharing ratio)	

6.4.1 Treatment of Goodwill at the time of dissolution of Firm

Treatment of Goodwill

- If Goodwill appears in the Balance Sheet, it is considered as purchased Goodwill and is treated like any other asset and is transferred to realization account.
- If Goodwill does not appear in the balance sheet, no entry is required for this.
- If something is realized or Goodwill is purchased by any one of the partners, then either Cash Account is debited or Partner's Capital A/c is debited and Realization Account is credited.

We will understand how to close the books of accounts through illustration the required journal entries to be made for closing the books of a firm with the example given below:

Balance Sheet of Fast and Quick as at Dec. 31, 20X1

Liabilities		₹	Assets		₹
Sundry Creditors		20,000	Plant and Machinery		40,000
Fast's Loan		10,000	Patents		6,000
General Reserve		10,000	Stock		25,000
Capitals:			Sundry Debtors	19,000	
Fast	30,000		Less: Prov. for doubtful debts	(1,000)	18,000
Quick	25,000	55,000	Cash		6,000
		95,000			95,000

Fast and Quick share profits in the ratio of 3:2. On 1st January, 20X2 the firm was dissolved. Fast took over the patents at a valuation of ₹ 5,000. The other assets realized as under:

Particulars	₹
Plant and Machinery	45,000
Stock	22,000
Sundry Debtors	<u>18,500</u>
Total	<u>85,500</u>

The Sundry Creditors were paid off at a discount of 5%. The expense amounted to ₹ 3,500. The steps to close the books are given below:

- I. Open a **Realization Account** and **transfer all assets** except cash in hand or at a bank at book values. Realization Account is debited and the various assets are credited and thus closed. It should be remembered that Sundry Debtors and Provisions for Bad Debts Accounts are two separate accounts and the gross amount of debtors should be transferred. In the above example the entry will be:

Particulars		₹	₹
Realization Account	Dr.	90,000	
To Plant and Machinery Account			40,000
To Patents Account			6,000
To Stock Account			25,000
To Sundry Debtors			19,000
(Transfer of various assets to the debit side of Realization Account)			

- II. **Transfer of liabilities** to outsiders and provisions and reserves against assets (e.g., Provision for Doubtful Debts) to the credit side of Realization account. The accounts of the liabilities and provisions will be debited and thus closed. The entry should be at book figures. The entry will be:

Particulars		₹	₹
Sundry Creditors Account	Dr.	20,000	
Provision for Doubtful Debts Account	Dr.	1,000	
To Realization Account			21,000
(Transfer of liabilities to outsiders and provision against debtors to Realization Account)			

Note: Accounts denoting accumulated losses or profits should not be transferred to the Realization Account.

- III. (i) The Realization Account should be **credited with the actual amount realized by the sale of assets**. This should take no note of the book figures. of course, Cash (or Bank) Account will be debited. Thus:

Particulars		₹	₹
Cash Account	Dr.	85,500	
To Realization Account			85,500
(Amount realized by the sale of various assets)			

- (ii) If a **partner takes over an asset**, his Capital Account should be debited and Realization Account credited with the value agreed upon, Thus:

Particulars		₹	₹
Fast's Capital Account Dr.		5,000	
To Realization Account			5,000
(Patents taken over by Fast at ₹ 5,000)			

- IV. **Expenses of dissolution** or realization of assets are debited to the Realization Account and credited to Cash Account. Thus

Particulars		₹	₹
Realization Account Dr.		3,500	
To Cash Account			3,500
(Payment of Expenses)			

- V. (i) The actual amount **paid to creditors** should be debited to the Realization Account and Cash Account is credited:

Particulars		₹	₹
Realization Account Dr.		19,000	
To Cash Account			19,000
(Payment of Sundry Creditors ₹ 20,000 less 5%)			

- (ii) If any **liability is taken over by a partner**, his Capital Account should be credited and Realization Account debited with the amount agreed upon.
- VI. At this stage, the Realization Account will show **profit or loss**. If the debit side is bigger, there is a loss; if the credit side is bigger, there is a profit. Profit or loss is transferred to the Capital Accounts of partners in the profit-sharing ratio. In the case of profit, Realization Account is debited and Capital Accounts are credited. The entry for loss is, naturally, reverse of this entry. The Realization Account in the example given above shows a loss of ₹ 1,000 (see account below).

Particulars		₹	₹
Fast's Capital Account Dr.		600	
Quick's Capital Account Dr.		400	
To Realization Account			1,000
(Transfer of loss to Capital Account in the ratio of 3:2)			

- VII. **Partner's Loans** if any, should now be paid. The entry is to debit the Loan Account and credit Cash Account. Thus:

Particulars		₹	₹
Fast's Loan Account Dr.		10,000	
To Cash Account			10,000
(Repayment of Fast's Loan)			

- VIII. Any reserve of accumulated profit or loss lying in the books (as shown by the Balance Sheet) should be transferred to the Capital Account in the profit-sharing ratio. Thus:

Particulars		₹	₹
General Reserve Dr.		10,000	
To Fast's Capital Account			6,000
To Quick's Capital Account			4,000
(General Reserve transferred to Capital Account in the ratio of 3:2)			

- IX. At this stage the Capital Accounts of partners will show how much amount is due to them or from them. The partner owing money to the firm will pay; Cash Account will be debited and his Capital Account credited and thus closed. Money owing to a partner will be paid to him; his Capital Account will be debited and the Cash Account credited. This will close the Capital Accounts' as well as the Cash Account. The entry in the above example is seen in the Capital Accounts below:

Particulars		₹	₹
Fast's Capital Account Dr.		30,400	
Quick's Capital Account Dr.		28,600	
To Cash Account			59,000
(Amount paid to partners on Capital Account)			

Ledger Accounts Plant and Machinery Account

20X2	Particulars	₹	20X2	Particulars	₹
Jan. 1	To Balance b/d	40,000	Jan. 1	By Realization A/c – Transfer	40,000

Patents Account

20X2	Particulars	₹	20X2	Particulars	₹
Jan. 1	To Balance b/d	6,000	Jan. 1	By Realization A/c – Transfer	6,000

Stock Account

20X2	Particulars	₹	20X2	Particulars	₹
Jan. 1	To Balance b/d	25,000	Jan. 1	By Realization A/c – Transfer	25,000

Sundry Debtors Account

20X2	Particulars	₹	20X2	Particulars	₹
Jan. 1	To Balance b/d	19,000	Jan. 1	By Realization A/c – Transfer	19,000

Provision for Doubtful Debts Account

20X2	Particulars	₹	20X2	Particulars	₹
Jan. 1	To Realization A/c Transfer	1,000	Jan. 1	By Balance b/d	1,000

Sundry Creditors Account

20X2	Particulars	₹	20X2	Particulars	₹
Jan. 1	To Realization A/c -Transfer	20,000	Jan. 1	By Balance b/d	20,000

Fast's Loan Account

20X2	Particulars	₹	20X2	Particulars	₹
Jan. 1	To Cash Account	10,000	Jan. 1	By Balance b/d	10,000

General Reserve Account

20X2	Particulars		₹	20X2	Particulars	₹
Jan. 1	To Capital Accounts			Jan. 1	By Balance b/d	10,000
	Fast	6,000				
	Quick	4,000	10,000			
			10,000			10,000

Realization Account

20X2	Particulars	₹	20X2	Particulars		₹
Jan. 1	To Sundry Assets		Jan. 1	By Sundry Creditors		20,000
	Plant and Machinery	40,000		By Provision for Doubtful Debts		1,000
	Patents	6,000		By Cash Account-		85,500
	Stock	25,000		assets realized		

Sundry Debtors	19,000	By Fast's Capital Account- patents taken over	5,000
To Cash Account-Exp.	3,500		
To Cash Account- Creditors paid	19,000	By Loss to:	
		Fast	600
		Quick	400
	1,12,500		1,12,500

Cash Account

20X2	Particulars	₹	20X2	Particulars	₹
Jan. 1	To Balance b/d	6,000	Jan. 1	By Realization A/c-Expenses	3,500
	To Realization b/d	85,500	Jan. 1	By Realization A/c-Creditors	19,000
			Jan. 1	By Fast's Loan Account	10,000
			Jan. 1	By Fast's Capital A/c	30,400
			Jan. 1	By Quick's Capital A/c	28,600
		91,500			91,500

Fast's Capital Account

20X2	Particulars	₹	20X2	Particulars	₹
Jan. 1	To Realization A/c-Patents	5,000	Jan. 1	By Balance b/d	30,000
	To Realization A/c-Loss	600	Jan. 1	By General Reserve	6,000
	To Cash Account	30,400			
		36,000			36,000

Quick's Capital Account

20X2	Particulars	₹	20X2	Particulars	₹
Jan. 1	To Realization A/c-loss	400	Jan. 1	By Balance b/d	25,000
	To Cash Account	<u>28,600</u>		By General Reserve	<u>4,000</u>
		29,000			29,000

Note:

- (1) If any of the assets are taken over by a partner at a value mutually agreed to by the partners, debit the Partner's Capital Account and credit Realization Account with the price of asset taken over.

- (2) Pay off the liabilities, crediting cash, and debiting the liability accounts, the difference between the book figure and the amount paid being transferred to the Realization Account.
- (3) Liabilities to outsiders may also be transferred to the Realization Account. In that case, the amount paid in respect of the liabilities in cash should be debited to the Realization Account, Cash Account being credited. If liability is taken over by a partner, Realization Account should be debited and the Partners' Capital A/cs credited at the figure agreed upon.
- (4) The balance of the Realization Account will represent either the profit or loss on realization. Divide it between the partners in the proportion in which they shared profits and losses. In the case of a loss, credit Realization Account and debit various partners' Capital Accounts; follow the opposite course in the case of a profit.
- (5) Pay off the partners' loans or advances which are separate from the capital (if any) contributed by them, after setting off against them any debit balance in the capital account of the concerned partner.
- (6) The balance of the cash account at the end will be exactly equal to the balance of capital account, provided they are in credit; credit cash, and debit the partners' capital account with the amount payable to them to close their accounts.

ILLUSTRATION 1

X, Y, and Z are partners of the firm XYZ and Co., sharing Profits and Losses in the ratio of 4: 3: 2. Following is the Balance Sheet of the firm as on 31st March, 20X1:

Balance Sheet as on 31st March, 20X1

Liabilities	₹	Assets	₹
Partners' Capitals:		Fixed Assets	5,00,000
X	4,00,000	Stock in trade	3,00,000
Y	3,00,000	Sundry 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 and 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.

SOLUTION

(i) Realization Account

Particulars	₹	Particulars	₹
To Fixed assets	5,00,000	By Creditors	3,20,000
To Stock in trade	3,00,000	By Cash (5,20,000+4,40,000)	9,60,000
To Debtors	5,00,000	By Y (Stock taken over)	2,50,000
To Cash – Expenses	6,000	By Loss transferred to partners' capital accounts	
To Cash -Creditors (3,20,000 x 95%)	3,04,000	X	35,555
		Y	26,667
		Z	17,778
	16,10,000		16,10,000

(ii) Partners' Capital Accounts

Particulars	X	Y	Z	Particulars	X	Y	Z
	₹	₹	₹		₹	₹	₹
To Realization Account	35,555	26,667	17,778	By Balance b/d	4,00,000	3,00,000	2,00,000
To Realization Account	-	2,50,000	-	By General reserve	40,000	30,000	20,000
To Cash	<u>4,04,445</u>	<u>53,333</u>	<u>2,02,222</u>				
	4,40,000	3,30,000	2,20,000		4,40,000	3,30,000	2,20,000

(iii) Cash Account

Particulars	₹	Particulars	₹
To Balance b/d	10,000	By Realization A/c (Expenses)	6,000
To Realization A/c (Fixed assets and book debts realized)	9,60,000	By Realization A/c (Creditors)	3,04,000
		By X	4,04,445
		By Y	53,333
		By Z	<u>2,02,222</u>
	9,70,000		9,70,000



6.5 CONSEQUENCES OF INSOLVENCY OF A PARTNER

If the capital account of a partner is in debit, after his share of loss or profit has been adjusted therein, the firm will not have sufficient cash or assets to pay off the amounts due to the other partners, until the amount is repaid by the partner whose account is in debit. If however, the partner is insolvent, the amount will not be realized. In such a case, the deficiency may be borne by the solvent partners in their profit-sharing ratio or according to the principle settled in the well-known case of *Garner vs. Murray*. In the latter case, the deficiency would be borne by the solvent partners in proportion to their capitals and not in the proportion in which they share profits and losses.

If a partner goes insolvent then the following are the consequences:

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 the insolvent partner is not liable for any act of the firm after the date of the order of adjudication, and	4. The firm cannot be held liable for any acts of the insolvent partner after the date of the order of adjudication.
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6.6 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 and the share of loss is to be borne by other solvent partners following the decision in the 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 realization 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 determination of capital ratio for this has been explained below. 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 the deed should be applied.

Capital Ratio on Insolvency

- The partners are free to have either fixed or fluctuating capitals in the firm.
- 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 the partners and capital ratio will be determined after adjusting all the reserves and accumulated profits to the date of dissolution, all drawings to the date of dissolution, all interest on capitals and drawings to the date of dissolution but before adjusting profit or loss on Realization 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 the loss on account of the insolvency of other partner.

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, it is better not to transfer the amount of creditors to Realization Account. The balance of the creditors' accounts is transferred to Deficiency Account.
- Creditors may be paid the amount available including the amount contributed by the partners.
- The unsatisfied portion of the creditor account is transferred to the Capital Accounts of the partners in the profit-sharing ratio. Then Capital Accounts are closed. In doing so first close the Partners' Capital Account which is having the worst position. The last account will be automatically closed.

ILLUSTRATION 2

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. Their balance sheet on 30th June, 20X1 is as follows:

Liabilities		₹	Assets		₹
Fixed Capital			Fixed Assets:		
P	20,000		Trademark		40,000
Q	20,000		Freehold Property		8,000
R	<u>10,000</u>	50,000	Plant and Equipment		12,800
Current Accounts:			Motor Vehicle		700
P	500		Current Assets		
Q	<u>9,000</u>	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
			Miscellaneous losses		
			R's Current Account		400
			Profit and Loss Account		<u>12,000</u>
		<u>79,900</u>			<u>79,900</u>

On 1st July, 20X1 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 realized the following amounts:

	₹
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.

Required

- Cash and Bank Account,
- Realization Account, and
- Partners Fixed Capital Accounts (after transferring Current Accounts' balances).

SOLUTION

Cash / Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	200	By Realization A/c- Creditors	11,700
To Realization A/c-		By Realization A/c- Expenses	1,500
Freehold property	7,000	By P's Loan A/c	8,000
Plant and Equipment	5,000	By P's Capital A/c	14,200
Stock	3,000	By Q's Capital A/c	24,200
Trade Debtors	1,600		
To Capital Accounts:			

P	25,500			
Q	17,000			
R	300	42,800		
		59,600		59,600

Realization Account

Particulars	₹	Particulars	₹
To Trademark	40,000	By Trade Creditors	12,400
To Freehold Property	8,000	By Provision for Bad Debts	100
To Plant and Equipment	12,800	By Bank:	
To Motor Vehicle	700	Freehold Property	7,000
To Stock	3,900	Plant and Equip.	5,000
To Sundry Debtors	2,000	Stock	3,000
To Bank (Creditors)	11,700	Debtors	<u>1,600</u>
To Bank (Expenses)	1,500	By Q (Car)	500
		By Current Accounts: (Loss)	
		P	25,500
		Q	17,000
		R	8,500
	80,600		51,000
			80,600

Partners' Capital Accounts

Particulars	P ₹	Q ₹	R ₹	Particulars	P ₹	Q ₹	R ₹
To Current A/c (Transfer) (WN)	31,000	12,000	10,900	By Balance b/d	20,000	20,000	10,000
To Realization A/c (Car)	—	500	—	By Bank	—	—	300
To R's Capital A/c (Deficiency)	300	300	—	By Bank	25,500	17,000	—
To Bank	14,200	24,200	—	(realization loss)			
				By P & Q (Deficiency)	—	—	600
	<u>45,500</u>	<u>37,000</u>	<u>10,900</u>		<u>45,500</u>	<u>37,000</u>	<u>10,900</u>

Working Note**Partners' Current Accounts**

Particulars	P	Q	R	Particulars	P	Q	R
To Bal. b/d	-	-	400	By Bal. b/d	500	9,000	-
To Profit & Loss A/c	6,000	4,000	2,000	By Capital A/c	31,000	12,000	10,900
To realization Loss	25,500	17,000	8,500	(Transfer) (Bal. Fig)			
	31,500	21,000	10,900		31,500	21,000	10,900

Note:

1. P, Q, and R will bring cash to make good their share of the loss on realization. In actual practice they will not be bringing any cash; only a notional entry will be made.
2. On following Garner Vs. Murray rule, solvent partners P and Q have to bear the loss due to insolvency of a partner R in their fixed capital ratio.

ILLUSTRATION 3

Amal and Bimal are in equal partnership. Their Balance Sheet stood as under on 31st March, 20X1 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 realized as under:

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

The expenses of realization 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.

SOLUTION

In the books of M/s Amal and Bimal

Realization Account

Particulars	₹	Particulars		₹
To Sundry Assets:		By Cash A/c:		
Plant & Machinery	2,500	Plant & Machinery	1,250	
Furniture	500	Furniture	150	
Debtors	1,000	Debtors	400	
Stock	800	Stock	<u>500</u>	2,300
Cash A/c-expenses	175	By Partners' Capital A/c		
		Loss on realization (Bal. fig.)		
		Amal	1,337	
		Bimal	1,338	2,675
	<u>4,975</u>			<u>4,975</u>

Cash Account

Particulars	₹	Particulars	₹
To Balance b/d	200	By Realization A/c- expenses	175
To Realization A/c		By Sundry Creditors A/c (Bal. fig.)	2,525
- Sale of sundry assets	2,300		
To Bimal's Capital A/c	200		
	<u>2,700</u>		<u>2,700</u>

Sundry Creditors Account

Particulars	₹	Particulars	₹
To Cash A/c	2,525	By Balance b/d	4,800
To Deficiency A/c-transfer (bal. fig.)	2,275		
	<u>4,800</u>		<u>4,800</u>

Partners' Capital Accounts

Particulars	Amal (₹)	Bimal (₹)	Particulars	Amal (₹)	Bimal (₹)
To Balance b/f	—	550	By Balance b/f	750	—
To Realization A/c			By Cash A/c	—	200
- loss	1,337	1,338	By Deficiency A/c- transfer (bal. fig.)	587	1,688
	1,337	1,888		1,337	1,888

Deficiency Account

Particulars	₹	Particulars	₹
To Partners' Capital A/c		By Sundry Creditors A/c	2,275
Amal	587		
Bimal	<u>1,688</u>		
	2,275		<u>2,275</u>

ILLUSTRATION 4

A, B, C, and D sharing profits in the ratio of 4:3:2:1 decided to dissolve their partnership on 31st March 20X1 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 <u>20,000</u>	60,000	Plant & Machinery	20,000
		Patents	8,000
		C's Capital A/c	3,200
		D's Capital A/c	8,415
	<u>82,000</u>		<u>82,000</u>

Following information is given to you: -

- 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.
- 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 realized 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 realization amounted to ₹ 1,500.

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

SOLUTION

Realization Account

Particulars		₹	Particulars		₹
To Sundry Assets: -			By Creditors		15,700
Debtors	15,850		By Employee's Provident Fund		6,300
Stock	25,200		By Bank A/c:		
Prepaid Expenses	800		Joint Life Policy	4,500	
Plant & Machinery	20,000		Debtors	10,800	
Patents	8,000	69,850	Stock	15,600	
To Bank-Creditors: (₹ 15,700 - ₹ 3,200 - ₹ 400)		12,100	Plant and Machinery	12,000	
To Bank A/c		6,300	Patents 60% of (₹ 8,000 - ₹ 5,000)	<u>1,800</u>	44,700
Employee's (P.F)			By Loss transferred to:		
To Bank A/c (expenses)		1,500	A's Capital A/c	9,220	
			B's Capital A/c	6,915	
			C's Capital A/c	4,610	
			D's Capital A/c	2,305	23,050
		89,750			89,750

Capital Accounts

Particulars	A (₹)	B (₹)	C (₹)	D (₹)	Particulars	A (₹)	B (₹)	C (₹)	D (₹)
To Bal. b/d	—	—	3,200	8,415	By Bal. b/d	40,000	20,000	—	—
To Realization A/c	9,220	6,915	4,610	2,305	By Bank				
To D's Capital (Deficiency)	5,360	2,680	—	—	(Realization loss)	9,220	6,915	4,610	—
To Bank	34,640	17,320	—	—	By Bank				
					(Recovery)	—	—	—	2,680
					By A's Capital (2/3)	—	—	—	5,360

					By B's Capital (1/3)	—	—	—	2,680
					By Bank A/c		—	3,200	—
	49,220	26,915	7,810	10,720		49,220	26,915	7,810	10,720

Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	535	By Realization A/c	12,100
To Realization A/c	44,700	By Realization A/c	6,300
To A's Capital A/c	9,220	By Realization A/c	1,500
To B's Capital A/c	6,915	By A's Capital A/c	34,640
To D's Capital A/c	2,680	By B's Capital A/c	17,320
To C's Capital A/c (4,610 + 3,200)	7,810		
	71,860		71,860

Working Note

D's loss will be borne by A and B only because only solvent partners having credit balance has to bear the loss on account of insolvency. C will bring his share of loss in cash.

ILLUSTRATION 5

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 on December 31, 20X1:

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, 20X1 and had been received but the purchase was not recorded in books.

Fixed assets realized ₹ 20,000; Stock ₹ 21,000 and Book Debt ₹ 20,500. Similarly, the creditors allowed a discount of 2% on average. The expenses of realization 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.

SOLUTION**Realization Account**

Particulars	₹	Particulars		₹
To Sundry		By Provision for Doubtful Debts		5,000
Fixed Assets (transfer)	40,000	By Cash (20,000+21,000+20,500)		61,500
Stock	25,000	By Sundry Trade Creditors		29,000
Book Debts	25,000			
To Cash—Expenses	1,080	By Loss: X (2/5)	9,600	
- Creditors	28,420	Y (2/5)	9,600	
		Z (1/5)	4,800	24,000
	1,19,500			1,19,500

Sundry Trade Creditors

Particulars	₹	Particulars	₹
To Realization A/c	29,000	By Balance b/d	25,000
		By Partners Capital Accounts (Purchase omitted)	4,000
	29,000		29,000

Z's Loan Account

Particulars	₹	Particulars	₹
To Cash Account	5,000	By Balance b/d	5,000

Mrs. X's Loan Account

Particulars	₹	Particulars	₹
To X's Capital A/c – transfer	10,000	By Balance b/d	10,000

Cash Account

Particulars	₹	Particulars	₹
To Balance b/d	1,000	By Sundry Trade Creditors (after deducting discount of 2%)	28,420
To Realization A/c- assets realized	61,500	By Realization A/c – expenses	1,080
To X's Capital A/c*	9,600	By Z's Loan	5,000
To Z's Capital A/c*	<u>4,800</u>	By X's Capital A/c	34,300
	76,900	By Z's Capital A/c	<u>8,100</u>
			76,900

*X and Z bring these amounts to make good their share of the loss on realization. In actual practice they will not be bringing any cash; only a notional entry will be made.

Capital Accounts

Particulars	X (₹)	Y (₹)	Z (₹)	Particulars	X (₹)	Y (₹)	Z (₹)
To Sundry Trade Creditors- omission	1,600	1,600	800	By Balance b/d	29,200	10,800	10,000
To Balance c/d	27,600	9,200	9,200				
	29,200	10,800	10,000		29,200	10,800	10,000
To Advance	-	4,000	-	By Balance b/d	27,600	9,200	9,200
To Realization A/c- loss	9,600	9,600	4,800	By Mrs. X's Loan	10,000	-	-
To Y's Capital A/c	3,300	-	1,100	By Cash (Realization loss)	9,600	-	4,800
				By X's Capital A/c		3,300	
To Cash	34,300	-	8,100	By Z's Capital A/c	-	1,100	-
	47,200	13,600	14,000		47,200	13,600	14,000

Note: Y's deficiency comes to ₹ 4,400 (difference in the two sides of his Capital Account); this has been debited to X and Z in the ratio of 27,600: 9,200 i.e., capital standing up just before dissolution but after correction of error committed while drawing up the accounts for 20X1.



6.7 PIECEMEAL PAYMENTS

Generally, the assets sold upon dissolution of partnership are realized 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.

6.7.1 Maximum Loss Method

Each installment realized is considered to be the final payment *i.e.*, outstanding assets and claims are considered worthless and partners' accounts are adjusted on that basis each time when a distribution is made, following either *Garner vs. Murray* Rule or the profit-sharing ratio rule.

ILLUSTRATION 6

A, B, and C are partners sharing profits and losses in the ratio of 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:

Liabilities	₹	Assets	₹
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 realized in full in the order in which they are listed above. B is insolvent.

You are required to prepare a statement showing the distribution of cash as and when available, applying the maximum possible loss procedure.

SOLUTION

Statement of Distribution of Cash

Realization	Interest on loans from partner's spouses	Interest on loans from partners	Partners Capitals			Total
			A	B	C	
₹	₹	₹	₹	₹	₹	₹
Balances due (1)	2,000	1,000	9,600	6,000	8,400	24,000
(i) Sale of Investments	(1,000)					
	1,000	1,000				
(ii) Sale of furniture	(1,000)	(1,000)				
(iii) Sale of machinery						
Maximum possible loss ₹ 22,800 (total of capitals ₹ 24,000 less Cash available ₹ 1,200) allocated to partners in the profit sharing ratio i.e. 5:3: 2			(11,400)	(6,840)	(4,560)	(22,800)
Amounts at credit			(1,800)	(840)	3,840	1,200
Deficiency of A and B written off against C			1,800	840	(2,640)	

10.235

10.235

ILLUSTRATION 7

The following is the Balance Sheet of A, B, C on 31st December, 20X1 when they decided to dissolve the 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	<u>9,000</u>		
	49,000		<u>49,000</u>

The assets realized the following sums in installments:

I	1,000
II	3,000
III	3,900
IV	6,000
V	<u>20,100¹</u>
	<u>34,000</u>

The expenses of realization 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.

SOLUTION

First of all, the following table will be constructed to show the amounts available for distribution among the various interests:

Statement showing Realization and Distribution of Cash Payments

Particulars	Realization	Creditors	Partners' Loan	Partners' Capitals
	₹	₹	₹	₹
1. After taking into account cash balance and amount set aside for expenses	1,000	1,000	-	-

¹ includes saving in expenses i.e. ₹ 100 (₹ 500 - ₹ 400).

2.	3,000	1,000	2,000	-
3.	3,900	-	3,000	900
4.	6,000	-	-	6,000
Including saving in expenses	20,100	-	-	20,100
	34,000	2,000	5,000	27,000

To ascertain the amount distributable out of each installment realized among the partners, the following table will be constructed:

Statement of Distribution on Capital Accounts

(1) Calculation to determine the mode of distribution of ₹ 900

Particulars	Total (₹)	A (₹)	B (₹)	C (₹)
Balance	42,000	15,000	18,000	9,000
Less: Possible loss, should remaining assets prove to be worthless (in their profit-sharing ratio)	(41,100)	(16,440)	(16,440)	(8,220)
	+ 900	- 1,440	+ 1,560	+ 780
Deficiency of A's capital written off against those of B and C in the ratio of their capital, 18,000:9,000 (<i>Garner vs. Murray</i>)			(960)	(480)
Manner in which the first ₹ 900 should be distributed			+ 600	+ 300

(2) Distribution of ₹ 6,000

Balance after making payment of amount shown in step (1)	41,100	15,000	17,400	8,700
Less: Possible Loss assuming remaining asset to be valueless (in their profit sharing ratio)	(35,100)	(14,040)	(14,040)	(7,020)
Balance available and to be distributed	6,000	960	3,360	1,680

(3) Distribution of ₹ 20,100

Balance after making payment of amount shown in step (2)	35,100	14,040	14,040	7,020
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Less: Possible loss, assuming remaining assets to be valueless (in their profit sharing ratio)	(15,000)	(6,000)	(6,000)	(3,000)
Manner of distribution of ₹ 20,100	20,100	8,040	8,040	4,020
<i>Summary:</i>				
Balance	42,000	15,000	18,000	9,000
Total amounts paid	27,000	9,000	12,000	6,000
Loss	15,000	6,000	6,000	3,000

6.7.2 Highest Relative Capital Method

According to this method, the partner who has the higher relative capital, that is, whose capital is greater in proportion to his profit-sharing ratio, is first paid off. This method is also called as proportionate capital method.

For determining the amount by which the capital of each partner is in excess of his relative capital, partners' capitals are first divided by figures that are in proportion to their profit-sharing ratio; the smallest quotient will indicate the basic capital. Having ascertained the partner who has the smallest basic capital, the amount of capital of other partners proportionate to the profit-sharing ratio of the basic capital is calculated. These may be called as their hypothetical capitals. The amount of hypothetical capital of each partner is then subtracted from the amount of his actual capital; the resultant figure will be the amount of excess capital held by him. By repeating the process once or twice, as may be necessary between the partners having excess capital, the amount by which the capital of each partner is in excess will be ascertained. The partner with the largest excess capital will be paid off first, followed by payment to the other or others who rank next to him until the capitals of partners are reduced to their profit-sharing ratio.

The illustration given above is now worked out according to this method.

Particulars	A	B	C
Capital	₹ 15,000	18,000	9,000
Profit-sharing ratio	2	2	1
Capital divided by the profit-sharing ratio	7,500	9,000	9,000
Proportionate Capital of B and C, taking A's capital as the base	₹ 15,000	15,000	7,500
Excess of actual over proportionate capital	₹ nil	3,000	1,500

This indicates that A should not get anything till ₹ 3,000 is paid to B and ₹ 1,500 is paid to C. Since capital of B and C are already according to their mutual profit-sharing ratio (2:1), they will share the available cash in this ratio.

After paying off creditors and A's loan, the available amount will be distributed as below in this method:

Particulars	Total	A	B	C
		₹	₹	₹
Third Installment	900	-	600	300
Fourth Installment (i)	3,600	-	2,400	1,200
(ii)	2,400	960	960	480
Fifth Installment	<u>20,100</u>	<u>8,040</u>	<u>8,040</u>	<u>4,020</u>
Total	27,000	9,000	12,000	6,000

Total payment made to each partner will, of course be same under both the methods.

ILLUSTRATION 8

A partnership firm was dissolved on 30th June, 20X1. Its Balance Sheet on the date of dissolution was as follows:

Liabilities	₹	₹	Assets	₹
Capitals:			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		
		<u>2,00,000</u>		<u>2,00,000</u>

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 5 th July, 20X1	25,200
On 30 th August, 20X1	60,000
On 15 th September, 20X1	80,000

SOLUTION

	<i>Creditors</i>	<i>B's Loan</i>	<i>A</i>	<i>B</i>	<i>C</i>
20X1	₹	₹	₹	₹	₹
June 30					
Balance b/d	30,000	10,000	76,000	48,000	36,000
Cash balance less Provision for expenses (₹ 10,800 – ₹ 5,400)	5,400	-	-	-	-
Balances unpaid	24,600	10,000	76,000	48,000	36,000
July 5					
1 st Instalment of ₹ 25,200	23,600	1,600	-	-	-
Discount received on full settlement	1,000	8,400	76,000	48,000	36,000
Less: Transferred to Realisation A/c	1,000				
	Nil				
August 30					
2 nd instalment of ₹ 60,000 (W.N. 2)		8,400	32,640	4,640	14,320
Balance unpaid		Nil	43,360	43,360	21,680
September 15					
Amount realised ₹ 80,000					
Add: Balance out of the Provision for Expenses A/c	1,400				
	81,400		32,560	32,560	16,280
Amount unpaid being loss on Realisation in the ratio of 2 : 2 : 1			10,800	10,800	5,400

Working Notes:**1. Highest relative capital basis**

		A	B	C
		₹	₹	₹
1.	Present Capitals	76,000	48,000	36,000
2.	Profit-sharing ratio	<u>2</u>	<u>2</u>	<u>1</u>
3.	Capital per unit of Profit share (1 ÷ 2)	<u>38,000</u>	<u>24,000</u>	<u>36,000</u>
4.	Proportionate capitals taking B, whose capital is the least, as the basis	48,000	48,000	24,000
5.	Excess capital (1-4)	28,000	Nil	12,000
6.	Profit-sharing ratio	<u>2</u>	-	<u>1</u>
7.	Excess capital per unit of Profit share (5 ÷ 6)	14,000		12,000
8.	Proportionate capitals as between A and C taking C capital as the basis	24,000	-	12,000
9.	Excess of A's Capital over C's Excess capital (5-8)	4,000	-	-
10.	Balance of Excess capital (5-9)	24,000		12,000
11.	Distribution sequence:			
	First ₹ 4,000 (2 : 0 : 0)	4,000	-	-
	Next ₹ 36,000 (2 : 0 : 1)	24,000	-	12,000
	Over ₹ 40,000 (2 : 2 : 1)			

2. Distribution of Second instalment

		<i>Creditors</i>	A	B	C
First	₹ 8,400	8,400	-	-	-
Next	₹ 4,000 (2 : 0 : 0)		4,000	-	-
Next	₹ 36,000 (2 : 0 : 1)		24,000	-	12,000
Balance	<u>₹ 11,600</u> (2 : 2 : 1)		4,640	4,640	2,320
	60,000	8,400	32,640	4,640	14,320



6.8 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.

ILLUSTRATION 9

P and Q were partners sharing profits equally in LLP. Their Balance Sheet as on March 31, 20X1 was as follows:

Balance Sheet as on 31st March, 20X1

Equity and Liabilities	₹	Assets	₹
Capitals:		Bank	30,000
P 1,00,000		Debtors	25,000
Q <u>50,000</u>	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		
	<u>2,00,000</u>		<u>2,00,000</u>

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.

SOLUTION**Books of P & Q LLP.****Realization Account**

Particulars	₹	Particulars	₹
To Debtors 25,000		By Creditors 20,000	
To Stock 35,000		By Bank overdraft 5,000	
To Furniture 40,000		By Bank:	
To Machinery 60,000	1,60,000	Investment 25,000	
To Bank:		Furniture 30,000	
Creditors 20,000		Machinery 50,000	
Bank overdraft 5,000		Debtors (90%) 22,500	
Outstanding bill 2,000	27,000	Stock 20,125	
To Profit transferred to:		Bad debts Recovered 1,245	1,48,870
P's capital 1,310		By P's capital 15,750	
Q's capital 1,310	2,620	(stock taken over)	
	1,89,620		1,89,620

Partners' Capital Accounts

	P	Q		P	Q
To P's current Account	16,940		By Balance b/d	1,00,000	50,000
To Bank	83,060	68,810	By Q's current Account		18,810
	1,00,000	68,810		1,00,000	68,810

Bank Account

	₹		₹
To Balance b/d	30,000	By Realization	27,000
To Realization	1,48,870	By P's capital	83,060
		By Q's capital	68,810
	1,78,870		1,78,870

Working Note:**Partners' Current Accounts**

	P	Q		P	Q
To Balance b/d	10,000		By Balance b/d		10,000
To Realization	15,750		By Reserves	7,500	7,500
To Q's capital		18,810	By Realization (profit)	1,310	1,310
			By P's Capital	16,940	
	25,750	18,810		25,750	18,810

SUMMARY

- Reasons for which a partnership could be dissolved are
 - expiry of term for which it was formed
 - death of a partner
 - insolvency of a partner.
- Reasons when a firm stands dissolved
 - when partners mutually decide to dissolve
 - partners except one becomes insolvent
 - business becomes illegal
 - if partnership is at will any partner can give notice for dissolution
 - Court orders.
- The winding up of a LLP may be either voluntary or by the Tribunal and LLP, so wound up may be dissolved.
- On dissolution assets are realized and all liabilities are paid off.
(if any liability remains unpaid then it is to be realized from partners in their profit-sharing ratio).
- Piecemeal distribution involves either of two methods:
 - Maximum loss method
 - Highest relative capital method.

TEST YOUR KNOWLEDGE

True and 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.

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).
 - (d) Retirement of a partner.
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.
 - (d) In the ratio of their drawings.
3. An unrecorded asset realized at the time of dissolution is credited to
 - (a) Realization account.
 - (b) Revaluation account.
 - (c) Capital accounts.
 - (d) Profit and Loss Account.

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.*
 - (d) *Cash Account.*
5. *Realization account is a*
 - (a) *Nominal account.*
 - (b) *Real account.*
 - (c) *Personal account.*
 - (d) *Representative 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).*
 - (d) *Fixed capital method.*

Theoretical Questions

- 1 *State the circumstances when Garner V/S Murray rule not applicable.*
- 2 *W paid a premium to other partners of the firm at the time of his admission to the firm, with a condition that they will not be dissolved before the expiry of five years. The firm is dissolved after three years. W claims refund of premium.*
 - (i) *List the criteria for the calculation of the amount of refund.*
 - (ii) *Also list any two conditions when no claim in this respect will arise.*

Practical Questions

1. *P, Q, and R are partners sharing profits and losses as to 2:2:1. Their Balance Sheet as on 31st March, 20X1 is as follows:*

Liabilities	₹	Assets	₹
Capital accounts		Plant and Machinery	1,08,000

P	1,20,000		Fixtures	24,000
Q	48,000		Stock	60,000
R	24,000	1,92,000	Sundry debtors	48,000
Reserve Fund		60,000	Cash	60,000
Creditors		<u>48,000</u>		
		<u>3,00,000</u>		<u>3,00,000</u>

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

Particulars	₹
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. An amount of ₹ 4,200 due for GST had come to notice during the course of realization and this was also paid.

You are required to prepare:

- (i) Realization account.
 - (ii) Partners' capital accounts.
 - (iii) Cash account.
2. 'Thin', 'Short' and 'Fat' were in partnership sharing profits and losses in the ratio of 2:2:1.

On 30th September, 20X1 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	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, 20X1 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, 20X1. 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 a book value less 5%. Debtors realize ₹ 45,900. Realization 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 in the partnership books following the rules in Garner vs. Murray:

- (i) Realization Account;
 - (ii) Partners' Current Accounts;
 - (iii) Partners' Capital Accounts showing the closing of the firm's books.
3. 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 20X1 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)
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) Realization 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 - Realized 120% of book value
 - Book Debts - ₹ 12,000 of debts proved bad, remaining were fully realized
 - Land & Building - Realized ₹ 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 20X1, but they were paid immediately on 31st March @ 6% discount "per annum".

Prepare the Realization Account, Bank Account and Partners' Capital Accounts in the books of Partnership firm.

ANSWERS/HINTS

True and False

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.

Multiple Choice Questions

1.	(c)	2.	(b)	3.	(a)	4.	(b)	5.	(a)	6.	(c)
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Theoretical Questions

- Non-Applicability of Garner vs Murray rule:
 - 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.
 - When the firm has only two partners.
 - When there is an agreement between the partners to share the deficiency in capital account of the insolvent partner.
 - When all the partners of the firm are insolvent.
- If the firm is dissolved before the term expires, as is the case, W being a partner who has paid a premium on admission will have to be repaid/refunded

The criteria for calculation of refund amount are:

- Terms upon which admission was made,
- The time period for which it was agreed that the firm will not be dissolved,
- The time period for which the firm has already been in existence.

No claim for refund will arise if:

- The firm is dissolved due to the death of a partner,
- If the dissolution of the firm is basically because of misconduct of W,
- If the dissolution is through an agreement and such an agreement does not have a stipulation for a refund of premium.

Practical Questions

1. Realization Account

Particulars	₹	Particulars	₹
To Debtors	48,000	By Creditors	48,000
To Stock	60,000	By Cash A/c (Assets realized):	
To Fixtures	24,000	Plant and Machinery	1,02,000
To Plant and machinery	1,08,000	Fixtures	18,000
To Cash A/c (Creditors)	45,600	Stock	84,000
To Cash A/c (GST)	4,200	Sundry Debtors	<u>44,400</u>
To Cash A/c (Realization expenses)	1,500	By Q (Unrecorded asset)*	4,800
To Profit on Realization			
P	3,960		
Q	3,960		
R	<u>1,980</u>		
	9,900		
	<u>3,01,200</u>		<u>3,01,200</u>

Partners' Capital Accounts

Particulars	P	Q	R	Particulars	P	Q	R
	₹	₹	₹		₹	₹	₹
To Realization A/c (unrecorded asset)		4,800		By Balance b/d	1,20,000	48,000	24,000
To Cash (Bal. Fig.)	1,47,960	71,160	37,980	By Reserve fund	24,000	24,000	12,000
				By Realization A/c (Profit)	3,960	3,960	1,980
	<u>1,47,960</u>	<u>75,960</u>	<u>37,980</u>		<u>1,47,960</u>	<u>75,960</u>	<u>37,980</u>

Cash Account

Particulars	₹	Particulars	₹
To Balance b/d	60,000	By Realization A/c (Creditors)	45,600
To Realization A/c (Assets)	2,48,400	By Realization A/c (Expenses)	1,500

* An unrecorded asset is in the nature of gain hence realization account is credited. Since this asset has been taken over by Q, therefore, his account has been debited.

		By Realization A/c (GST)	4,200
		By P's Capital A/c	1,47,960
		By Q's Capital A/c	71,160
		By R's Capital A/c	37,980
	3,08,400		3,08,400

2.

Realization Account

Particulars	₹	Particulars		₹
To Premises	50,000	By Sundry Creditors		84,650
To Plant	1,25,000	By Bank:		
To Fixtures	32,500	Premises	60,000	
To Stock	43,200	Plant	1,07,500	
To Debtors	54,780	Fixtures	20,000	
To Bank (Creditors)	84,650	Stock	41,040	
To Bank (Expenses)	4,500	Debtors	<u>45,900</u>	2,74,440
		By Loss on Realization transferred to Partners' Current A/cs		
		Thin	14,216	
		Short	14,216	
		Fat	<u>7,108</u>	35,540
	3,94,630			3,94,630

Partners' Current Accounts

Particulars	Thin	Short	Fat	Particulars	Thin	Short	Fat
	₹	₹	₹		₹	₹	₹
To Balance b/d	–	–	14,500	By Balance b/d	29,700	11,300	–
To Realization	14,216	14,216	7,108	By Capital A/c			
To Capital A/c transfer	15,484	–	–	Transfer	–	2,916	21,608
	29,700	14,216	21,608		29,700	14,216	21,608

Partners' Capital Accounts

Particulars	Thin	Short	Fat	Particulars	Thin	Short	Fat
	₹	₹	₹		₹	₹	₹
To Current A/c	–	2,916	21,608	By Balance b/d	80,000	50,000	20,000
To Fat's Capital A/c				By Current A/c			
Deficiency in the				(transfer)	15,484	–	–
ratio of 8:5	990	618	–	By Bank	14,216	14,216	
				(Realization loss)			
To Bank	1,08,710	60,682	–	By Thin & Short			
				Capital A/cs			1,608
	1,09,700	64,216	21,608		1,09,700	64,216	21,608

Working Notes:

(i)

Bank Account

Particulars	₹	Particulars	₹
To Realization A/c	2,74,440	By Balance b/d	44,330
To Thin's Capital A/c	14,216	By Realization A/c (Creditors)	84,650
To Short's Capital A/c	14,216	By Realization A/c (Expenses)	4,500
		By Thin's Capital A/c	1,08,710
		By Short's Capital A/c	60,682
	3,02,872		3,02,872

- (ii) Fat's deficiency has been borne Thin & Short in the ratio of their fixed capitals i.e., 8:5 following the rule in *Garner vs. Murray*.

3.**Realization Account**

Particulars	₹	Particulars	₹
To Land and Building	1,35,000	By Provision for bad debts	6,000
To Plant and Machinery	45,000	By Loan from D	1,20,000
To Furniture	25,500	By Trade creditors	30,000
To Investments	15,000	By Bills payable	12,000
To Book debts	60,000	By Outstanding salary	7,500
To Stock	36,000	By Kumar - Furniture taken over	
To Bank (Realization		(13,500 x .9)	12,150
expenses)	15,000	By Bank A/c -	

To Amit– Realization expenses	3,000	Stock Realized	43,200	
		Land & Building	1,65,000	
		Debtors	<u>48,000</u>	2,56,200
To Bank A/c -				
Bill payable	11,940	By Amit (Investment taken over)		12,750
D's Loan	61,500			
Creditors	18,000			
Salary	7,500			
To Profit transferred to partners' capital Accounts				
Amit	9,264			
Sumit	9,264			
Kumar	<u>4,632</u>			
	23,160			
	<u>4,56,600</u>			<u>4,56,600</u>

Bank Account

Particulars	₹	Particulars	₹
To Balance b/d	13,500	By Realization A/c (payment of liabilities: 11,940 + 7,500 + 54,000 + 15,000 + 18,000 + 7,500)	1,13,940
To Realization A/c (assets realized)	2,56,200	By Amit	79,314
To Kumar	12,618	By Sumit	89,064
	<u>2,82,318</u>		<u>2,82,318</u>

Partners' Capital Accounts

Particulars	Amit ₹	Sumit ₹	Kumar ₹	Particulars	Amit ₹	Sumit ₹	Kumar ₹
To Balance b/d			32,400	By Balance b/d	55,200	55,200	
To Realization A/c (Investment taken over)	12,750			By Kumar's Loan			15,000
To Realization A/c (Furniture taken over)			12,150	By General Reserve	24,600	24,600	12,300
To Bank A/c	79,314	89,064		By Realization A/c (expense)	3,000		
				By Realization A/c (profit)	9,264	9,264	4,632
				By Bank A/c			12,618
	<u>92,064</u>	<u>89,064</u>	<u>44,550</u>		<u>92,064</u>	<u>89,064</u>	<u>44,550</u>

Working Notes:**1. Payment for Bills Payable**

Particulars	Amount (₹)
Bills Payable as per Balance Sheet	12,000
Less: Discount for early payment {12,000 x 6% x (1/12)}	60
Amount Paid in Cash	11,940

2. Payment to D's Loan

Particulars	Amount (₹)
D's Loan as per Balance Sheet	120,000.00
50% of Loan adjusted as below:	
Plant & Machinery accepted at Book Value (₹ 45,000) and ₹ 7,500 in cash.	7,500
Balance 50% of Loan adjusted as below:	
In cash after allowing discount of 10% i.e. ₹ 60,000 – ₹ 6,000 = ₹ 54,000.	54,000

3. Payment to Trade Creditors

Particulars	Amount (₹)
Trade Creditors as per Balance Sheet	30,000
Less: Furniture of Book Value ₹ 12,000 accepted at value ₹ 10,800	10,800
	19,200
Less: Discount @ 6.25%	1,200
Amount paid in Cash	18,000

4. Furniture taken over by Kumar

Particulars	Amount (₹)
Furniture as per Balance Sheet	25,500
Less: Furniture of Book Value ₹ 12,000 accepted by trade creditors	12,000
	13,500
Less: 10% of Book Value	1,350
Value of Furniture taken over by Kumar	12,150

Case Scenarios for Practice

1. P, Q and R are partners sharing profits in the ratio 3:2:1 and maintain fixed capital accounts. The firm's average profit for the last 3 years is ₹1,50,000, capital employed is ₹10,00,000, and the normal rate of return in similar businesses is 10%. Q retires, and the continuing partners decide to admit S in his place, with R and S sharing future profits equally. Goodwill is to be valued at 2 years' purchase of super profit.

Multiple Choice Questions

- 1.1 Under the fixed capital account method, a partner's share of profit and interest on capital is recorded through:
 - (a) Capital Account
 - (b) Current Account
 - (c) Goodwill Account
 - (d) Realization Account
- 1.2 The Normal Profit of the firm is
 - (a) ₹ 50,000
 - (b) ₹ 1,00,000
 - (c) ₹ 1,50,000
 - (d) ₹ 10,00,000
- 1.3 The value of goodwill under the Super Profit method is
 - (a) ₹50,000
 - (b) ₹1,00,000
 - (c) ₹1,50,000
 - (d) ₹3,00,000

Answer to Multiple Choice Questions

Question No	Correct Option	Reasoning
1.1	(b)	Under the fixed capital method, the capital balance remains unchanged whereas adjustments such as profit share,

		interest, salary, and drawings are recorded in the Current Account.
1.2	(b)	Normal Profit = Capital Employed $\times$ Normal Rate of Return = ₹10,00,000 $\times$ 10%.
1.3	(b)	Super Profit (₹1,50,000 – ₹1,00,000 = ₹50,000) $\times$ 2 years' purchase = ₹1,00,000.

2. A, B and C are partners sharing profits in the ratio of 3:2:1. Due to continuous disagreements, they decide to dissolve the firm. The firm has various assets, creditors, and General Reserve. One of the assets i.e. stock is taken over by partner B, while the remaining assets are realized. After discharging the creditors, the profit or loss on realization is transferred to the partners' capital accounts in their profit-sharing ratio.

Multiple Choice Questions

- 2.1 When a partnership firm is dissolved, the account prepared to record the sale of assets and payment of liabilities is:
- Revaluation Account
 - Capital Account
 - Realization Account
 - Cash Account
- 2.2 After payment of outside liabilities and partners' loans, the remaining amount is applied towards:
- Goodwill
 - Partners' capital
 - General reserve
 - Drawings
- 2.3 A realization loss is distributed among partners in:
- Capital ratio
 - Sacrificing ratio
 - Profit-sharing ratio
 - Gaining ratio

Answer to Multiple Choice Questions

Question No	Correct Option	Reasoning
2.1	(c)	On dissolution, all assets and liabilities (except cash and certain partner accounts) are transferred to the Realization Account.
2.2	(b)	After outsiders and partners' advances are paid, partners' capital is repaid.
2.3	(c)	Realization profit or loss is transferred to partners' capital accounts in their profit-sharing ratio.