

- Dissolution of Partnership Firm
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## Dissolution of Partnership Firm

**Concept Explanation:** Dissolution of a partnership firm refers to the process where the firm ceases its business operations and the partnership comes to an end. This involves selling the firm's assets, paying off liabilities, and settling accounts among partners.

### Key Definitions / Features:

- **Dissolution of Partnership:** Change in the relationship among partners without necessarily ending the business.
- **Dissolution of Partnership Firm:** Complete closure of the firm, ending both business and partnership.
- **Accounts Prepared:** Realisation Account, Cash/Bank Account, Partner's Loan Account, Partner's Capital Account.
- **Settlement of Accounts:** Payment of debts, liabilities, loans, and distribution of remaining capital and profits according to profit-sharing ratio.

**Illustrative Example:** When a firm is dissolved, assets like furniture and stock are sold or taken over by partners, liabilities are paid off, and remaining amounts are distributed among partners.

## Practice Set:

- *Level 1 – Easy:* Define dissolution of partnership firm and list the accounts prepared during dissolution.
- *Level 2 – Moderate:* Explain the difference between dissolution of partnership and dissolution of firm with examples.
- *Level 3 – Challenging:* Prepare a Realisation Account and Partners' Capital Accounts from given data of asset sales and liabilities payment during dissolution.

**Answer Key:** Provided in subsequent sections with detailed journal entries and ledger accounts.

**Quick Reference:** Dissolution involves closing business, selling assets, paying liabilities, and settling partners' accounts.

## Glossary:

- **Realisation Account:** Nominal account to record sale of assets and payment of liabilities during dissolution.
- **Capital Account:** Account showing partners' capital balances and adjustments.
- **Loan Account:** Account showing loans given by partners to the firm.

## Modes of Dissolution of Partnership Firm

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**Concept Explanation:** The Indian Partnership Act, 1932, specifies various modes by which a partnership firm can be dissolved.

### Key Definitions / Features:

- **Dissolution by Agreement (Section 40):** All partners agree to dissolve the firm.

- **Compulsory Dissolution (Section 41):** Occurs by operation of law, e.g., business becomes unlawful or partners declared insolvent.
- **Dissolution on Unexpected Event (Section 42):** On expiry of partnership period, death or insolvency of partner, or completion of venture.
- **Dissolution by Notice (Section 43):** In partnership at will, any partner may dissolve by notice.
- **Dissolution by Court (Section 44):** Court orders dissolution under specific conditions like unsound mind, misconduct, or just and equitable grounds.

**Illustrative Example:** A firm formed for 5 years dissolves automatically after 5 years (Section 42).

#### Practice Set:

- *Level 1 – Easy:* List the modes of dissolution under the Indian Partnership Act.
- *Level 2 – Moderate:* Explain compulsory dissolution with examples.
- *Level 3 – Challenging:* Analyze a case where a partner's misconduct leads to court-ordered dissolution.

**Answer Key:** Detailed explanations with legal references.

**Quick Reference:** Dissolution can be voluntary, compulsory, by notice, unexpected event, or court order.

#### Glossary:

- **Partnership at Will:** Partnership with no fixed duration, dissolvable by notice.
- **Compulsory Dissolution:** Dissolution mandated by law.

## Settlement of Accounts During Dissolution

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**Concept Explanation:** Settlement involves paying off losses, debts, loans, and distributing remaining assets and profits among partners.

### Key Definitions / Features:

- **Payment of Losses:** Losses paid first from profits, then capital, then partners individually in profit-sharing ratio.
- **Distribution of Assets:** Assets used to pay third-party debts, partner advances, capital, and remaining profits.
- **Realisation Account:** Nominal account to record asset sales and liability payments, showing profit or loss on realisation.
- **Partner's Loan Account:** Loans from partners paid after outside liabilities.
- **Cash/Bank Account:** Records all cash receipts and payments during dissolution.

**Illustrative Example:** Assets sold, liabilities paid, expenses recorded, and profit/loss transferred to partners' capital accounts.

### Practice Set:

- *Level 1 – Easy:* Define Realisation Account and its purpose.
- *Level 2 – Moderate:* Prepare Realisation Account from given asset and liability data.
- *Level 3 – Challenging:* Pass journal entries for asset sales, liability payments, and realisation expenses.

**Answer Key:** Provided with journal entries and ledger postings.

**Quick Reference:** Realisation Account debited with assets and expenses, credited with liabilities and capital accounts.

### Glossary:

- **Realisation Expenses:** Expenses incurred during dissolution.
- **Profit on Realisation:** Excess of assets realised over liabilities paid.
- **Loss on Realisation:** Excess of liabilities paid over assets realised.

## Accounting Entries in Dissolution

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**Concept Explanation:** Specific journal entries are passed to record transactions during dissolution, including asset sales, goodwill treatment, liabilities payment, and closing accounts.

### Key Definitions / Features:

- **Assets:** Debited to Realisation Account except cash/bank.
- **Goodwill:** Treated as an asset; if no realisation, considered valueless.
- **Liabilities:** Credited to Realisation Account when paid.
- **Realisation Expenses:** Debited to Realisation Account.
- **Profit/Loss Transfer:** Profit credited or loss debited to partners' capital accounts.
- **Closing Accounts:** Partner's loan, current, and capital accounts closed with cash/bank.

**Illustrative Example:** Journal entries for asset sale to partner, payment of liabilities by partner, and payment of realisation expenses.

### Practice Set:

- *Level 1 – Easy:* Pass journal entry for sale of asset for cash.
- *Level 2 – Moderate:* Pass entries for payment of liabilities by partner.
- *Level 3 – Challenging:* Prepare complete journal entries for dissolution including profit/loss transfer.

**Answer Key:** Structured journal entries with narration.

**Quick Reference:** Debit Realisation Account for assets and expenses; credit for liabilities and capital.

### Glossary:

- **Nominal Account:** Account used to record income, expenses, gains, and losses.
- **Capital Account:** Account showing partner's investment and share of profit/loss.

## Example of Dissolution Accounting

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**Concept Explanation:** Practical application of dissolution accounting through a case where partners dissolve a firm, realise assets, pay liabilities, and settle accounts.

**Example:** Parth and Shivika share profits 3:2. On dissolution, assets are realised partly by partners and partly by sale, liabilities paid, expenses incurred. Realisation Account, Partners' Capital Accounts, and Bank Account are prepared.

### Step-by-step Solution:

- Record asset realisation and liabilities payment in Realisation Account.
- Calculate profit or loss on realisation and transfer to partners' capital accounts.
- Prepare Partners' Capital Accounts adjusting for profit/loss and payments.
- Prepare Bank Account recording cash receipts and payments.

### Practice Set:

- *Level 1 – Easy:* Identify assets and liabilities from balance sheet.
- *Level 2 – Moderate:* Calculate profit or loss on realisation.
- *Level 3 – Challenging:* Prepare Realisation Account, Partners' Capital Accounts, and Bank Account from given data.

**Answer Key:** Detailed ledger accounts and calculations provided.

**Quick Reference:** Follow systematic approach: Realisation Account → Capital Accounts → Bank Account.

**Glossary:**

- **Profit Sharing Ratio:** Ratio in which partners share profits and losses.
- **Realisation Expenses:** Expenses incurred during asset realisation.

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