Class: B.Com (Hons) Part I
Paper: I
Sub: Financial Accounting

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CHAPTER: Dissolution of the Firm (Partnership)
2nd Lesson.

Settlement of Accounts:

Sec. 48 of the Indian Partnership Act, 1932 states the following:

(a) Losses, including deficiencies of capital, shall be paid first out of profits, next out of capital, & at lastly, if necessary, by the partners individually in the proportions in which they were entitled to share profits.

(b) The assets of the firm, including any sums contributed by the partners to make up deficiencies of capital, shall be applied in the following manner:—

(i) in paying the debts of the firm to third parties;

(ii) in paying each partner rateably what is due to him from the firm for advances as distinguished from capital;

(iii) in paying each partner rateably what is due to him on account of capital; and

(iv) the residue, if any, shall be divided among the partners in the proportions in which they were entitled to share profits.

Accounting Entries for Dissolution:

On the dissolution of firm, the following two steps have to be fulfilled:

(A) Realisation of assets and settlement of liabilities.
(B) Settlement of the accounts of the partners.

(A) Realisation of Assets and Settlement of Liabilities.

On the date of dissolution of the firm, first Balance Sheet of the firm is prepared and a Realisation Account is opened to ascertain net gain or loss on realisation of assets and settlement of liabilities.

1. To close the various assets accounts ;
All the tangible assets appearing in the Balance Sheet are all having debit balances. These assets are closed by transferring to Realisation Account by crediting them at their respective book values. The following entry is passed:

Realisation A/c Dr
To Land & Building A/c
To Plant & Machinery A/c
To Furniture & Fixture A/c
To Stock A/c
To Sundry Debtors A/C.
(Being the assets transferred to the Realisation A/c at their book values)

N.B: In this connection we should take in account the following:

(i) Cash or Bank Account will not be transferred to Realisation A/c because they are not to be realised — they can be distributed their present form instead. A separate Cash/Bank Account will be opened with the balance as appearing in the last Balance Sheet.

(ii) Sometimes, in the B/S some assets are shown at their realisable market values or some assets at their unexpired portion. The example for the former is ;

Sundry Debtors . . Rs. 40,500
Less: Provision for doubtful debts Rs. 500
Rs. 40,000

The example for the other is provision for depreciation, which appear as under:

	Rs.
Assets (at cost)	100,000
Less: Provision for Depreciation	10,000
	90,000

In facts, the accounts like provision for doubtful debts or provision for depreciation, etc, are called Valuation Accounts or Contra-Asset Accounts. They are having credit balances and they should appear in the liability side of the Balance sheet. But they appear on the debit side as a deduction from the main Asset Account. The assets should be transferred to debit side of the Realisation Account at the gross figures and provisions should be transferred to the credit side of the Realisation Account. For example, to close Sundry Debtors and provisions for doubtful debts, following are the two entries to be passed:

	Rs.	Rs.
Realisation A/c Dr	40,500	
To Sundry Debtors A/c		40,500
Provision for Doubtful Debts A/c Dr	500	
To Realisation A/c		500

Likewise, to close as asset and provisions for depreciation A/c following two entries will be passed:

	Rs	Rs.
Realisation A/c . . . Dr	100,000	
To Plant & Machinery A/c		100,000

Rs.

Provision for Depreciation A/c Dr 10,000
To Realisation A/c 10,000

(iii) If Goodwill A/c appears in the Balance sheet, it will be closed alongwith other assets by transferring to the Realisation A/c at book value. If it does not appear in the books, no entry is required.

2. To close the various outside liabilities A/cs.

The various outside liabilities awaiting final settlement are to transferred to the Realisation Account at the book value. The following entry is passed:

Sundry Creditors A/c ... Dr
Bills payable A/c .. .. Dr
Outstanding Expenses A/c .. Dr
Bank O/D/ Loan A/c ... Dr
To Realisation A/c
(Being the outside liabilities transferred to Realisation Account)

3. On sale of Assets the following J/E is passed:
Cash A/c/ Bank A/c .. Dr
To Realisation A/c
(Being the assets sold)

4. When some of the assets are taken over by a partner/ partners:
Partner's capital A/c .. Dr
To Realisation A/c
(Being the assets taken over by....)

5. When outside liabilities of the firm is paid.
Realisation A/c ... Dr
To Cash A/c/ Bank A/c
(Being the liabilities paid off)

6. When some of the assets are taken over by creditors:
No entry is passed. Direct payment is made.
If there is balance remains after taken over of the asset; the entry for balance amount is made as follows.
Realisation A/c ... Dr
To Cash A/c / Bank A/c

7. When unrecorded liabilities are paid:
Realisation A/c Dr
To Bank A/c / Cash A/c.
(Being payment of unrecorded liabilities)

8. When one of the partners agrees to discharge a liability personally.
Realisation A/c ... Dr
To Partner's capital A/c
(Being the liability taken over by ---)

9. For payment of Realisation A/c
Realisation A/c ... Dr
To Cash A/c / Bank A/c
(Being Realisation expenses paid)

10. For closing the Realisation A/c
(A) For Profit
Realisation A/c Dr
To partners' capital A/c
(B) For Loss
Partners' capital A/c Dr
To Realisation A/c

That is, profit or loss arise in Realisation A/c is transferred to partners' capital A/c.