Name of the Course: Financial Accounting

Name of the Chapter:

ACCOUNTING FOR DISSOLUTION OF PARTNERSHIP FIRM

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ACCOUNTING FOR DISSOLUTION OF PARTNERSHIP FIRM

1.0 LEARNING OBJECTIVES

After going through this unit, you should be able to:

• understand the concept of dissolution
• difference between dissolution of partnership and dissolution of partnership firm
• make necessary treatments in the books on dissolution under various cases
• enlist the procedure for settlement of accounts
• understand the meaning of piecemeal distribution and its mechanism
• know how to make accounting treatment on sale of a partnership firm to a company

1.1 KEY WORDS

Dissolution: Break-up or discontinuance or closure.

Dissolution of partnership: Reconstitution of partnership on admission or retirement or death of a partner or insolvency of a partner but the business continues as usual.

Dissolution of partnership farm: The business of the firm stops its affairs and winds up by selling the assets and by paying the liabilities and discharging the claims of the partners.

Garner v/s Murray Rule: The deficiency (loss) of an insolvent partner to be shared by solvent partners in their opening capitals, **if the fixed capitals are maintained.** But **if the capitals are fluctuating**, all necessary adjustments in respect of reserves or profit and loss account, etc., should first be made to their capital accounts (but without adjusting the loss on realization). The loss is to be shared among the solvent partners in the ratio of such adjusted capitals just before dissolution.

Insolvent partner: A partner who is unable to pay off his debts in full.

Cost of Winding-up: The cost of realization of assets and paying off liabilities at the time of dissolution.

1.2 SUMMARY OF THE CHAPTER

When a new partner is admitted, retired, or dies, the reconstitution of the partnership firm takes place. In that situation, the existing partnership is dissolved, but the firm may continue under the same name if the partners agree. In other words, a partnership dissolves, but the firm does not. The dissolution of a firm is defined as the dissolution of the partnership between all of the partners under Section 39 of the Partnership Act of 1932. This means that the Act differentiates between the breaking of a relationship between all the partners of a firm and between a few of the partners; and it is the breaking of a relationship between all the partners, which is termed as the dissolution of the partnership firm. This ends the firm's existence, and no business is conducted after dissolution. Still, the activities related to the firm's closing must be wound up by selling its assets, paying its debts, and satisfying the partners' claims.

1.3 INTRODUCTION

When a partner retires or dies, the partnership ends, but the firm can continue. However, under some situations, the firm must be discontinued and closed, which is referred to as dissolution of firm. When a partnership firm dissolves, its assets must be sold, external liabilities must be paid, and partner claims must be settled. In this unit, you will learn about the various forms and types of dissolution, as well as the accounting entries that must be made when the firm's assets are sold and liabilities are paid and also the settlement of the partners' accounts.

1.4 MEANING OF DISSOLUTION

The term "dissolution" refers to discontinuance. When it comes to the relationship between partners, it's termed as dissolution of partnership, and when it comes to the partnership, it's called dissolution of the firm. According to the Partnership Act, 1932 "The dissolution of partnership between all the partners of a firm is called the dissolution of the firm". The legislation distinguishes between partnership dissolution and a firm dissolution.

Dissolution of partnership means, the partners' relationship changes, but the firm may continue to operate under the same name if the partners so want. On the other hand, dissolution of a firm means the complete closure of the firm's business.

1.4.1 Dissolution of partnership

Dissolution of partnership means change in relationship among the partners but the firm continues. For instance, reconstitution of partnership on admission or retirement or death of a partner is called dissolution of partnership. On the other hand, dissolution of firm means business of the firm is discontinued or closed and the firm is wound up or dissolved. According to section 39 of partnership Act, 1932, "Dissolution of firm means dissolution of partnership among all the partners in the firm." The firm comes to an end i.e., the business is closed permanently.

1.4.2 Dissolution of partnership Firm

On dissolution of the firm, the business of the firm stops its affairs and winds up by selling the assets and by paying the liabilities and discharging the claims of the partners. The dissolution of partnership among all partners of a firm is called dissolution of the firm.

The different methods of dissolution are as follows:

(i) **By mutual consent:** Section 40 provides that a firm may, at any time, be dissolved with the consent of all the partners. This applies to all cases whether the firm is for a fixed period or otherwise.

(ii) **By agreement**: Section 40 also provides for the dissolution of a firm in accordance with a contract between the partners. The contract providing for dissolution may have been incorporated in the partnership deed itself or in a separate agreement.

(iii) **By the insolvency of all the partners but one**: If all the partners or all the partners but one become insolvent, there is dissolution of the firm. Section 41 calls this as compulsory dissolution.

(iv**) By business becoming illegal:** Section 41 provides that a firm is dissolved by the happening of any event which makes it unlawful for the business of the firm to be carried on. But, if the partnership relates to more than one adventure, the illegality of one or more of them does not prevent the lawful adventure from being carried on by the firm.

(v) **Partners becoming alien enemies**: Section 41 also covers cases of partnership between persons some of whom become alien enemies by a subsequent declaration of war. In such a case partnership is dissolved, because trading with an alien enemy is against public policy. Section 41 covers cases of compulsory dissolution of firm by operation of law.

(vi) **By notice of dissolution of partnership at will:** Section 43 provides that where the partnership is at will, a partner may give a notice in writing to the other partners of his intention to dissolve the firm.

(vii) **Dissolution by Court (s.44):** At the suit of a partner, the court may dissolve a firm on any of the following grounds:

(a) **If a partner has become of unsound mind**: The application in this case may be made by any of the partners or by the next friend of the insane partner. In the case of insanity of a dormant partner, the court will not order dissolution, unless a very special case is made out for dissolution.

(b) **Permanent incapacity of a partner:** The court may order for dissolution of partnership, if a partner becomes permanently incapable of performing his duties as a partner. The application for dissolution, in such a case, may be made by any of the partners and not by the incapacitated partner.

(c) **Misconduct of a partner affecting the business:** If a partner is guilty of conduct which is likely to affect prejudicially the carrying on of the business of the firm, the court may order dissolution.

(d) **Willful and persistent disregard of partnership agreement by a partner**: If a partner willfully and persistently commits a breach of the partnership agreement regarding management, or otherwise conducts himself in such a way that is not reasonably practicable for the other partners to carry on business in partnership with him, the court may order dissolution.

(e) **Transfer of interest or share by a partner:** If a partner transfers, in any way (e.g., by sale, mortgage or charge), his whole interest in the partnership to a third party (outsider) or allows his share to be charged in execution of a decree against him or allows the same to be sold for arrears of land revenue or for charges recoverable as land revenue, the court may dissolve the partnership.

(f) **The court can also dissolve partnership:** where the business of the firm cannot be carried on except at a loss. The court can order dissolution even though the partnership is for a fixed period [Rehmat-un-nisa-v. Price, 42 Bom. 380].

(g) **Just and equitable:** The court can order dissolution on any other ground which in the opinion of the court is a fit ground for dissolution of partnership.

1.5 TREATMENT OF FIRM'S DEBTS AND PRIVATE DEBTS

Under section 49 of the Indian Partnership Act, the following provisions shall apply in case of firm's debts and private debts:

(i) The creditors of the firm (third party liabilities) should be paid out of the assets of the firm. If there is any surplus, it will be divided among the partners as per their claims which can be utilised for paying the private liabilities of the partners.

(ii) Similarly, the private property of each partner is applied towards the payment of his private debts and surplus, if any is applied towards payment of firm's debt.

1.6 ACCOUNTING TREATMENT

1.6.1 Treatment of Dissolution of Firm

On dissolution of a firm, the books of the firm will have to be closed. Assets are realized, liabilities are paid and the balance, if any is distributed among the partners. In case of deficiency, the shortfall is met by the partners from their private property. Assets and liabilities a/cs are closed by transferring them to a realization a/c.

Realization is an account in which assets excluding cash in hand and bank are transferred at their book values and all external liabilities are transferred at their book values also except partners' loan a/c, accumulated profits and losses and reserves and partners' capital a/c. The object of opening the realization a/c is to close the books of accounts of the dissolved firm and to determine gain or loss on realization of assets and liabilities. The following journal entries are recorded on dissolution of firm:

1. For closing the assets accounts:

Realization A/c Dr.

To Sundry Assets A/c (at Book Values)

(Being assets closed)

*Note: The following items on the assets side of the Balance Sheet are not transferred to the Realization Account:

(a) Undistributed loss (i.e., Debit Balance of Profits and Loss account) & fictitious assets or deferred revenue expenditures such as preliminary expenses;

(b) Cash in hand, and Cash at Bank

(c) Provisions and reserves against assets should be closed by crediting the Realization Account.

2. For closing the Liabilities accounts

External Liabilities A/c Dr (Book Values)

To Realization A/c

(Being Transfer of external liabilities)

3. Treatment of Accumulated Reserves and Profit/loss

All the balance of Reserve or Undistributed Profit, Reserve fund or other reserves are transferred to partner's capital account in their profit-sharing ratio. The following entries are to be passed:

Reserve A/c Dr.

Profit and Loss A/c Dr.

Any Other fund A/c Dr

To Partner's Capital A/c

(Transfer of profit and reserves)

Note: In case of Loss reverse entry is recorded.

4. For Sale of Assets

Cash/Bank A/c Dr.

To Realization A/c

(Being sale of assets)

5. For assets taken over by the partner

Partner's Capital A/c Dr.

To Realization A/c

(Being Assets taken over by partner)

6. For Payment of liabilities in cash

Realization A/c Dr.
To Cash/Bank A/c
(Being payment of liabilities)

7. Payment of liabilities by the partners

Realization A/c Dr.
To Partner's Capital A/c
(Being liabilities taken over by partner)

8. For Settlement of loan given by the partner

Partner's Loan A/c Dr.
To Bank A/c
(Being Partner's loan paid off)

9. For Payment of realization expenses:

(a) When realization expenses are paid by firm:

Realization A/c Dr.
To cash A/c
(Being expenses paid off)

(b) When realization expenses are paid by partner on behalf of the firm:

Realization A/c Dr.
To Partner's capital A/c
(Being payment of realization expenses by partner on behalf of the firm)

10. For Closing of realization A/c

The balance in the realization account would show either profit or loss on realization. It is transferred to Partner's capital accounts in their profit-sharing ratio.

(a) In case of profit, the following entry is to be passed:

Realization A/c Dr.

To Partner's Capital A/c

(Being Profit on realization transferred)

(b) In case of loss, Reverse entry is to be passed.

Partner's Capital A/c Dr.

To Realization A/c

(Being Loss on realization transferred)

Format of Realization Account

Table 1.1 Realization Account

Particulars	Amount	Particulars	Amount
1. All assets a/c (Book Value) except cash/bank 2. Cash/bank a/c (payment of external liabilities) 3. Partner capital a/c (if any liability paid by partner) 4. Cash/bank a/c (Expenses on realisation) 5. Partners' capital a/c (if realisation expenses paid by partner) 6. Partners' capital accounts (for transferring profit on realisation)		1. All external liabilities (Book Value) 2. Cash/bank a/c (amount realised on sale of assets) 3. Partners' capital a/c (if any asset is taken over by partner) 4. Partners' capital accounts (transferring loss on realisation	

1.6.2 Treatment of Goodwill

Section 55 provides that in settling the accounts of a firm after dissolution, goodwill shall subject to the contract between the partners, be included in the assets.

Where the goodwill of a firm is sold after dissolution, a partner may carry on a business competing with that of the buyer and he may advertise such business but subject to agreement between him and the buyer, he may not (a) use the firm's name; (b) represent himself as carrying on business of the firm; or (c) solicit the custom of persons who were dealing with the firm before its dissolution.

Any partner may, upon the sale of goodwill of a firm, make an agreement with the buyer that such partner will not carry on any business similar to that of the firm within a specified period or within specified local limits. Such an agreement shall be void if the restrictions imposed are unreasonable.

There is nothing special in treatment of goodwill on dissolution of a firm. On dissolution of a firm:

(i) If goodwill appears in the Balance Sheet, it is treated like any other asset and is transferred to realization account to close the goodwill account. The entry will be-
Realisation a/c Dr
    To Goodwill a/c

(ii) If Goodwill is purchased by any one of the partners,
Partner's Capital A/c Dr
To Realization Account

(iii) If cash is realized by selling goodwill, then
Cash a/c Dr
To Realisation

(iv) If no goodwill a/c appears in the balance sheet, no record is made for this.

1.6.3 Treatment of unrecorded Assets or Liabilities

Unrecorded assets and liabilities are those assets/liabilities that have been written-off from the books of accounts but physically still exist in the operation. For example, there is an old typewriter, which is still in working condition though its book value is zero. Similarly, there may be some liabilities, which do not appear in the Balance Sheet, but actually they are still there. For example, a bill discounted with bank, on dissolution it was dishonored and had to be taken up by the firm for payment purposes.

The following journal entries will be passed to record such transactions:

1. For sale of unrecorded assets for cash:

Cash/Bank A/c Dr.
To Realization A/c
(Being sale of unrecorded assets)

2. For unrecorded assets taken over by the partner

Partner's Capital A/c Dr.

To Realization A/c

(Being unrecorded assets taken over by partner)

3.For Payment of unrecorded liabilities in cash

Realization A/c Dr.

To Cash/Bank A/c

(Being payment of unrecorded liabilities)

4. Payment of unrecorded liabilities in cash by the partner on behalf of the firm

Realization A/c Dr.

To Partner's Capital A/c

(Being payment of unrecorded liabilities by partner on behalf of the firm)

1.7 SETTLEMENT OF ACCOUNTS

Usually, the Partnership Deed contains an accounting clause according to which the final accounts between partners are settled. In the absence of such an agreement, Section48 provides as follows:

- The losses must be paid first from profits, next out of capital and lastly, if necessary, by contribution of each partner in proportion to his share in profits.
- The assets of the firm, including sums contributed by partners to make up deficiency of capital, shall be applied as follows:
  (a) in paying debts of the firm to outsiders;
  (b) in paying each partner rateably for advances made by him to the firm as distinct from capital;
  (c) in paying each partner, rateably, amount due for capital contribution, and
  (d) the residue in paying each partner in accordance with his share in the profits of the firm.
- Finally, partners' capital accounts are to be closed.
  The procedure of closing partners' capital accounts will be different in each of the following cases:
  Case-1: when all the partners are solvent
  Case-2: when some of the partners are solvent and others are insolvent. (Garner vs Murray Rule)
  Case-3: when all the partners are insolvent.
  Case-1: when all the partners are solvent
  - All assets' accounts (Except cash/bank and fictitious assets) and liabilities accounts (except accumulated profits and reserves, partners' loan accounts and also partners' capital a/c) are closed by transferring them to realisation a/c.
  - Partners' loan a/c is paid directly.
  - Fictitious accounts like accumulated losses, preliminary expenses, deferred revenue expenditure etc are closed by transferring to partners' capital accounts
  - All accumulated profits, reserves, funds no more to be payable will also be closed by transferring to partners' capital accounts.
  - Partners' capital accounts are prepared. If partners' capital accounts show debit balance (deficiency), they are required to bring in cash to the firm from their private property. If partners' capital accounts show credit balance (surplus), cash is paid to them for final settlement.
  - Finally, cash/Bank account is prepared to ensure that it is balanced.

Illustration 1

The following is the Balance Sheet of A and B as on 31st March 2021.

Liabilities	Amount	Assets	Amount
Creditors	38,000	Bank	11,500
A's Loan	10,000	Stock	6,000

B's Loan Reserve A's Capital B's Capital	15,000 5,000 10,000 8,000	Debtors Furniture Plant Investment Profit and Loss a/c	19,000 4,000 28,000 10,000 7,500
	86,000		86,000

The firm was dissolved on 31st March, 2021on the following terms:

1. A agreed to take the Investments at Rs. 8,000

2. Other Assets were realized as follows:

Stock Rs. 5,000; Debtors Rs. 18,500; Furniture Rs. 4,500; Plant Rs. 25,000

3. Expenses on realization amounted to Rs. 1,600.

4. Creditors agreed to accept Rs. 37,000.

The profits and losses were shared in the ratio of 2:1. You are required to prepare Realization A/c, Partner's capital A/c and Bank A/c.

Solution:

Realization Account

Particulars	Amount	Particulars	Amount
To Stock To Debtors To Furniture To Plant To Investment To cash a/c (37000+ 1600)	6,000 19,000 4,000 28,000 10,000 38,600	By Creditors By A's capital a/c By cash a/c (5000+18500+4500+25000) By Loss on realisation transferred to capital A/Cs A 4,400 B 2,200	38,000 8,000 53,000 6,600
Total	1,05,600	Total	99,000

Partners' capital Account

Particulars	A	B	Particulars	A	B
To Realisation a/c (Investment)	8,000	-	By Balance b/d	10,000	8,000
			By Reserve	3,333	1,667
To realisation a/c (Loss)	4,400	2,200	By Bank a/c (deficiency brought)	4,067	-
To P/L a/c	5,000	2,500			

To Bank a/c (surplus paid)	-	4,967			
	17,400	9,667		17,400	9,667

Bank A/C

Particulars	Amount	Particulars	Amount
To Balance b/d To Realisation a/c To A's Capital a/c	11,500 53,000 4,067	By A's Loan a/c By B's Loan a/c By Realisation a/c By B's capital a/c	10,000 15,000 38,600 4,967
Total	68,567	**Total**	68,567

1.8 ACCOUNTING OF DISSOLUTION OF THE PARTNERSHIP FIRM INCLUDING INSOLVENCY OF PARTNERS (GARNER V/S MURRAY RULE)

Case-2: when some of the partners are solvent and others are insolvent.

In case one partner or more than one partner are insolvent and the remaining partners are solvent, then solvent partners are required to compensate the loss (deficiency) of insolvent partner. Now, the problem arises as to how to compensate that deficiency or in what ratio the solvent partners are required to compensate.

This deficiency is to be compensated in two ways:

(1) This deficiency (Loss) is to be shared by solvent partners in their profit-sharing ratio like other business losses, or

(2) The deficiency is shared according to **Garner Vs. Murray** rule. According to this rule, the loss is to be shared among the solvent partners in the ratio of their opening capitals, **if the fixed capitals are maintained.**

But **if the capitals are fluctuating**, all necessary adjustments in respect of reserves or profit and loss account, etc., should first be made to their capital accounts (but without adjusting the loss on realization). The loss is to be shared among the solvent partners in the ratio of such adjusted capitals just before dissolution.

when a partner is insolvent, the following procedures may be applied as follows:

a) Realization a/c is prepared in the usual way and profit or loss on realization is transferred to partners' capital accounts.
b) All assets (except cash/bank a/c and fictitious a/c) and all liabilities (except accumulated profits and reserves and partners' Loan a/c) are transferred to Realisation a/c
c) Partners' loan is paid directly.

d) Fictitious assets, accumulated profits and reserves are transferred to partners' capital a/c
e) If anything is received from the private estate of the insolvent partner, it should be credited to his capital account.
f) The debit balance (Deficiency) in the capital account of the insolvent partner should be borne by solvent partners in the ratio of capitals as they stand just before dissolution (or in the ratio of fixed capitals, if capitals are fixed).
g) The solvent partners are required to bring in cash to make good their share of loss on realization.
h) The solvent partners will then draw out cash according to their claims.
i) Finally, Cash/Bank account is prepared to ensure that it is balanced.

Illustration 2

The following is the balance sheet of A, B and C. on March 31, 2012:

Liabilities	Amount	Assets	Amount
Creditors	20,000	Cash	6,000
General Reserve	15,000	Debtors	10,000
Capital Accounts:		Stock	20,000
A	25,000	Furniture	10,000
B	15,000	Machinery	20,000
		C's Capital (Overdrawn)	9,000
Total	75,000	Total	75,000

C is insolvent but his estate pays Rs 2,000. It is decided to wind up the partnership. The assets realized as follows: debtors, Rs 7,500; stock, Rs 16,000 furniture, Rs 7,000; and machinery, Rs 14,000. The cost of winding up came to Rs 2,500. Give accounts to close the books of the firm (1) if the capitals are fixed, and (2) if the capitals are fluctuating.

Solution:

1. **If Fixed Capitals**

Realization A/C

Particular	Amount	Particulars	Amount
To debtors	10,000	By Creditors a/c	20,000
To stock	20,000	By cash a/c (realisation of assets)	44,500
To Furniture	10,000		
To Machinery	20,000	By loss on realisation transferred to capital a/cs	
To cash a/c (payment to creditors)	20,000	A 6,000	18,000
To cash (realisation cost)	2,500	B 6,000	
		C 6,000	
Total	82,500	Total	82,500

Capital Accounts

Particulars	A	B	C	Particulars	A	B	C
To Balance b/d	-	-	9,000	By Balance b/d	25,000	15,000	-
To Loss on realisation	6,000	6,000	6,000	By General Reserve	5,000	5,000	5,000
To C's capital (8,000 in the ratio of 25:15)	5,000	3,000		By cash a/c (private property)			2,000
To cash (settlement)	25,000	17,000		By Cash (Loss on realisation)	6,000	6,000	
				By A's capital			5,000
				By B's capital			3,000
	36,000	26,000	15,000		36,000	26,000	15,000

Calculation of Deficiency of Insolvent partner "C"

C's credit Total = 5,000+ 2,000=7,000

C's Debit Total = 9,000 + 6,000=15,000

Deficiency = 15,000-7,000= 8,000

Since capital accounts are fixed as per Garner Vs Murray rule, deficiency will be shared by solvent partners A and B in their opening capital ratio i.e., 25,000: 15,000= 25:15

Cash A/C

Particulars	Amount	Particulars	Amount
To Balance c/d	6,000	By Realisation a/c (creditors)	20,000
To Realisation	44,500	By realisation (expense)	2,500
To C's capital (Pvt Property)	2,000	By A's capital (Settlement)	25,000
To A's Capital	6,000	By B's Capital (Settlement)	17,000
To B's capital	6,000		
Total	64,500	Total	64,500

If capital accounts are fluctuating

Realization A/C

Particular	Amount	Particulars	Amount
To debtors	10,000	By creditors	
To stock	20,000	By cash a/c (realisation of	44,500

To Furniture To Machinery To cash (payment to creditors) To cash (realisation cost)	10,000 20,000 20,000 2,500	assets) By loss on realisation transferred to capital a/cs A 6,000 B 6,000 C 6,000	 18,000
Total	82,500	Total	82,500

Capital Accounts

Particulars	A	B	C	Particulars	A	B	C
To Balance b/d	-	-	9,000	By Balance b/d	25,000	15,000	-
To Loss on realisation	6,000	6,000	6,000	By General Reserve	5,000	5,000	5,000
To C's capital (8,000 in the ratio of 3:2)	4,800	3,200		By cash a/c (private property)			2,000
To cash (settlement)	25,200	16,800		By Cash (Loss on realisation)	6,000	6,000	
				By A's capital			4,800
				By B's capital			3,200
	36,000	26,000	15,000		36,000	26,000	15,000

A's Adjusted Capital = 25,000+5,000=30,000

B's Adjusted Capital=15,000 + 5,000=20,000

Capital ratio before dissolution= 30,000:20,000=3:2

So, the deficiency of insolvent partner C (Rs.8,000) is to be borne by A and B in the adjusted capital ratio i.e., 3:2;

Cash A/C

Particulars	Amount	Particulars	Amount
To Balance c/d	6,000	By realisation a/c(creditors)	20,000
To Realisation	44,500	By realisation (expense)	2,500
To C's capital (Pvt Property)	2,000	By A's capital (Settlement)	25,200
To A's Capital	6,000	By B's Capital (Settlement)	16,800
To B's capital	6,000		
Total	64,500	Total	64,500

Case-3: when all the partners are insolvent.

The following steps are used to close the books of accounts of a partnership firm:

- All assets are except cash/bank a/c and fictitious assets are only transferred to realisation a/c.
- Fictitious accounts are transferred to partner's capital accounts.
- Accumulated profits and reserves are also transferred to partners' capital accounts.
- Profit or loss on realisation is transferred to all partners' capital accounts in their profit and loss sharing ratio.
- **Liabilities are not transferred to realisation a/c.**
- Cash/Bank account is opened to determine the balance of cash available for payment of liabilities.
- All liabilities are discharged directly on the basis of available cash in the firm to the extent possible. If there is shortfall, it is transferred to Deficiency account.
- Partners' capital accounts then are closed by transferring the balance to **Deficiency Account**.
- Finally, it is ensured that Deficiency account is balanced.

Illustration 3

A and B were equal partners in a firm. Their balance sheet stood as at 31st march, 2020 when the firm was dissolved.

Liabilities	Amount	Assets	Amount
Creditors A's capital	3,200 400	Plant and Machinery Furniture and Fixtures Sundry Debtors Stock Cash a/c B's Capital	1,200 300 500 400 180 1020
Total	3,600	Total	3,600

Assets are realized as follows:

Plant and Machinery Rs. 600; Furniture Rs.100; Debtors Rs. 400; Stock Rs. 300

Realization Expenses Rs. 140 and B's private contributes Rs. 140 only

A and B became insolvent. Give accounting treatment to close the books of the firm.

Solution:

Realization A/C

Particulars	Amount	Particulars	Amount
To plant and machinery	1,200	By cash a/c	

To Furniture and Fixture To sundry debtors To stock To cash a/c (realisation expenses)	300 500 400 140	plant and machinery 600 Furniture and Fixture 100 sundry debtors 400 stock 300 by loss on Realisation transferred to partners' capital a/c A B	 1,400 570 570
Total	2,540	Total	2,540

Cash A/C

Particulars	Amount	Particulars	Amount
To Balance b/d To realisation (realisation of assets) To B's capital	180 1,400 140	By Realisation (Expenses) **By creditors (BF) (final payment to creditors)**	140 1,580
Total	**1,720**	**Total**	**1,720**

Creditors' a/c

Particulars	Amount	Particulars	Amount
To cash To **Deficiency A/C**	1,580 1,620	By Balance b/d	3,200
Total	3,200	Total	3,200

Partners' Capital Accounts

Particulars	A	B	Particulars	A	B
To balance b/d To loss on realisation	 570	1,020 570	By Balance b/d By cash (Pvt Estate) By **Deficiency a/c**	400 70	 140 1, 450
total	570	1,590	Total	570	1,590

Deficiency Account

Particulars	Amount	Particulars	Amount
To A's capital a/c To B's capital a/c	170 1,450	By creditors	1,620
Total	1,620	Total	1,620

1.9 PIECEMEAL DISTRIBUTION

On dissolution of partnership firm, it is assumed that all assets are realized simultaneously and liabilities are paid together. However, the process of realizing the assets may take place at different points of time (in installments over a period of time) and liabilities are discharged as and when cash is realized from assets. Such a process of gradual distribution of money is known as "Piecemeal Distribution".

Priority of Distribution

When assets are realized gradually, the cash available is utilized in the following order:

(a) To meet the realization expenses
(b) To pay off creditors (outside liabilities)
(c) To pay off partners' Loan
(d) To pay off partners' capital

The following methods are used for distribution of cash under piecemeal distribution:

(i) Surplus Capital Method
(ii) Maximum Loss Method

Surplus Capital Method:

This method is used when the following two conditions are satisfied-

(a) Partners' profit-sharing ratio is not as per their capital contribution
(b) All the partners are solvent and likely to remain so.

The following principles are applied while distributing cash available among the partners' capital accounts:

- The partner with absolute surplus capital is first paid off.
- Then partner with surplus capital is paid off second and
- At last payment is to be made to the partners as per their profit-sharing ratio.
- The unpaid balance of capital accounts will represent loss on realisation and this loss will be exactly in their profit-sharing ratio

Calculation of Absolute surplus capital and surplus capital

Step 1 Calculate adjusted capital of all partners

Adjusted capital= capital account + current Capital account + Reserves or profit/Loss

Step 2 Adjusted capitals are divided by profit sharing ratio. The smallest quotient is taken as

Base capital

Steps 3 Calculate **Relative capital**

Relative Capital= Base Capital x profit sharing ratio of each partner

Step 4 Calculate **Surplus capital**

Surplus Capital = Adjusted capital of each partner – Relative capital of each partner

Step 5 Divide surplus Capital by profit sharing ratio of each partner. The smallest quotient is called **Revised Base Capital**.

Step 6 Again calculate **revised relative capital** by multiplying revised capital base and profit-sharing ratio.

Step 7 calculate **absolute surplus capital**

Absolute surplus capital= surplus capital – revised relative capital

Illustration 4

From the following information calculate surplus capital and absolute surplus capital.

Partners' capital accounts as per the balance sheet are-

A's capital Rs. 40,000; B's Capital Rs. 25,000; C's Capital Rs. 10,000

General Reserves as per the balance sheet Rs. 12,000

Profit sharing ratio= 3:2:1

Solution:

Steps	Particulars	A	B	C
	Capital accounts	40,000	25,000	10,000
	General Reserve (3:2:1)	6,000	4,000	2,000
Step 1	**(a) Adjusted Capital**	46,000	29,000	12,000
	(b) Profit sharing ratio	3	2	1
Step 2	(a) / (b) (Base capital being smallest i.e., 12,000)	15,333	14,500	**12,000**
Step 3	Relative capital= 12,000 x profit sharing ratio	36,000	24,000	12,000
Step 4	**Surplus Capital**= Step 1 - Step 3	10,000	5,000	NIL
Step 5	Revised Base Capital= step 4/ profit sharing ratio (Revised Base capital –being smallest i.e., 2,500)	3,333	**2,500**	NIL
Step 6	Revised Relative Capital= 2,500 x profit sharing ratio	7,500	5,000	NIL
Step 7	**Absolute surplus capital** = surplus capital- revised relative capital	**2,500**	NIL	NIL

Illustration 5

A, B and C are partners sharing profits and losses in the ratio of 3:2:1. Their balance sheet is as follows:

Liabilities	Amount	Assets	Amount
Creditors	10,000	Cash	17,000
A's Loan	5,000	Machinery	20,000
Capital Accounts		Stock	3,000
A	24,000	Debtors	2,000
B	16,000	Investment	23,000
C	10,000		
Total	65,000	Total	65,000

The firm was dissolved and assets were realized in installments as follows:

1st installment Rs. 20,000; 2nd installment Rs. 12,000; 3rd installment Rs. 3,000

Realization Expenses was Rs. 2,000

Prepare statement showing how the amounts realized should be distributed as and when they are received.

Solution:

Calculation of surplus capital and absolute capital

Steps	Particulars	A	B	C
Step 1	Capital accounts	24,000	16,000	10,000
	(a) **Adjusted Capital**	24,000	16,000	10,000
Step 2	(b) Profit sharing ratio	3	2	1
Step 3	(a)/ (b) (Base capital being smallest i.e., 8,000)	**8,000**	8,000	10,000
Step 4	Relative capital= 8,000 x profit sharing ratio	24,000	16,000	8,000
	Surplus Capital= step 1 - Step 3	NIL	NIL	2,000

Statement Showing Priority of Distribution

1. Realisation Expense Rs 2,000
2. A's Loan Rs 5,000
3. Creditors Rs. 10,000
4. Partners' capital- balance amount

Statement showing Distribution of proceeds of Realisation

Particulars	Amount available	Realisation Expenses	A's Loan	Creditors	A's capital	B's capital	C, capital
Amount Due		2,000	5,000	10,000	24,000	16,000	10,000
Cash Balance	17,000						
1st instalment	20,000						
	37,000						
Less Realisation Expenses	2,000	2,000					
Less A's Loan	5,000		5,000				
Less creditors	10,000			10,000			
Balance due	20,000	-	-	-	24,000	16,000	10,000
Balance	2000						
Less paid to C (Surplus Capital)							2,000
	18,000				24,000	16,000	8,000
Balance Due							
Balance	18,000				9,000	6,000	3,000
Less paid to A, B and C (3:2:1)	12,000				15,000	10,000	5,000
2nd instalment realised	12,000				6,000	4,000	2,000
Less paid to A, B and C (3:2:1)							
Balance Due	3,000				9,000	6,000	3,000
3rd instalment realised							
Less paid to A, B and C (3:2:1)	3,000				1,500	1,000	500
Balance Due (Being loss on realisation)	--				7,500	5,000	2,500

Maximum Loss Method:

This method is suitable when a partner or partners is known to be insolvent or is likely to be insolvent. The following steps are used under this method for distribution:

(a) Every instalment is considered as final realization.

(b) The maximum possible loss (Balance due-assets realized) is distributed among all the partners' capital accounts in the profit-sharing ratio assuming the remaining assets worthless.
(c) If a partner's share of maximum possible loss is more than the amount standing to the credit of his capital account, he should be treated as insolvent and his deficiency should be debited to the capital accounts of the solvent partners in the proportion of their capitals which stood on the dissolution date as stated under the Garner V/s. Murray Rule.
(d) This process is repeated till the negative balance is abolished.
(e) The partners having positive balance are paid off first.
(f) This process is to be applied for all subsequent realisation

Illustration 6

P, Q and R are partners sharing profit and loss in the ratio of 3:2:1. Their balance sheet is given as at 31st march, 2020.

Liabilities	Amount	Assets	Amount
Capital accounts		Plant and machinery	30,000
P	40,000	Investment	20,000
Q	30,000	Sundry Debtors	15,000
R	10,000	Stock	15,000
Total	80,000	Total	80,000

They dissolved the firm and the assets were realized as follows:

1st realization Rs. 10,000; 2nd realization Rs. 15,000; 3rd and final realization Rs. 25,000

Solution:

Statement showing Distribution of cash realization on capital accounts under Maximum Loss method

Particulars	Total	P	Q	R
(1) Distribution of Rs. 10,000 (1st Realization)				
Balance Due	80,000	40,000	30,000	10,000
Less probable Loss assuming remaining assets worthless 80,000-10,000=70,000 in 3:2:1	70,000	35,000	23,333	11,667
		5,000	6,667	(-) 1,667
Deficiency of R's Capita written off against P and Q in their capital ratio i.e., 4:3		953	714	(-) 1,667
Amount paid to partners		4,047	5,953	NIL

(2) Distribution of Rs. 15,000 (2nd Realization)				
Balance Due after making payment	70,000	35,953	24,047	10,000
Less possible loss assuming remaining assets worthless (70,000-15,000) (3:2:1)	55,000	27,500	18,333	9,167
Amount paid to partners	15,000	8,453	5,714	833
(3) Distribution of Rs. 25,000 (final Realization)				
Balance Due	55,000	27,500	18,333	9,167
Less possible loss assuming remaining assets worthless (55,000-25,000) i.e., 30,000 in 3:2:1	30,000	15,000	10,000	5,000
Amount paid to partners	25,000	12,500	8,333	4,167

Summary of amount paid to partners' capital

Particulars	P	Q	R
1st Realisation	4,047	5,953	-
2nd Realisation	8,453	5,714	833
Final realisation	12,500	8,333	4,167
Total Rs 50,000	25,000	20,000	5,000

1.10 SALE OF A PARTNERSHIP FIRM TO A COMPANY

For getting the benefits of a company form of businesslike limited liability, perpetual succession, easy access to funds, transferability of shares and many more, a partnership firm may be converted in to a joint stock company in two ways:

(i) The partnership firm itself converts in to a company. This is called floatation of a new company to take over the business of the firm.

(ii) The partnership is sold to a company. It is called absorption of partnership firm by the company.

In either of the above cases two parties are associated. They are:

(i) **Partnership firm** which is to be dissolved otherwise called also selling entity/business. The books of accounts of the partnership firm are closed in the same way as the dissolution of firm which has been discussed earlier in this chapter.

(ii) **The company** which purchases the partnership firm. It is also called purchasing company.

Purchase consideration

When a partnership firm is sold to a company, the assets and liabilities of the firm are taken over by the company and in return the company pays a fixed agreed amount of money to the partnership firm which is known as purchase consideration. It is paid in the form of:

(i) Cash
(ii) Shares (Both equity and preference shares)
(iii) debentures
(iv) other securities
Or
(v) Combination of two or more of these

In the absence of agreement shares received from purchasing company should be distributed among the partners in the profit-sharing ratio.

Accounting Treatment for Sale of a Partnership Firm to a Company

(i) Accounting Entries in the books of the Selling firm (Partnership Firm)
(ii) Accounting Entries in the books of the Purchasing Company

Accounting Entries in the books of the Selling firm

1. For closing the asset accounts taken over by the company

Realization A/c Dr

To Sundry Assets A/c (Individually at Book Values)

(Being assets A/Cs closed)

*Note: The following items on the assets side of the Balance Sheet are not transferred to the Realization Account unless otherwise it is taken over by the company)

(a) Undistributed loss (i.e., Debit Balance of Profits and Loss account) & fictitious assets or deferred revenue expenditures such as preliminary expenses;

(b) Cash in hand, and Cash at Bank, will be the opening balance of the Cash/Bank account.

(c) Provisions and reserves against assets should be closed by crediting the Realization Account.

2. For closing the Liabilities accounts taken over by the company

External Liabilities A/c Dr (Individually at Book Values)

To Realization A/c

(Being Transfer of external liabilities)

3.For purchase consideration due

Purchasing Company a/c Dr

To Realization a/c

(Purchase consideration due)

4. Treatment of Accumulated Reserves and Profit/loss

All the balance of Reserve or Undistributed Profit, Reserve fund or other reserves is transferred to partner's capital account in their profit-sharing ratio. The following entries are to be passed:

Reserve A/c Dr

Profit and Loss A/c Dr

Any Other fund A/c Dr

To Partner's Capital A/c

(Transfer of profit and reserves)

Note: In case of Loss reverse entry is recorded.

5**.** For realization of assets not taken over by the firm

Cash/Bank A/c Dr

To Realization A/c

(Being sale of assets not taken over by the firm)

6. For assets taken over by the partner

Partner's Capital A/c Dr

To Realization A/c

(Being Assets taken over by partner)

7. For recording unrecorded assets

Asset's a/c Dr

To partners' capital a/c

(Being unrecorded assets)

8. For realization of unrecorded assets not taken over by the company

Bank a/c Dr

To Assets a/c

(Being assets realized)

Or

If unrecorded assets are taken over by the company, then entry will be

Realization a/c Dr

To Assets a/c

(Being unrecorded assets taken over by the company)

9. For Payment of liabilities not taken over by the company

Realization A/c Dr

To Cash/Bank A/c

(Being payment of liabilities)

10. Payment of liabilities by the partners

Realization A/c Dr

To Partner’s Capital A/c

(Being liabilities taken over by partner)

11. For recording unrecorded liabilities

Partners’ capital a/c Dr

To liabilities a/c

(Being recording of unrecorded liabilities)

12. For payment of unrecorded liabilities not taken over by the firm

Liabilities a/c Dr

To cash / Bank a/c

(Being unrecorded liabilities paid)

Or

If unrecorded liabilities are taken over by the company, then entry will be

Liabilities a/c Dr

To Realization a/c

(Being unrecorded liabilities taken over by the company)

13. For Settlement of loan given by the partner

Partner’s Loan A/c Dr

To Partners’ capital a/c

(Being Partner’s loan transferred to partners’ capital a/c)

14. For Payment of realization expenses:

(a) When realization expenses are paid by firm:

Realization A/c Dr

To cash A/c

(Being expenses paid off)

(b)When realization expenses are paid by the purchasing company

No Entry

15. For Closing of realization A/c

The balance in the realization account would show either profit or loss on realization. It is transferred to Partner's capital accounts in their profit-sharing ratio.

(a) In case of profit, the following entries are to be passed:

Realization A/c Dr

To Partner's Capital A/c

(Being Profit on realization transferred)

(b) In case of loss, Reverse entry is to be passed.

Partner's Capital A/c Dr

To Realization A/c

(Being Loss on realization transferred)

16. For transferring partners' current accounts to partners' capital accounts

Partners' current a/c Dr

To partners' capital a/c

(Being transfer of current accounts)

17. For settlement of purchase consideration by the company

Cash/Bank a/c Dr

Shares in purchasing company Dr

Debentures in purchasing company Dr

To purchasing company a/c

(Being purchase consideration settled)

18. For final adjustment of partners' capital accounts

Partners' capital a/c Dr

To Cash/Bank a/c

To Shares in purchasing company

To Debentures in purchasing company

(Being partners' capital accounts closed)

Accounting Entries in Books of the Purchasing Company

Purchasing company will record all the assets and liabilities at the values taken over.

If the purchase consideration payable is more than the net assets acquired, the excess amount is goodwill. if the purchase consideration payable is less than the net assets acquired, the difference is capital reserve.

Net Assets= Assets taken over – Liabilities taken over

1. Entry for assets and liabilities taken over
   Asset's a/c (taken over at agreed value) Dr
   Goodwill a/c Dr (Balancing Figure)
   To Liabilities a/c (taken over at agreed value)
   To Selling Firm's a/c (Purchase consideration)
   To Capital Reserve (Balancing Figure)
   (Being firm purchased)

Note: In the above entry either goodwill or capital reserve will appear depending upon debit or credit balance.

2. For settlement of Purchase consideration by the company
   Selling Firm a/c Dr
   To cash/Bank a/c
   To share capital a/c
   To Debenture a/c
   (Being purchase consideration paid to the selling firm)
3. For realization expenses paid by the company
   Goodwill a/c Dr
   To cash/Bank a/c
   (Being realization expenses paid by the company)

Illustration 7

A and B were partners sharing profits and losses in the ratio of 3:2. On 31 March, 2020 X Ltd Company acquired the partnership firm of A and B on the following terms and conditions:

Fixed assets are taken over at Rs. 4, 00,000
Debtors are taken over at Rs. 60,000
Stocks are taken over at Rs.20,000
Creditors are taken over by the X Ltd to be discharged
All other assets and liabilities are realised and discharged by the partnership firm.
Investment is realised at Rs. 50,000
Realisation expense Rs. 5,000 paid by the firm and purchase consideration is agreed to be Rs. ,6,50,000 for which X Ltd agreed to issue shares.

The balance sheet of the firm as at 31st March, 2020 is given as follows:

Liabilities	Amount	Assets	Amount
Creditors	60,000	Fixed assets	5,00,000
Bills Payable	40,000	Debtors	70,000
A's Loan a/c	55,000	Stock	35,000
Partners' capital		Investments	40,000
A	3,20,000	Cash a/c	10,000
B	1,80,000		
Total	6,55,000	Total	6,55,000

Pass journal entries in books of the partnership firm and X Ltd. Company and prepare balance sheet in the books of X ltd. Company.

Solution:

Journal Entries in Books of the partnership Firm

1. For transferring assets taken over by the company to realization a/c at book values
   Realization a/c Dr 6, 05,000
   To Fixed Assets a/c 5, 00,000
   To Debtor a/c 70,000
   To Stock a/c 35,000
   (Being transfer of assets taken over by the company to realization a/c at book values)
2. For Realisation of investment by the firm
   Cash a/c Dr 50,000
   To investment a/c 40,000
   To realisation a/c 10,000
   (Being investment realised by the firm)

3. For transferring liabilities taken over by the company to realization a/c at book values
   Creditor's a/c Dr 60,000
   To Realization a/c 60,000
   (Being transfer of liabilities taken over by the company to realization a/c at book values)
4. For discharge of liabilities by the firm
   Bills Payable a/c Dr 40,000
   To cash a/c 40,000
   (Being discharge of liabilities by the firm)

5. For transfer of partners' loan a/c to their capital accounts.
   A's Loan a/c Dr 55,000
   To A's Capital a/c 55,000
   (Being transfer of partners' loan a/c to their capital accounts)
6. For purchase consideration due
   X Ltd. Company a/c Dr 6,50,000
   To Realization a/c 6,50,000
   (Being purchase consideration due)
7. For Realization Expense paid by the firm
   Realization a/c Dr 5,000
   To Cash a/c 5,000
   (Being Realization Expense paid by the firm)
8. For receipt of purchase consideration
   Shares in X Ltd a/c Dr.6,50,000
   To X Ltd. Company a/c 6,50,000
   (Being receipt of purchase consideration)
9. For profit on realization
   Realization a/c Dr 1,10,000
   To A's capital 66,000
   To B's capital 44,000
   (Being profit on realization)
10. For final adjustment of partners' capital accounts
   A's Capital a/c Dr 4,41,000
   B's Capital a/c Dr 2,24,000
   To Share in X ltd 6, 50,000
   To cash a/c 15,000
   (Being final adjustment of partners' capital accounts)

Realization Account

Particulars	Amount	Particulars	Amount
To Fixed Assets	5,00,000	By Creditors	60,000
To Debtors	70,000	By Cash (investment)	10,000
To Stock	35,000	By X Ltd.	6,50,000
To Cash (realization expense)	5,000		
To Profit on realization			
A's capital	66,000		
B's capital	44,000		
Total	7,20,000	Total	7,20,000

Cash Account

Particulars	Amount	Particulars	Amount
To Balance b/d	10,000	By Bills payable	40,000
To Investment	40,000	By Realization	5,000

To Realization	10,000	By Partners' capital a/c A B	 9,000 6,000
	60,000		60,000

Partners' Capital Accounts

Particulars	A	B	Particulars	A	B
To cash To Shares in X Ltd	9,000 4,32,000	6,000 2,18,000	By Balance b/d By profit on realization By A's Loan	3,20,000 66,000 55,000	1,80,000 44,000
Total	4,41,000	2,24,000	Total	4,41,000	2,24,000

Journal Entries in the Books of X Ltd Company

1. For assets and liabilities taken over at agreed values
   Fixed Assets a/c Dr 4,00,000
   Debtors' a/c Dr 60,000
   Stock a/c Dr 20,000
   Goodwill a/c Dr 2,30,000
   To Creditors a/c 60,000
   To Partnership Firm a/c (PC) 6,50,000
   (Being assets and liabilities taken over at agreed values)
2. For payment of Purchase consideration
   Partnership Firm a/c Dr 6,50,000
   To Share Capital 6,50,000
   (Being payment of Purchase consideration)

Balance Sheet of X Ltd. Company

Liabilities	Amount	Assets	Amount
Share Capital Creditors	6,50,000 60,000	Fixed assets Debtors Stocks Goodwill	4,00,000 60,000 20,000 2.30,000
Total	7,10,000	Total	7,10,000

1.11 SOME USEFUL BOOKS

- Robert N Anthony, David Hawkins, Kenneth A. Merchant, *Accounting: Text and Cases*. McGraw-Hill Education, 13th Ed. 2013.
- Charles T. Horngren and Donna Philbrick, *Introduction to Financial Accounting,* Pearson Education.
- J.R. Monga, *Financial Accounting: Concepts and Applications*. Mayur Paper Backs, New Delhi.
- M. C. Shukla, T.S. Grewal and S. C. Gupta. *Advanced Accounts. Vol.-I. S.* Chand & Co., New Delhi.
- S.N. Maheshwari, and. S. K. Maheshwari. *Financial Accounting*. Vikas Publishing House, New Delhi.
- Deepak Sehgal. *Financial Accounting.* Vikas Publishing H House, New Delhi.
- Bhushan Kumar Goyal and HN Tiwari, *Financial Accounting,* International Book House
- Goldwin, Alderman and Sanyal, *Financial Accounting,* Cengage Learning.
- Tulsian, P.C. *Financial Accounting,* Pearson Education.
- *Compendium of Statements and Standards of Accounting*. The Institute of Chartered Accountants of India, New Delhi

1.12 QUESTIONS/EXCERSISES

Questions

Dissolution of Partnership Firm

1. What is dissolution of firm/ How is it different from dissolution of partnership?

2. Discuss the different modes of dissolution of a firm.

3. Explain the provisions of section 48 of partnership Act, 1932 regarding the settlement of accounts of partnership firm on its dissolution.

4.How is payment of firm's debt and private debts dealt with on dissolution of a partnership firm?

5. What are the accounting treatments on dissolution of a firm? Discuss them.

6. What are the journal entries necessary to be made to close the books of accounts on dissolution of a firm?

7. What is the difference between revaluation account and realization?

8.(When all partners are solvent) Balance sheet of a firm as at 31stmarch 2018 was:

Liabilities	Amount	Assets	Amount
Capital A/Cs		Freehold property	8,00,000
X	5,00,000	Investments	2,00,000
Y	4,00,000	Sundry debtors	1,00,000
Z	3,00,000	Stock	1,50,000
Sundry creditors	2,00,000	Cash at bank	3,00,000
Profit and Loss a/c	1,50,000		
Total	15,50,000	Total	15,50,000

The partnership firm was dissolved on the above date. X took over the investments at a value of Rs. 1, 90,000. Cash realized was:

Freehold property Rs. 9, 00,000

Sundry debtors Rs. 90,000

Stock Rs. 1, 40,000

Creditors were paid at discount of 5%. Expenses of realization came to Rs. 20,000.

Pass the journal entries and prepare realization account, partners' capital accounts and bank account to close the books.

(Answer: Profit on Realization- Rs. 60,000; Cash paid to partners on settlement: X – Rs. 3,80,000; Y –Rs.4,70,000; Z – Rs. 3,70,000)

9. (When all partners are solvent) A, B and C are partners in a firm sharing profits in the ratio of 2:1:1. Their balance sheet as at 31st march, 2018 was as follows:

Liabilities	Amount	Assets	Amount
Creditors	50,000	Goodwill	30,000
Capital A/Cs		Land and Building	80,000
A	80,000	Plant and Machinery	56,000
B	80,000	Stock	54,000
C	60,000	Debtors	48,000
		Cash	2,000
Total	2,70,000	Total	2,70,000

The firm was dissolved on that date. Assets realized: Goodwill Rs. 20,000; Land Building Rs. 1,00,000; plant and Machinery Rs 50,000; stock Rs. 28,000 and debtors 50% of book value.

Realization expenses were Rs. 2,000. Prepare realization account, capital accounts of partners and cash account to close the books of accounts of the firm.

(Answer: Loss on Realization- Rs. 48,000; Cash paid to partners on settlement: A –Rs. 56,000; B – Rs. 68,000; C -Rs.48,000)

10. (When some partners are solvent and others are insolvent) The following is the balance sheet of X, Y and Z. on March 31, 2020:

Liabilities	Amount	Assets	Amount
Bills payable	20,000	Bank	6,000

Profit and Loss a/c	15,000	Sundry Debtors	10,000
Capital Accounts		Stock	20,000
X	15,000	Furniture and Fixtures	10,000
Y	25,000	Plant and Machinery	20,000
		Z's Capital	9,000
Total	75,000	Total	75,000

Z is insolvent but his estate pays Rs 4,000. It is decided to wind up the partnership. The assets realized as follows: sundry debtors, Rs 6,500; stock, Rs 15,000 furniture and fixture, Rs 6,000; and plant and machinery, Rs 16,000. The cost of winding up came to Rs 3,000. Give accounts to close the books of the firm (1) if the capitals are fixed, and (2) if the capitals are fluctuating. Follow Garner vs Murray rule.

(Answer: Loss on Realization- Rs. 19,500; Cash paid to partners on settlement: X – Rs. 17,562; Y – Rs. 25,938; Deficiency of Z Rs. 6,500 brought by X – Rs. 2,438 and Y – Rs. 4,062 if capital is fixed; if capital is fluctuating Deficiency of Z Rs. 6,500 brought by X – Rs. 2,600 and Y – Rs. 3,900)

11. (When all partners are insolvent) A and B are partners sharing profits and losses in the ratio of 3:2 in a firm. Their balance sheet stood as at 31st march, 2020 when the firm was dissolved.

Liabilities	Amount	Assets	Amount
Bills payable Account	6,400	Machinery	2,400
A's capital	800	Furniture	600
		Sundry Debtors	1,000
		Stock	800
		Cash a/c	320
		B's Capital	2,080
Total	7,200	Total	7,200

Assets are realized as follows:

Machinery Rs. 1,200; Furniture Rs.200; Debtors Rs. 800; Stock Rs. 600
Realization Expenses Rs. 200 and B's private contributes Rs. 100 only
A and B became insolvent. Give accounting treatment to close the books of the firm.
(Answer: Loss on Realization- Rs. 2,200; Cash paid to partners on settlement: A – Rs. 17,562; B – Rs. 25,938; Deficiency for bills payable – Rs. 3,380; Capital deficiency: A – Rs. 520, B – Rs. 2,860)

Piecemeal Distribution

12.From the following information calculate surplus capital and absolute surplus capital.

Partners' capital accounts as per the balance sheet are-
X's capital Rs. 80,000; Y's Capital Rs. 50,000; Y's Capital Rs. 20,000
General Reserves as per the balance sheet Rs. 24,000

Profit sharing ratio= 2:2:1

(Answer: Surplus capital: A – Rs. 40,000; B - Rs.10,000; Base capital – Rs. 24,800)

13. X, Y and Z are partners sharing profits and losses in the ratio of 3:2:1. Their balance sheet is as follows:

Liabilities	Amount	Assets	Amount
Bills Payable	10,000	Bank Balance	17,000
Y's Loan	5,000	Machinery	21,000
Capital Accounts		Stock	2,000
X	24,000	Debtors	5,000
Y	16,000	Investment	20,000
Z	10,000		
Total	65,000	Total	65,000

The firm was dissolved and assets were realized in installments as follows:

1st installment Rs. 24,000; 2nd installment Rs. 18,000; 3rd installment Rs. 6,000

Realization Expense was Rs. 1,000

Prepare statement showing how the amounts realized should be distributed as and when they are received under

(a) Capital surplus Method
(b) Maximum Loss method

(Answer: Refer to illustration 5)

Sale of a partnership firm to a Company

14. X and Y were partners sharing profits and losses in the ratio of 7:3. On 31 March, 2020. A Ltd Company acquired the partnership firm of A and B on the following terms and conditions:

Plant and Machinery is taken over at Rs. 3, 00,000
Debtors are taken over at Rs. 50,000
Stocks are realised by the firm for Rs.20, 000
Creditors are taken over by the A Ltd to be discharged
All other assets and liabilities are realised and discharged by the partnership firm.
Investment is realised at Rs. 30,000
Realisation expense Rs. 12,000 paid by the firm and purchase consideration is agreed to be Rs. ,6,00,000 for which A Ltd agreed to issue shares.
The balance sheet of the firm as at 31st March, 2020 is given as follows:

Liabilities	Amount	Assets	Amount
Creditors	50,000	Plant and Machinery	4,00,000
Bills Payable	30,000	Debtors	50,000
Y's Loan a/c	20,000	Stock	45,000
Partners' capital		Investments	55,000
X	3,00,000	Cash a/c	50,000
Y	2,00,000		

Total	6,00,000	Total	6,00,000

Pass journal entries in books of the partnership firm and A Ltd. Company and prepare balance sheet in the books of X ltd. Company.

(Answer: Balance sheet of the company: Rs, 6,50,000; Goodwill – Rs. 3,00,000)

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