LESSON-25
DISSOLUTION OF PARTNERSHIP FIRM

SUMMARY

The term dissolution means coming to an end or discontinuation. The dissolution of the firm implies a complete breakdown of the partnership relation among all the partners. Dissolution of the partnership (owing to retirement, death or insolvency of a partner), merely involves change in the relation of the partners but it does not end the firm; the partnership would certainly come to an end but the firm, the reconstituted one might continue under the same name. So the dissoluton of the partnership may or may not include the dissolution of the firm but the dissoluton of the firm necessarily means the dissoluton of the partnership.

DISSOLUTION OF PARTNERSHIP AND DISSOLUTION OF PARTNERSHIP FIRM

On dissolution of the firm, the business of the firm ceases to exist since its affairs are wound 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.

- **Dissolution by Agreement**
- **Compulsory dissolution**
- **Dissolution by Notice**
- **Dissolution by Court**

Distinction Between Dissolution of Partnership and Dissolution of Partnership Firm

Dissolution of a firm means that the firm closes its business and comes to an end. While dissolution of a partnership means termination of old partnership agreement and a reconstitution of firm due to admission, retirement and death of a partner. In dissolution of a partnership the remaining partners may agree to carry on the business under a new agreement.

TREATEMENT OF ASSETS AND LIABILITIES

When the partners decide to discontinue the business of the firm, it becomes necessary to settle its accounts. For this purpose, it disposes off all its assets (except cash and bank balances) for satisfying all the claims against it. For this purpose a separate account called 'Realisation Account' is opened. Realisation Account is an account in which assets excluding cash in hand and bank are transferred at their book value and all external liabilities are transferred at their book value.

In order to record the disposal of assets and discharge of liabilities, the following journal entries are recorded:

- **For Transfer of Assets**
- **For Transfer of Liabilities**
- **Treatment of Accumulated Reserves and Profit/Loss**
- **For Sale of Assets (for cash)**
- **For Assets taken Over by the Partner**
- **Settlement of loans given by the Partner**
- **Payment of Liabilities in Cash**
- **Payment of Liabilities by the Partner(s)**

Treatment of Unrecorded Assets and Liabilities

Sometimes, there may be some assets that have already been written off completely in previous years and thus, do not appear in the Balance Sheet but physically they still exist for operational purposes.

PARTNERS' CAPITAL ACCOUNT AND CASH/BANK ACCOUNT

Settlement of Partners' Capital Accounts

After all the adjustments related to partners' capital accounts and transfer of profit or loss on realisation to the partners' capital accounts, the capital accounts are closed.

Preparation of Cash/Bank account

After closing the partners' capital accounts, bank account is prepared and all entries pertaining to the bank/cash are posted in it including any cash brought in by the partner on the dissolution of firm. Partners' capital accounts are closed by making payment from the bank account and thereby bank account stands closed by making/receiving payment. In this way all the accounts stand closed. If cash/bank account does not show any balance, it implies that all the accounts of the dissolved firm have been closed properly.