Accounting for Dissolution of Partnership Firm

Introduction

Dissolution of a partnership firm refers to the process of winding up the business operations and closing down the firm. It involves settling accounts, distributing assets, and discharging liabilities among the partners. The dissolution may occur voluntarily or by order of law.

Modes of Dissolution

1. Dissolution by Agreement: Partners may mutually agree to dissolve the firm.
2. Compulsory Dissolution: Occurs in cases of illegality, such as when the business becomes unlawful.
3. Dissolution by Notice: In case of a partnership at will, any partner may dissolve by giving notice.
4. Dissolution by Court: When a partner becomes insane, permanently incapable, or when business cannot be carried on, the court may order dissolution.

Accounting Treatment

When a firm is dissolved, proper accounting is essential to ensure fair settlement. The following accounts are prepared:

1. Realisation Account: To record the sale of assets and payment of liabilities.
2. Partner’s Loan Account: To settle any outstanding loans given by partners.
3. Partner’s Capital Account: To record the final settlement of balances due to or from partners.
4. Cash/Bank Account: To record all cash transactions during dissolution.

Steps in Accounting for Dissolution

1. Transfer all assets (except cash/bank, fictitious assets) to the Realisation Account.
2. Transfer all external liabilities to the Realisation Account.
3. Record sale proceeds of assets and any payment of liabilities.
4. Transfer unrecorded assets/liabilities if discovered during dissolution.
5. Transfer expenses of dissolution to the Realisation Account.
6. Transfer profit/loss from Realisation Account to partners’ capital accounts in profit-sharing ratio.
7. Settle partner loans and capital accounts.
8. Distribute remaining cash to partners.

Example

Suppose a firm with partners A and B decides to dissolve. Assets worth ■50,000 are sold for ■45,000. Liabilities of ■20,000 are settled at ■19,000. Dissolution expenses of ■1,000 are paid. The profit/loss is shared between partners in their agreed ratio, and balances are settled accordingly.

Conclusion

Dissolution of a partnership firm is a systematic process involving settlement of liabilities, disposal of assets, and distribution of the remaining balance among partners. Proper accounting ensures fairness and transparency.

Note:

Accounting for dissolution ensures smooth closure of the partnership business with proper legal compliance.