Q3. How deficiency of creditors is paid off?

Solution:

Dissolution of a firm calls for closure of all accounts and realisation of assets and making payment to meet liabilities. At the time of dissolution of a firm, the amount received from the sale of the firm's assets is used to pay off creditors. If the amount received from the sale falls short, then the partner's private assets are used for settling the dues of the firm's creditors. Even if some portion of the amount due to creditors is left unpaid, then there arises deficiency of creditors. This deficiency can be treated in the following two ways:

1. Transferring deficiency to the Deficiency Account
2. Transferring deficiency to the Partner's Capital Account

In case the amount of deficiency is to be transferred to the Deficiency Account, then a separate account is prepared for the firm's creditors. A Cash Account is prepared to ascertain the firm's cash balance accruing from the sale of the firm's assets and partner's private assets. After ascertaining the cash availability with the firm, creditors and external liabilities are paid proportionately. The remaining unpaid creditors or the deficiency is transferred to the Deficiency Account.

In the second case, creditors are paid by the cash available with the firm, including the partner's individual contribution. The deficiency or unpaid creditor's amount is transferred to the Partner's Capital Account. Thus, the deficiency of creditors is borne by all partners in their profit-sharing ratio. If any partner becomes insolvent and is unable to bear the deficiency, then this will be regarded as a capital loss to the firm. If the partnership deed is silent about such capital loss in the facet of insolvency of a partner, then according to the Garner vs. Murray case, such capital loss needs to be borne by the solvent partners in their capital ratio.

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