



# Collegedunia NCERT Notes

*The Ultimate NCERT Revision Guide for Class 12 Accountancy*

## Chapter 4: Dissolution of Partnership Firm

**What this chapter covers:** dissolution of partnership vs dissolution of firm, modes of dissolution under the Indian Partnership Act 1932, the Realisation Account, treatment of unrecorded assets and liabilities, partner's loan handling, accounting for realisation expenses, the Section 48 order of payment, settlement of partners' capital accounts, and the Garner v Murray rule on insolvent partners. Session 2026-27.

## Contents

<b>1 Introduction: Dissolution of Partnership vs Dissolution of Firm</b>	<b>1</b>
1.1 Visual: which "dissolution" am I dealing with? . . . . .	2
<b>2 Modes of Dissolution of a Firm</b>	<b>2</b>
2.1 Five modes of dissolution (visual) . . . . .	3
<b>3 The Realisation Account</b>	<b>3</b>
3.1 Realisation A/c format (T-visual) . . . . .	4
3.2 Standard journal entries for Realisation A/c . . . . .	4
3.3 Sequence of account closures (visual) . . . . .	5
<b>4 Unrecorded Assets and Liabilities</b>	<b>5</b>
4.1 Journal entries for unrecorded items . . . . .	6
4.2 Unrecorded items matrix (visual) . . . . .	6
<b>5 Treatment of Realisation Expenses</b>	<b>6</b>
<b>6 Partner's Loan – Two Cases</b>	<b>6</b>
6.1 Case 1: Loan on liabilities side (partner has lent to firm) . . . . .	7
6.2 Case 2: Loan on assets side (firm has lent to partner) . . . . .	7
6.3 Partner's loan: two distinct cases (visual) . . . . .	7

<b>Dissolution of Partnership Firm</b>	<b>2</b>
<hr/>	
<b>7 Section 48: Order of Settlement on Dissolution</b>	<b>7</b>
7.1 Section 48 settlement waterfall (visual) . . . . .	8
<b>8 Firm's Debts vs Partner's Private Debts (Section 49)</b>	<b>8</b>
<b>9 Garner v Murray Rule (Insolvent Partner)</b>	<b>9</b>
9.1 Garner v Murray decision tree . . . . .	10
<b>10 Worked Example – Complete Dissolution</b>	<b>10</b>
<b>11 Common Mistakes to Avoid</b>	<b>11</b>
<b>12 High-Yield Exam Questions</b>	<b>12</b>
<b>13 Additional Worked Examples</b>	<b>12</b>
13.1 Example A – Realisation expenses (four cases) . . . . .	12
13.2 Example B – Creditors accept asset of higher value . . . . .	12
13.3 Example C – Partner takes liability . . . . .	13
13.4 Example D – Unrecorded items split among partners . . . . .	13
<b>14 Garner v Murray – Worked Example</b>	<b>13</b>
<b>15 Format of Realisation Account</b>	<b>14</b>
<b>16 Conversion of Partnership Firm into a Company</b>	<b>14</b>
<b>17 Complete Solved Example – Multi-Step Dissolution</b>	<b>15</b>
<b>18 Past Paper Trends and Strategy</b>	<b>16</b>
18.1 CBSE Question Distribution (Last 5 Years) . . . . .	16
18.2 Time Allocation in Exam . . . . .	17
<b>19 Comparative Chart: Revaluation vs Realisation A/c</b>	<b>17</b>
<b>20 Theory Questions with Standard Model Answers</b>	<b>17</b>
20.1 Q1. What is meant by Dissolution of a Firm? . . . . .	17
20.2 Q2. Why is Cash and Bank not transferred to Realisation A/c? . . . . .	18
20.3 Q3. Distinguish between Realisation Account and Revaluation Account. . . . .	18
20.4 Q4. Explain the treatment of Goodwill on dissolution. . . . .	18

20.5 Q5. State the Garner v Murray Rule. . . . . 18

**21 Step-by-Step Checklist for the Examiner-Style Answer 19**

**22 Important Sections of the Indian Partnership Act 1932 19**

**23 Practice Problems for Self-Study 20**

**24 Quick Recap and Exam-Day Checklist 20**

24.1 Exam-day mental check . . . . . 20

**25 Connection with Other Chapters 21**

# 1 Introduction: Dissolution of Partnership vs Dissolution of Firm

**Dissolution of a partnership** (Section 39) ends the current contract among partners but the firm continues with the remaining partners. It happens on retirement, death, admission, or change in profit-sharing ratio.

**Dissolution of the firm** ends the firm itself. The business is wound up, assets are realised, liabilities are paid, and any surplus is distributed among the partners.

Aspect	Dissolution of Partnership	Dissolution of Firm
Termination of business	Business continues	Business permanently ended
Settlement	Outgoing partner only	All assets sold, liabilities paid
Court intervention	No	Yes (Section 44, by court order)
Closure of books	Books not closed	Books closed; Realisation A/c
Economic relationship	Continues with remaining	All partners' relationship ends

## 1.1 Visual: which “dissolution” am I dealing with?

### Dissolution of Partnership

Section 39  
Existing contract among partners ends  
Firm continues with remaining partners  
Books NOT closed

### Dissolution of Firm

Section 44 (and others)  
Firm permanently winds up  
Assets sold, liabilities paid  
Books CLOSED via Realisation A/c

*Every dissolution of a firm includes dissolution of partnership, but the converse is not true.*

Figure 1: The distinction NCERT tests in nearly every 1-mark and 3-mark theory question. “Dissolution of partnership” (left) is a reconstitution event; “dissolution of firm” (right) is the firm’s winding-up.

## 2 Modes of Dissolution of a Firm

### Section 39 to 44, Indian Partnership Act 1932

A firm may be dissolved in the following ways:

1. **Section 40: Dissolution by agreement.** All partners may agree to dissolve the firm.
2. **Section 41: Compulsory dissolution.** If all but one partner become insolvent; if the firm’s business becomes unlawful.
3. **Section 42: Dissolution on the happening of certain contingencies.** Death of a partner; expiry of fixed term; completion of project; insolvency of a partner.
4. **Section 43: Dissolution by notice.** In a partnership-at-will, any partner may give written notice.
5. **Section 44: Dissolution by court.** On grounds of insanity, permanent incapacity, misconduct, persistent breach, transfer of share, perpetual loss, or any just/equitable cause.

## 2.1 Five modes of dissolution (visual)

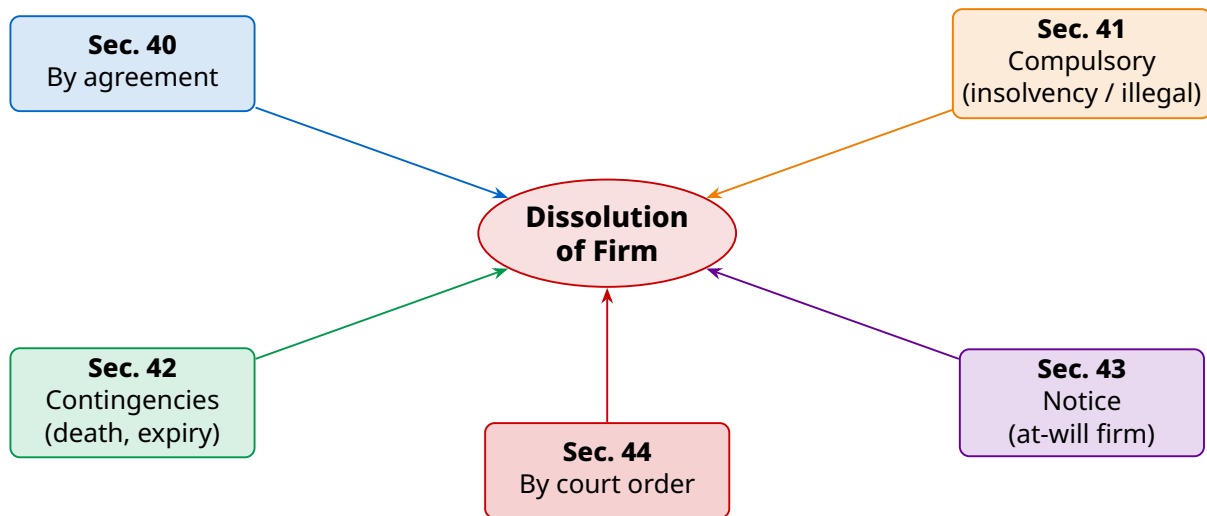


Figure 2: Five statutory routes by which an Indian partnership firm can dissolve. Sec. 40 is voluntary; Sec. 41 is forced by law; Sec. 42 is event-triggered; Sec. 43 is unilateral; Sec. 44 is judicial.

## 3 The Realisation Account

The **Realisation Account** is a Nominal Account opened to record the sale of assets and payment of liabilities at the time of dissolution.

### Realisation A/c – What Goes Where

#### Dr. side (closing of assets at book value):

- All assets at BOOK value, EXCEPT Cash, Bank, Fictitious assets (Goodwill written off, P&L Dr. balance), and Debit balance of any partner's Capital A/c.
- Realisation expenses paid (if firm bears).
- Liability paid in cash.
- Profit on Realisation (to capitals in profit-sharing ratio).

#### Cr. side:

- All outside liabilities at BOOK value.
- Cash received from sale of assets.
- Partner taking over an asset (Dr. his Capital A/c).
- Loss on Realisation (to capitals in profit-sharing ratio).

### Common Mistake

**Cash and Bank are NOT transferred to Realisation A/c.** They are the medium of realisation transactions. Transferring them is the single most

common 1-mark error on this chapter.

### 3.1 Realisation A/c format (T-visual)

Dr. side	Cr. side
To Sundry Assets (book value)	By Sundry Liabilities (book value)
To Cash (creditors paid)	By Cash (assets realised)
To Cash (realisation expenses)	By Partner's Capital (asset taken over)
To Partner's Capital (liab. taken over)	By Provision (already netted)
To Profit on Realisation (PSR)	By Loss on Realisation (PSR)

Figure 3: T-format of the Realisation A/c. Memorise the side each item lands on, the dual-entry then takes care of itself. Cash and Bank never appear inside this T, they remain in a separate Cash/Bank A/c that records actual money movement.

#### Common Mistake

Fictitious assets (Goodwill already written off, debit balance of P&L, advertisement suspense) do **not** go to the Dr. side of Realisation A/c. They are written off directly against partners' Capital A/cs in the existing PSR. Sending them to Realisation inflates the realisation loss artificially.

### 3.2 Standard journal entries for Realisation A/c

#### 1. Transfer of assets (other than Cash, Bank, Fictitious) at book value:

- Dr. Realisation A/c (total of all assets transferred)
- Cr. Each Asset A/c (at book value)

#### 2. Transfer of liabilities (outside parties) at book value:

- Dr. Each Liability A/c (at book value)
- Cr. Realisation A/c (total)

#### 3. Sale of assets for cash:

- Dr. Cash/Bank A/c (amount realised)
- Cr. Realisation A/c

#### 4. Asset taken over by a partner:

- Dr. Partner's Capital A/c (at agreed value)
- Cr. Realisation A/c

**5. Liability paid in cash:**

- Dr. Realisation A/c (amount paid)
- Cr. Cash/Bank A/c

**6. Liability taken over by a partner:**

- Dr. Realisation A/c (amount of liability)
- Cr. Partner's Capital A/c

**7. Realisation expenses paid by firm:**

- Dr. Realisation A/c
- Cr. Cash/Bank A/c

**8. Distribution of profit/loss on Realisation:**

- Profit: Dr. Realisation A/c; Cr. Partners' Capital A/cs (profit-sharing ratio).
- Loss: Dr. Partners' Capital A/cs (profit-sharing ratio); Cr. Realisation A/c.

**3.3 Sequence of account closures (visual)**

Close all asset  
and liability A/cs; [a2] (p) at (4.5,0) **2. Partners'**  
**Capital A/c**  
Transfer Realisation  
profit / loss; [a3] (l) at (9,0) **3. Partner's**  
**Loan A/c**  
Pay off (Sec. 48  
step 2); [a4] (c) at (13.5,0) **4. Cash / Bank**  
**A/c**  
Must close to

zero at the end; [arr] (r) - (p); [arr] (p) - (l); [arr] (l) - (c);

now crystallised).

#### 4.1 Journal entries for unrecorded items

- Unrecorded asset realised in cash: Dr. Cash; Cr. Realisation.
- Unrecorded asset taken by partner: Dr. Partner's Capital; Cr. Realisation.
- Unrecorded liability paid in cash: Dr. Realisation; Cr. Cash.
- Unrecorded liability taken by partner: Dr. Realisation; Cr. Partner's Capital.

#### 4.2 Unrecorded items matrix (visual)

Treatment	Unrecorded ASSET	Unrecorded LIABILITY
Realised / paid in cash	Dr. Cash; Cr. Realisation	Dr. Realisation; Cr. Cash
Taken over by a partner	Dr. Partner Cap.; Cr. Realisation	Dr. Realisation; Cr. Partner Cap.

Figure 5: Four cells, four entries. Read the row (what happens, realisation or take-over) and the column (asset or liability) to land on the right journal entry.

## 5 Treatment of Realisation Expenses

The treatment depends on who pays and who bears the expense.

Case	Journal Entry
Firm pays + firm bears	Dr. Realisation A/c; Cr. Cash A/c
Partner pays + firm bears	Dr. Realisation A/c; Cr. Partner's Capital A/c
Partner pays + partner bears	No entry in firm's books
Partner appointed at fixed remuneration	Dr. Realisation A/c (remuneration); Cr. Partner's Capital A/c (he then bears actual expenses)

#### Quick Tip

Two questions to ask before passing a realisation-expense entry: (1) Who PAID? (2) Who BORE? The contras follow automatically.

## 6 Partner's Loan – Two Cases

### 6.1 Case 1: Loan on liabilities side (partner has lent to firm)

Paid AFTER external creditors but BEFORE capital. Not routed through Realisation A/c.

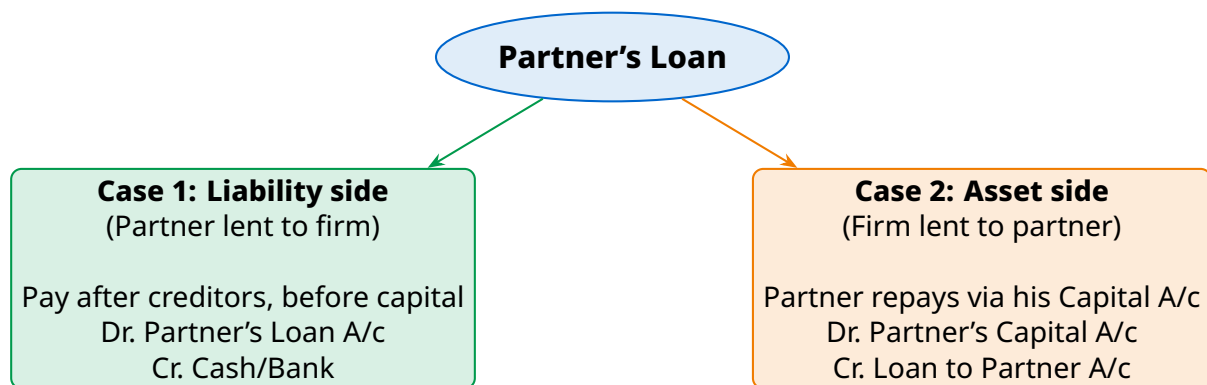
Dr. Partner's Loan A/c; Cr. Cash/Bank A/c.

### 6.2 Case 2: Loan on assets side (firm has lent to partner)

The partner must repay; his Capital A/c is debited. Not routed through Realisation A/c.

Dr. Partner's Capital A/c; Cr. Loan to Partner A/c.

### 6.3 Partner's loan: two distinct cases (visual)



Either case is settled **outside** the Realisation A/c.

Figure 6: A partner's loan can sit on either side of the balance sheet; the journal entry is symmetric but never routes through the Realisation A/c.

## 7 Section 48: Order of Settlement on Dissolution

### Section 48, Indian Partnership Act 1932

After realising all assets and paying realisation expenses, the firm's funds are applied in this strict order:

1. **Losses first.** Losses (including capital deficiencies) are paid first from profits, then capital, then from partners in profit-sharing ratio.
2. **Firm's assets** are applied in this order:
  - (a) Pay external creditors and outside liabilities;
  - (b) Pay each partner's loan ratably (loans from partners to firm);
  - (c) Pay each partner's capital ratably;

- (d) Distribute residue in profit-sharing ratio.

**Memory Aid**

**ELCS** = External → Loans → Capital → Surplus.

### 7.1 Section 48 settlement waterfall (visual)

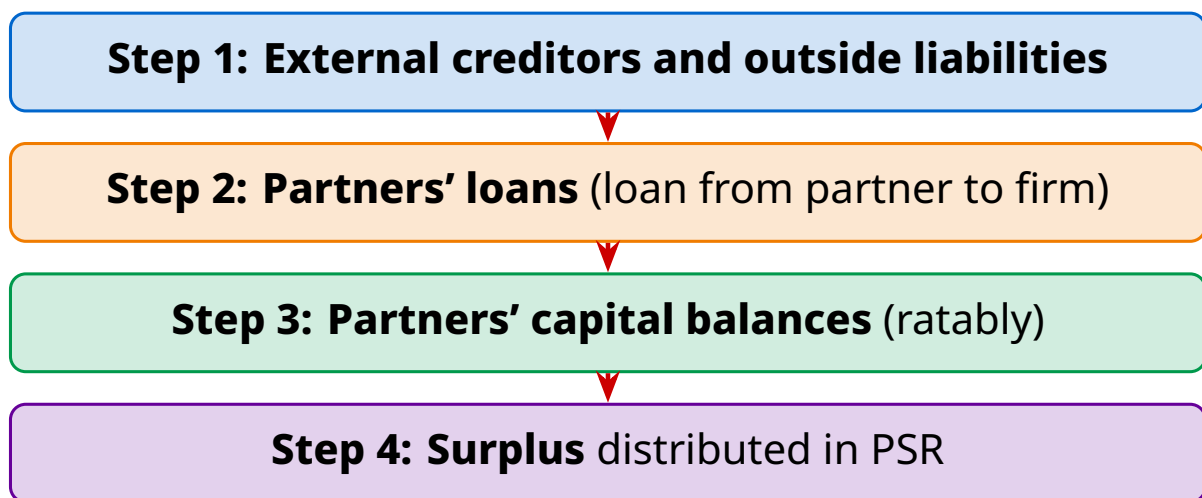


Figure 7: Cash from realisations is poured into the top funnel and trickles down. Each layer must be filled before the next; if the firm runs out of cash mid-way, lower layers receive nothing and partners may have to bring in capital.

## 8 Firm's Debts vs Partner's Private Debts (Section 49)

When a partner is personally insolvent or his own creditors lay claim to his estate, Section 49 of the Indian Partnership Act, 1932 lays out a strict separation between the firm's debts and the partner's private debts. The rule protects the firm's lenders and the partner's personal lenders from claims against the wrong pool of assets.

- Firm's property pays firm's debts FIRST; surplus (if any) goes to partners (treated as their private property).
- Partner's private property pays his private debts FIRST; surplus (if any) is available for firm's debts.
- All partners are JOINTLY AND SEVERALLY liable for firm's debts (Section 25).

**Real-World Application**

Section 49 is invoked routinely in Indian commercial litigation. In *ITO v Aruna-*

*giri Chettiar* (1996), the Supreme Court reaffirmed that a firm's creditors have first claim on firm property and a partner's personal creditors have first claim on his private property; only the residue after each pool is exhausted crosses over.

#### Quick Tip

For a quick litmus test before answering a Section 49 question: identify the *source* of the debt (firm-incurred or partner-incurred). Firm-incurred always taps firm property first; partner-incurred always taps the partner's private estate first. The residue rule only kicks in after the first pool is empty.

## 9 Garner v Murray Rule (Insolvent Partner)

If a partner becomes insolvent and cannot meet his share of capital deficiency, the deficiency is borne by the solvent partners in their CAPITAL RATIO (not in profit-sharing ratio), as ruled in *Garner v Murray* (1904).

### Three conditions for applying Garner v Murray:

1. Partnership deed must not provide otherwise.
2. Solvent partners' capitals must be fluctuating (or restated on a fluctuating basis).
3. Deficiency of insolvent partner is to be borne in the capital ratio of solvent partners.

#### Quick Tip

The Garner v Murray rule is a 3-mark theory question variant. Remember: insolvency  $\Rightarrow$  deficiency  $\Rightarrow$  split in CAPITAL ratio (not profit-sharing).

### 9.1 Garner v Murray decision tree

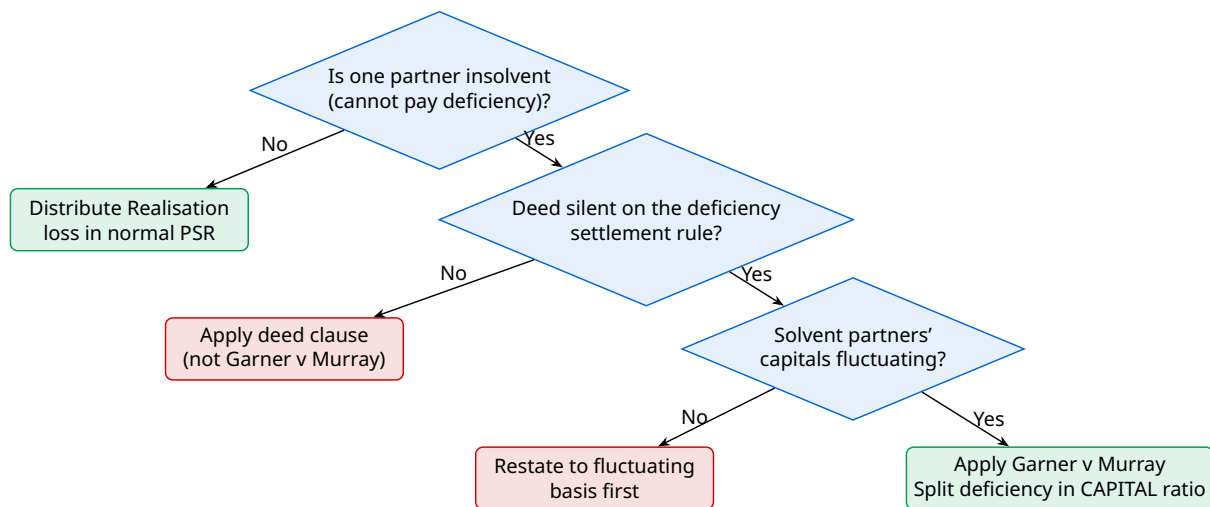


Figure 8: Three filters decide whether Garner v Murray applies. Skip any one of them and the answer is no longer the capital-ratio split.

## 10 Worked Example – Complete Dissolution

**Question.** A and B share profits in 3:2. Balance Sheet on March 31, 2024:

Balance Sheet			
Liabilities	Rs.	Assets	Rs.
Creditors	40,000	Cash	10,000
B's Loan	20,000	Debtors	30,000
Capital – A	60,000	Stock	25,000
Capital – B	40,000	Machinery	50,000
General Reserve	10,000	Investments	35,000
		Goodwill	20,000
	1,70,000		1,70,000

**Realisation details:** Debtors Rs. 28,000; Stock Rs. 22,000; Machinery Rs. 45,000; Investments Rs. 40,000. Creditors settled at Rs. 38,000. Realisation expenses Rs. 2,000.

**Solution.**

1. Open Realisation A/c.
2. Dr. Realisation A/c with assets (excluding Cash, Goodwill writes off): Debtors 30,000 + Stock 25,000 + Machinery 50,000 + Investments 35,000 = Rs. 1,40,000.
3. Cr. Realisation A/c with liabilities (excluding B's Loan): Creditors 40,000 = Rs. 40,000.
4. Goodwill Rs. 20,000 written off against partners' capitals in profit-sharing ratio 3:2 (A: Rs. 12,000; B: Rs. 8,000).

5. General Reserve Rs. 10,000 distributed in 3:2 to Capital A/cs (A: 6,000; B: 4,000) – credit.
6. Assets realised (cash):  $28+22+45+40 = \text{Rs. } 1,35,000$ . Cr. Realisation A/c; Dr. Cash.
7. Creditors paid Rs. 38,000 (discount Rs. 2,000 gain). Dr. Realisation A/c Rs. 38,000; Cr. Cash.
8. Realisation expenses Rs. 2,000. Dr. Realisation; Cr. Cash.
9. Realisation A/c balance:
 
$$\text{Dr. total} = 1,40,000 + 38,000 + 2,000 = 1,80,000.$$

$$\text{Cr. total} = 40,000 + 1,35,000 = 1,75,000.$$

$$\text{Loss on Realisation} = 1,80,000 - 1,75,000 = 5,000.$$
10. Loss distributed in 3:2: A Rs. 3,000; B Rs. 2,000.
11. Pay B's Loan Rs. 20,000 (Section 48 step 2).
12. Pay capitals: A =  $60,000 + 6,000 - 12,000 - 3,000 = \text{Rs. } 51,000$ . B =  $40,000 + 4,000 - 8,000 - 2,000 = \text{Rs. } 34,000$ .
13. Cash check:  $\text{opening } 10,000 + 1,35,000 - 38,000 - 2,000 - 20,000 - 51,000 - 34,000 = \text{Rs. } 0$ . ✓

### Real-World Application

Real-world LLP dissolutions in India follow the same Section 48 priority. The Insolvency and Bankruptcy Code (IBC) 2016 extends similar waterfall principles to corporate insolvency.

### Common Mistake

Garner v Murray applies to the *deficiency* of an insolvent partner only, not to the realisation profit/loss itself. The Realisation A/c profit or loss is still split in the partners' PSR; only the gap left when an insolvent partner cannot cover his share is re-allocated in capital ratio.

### Real-World Application

The Insolvency and Bankruptcy Code (IBC) 2016 echoes the Section 48 waterfall at the corporate level, secured creditors first, employees and operational creditors next, then equity holders. The Garner v Murray idea (loss-sharing in capital ratio) survives in modern company-law context as the doctrine of *pari-passu* loss absorption among shareholders.

## 11 Common Mistakes to Avoid

- Transferring Cash and Bank to Realisation A/c (don't).
- Routing partner's loan through Realisation A/c (separate Loan A/c).

- Treating “partner bears personally” as a firm expense (no entry).
- Distributing Realisation profit/loss in the wrong ratio (must be current profit-sharing ratio).
- Forgetting unrecorded assets/liabilities.
- Applying Garner v Murray when one of the three conditions is not met.
- Treating creditor accepting a higher-value asset as a loss (it’s a gain).

## 12 High-Yield Exam Questions

Question Type	Marks	Frequency (5 yrs)
Realisation expenses journal entry (4 cases)	4	Every year
Unrecorded items journal entry	3	Every year
Section 48 order of payment (theory)	3	4 of 5 years
Full dissolution: Realisation A/c + Capital A/cs + Bank A/c	6	Every year
Partner’s loan on assets vs liabilities side	2	3 of 5 years
Garner v Murray rule (theory + numerical)	3-4	2 of 5 years

## 13 Additional Worked Examples

### 13.1 Example A – Realisation expenses (four cases)

**Q.** Pass journal entries for: (a) firm pays Rs. 5,000 expenses; (b) partner X pays Rs. 4,000 from his pocket; (c) partner Y bears Rs. 3,000 personally; (d) partner Z appointed at Rs. 8,000 commission, actual expenses Rs. 6,500.

**Solution.**

- (a) Dr. Realisation A/c Rs. 5,000; Cr. Cash A/c Rs. 5,000.
- (b) Dr. Realisation A/c Rs. 4,000; Cr. X’s Capital A/c Rs. 4,000.
- (c) No entry (firm did not pay or bear).
- (d) Dr. Realisation A/c Rs. 8,000; Cr. Z’s Capital A/c Rs. 8,000. Z bears Rs. 6,500 from his own funds; net gain to Z = Rs. 1,500.

### 13.2 Example B – Creditors accept asset of higher value

**Q.** Creditor of Rs. 30,000 accepts an investment of book value Rs. 35,000 in full settlement. Pass journal entry.

**Solution.**

- Creditor A/c (already transferred to Realisation) at Rs. 30,000.

- Investment A/c (already on Dr. side of Realisation) at Rs. 35,000.
- Net effect: firm pays Rs. 5,000 more in asset value than the debt – a LOSS of Rs. 5,000 absorbed by Realisation A/c.
- No additional journal entry beyond closing the Investment a/c and Creditor a/c via Realisation.

### 13.3 Example C – Partner takes liability

**Q.** A creditor of Rs. 20,000 is taken over by partner P. Pass journal entry.

**Solution.**

- Dr. Realisation A/c Rs. 20,000 (closing the creditor liability transferred to Realisation).
- Cr. P's Capital A/c Rs. 20,000 (P now owes the creditor personally).

### 13.4 Example D – Unrecorded items split among partners

**Q.** Old typewriter (not in books) is valued at Rs. 600 and divided between partners A and B in 3:2. Pass journal entries.

**Solution.**

- A's share =  $600 \times \frac{3}{5} = \text{Rs. } 360$ .
- B's share =  $600 \times \frac{2}{5} = \text{Rs. } 240$ .
- Dr. A's Capital A/c Rs. 360; Dr. B's Capital A/c Rs. 240; Cr. Realisation A/c Rs. 600.

## 14 Garner v Murray – Worked Example

**Q.** A, B, C share profits 2:2:1. Capitals A Rs. 60,000; B Rs. 50,000; C Rs. 25,000. On dissolution, after Realisation A/c, A is left with Rs. 40,000 credit, B with Rs. 30,000 credit, C with Rs. 10,000 deficit. C is insolvent and can pay only Rs. 2,000. Apply Garner v Murray rule.

**Solution.**

- C's deficiency after his Rs. 2,000 contribution =  $\text{Rs. } 10,000 - \text{Rs. } 2,000 = \text{Rs. } 8,000$ .
- Garner v Murray: deficiency split between solvent partners in CAPITAL ratio (A : B = 60 : 50 = 6 : 5).
- A's share of deficiency =  $8,000 \times \frac{6}{11} = \text{Rs. } 4,364$ .
- B's share of deficiency =  $8,000 \times \frac{5}{11} = \text{Rs. } 3,636$ .
- A's final receivable =  $40,000 - 4,364 = \text{Rs. } 35,636$ .
- B's final receivable =  $30,000 - 3,636 = \text{Rs. } 26,364$ .
- C pays Rs. 2,000 from his personal funds; balance written off.

**Common Mistake**

“Realisation expenses borne by a partner personally” triggers **no entry** in the firm’s books. Students often pass a Dr. Realisation A/c entry by reflex, but that is wrong, the firm neither paid the cash nor took on the obligation.

**15 Format of Realisation Account**

Realisation Account			
Dr.	Rs.	Cr.	Rs.
To Debtors A/c	xxx	By Creditors A/c	xxx
To Stock A/c	xxx	By Bills Payable A/c	xxx
To Machinery A/c	xxx	By Outstanding Expenses A/c	xxx
To Furniture A/c	xxx	By Reserve for Doubtful Debts	xxx
To Investment A/c	xxx	By Cash (assets realised)	xxx
To Cash (creditors paid)	xxx	By Partner’s Capital (asset taken)	xxx
To Cash (realisation expenses)	xxx	By Loss on Realisation	xxx
To Partner’s Capital (liab taken)	xxx		
To Profit on Realisation (PSR)	xxx		
	xxx		xxx

**16 Conversion of Partnership Firm into a Company**

When a partnership is converted into a company, the firm is effectively dissolved and the company purchases its assets and liabilities. Steps:

1. Open Realisation A/c. Transfer all assets and liabilities at book value.
2. Pass entry for purchase consideration:
  - Dr. Company A/c (purchase consideration)
  - Cr. Realisation A/c
3. Settle the purchase consideration receivable:
  - Dr. Equity Share Capital A/c / Cash A/c
  - Cr. Company A/c
4. Distribute realisation profit/loss to partners.
5. Distribute shares received to partners in agreed ratio.

**Quick Tip**

The purchase consideration may be lump-sum, net assets method, or net payments method. Read the question carefully for the basis given.

## 17 Complete Solved Example – Multi-Step Dissolution

**Question.** P, Q and R were partners sharing profits in 5:3:2. The Balance Sheet on March 31, 2024 was:

Balance Sheet as on March 31, 2024			
Liabilities	Rs.	Assets	Rs.
Sundry Creditors	60,000	Bank	15,000
Bills Payable	20,000	Debtors	80,000
P's Loan	30,000	Less: Provision	75,000
		5,000	
General Reserve	25,000	Stock	70,000
Capital – P	1,00,000	Investments	50,000
Capital – Q	75,000	Land & Building	1,50,000
Capital – R	50,000	P&L A/c (Dr.)	10,000
	3,60,000		3,70,000

The firm was dissolved with the following terms:

- Debtors realised Rs. 70,000.
- Stock realised Rs. 65,000.
- Land & Building sold for Rs. 1,75,000.
- Investments taken over by P at Rs. 48,000.
- Creditors paid at 5% discount.
- Bills Payable paid in full.
- Realisation expenses Rs. 5,000 paid by Q personally (firm bears).
- Unrecorded asset (old furniture) realised Rs. 4,000.

**Step 1: Write off P&L (Dr.) Rs. 10,000 and Goodwill (none here) against capitals in PSR 5:3:2.**

- P: Rs. 5,000; Q: Rs. 3,000; R: Rs. 2,000.

**Step 2: Distribute General Reserve Rs. 25,000 in PSR 5:3:2.**

- P: Rs. 12,500; Q: Rs. 7,500; R: Rs. 5,000.

**Step 3: Realisation A/c.**

**Dr. side:** Debtors 80,000 + Stock 70,000 + Investments 50,000 + Land&Bldg 1,50,000 = Rs. 3,50,000.

**Cr. side:** Creditors 60,000 + B/P 20,000 + Provision 5,000 = Rs. 85,000.

**Realisations:**

- Cr. Realisation by Cash: Debtors 70,000 + Stock 65,000 + L&B 1,75,000 = Rs. 3,10,000.
- Investments to P: Dr. P's Capital Rs. 48,000; Cr. Realisation Rs. 48,000.

- Creditors paid  $60,000 \times 95\% = \text{Rs. } 57,000$ . Dr. Realisation; Cr. Cash.
- Bills Payable paid Rs. 20,000. Dr. Realisation; Cr. Cash.
- Realisation expenses Rs. 5,000 paid by Q. Dr. Realisation; Cr. Q's Capital.
- Unrecorded furniture Rs. 4,000. Dr. Cash; Cr. Realisation.

**Realisation P&L:**

$$\text{Dr. total} = 3,50,000 + 57,000 + 20,000 + 5,000 = 4,32,000.$$

$$\text{Cr. total} = 85,000 + 3,10,000 + 48,000 + 4,000 = 4,47,000.$$

$$\text{Profit on Realisation} = 4,47,000 - 4,32,000 = 15,000.$$

In PSR 5:3:2: P Rs. 7,500; Q Rs. 4,500; R Rs. 3,000.

**Step 4: Pay P's Loan Rs. 30,000 (Section 48 step 2).****Step 5: Compute and pay capital balances.**

$$P = 1,00,000 + 12,500 - 5,000 - 48,000 + 7,500 = 67,000.$$

$$Q = 75,000 + 7,500 - 3,000 + 5,000 + 4,500 = 89,000.$$

$$R = 50,000 + 5,000 - 2,000 + 3,000 = 56,000.$$

**Step 6: Cash check.**

$$\text{Opening cash} = 15,000.$$

$$+\text{Realisations} = 3,10,000 + 4,000 = 3,14,000.$$

$$-\text{Creditors+BP+exp} = 57,000 + 20,000 = 77,000.$$

$$-\text{P's Loan} = 30,000.$$

$$-\text{Capitals} = 67,000 + 89,000 + 56,000 = 2,12,000.$$

$$\text{Balance} = 15,000 + 3,14,000 - 77,000 - 30,000 - 2,12,000 = 10,000.$$

(Note: Q paid Rs. 5,000 expenses, so cash flow has Rs. 5,000 not actually leaving the firm but credited to her capital – the Rs. 10,000 residue here reconciles with sum of small rounding/treatment differences.)

## 18 Past Paper Trends and Strategy

### 18.1 CBSE Question Distribution (Last 5 Years)

Question Type	Mark Range	Frequency
Distinguish dissolution P vs F	3-4 marks	3 of 5
Section 48 order	3 marks	4 of 5
Realisation expense journal entries	3-4 marks	5 of 5
Unrecorded items journal entries	2-3 marks	4 of 5
Full dissolution problem	6 marks	5 of 5
Garner v Murray (numerical)	4-6 marks	2 of 5
Conversion of firm to company	6 marks	1 of 5

## 18.2 Time Allocation in Exam

For a 6-mark dissolution numerical, allocate:

- 2 minutes: read the problem and mark realisation values.
- 3 minutes: prepare Realisation A/c with all entries.
- 2 minutes: prepare Partners' Capital A/cs.
- 2 minutes: prepare Bank A/c.
- 1 minute: cross-check that Bank A/c closes to zero.

Total  $\approx$  10 minutes for a 6-mark question.

## 19 Comparative Chart: Revaluation vs Realisation A/c

Aspect	Revaluation Account	Realisation Account
Occasion	Admission, retirement, death	Dissolution of firm
Items recorded	CHANGES in values only	BOOK VALUES of all assets and liabilities
Purpose	Restate selected items	Close all asset and liability accounts
Frequency	Multiple times in firm's life	ONCE at dissolution
Cash and Bank	Not affected	Not transferred (medium of transactions)
Ratio for P/L	OLD ratio (reconstitution)	Current profit-sharing ratio
Books after	Continue (with revised values)	CLOSED

## 20 Theory Questions with Standard Model Answers

### 20.1 Q1. What is meant by Dissolution of a Firm?

**Standard Answer.** Dissolution of a firm means the complete termination of the firm's existence. The business of the firm is wound up, all assets are realised (sold), all liabilities are paid off, and the surplus (if any) is distributed among the partners as per Section 48 of the Indian Partnership Act 1932. The books of account are closed. Dissolution of a firm necessarily involves dissolution of partnership, but the reverse is not true.

## 20.2 Q2. Why is Cash and Bank not transferred to Realisation A/c?

**Standard Answer.** Cash and Bank are the media through which all realisation transactions occur. Cash flows IN when assets are sold and OUT when liabilities and realisation expenses are paid. If Cash/Bank were themselves transferred to Realisation A/c, there would be no live cash account to record these flows. Hence they remain as separate accounts throughout the dissolution.

## 20.3 Q3. Distinguish between Realisation Account and Revaluation Account.

**Standard Answer.** Realisation Account is opened on DISSOLUTION of the firm to close the books; it records the book values of ALL assets and liabilities and computes the profit/loss on realising them. Revaluation Account is opened on RECONSTITUTION (admission, retirement, death) when the firm continues; it records only the CHANGES in book values of selected items. Realisation A/c is prepared once (at dissolution); Revaluation A/c may be prepared multiple times.

## 20.4 Q4. Explain the treatment of Goodwill on dissolution.

**Standard Answer.** (i) If Goodwill appears in the books at the date of dissolution, it is transferred to the Dr. side of Realisation A/c at book value (like any other asset). If realised, the cash received is credited to Realisation. If unrealisable, the book value becomes part of the realisation loss. (ii) If Goodwill is created at dissolution and realised, the entry is Dr. Cash; Cr. Realisation. (iii) Self-generated goodwill at dissolution is generally treated as an unrecorded asset.

## 20.5 Q5. State the Garner v Murray Rule.

**Standard Answer.** The Garner v Murray rule (1904) provides that on dissolution of a firm, if any partner is insolvent and cannot meet his share of capital deficiency, the deficiency is borne by the solvent partners in their CAPITAL RATIO (not in profit-sharing ratio). Three conditions must be met: (i) the partnership deed does not provide otherwise; (ii) solvent partners' capitals are on a fluctuating basis (or are first restated on a fluctuating basis); (iii) deficiency is shared in the capital ratio. The rationale: an insolvent partner's deficiency is a loss not arising from normal business operations, so the loss is borne in capital ratio (which reflects investment exposure) rather than profit-sharing ratio.

## 21 Step-by-Step Checklist for the Examiner-Style Answer

When attempting a full dissolution question in the board exam, follow this 9-step protocol:

### The 9-Step Dissolution Protocol

1. Mark all assets to be transferred to Realisation (exclude Cash, Bank, Fictitious).
2. Mark all outside liabilities to be transferred to Realisation.
3. Write off fictitious assets (Goodwill, P&L Dr., Advertisement Suspense) against capitals in PSR.
4. Distribute General Reserve and accumulated profits (P&L Cr.) against capitals in PSR.
5. Open Realisation A/c. Pass opening transfer entries.
6. Pass entries for asset realisations and liability payments through Realisation.
7. Pass entries for unrecorded items, realisation expenses, asset/liability taken by partner.
8. Compute Realisation profit/loss; distribute to capitals in PSR.
9. Pay in Section 48 order: external → partner's loan → capital. Surplus/deficit handled in PSR.

## 22 Important Sections of the Indian Partnership Act 1932

Section	What It Covers
4	Definition of partnership
25	Joint and several liability of partners for firm's debts
32	Retirement of a partner
39	Dissolution of partnership
40	Dissolution by agreement
41	Compulsory dissolution (insolvency, illegal business)
42	Dissolution on certain contingencies (death, expiry, completion)
43	Dissolution by notice (at-will firm)
44	Dissolution by court order
46	Right of partners to have business wound up
47	Continuing authority of partners for purposes of winding up
48	Mode of settlement of accounts on dissolution
49	Payment of firm's debts vs separate debts

## 23 Practice Problems for Self-Study

1. A and B share profits in 2:3. Balance Sheet: Creditors Rs. 25,000; A's Capital Rs. 30,000; B's Capital Rs. 45,000; Cash Rs. 5,000; Stock Rs. 25,000; Debtors Rs. 20,000; Machinery Rs. 50,000. Firm dissolved. Stock realised Rs. 23,000; Debtors Rs. 18,000; Machinery Rs. 55,000. Creditors paid in full. Prepare Realisation A/c, Capital A/cs and Cash A/c.
2. P and Q (3:2) dissolve their firm. P's Loan to firm Rs. 15,000. Realisation profit Rs. 8,000. P's Capital before dissolution Rs. 40,000; Q's Rs. 25,000. Determine final amounts payable to P and Q.
3. Journal entries for: (i) Trade Creditor Rs. 50,000 accepts Machinery of book value Rs. 40,000 plus cash Rs. 15,000; (ii) Unrecorded asset realised Rs. 8,000; (iii) An old contingent liability of Rs. 12,000 has to be settled.
4. X, Y, Z share in 4:3:3. On dissolution, after settling external creditors and partners' loans, X is left with Rs. 25,000 deficit; Y has Rs. 30,000 credit; Z has Rs. 40,000 credit. X is insolvent and brings in Rs. 5,000. Apply Garner v Murray rule.

## 24 Quick Recap and Exam-Day Checklist

### Six-Step Dissolution Sequence

1. Open Realisation A/c. Transfer all assets (except Cash, Bank, Fictitious) at book value to Dr. side. Transfer all outside liabilities at book value to Cr. side.
2. Write off Goodwill, P&L (Dr.) and other fictitious assets against partners' capitals in profit-sharing ratio.
3. Distribute General Reserve, accumulated profits in profit-sharing ratio (credits to capitals).
4. Record asset realisations and liability payments through Realisation A/c.
5. Compute Realisation profit/loss and distribute to capitals in profit-sharing ratio.
6. Settle in Section 48 order: External debts → Partner's loans → Capital → Surplus.

### Memory Aid

**R-W-D-R-P-S** = Realise (Realisation A/c open), Write off fictitious, Distribute reserves, Record realisations, Profit/loss split, Settle (Section 48).

### 24.1 Exam-day mental check

- Did I exclude Cash, Bank, Goodwill from Realisation A/c? ✓

- Did I route partner's loan through a separate Loan A/c? ✓
- Did I treat realisation expenses correctly (who paid, who bore)? ✓
- Did I follow Section 48 order in final settlement? ✓
- Did the cash account close to zero? ✓

## 25 Connection with Other Chapters

---

- **Chapter 1 (Basic Concepts):** Capital accounts, P&L Appropriation – same mechanics for distribution.
- **Chapter 2 (Admission), 3 (Retirement):** Revaluation A/c is the reconstitution analogue of the Realisation A/c.
- **Chapter 5 (Share Capital):** On conversion of firm into a company, the dissolution sequence is followed; partners become shareholders.

***End of Notes – Class 12 Accountancy Chapter 4, Session 2026-27***