

Introduction

The owner of an asset (e.g. mines, quarries, patent, copyright, etc), as a business arrangement, may allow other party (lessee, licensee, publisher, etc) the right to use that asset against some consideration. Such consideration is calculated with reference to the quantity produced or sold. This payment to the owner by the user of the asset is termed as **Royalty**.

We can therefore say that the royalty is the amount of consideration paid by a party to the owner of the asset in return for the right to use that asset.

Forexample, when a publisher publishes a book, he makes a payment to the author which is based on the number of copies sold known as royalty.

Common terms Used in Connection with Accounting for Royalty :

1. Minimum Rent / Dead Rent

A contract is entered into between the landlord and the lessee for payment of royalty, usually calculated upon the quantum of production or sale at a certain stipulated rate.

Since sale or production mostly depends on the capacity of the person to whom the rights have been given. To avoid such a situation, the landlord and the lessee agreed upon a minimum periodical amount that the landlord will receive from the lessee, even if the actual royalty as calculated on the basis of actual production or sale is less than such minimum amount.

This assured and mutually agreed periodical minimum amount is known as "**Minimum Rent**".

The minimum rent is also called dead rent, certain rent, fixed rent, etc.

2. Short workings/Redeemable Dead Rent

Short workings is the amount by which the minimum rent exceeds the actual royalty. It is the difference between Actual Rent and Minimum Rent.

The question of short workings will arise only when there is a stipulation for minimum rent in the agreement.

3. Excess working

It refers to the amount by which the actual royalty exceeds the minimum rent.

4. Ground Rent/Surface Rent

It refers to the fixed yearly or half-yearly rent payable by the lessee to the landlord in addition to the minimum rent.

5. Recoupment of Short workings

Generally the royalty agreement contains a provision for carrying forward of short workings with a view to adjust it in the future. In the subsequent years, such short working is adjusted against the surplus royalty. This process of adjustment is called recoupment of short workings. The right of recoupment of short workings enables the lessee to recover the excess payment, made in the earlier years to meet the condition of payment of minimum rent. A time is usually agreed upon the number of years for which such short workings can be recouped. This time limit for recoupment of short workings may be fixed or fluctuating. If the short workings cannot be recouped within the specified time, they lapse and are charged to Profit and Loss Account in the year when that specified time limit for recoupment ends.

(i) Fixed right :

When the lessee can recoup short workings within a certain period from the date of the lease it is known as fixed right. For example, short workings can be recouped within three years from the date of the lease. So, after three years from the date of the lease the short workings cannot be recouped.

(ii) Fluctuating right :

In this type of agreement, lessee can recoup short workings of any year during the next following year(s). For example, short workings can be recouped in the year subsequent to the year of short workings.

6. Strike and Lockout, etc :

If agreement so provides, the minimum rent may be proportionately reduced in the event of strike and/or lockout. So special entry is required for the same except the adjustment of minimum rent for that particular year.

Accounting Entries in the Books of the Lessee/Licencee/Publisher etc.**(a) Where the actual royalty is less than the minimum rent**

| | | | | | |
|--------------|--|------------|--|--|--|
| (i) | Royalties Account | Dr. | | | [Actual royalties for the period] |
| | Short workings Account | Dr. | | | [Minimum rent - Actual royalties] |
| | To Landlord Account | | | | [Minimum rent] |
| (ii) | Landlord Account | Dr. | | | [Minimum rent] |
| | To Bank Account | | | | [Net amount paid] |
| (iii) | Manufacturing / Profit & Loss Account | Dr. | | | [Transfer] |
| | To Royalties Account | | | | [Actual royalties for the period] |

Important Points:

1. If the user is a manufacturer and royalties are calculated on the basis of production, the actual royalties are debited to Manufacturing Account. Where royalties are calculated on the basis of sales, they are debited to Profit and Loss Account.
2. In case of a limited company, which does not prepare Manufacturing Account separately, the actual royalties are debited to Profit and Loss Account and they are shown in production or manufacturing section of the Profit and Loss Account.

Treatment of Short workings

As per agreed terms, short workings can be recouped in the year when the actual royalty is more than the Minimum rent. Any short workings, which cannot be recouped within the specified period becomes irrecoverable and it should be charged to Profit and Loss Account in the year in which the period ends.

However, the recoupable short workings should be carried forward and they are shown in the Balance Sheet as a Current Asset.

The relationship between Minimum rent, Actual Royalty and Royalty payable are in below: Minimum rent = Actual Royalty + Short workings.

(b) Where the actual royalty is more than the minimum rent:

| | | | | | |
|--------------|---------------------------------------|------------|--|--|---|
| (i) | Royalties Account | Dr. | | | |
| | To Landlord Account | | | | [Actual royalties for the period] |
| (ii) | Landlord Account | Dr. | | | |
| | To Short workings Account | | | | [Short workings, if any, recouped] |
| (iii) | Landlord Account | Dr. | | | |
| | To Bank | | | | |
| (iv) | Profit & Loss Account | Dr. | | | |
| | To Short workings Account | | | | [Short workings, (which can not be recouped)] |
| (iii) | Manufacturing / Profit & Loss Account | Dr. | | | |
| | To Royalties Account | | | | |

Important Points:

1. When the royalty agreement does not contain a clause for minimum rent, the question of short workings and its recoument does not arise.
2. The landlord is always entitled to get either the minimum rent or the actual royalty whichever is higher subject to any adjustment for short workings recouped.

Accounting Entries in the Books of the Landlord / Lessor**(a) Where the actual royalty is less than the minimum rent:**

| | | | | | |
|--------------|--|------------|--|--|-----------------------------------|
| (i) | Lessee Account | Dr. | | | [Minimum rent] |
| | To Royalty Account | | | | [Actual Royalties for the period] |
| | To Royalty Suspense Account/ or Shortworkings Allowable A/c | | | | [Short fall in Royalties] |
| (ii) | Bank Account | Dr. | | | |
| | To Lessee Account | | | | |
| (iii) | Royalties Account | Dr. | | | |
| | Profit & Loss Account | | | | [Transfer] |

(b) Where the actual royalty is more than the minimum rent :

| | | | | | |
|--------------|---|------------|--|--|---|
| (i) | Royalty Suspense Account/ or Shortworkings Allowable A/c | Dr. | | | |
| | To Lessee Account | | | | [Recoument of Short workings, if any] |
| (ii) | Bank Account | Dr. | | | [Net amount paid] |
| | To Lessee Account | | | | |
| (iii) | Royalties Account | Dr. | | | |
| | Profit & Loss Account | | | | [Transfer] |
| (iv) | Royalty Suspense Account/ or Shortworkings Allowable A/c | Dr. | | | |
| | To Profit & Loss Account | | | | [Short workings, which can not be recouped] |

ASSIGNMENTS FOR CLASS

1).

The Bihar Coal Co. Ltd. holds a lease of coal mines for a period of twelve years, commencing from 1st April 2006. According to the lease, the company is to pay ₹7.50 as royalty per ton with a minimum rent of ₹150,000 per year. Short workings can, however, be recovered out of the royalty in excess of the minimum rent of the next two years only. For the year of a strike the minimum rent is to be reduced to 60%. The output in tons for the 6 years ending 31st March, 2012 is as under :

2006-07 :10,000; 2007-08 :12,000; 2008-09:25,000; 2009-10: 20,000; 2010-11: 50,000; and 2011-12: 15,000 (strike).

prepare the necessary Ledger Accounts

- 1) in the books of Bihar Coal Co. Ltd. and
- 2) accounts in the books of Landlord

2).

A. Ltd. obtain from B.S. Ltd. a lease of some coal-bearing land, the terms being a royalty of ₹15 per ton of coal raised subject to a minimum rent of ₹75,000 p.a. with a right of recoupment of short-working over the first four years of the lease. From the following details, show

(i) Short-working Account, (ii) Royalty Account and (iii) B.S. Ltd. Account in the books of A. Ltd.

| Year | Sales(Tons) (₹) | Closing Stock(Tons) (₹) |
|------|--------------------|----------------------------|
| 2009 | 2,000 | 300 |
| 2010 | 3,500 | 400 |
| 2011 | 4,800 | 600 |
| 2012 | 5,600 | 500 |
| 2013 | 8,000 | 800 |

3).

The following information has been obtained from the books of a lessee relating to the years 2008-09 to 2011-12 : Payments to Landlord (after tax deducted @ 20% at Source) :

| | 2008-09 | 12,000 |
|-----------------------------|---------|--------|
| | 2009-10 | 12,000 |
| | 2010-11 | 12,000 |
| | 2011-12 | 19,200 |
| Short-working recovered : | 2009-10 | 2,500 |
| | 2010-11 | 1,000 |
| Short-working written-off : | 2010-11 | 500 |

Balance of Short-working Account forward on April 1, 2008 ₹800 (which arose in 2007-08). According to the terms of agreement short-working is recoverable within the next two years following the year in which short-working arises.

You are required to show the necessary accounts in the books of the lessee for the four years ended 31st March 2012.

4).

A fire occurred in the office premises of lessee in the evening of 31.3.2012 destroying most of the books and records. From the documents saved, the following information is gathered:

Short-working recovered :

2009-10 ₹4,000 (towards short-workings which arose in 2006-07)

2010-11 ₹8,000 (including ₹1,000 for short-working 2007-08)

2011-12 ₹2,000

Short-working lapsed :

2008-09 ₹3,000

2009-10 ₹3,600

2011-12 ₹2,000

A sum of ₹50,000 was paid to the landlord in 2008-09. The agreement of Royalty contains a clause of Minimum Rent payable for fixed amount and recoupment of short-workings within 3 years

Following the year in which Short- workings arise.

Information as regards payments to landlord subsequent to the year 2008-09 is not readily available.

Show the Short – working Account and the Royalty Account in the books of lessee.

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Classes