

ROYALTY

Important Terms

Following are the important terms, which are used in Royalty agreements –

Royalty

A periodic payment, which may be based on a sale or output is called Royalty. Royalty is payable by the lessee of a mine to the lessor, by publisher of the book to the author of the book, by the manufacturer to the patentee, etc.

Landlord

Landlords are the persons who have the legal rights on mine or quarry or patent right or copybook rights.

Tenet

An Author or publisher; lessee or patent or who takes out rights (usually commercial or personal rights) from the owner on lease against the consideration is called tenet..

Minimum Rent

According to the lease agreement, minimum rent, fixed rent, or dead rent is a type of guarantee made by the lessee to the lessor, in case of shortage of output or production or sale. It means, lessor will receive a minimum fix rent irrespective of the reason/s of the shortage of production.

Sub Lease

Sometime, landlord or lessor allows lessee to sublet some part of the mine or land as a sub-lessee. In this case, lessee will become lessor for sub lessee and lessee for main landlord.

In such a case, as Lessee, he will maintain the following books of accounts –

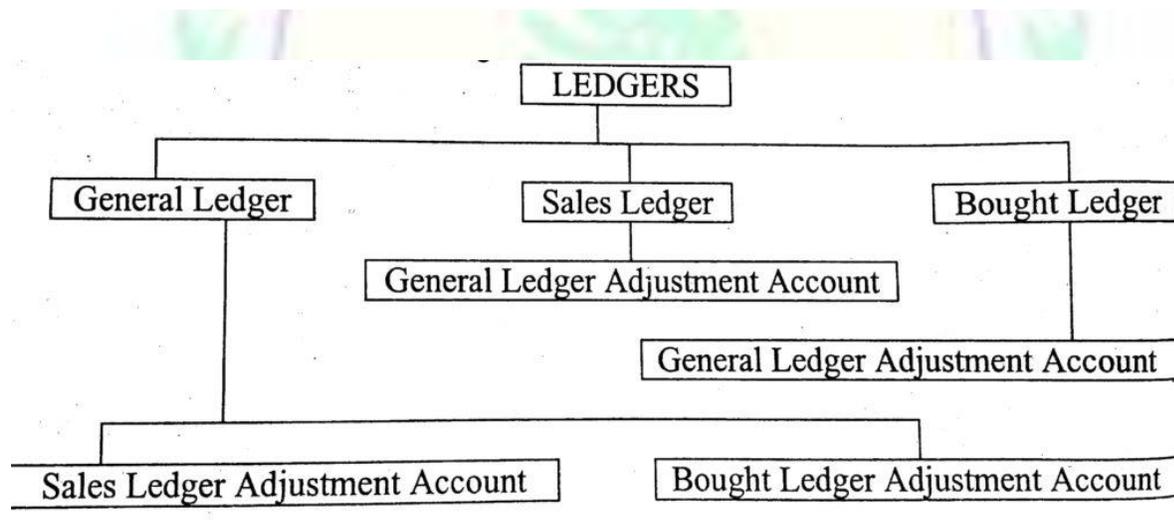
As a Lessee

- Landlord account
- Minimum Rent Account
- Royalty Account
- Short workings Recoupable Accounts

As a Sub Lessor

- Royalties receivable account
- Sub lessee account
- Short workings allowable Account

Self-Balancing Ledger System: Diagram



Consider a small business having limited number of transactions. For them, it is possible to open a single ledger with all the accounts in it. This single ledger is known as the **General Ledger**.

However, when the size of the business is large, a considerable number of accounts become involved. It is difficult to maintain all the accounts in a single General Ledger then.

Thus, for proper book-keeping, large businesses opt for the Self Balancing System where the following ledgers are maintained:

1. **Debtors or Sales or Sold Ledger:** It contains **personal accounts of all trade debtors** to whom goods are sold on **credit**.
2. **Creditors or Purchases or Bought Ledger:** It contains **personal accounts of trade creditors** from whom goods are purchased on **credit**.
3. **General or Nominal Ledger:** Contains **all other accounts** except the debtors and creditors.

The division of the Ledger into the three ledgers shown above eases the process of book keeping but also brings some problems which we will discuss below. These problems will help you understand why the Self Balancing System was developed.

Accounting Entries

When there is no royalty in the year	(a) Minimum Rent A/cDr To Landlord A/c (b) Shortworking A/cDr To Minimum Rent A/c
Where Royalties are less than minimum rent and shortworkings are recoverable in next years.	(c) Minimum Rent A/cDr To Landlord A/c (d) Royalties A/cDr Shortworkings A/cDr To Minimum Rent A/c (e) Landlord A/cDr To Bank A/c (f) Profit & Loss A/cDr To Royalty A/c
When Short workings are recouped	(g) Royalties A/cDr To short workings A/c To Landlord A/c (h) Landlord A/cDr To Bank A/c
Transfer of irrecoverable Short workings	(i) Profit & Loss A/cDr

	To Short workings A/c
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Problem: 1

AB Ltd. got the lease of a colliery on the basis of Rs.5 per tonne of coal raised subject to a Minimum Rent of Rs.1,00,000 p.a. The tenant has the right to recoup short-workings during first four years of the lease and not afterward. Assume that the year ends on 31 December every year.

The output in four years was 9000, 13000, 25000, 27000 and 50000 respectively. Give the Journal entries and ledger accounts in the books of AB Ltd.

Ans: Computation of Royalty, Minimum Rent and Short-workings

Year	Quantity in tonnes	Rate per tonne	Royalty	Minimum Rent	Short-workings
1	9000	5	45000	100000	65000
2	13000	5	65000	100000	45000
3	25000	5	125000	100000	
4	27000	5	135000	100000	
5	50000	5	250000	100000	

Computation of Recoupment, Short-workings carried forward, Transferred to P&L Account

Year	Recoupment	Short-working carried forward	Transferred to P&L Account	Payment to Lessor
1		65000		100000
2		100000		100000
3	25000	75000		100000
4	35000		40000	100000
5				250000

Journal Entries Year: 1

Date	Particular		Amount (Dr.)	Amount (Cr.)
31 Dec	Royalty A/c	Dr.	45000	
	Short-workings A/c	Dr.	65000	

	To Lessor A/c			100000
	(Being payment due)			
31 Dec	Lessor A/c	Dr.	100000	
	To Bank A/c			100000
	(Being amount paid)			
31 Dec	Profit and Loss A/c	Dr.	45000	
	To Royalty A/c			45000
	(Being amount charged to relevant a/c)			

Journal Entries Year 2

Date	Particular		Amount (Dr.)	Amount (Cr.)
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31 Dec	Royalty A/c	Dr.	65000	
	Short-workings A/c	Dr.	45000	
	To Lessor A/c			100000
	(Being payment due)			
31 Dec	Lessor A/c	Dr.	100000	
	To Bank A/c			100000
	(Being amount paid)			
31 Dec	Profit and Loss A/c	Dr.	65000	
	To Royalty A/c			65000
	(Being amount charged to relevant a/c)			

Journal Entries Year 3

Date	Particular		Amount (Dr.)	Amount (Cr.)
31 Dec	Royalty A/c	Dr.	125000	
	To Short-workings A/c			25000
	To Lessor A/c			100000
	(Being payment due)			
31 Dec	Lessor A/c	Dr.	100000	
	To Bank A/c			100000
	(Being amount paid)			
31 Dec	Profit and Loss A/c	Dr.	125000	
	To Royalty A/c			125000

	(Being amount charged to relevant a/c)			
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Journal Entries Year 4

Date	Particular		Amount (Dr.)	Amount (Cr.)
31 Dec	Royalty A/c	Dr.	135000	
	To Short-workings A/c			35000
	To Lessor A/c			100000
	(Being payment due)			
31 Dec	Lessor A/c	Dr.	100000	
	To Bank A/c			100000
	(Being amount paid)			

31 Dec	Profit and Loss A/c	Dr.	135000	
	To Royalty A/c			135000
	(Being amount charged to relevant a/c)			
31 Dec	Profit and Loss A/c	Dr.	40000	
	To short-working A/c			40000
	(Being amount charged to relevant a/c)			

Journal Entries Year 5

Date	Particular		Amount (Dr.)	Amount (Cr.)
31 Dec	Royalty A/c	Dr.	250000	
	To Lessor A/c			250000

	(Being payment due)			
31 Dec	Lessor A/c	Dr.	250000	
	To Bank A/c			250000
	(Being amount paid)			
31 Dec	Profit and Loss A/c	Dr.	250000	
	To Royalty A/c			250000
	(Being amount charged to relevant a/c)			

Ledgers account in Lessee Books

Lessor A/c

Date	Particulars	Amount		Date	Particulars	Amount
Year1	To Bank a/c	100000		Year1	By Royalty a/c	45000
					By Short-workings	65000

		100000				100000
Year2	To Bank a/c	100000		Year2	By Royalty a/c	65000
					By Short-workings	45000
		100000				100000
Year3	To Bank a/c	100000		Year3	By Royalty a/c	100000
		100000				100000
Year4	To Bank a/c	100000		Year4	By Royalty a/c	100000
		100000				100000
Year5	To Bank a/c	250000		Year5	By Royalty a/c	250000
		250000				250000

Short-workings A/c

Date	Particulars	Amount		Date	Particulars	Amount
Year1	To Lessor a/c	65000		Year1	By balance c/d	65000
		65000				65000
Year2	To balance b/d	65000		Year2		
	To Lessor a/c	45000			By balance c/d	100000
		100000				100000
Year3	To balance b/d	100000		Year3	By Royalty a/c	25000
					By balance c/d	75000
		100000				100000
Year4	To balance b/d	75000		Year4	By Royalty a/c	35000

					By P&L a/c	40000
		75000				75000

Royalty A/c

Date	Particulars	Amount		Date	Particulars	Amount
Year1	To Lessor	45000		Year1	By P&L	45000
		45000				45000
Year2	To Lessor	65000		Year2	By P&L	65000
		65000				65000
Year3	To Lessor	100000		Year3	By P&L	125000
	To Short-workings	25000				
		125000				125000

Year4	To Lessor	100000		Year4	By P&L	135000
	To Short-workings	35000				
		135000				135000
Year5	To Lessor	250000		Year5	By P&L	250000

