



Jagatpur Post Graduate College

Jagatpur – Varanasi - 221301



Affiliated to – Mahatma Gandhi Kashi Vidyapeeth

Varanasi - 221002

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Dr. Rakesh Kumar Mehta

Department of Commerce

Email-id: drmehta.rk1961@gmail.com

Mobile No: 9450248705

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Dr. Rakesh Kumar Mehta

Royalty account

Meaning and nature. The word reality is used to mean the sum one person called lessee to another person called lessor for using the right by the former (lessee) vested in the latter (lessor). In other words, it is the periodic payment to the owner of some form privilege or Monopoly for being allowed to use such right or privilege. Royalties I usually payable in the following cases;

- For the extraction of oil coal and minerals from the ground.
- To an author for sales of his book
- to a holder of patent rights for the use of his patent by other manufacturers.

Royalty account is a nominal account in nature and is synonymous with rent account.

Since it is a nominal account, it is debited in the books of the party paying it and credited in the books of the party receiving it.

Explanation of terms.

- **Minimum Rent:** It is also called 'Dead Rent' or 'Fixed Rent', because the amount of minimum rent is fixed in advance, and it is fixed at all level of production or sale. The main objective of minimum rent is to safeguard the owner by the laws which may occur on account of low production in initial years. In this way a minimum rent provides a safety or insurance to the landlord

- **Short working:** The excess of minimum rent over the actual royalty achieved is called short working.
- **Recoupment of Short working:** It is normally seen that in the first few years the work does not gather the required momentum because of the absorption of time in the preparation of starting the production, still the lessee has to pay minimum rent which is more than the actual royalty. So, to compensate him, the owner (i.e. landlord) allows to recover or recoup such short working during a stipulated period out of the excess royalty (i.e. surplus) earned over and above the minimum rent. This is called as a right of recoupment of short working. Right of recoupment maybe fixed or floating. When the lessor promises to compensate the loss in the first few years (three or four years) the right is said to be fixed. Any short working falling beyond this period cannot be reimbursed. But when the lessor promises to compensate the loss of any year in the next (or following or subsequent) two or three years then the right is said to be floating because this can be afraid of an any year when shortworking arises.

Difference between Rent and Royalty

On the basis of definition: Rent is paid to the owner of the asset for the use of tangible assets like land, building, machine, etc., while royalty is paid for the use of any tangible or intangible assets.

On the basis of payment: Payment of rent is made on the basis of some period, while amount of royalty depends upon the limit of using any property such as on quantity of production in mines, on the number of copies of books sold etc.

Accounting treatment:

The accounting treatment has been dealt with in the books of lessor as well as lessee.

In the Books of lesseeor tenant.

A. Entries without minimum rent account.

1. When production is less:

Royalty account Dr
 Short working account Dr
 To landlord's account

2. When royalty is paid:

Landlord's account Dr
 To bank account

3. When royalty is transferred:

Profit and loss account Dr
 To royalty account

Short working account will show the debit balance and will appear in the Balance Sheet on the assets side. These entries will be repeated every. But when the production exceeds the minimum rent, the entries will be;

Royalty account Dr
 To landlord's account

If Royalty on production is more than the minimum rent, the shortworking does not arise. On the other hand, the lessee will have the opportunity to recoup the shortworking that have arisen in the past. The entries will be;

Landlord's account Dr

To shortworking account

4. Writing off unrecouped short-workings, entry will be:

Profit and Loss account Dr

To shortworking account.

B. Entries with Minimum Rent Account.

1. When royalty is less than minimum rent.

For Minimum Rent

Minimum Rent account Dr

To landlord's account

For Short working

Royalty account Dr

Shortworking account

To minimum rent account

For payment of royalty

Landlords account Dr

To bank account

2. If the royalty is more than minimum rent no need to open Minimum Rent Account.

In the Books of Lessor or Landlord

Journal entries in the books of landlord or lessor are reversed. They are as follows:

1. When production is less.

Landlord's account Dr

To royalty account

To shortworking account

2. When payment is received

Bank account Dr

To lessee's account

3. When royalty is transferred

Royalty account Dr

To Profit and Loss account

4. When shortworking is recouped

Short working account Dr

To Lessee's account

5. When short working is closed on the expiry of right

Shortworking account Dr

To Profit and Loss account

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Long Answer Type Questions:

1. What journal entries are passed in the books of Lessee and Landlord in connection with royalty?

2. Write short notes on the following:

- i. Dead Rent, ii. Short workings, iii. Recoupment of short workings.

Short Answer Type Questions:

1. Explain with example the meaning of Royalty.
2. What is the difference between Royalty and Rent?
3. Explain Short workings Recoverable and Short workings Irrecoverable
4. Explain Minimum Rent

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