NAME: INEGBDION STEPHANIE

MATRIC NO: 17/SMS02/026

COURSE: ACC202

LEVEL: 300

ANALYSIS OF ROYALTY PAYABLE

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| year | Output of lease  A | Output of sublease  B | Combined output  C=A+B | Actual royalty  E= ₦2×6 | Minimum royalty E=₦2×1000 | Short workings F=E-D  ₦ | Short workings recouped  G  ₦ | Short working lapsed  H  ₦ | Royalty paid  D+F-G  ₦ |
| 2001 | 720 | 100 | 820 | 1640 | 2000 | 360 | - | - | 2000 |
| 2002 | 800 | 140 | 940 | 1880 | 2000 | 120 | - | 360 | 2000 |
| 2003 | 1200 | 300 | 1500 | 3000 | 2000 | - | 120 | - | 2880 |
| 2004 | 600 | 320 | 920 | 1840 | 2000 | 160 | - | - | 2000 |
| 2005 | 900 | 400 | 1300 | 2600 | 2000 | - | 160 | - | 2440 |

JOURNAL ENTRIES

|  |
| --- |
| Year 1 Dr bank ₦2,000  Cr short working allowable ₦360  Cr P/L ₦1,640 |
| Year 2 Dr bank ₦2,000  Cr P/L(1,880+360) ₦2,240  Dr short working allowable ₦240 |
| Year 3 Dr bank ₦2,880  Dr short working allowable ₦120  Cr P/L ₦3,000 |
| Year 4 Dr bank ₦2000  Cr P/L ₦1,840  Cr short working allowable ₦160 |
| Year 5 Dr bank ₦2,440  Dr short working allowable ₦160  Cr P/L ₦2,600 |

|  |  |
| --- | --- |
| Dr ROYALTIES RECIEVABLE A/C Cr  ₦ ₦ | |
| 31/12/01 P/L a/c 1,640 | 31/12/01 Lessee a/c 1,640 |
| 31/12/02 P/L a/c 1,880 | 31/12/02 Lessee a/c 1,880 |
| 31/12/03 P/L a/c 3,000 | 31/12/03 Lessee a/c 3,000 |
| 31/12/04 P/L a/c 1,640 | 31/12/04 Lessee a/c 1,640 |
| 31/12/05 P/L a/c 2,600 | 31/12/05 Lessee a/c 2,600 |

LESSEE (AKEREDOLU’S) A/C

|  |  |
| --- | --- |
| Dr ₦ | Cr ₦ |
| 31/12/01 Royalties (₦2×720) 1,440  Royalties recoverable  (sub-lease)(₦2×100) 200  Short working 360  2,000 | 31/12/01 bank 2,000  ------  2,000 |
| 31/12/02 Royalties (₦2×800) 1,600  Royalties recoverable  (sub-lease)(₦2×140) 280 short working 120  2,000 | 31/12/02 bank 2,000  ------  2,000 |
| 31/12/03 Royalties(₦2×1200) 2,400  Royalties recoverable  (sub-lease)(₦2×300) 600 3,000 | 31/12/03 bank 2,880    Short working 120 3,000 |
| 31/12/04 Royalties(₦2×600) 1,200  Royalties recoverable  (sub-lease)(₦2×320) 640  Short working 160  2,000 | 31/12/04 bank 2,000  ------  2,000 |
| 31/12/05 Royalties(₦2×900) 1,800  Royalties recoverable  (sub-lease)(₦2×400) 800  2,600 | 31/12/05 bank 2,440  Short working 160  2,600 |

SHORT WORKING PAYABLE A/C

Dr Cr

|  |  |
| --- | --- |
| Dr ₦ | Cr ₦ |
| 31/12/01 bal c/d 360 | 31/12/01 bal c/d 360 |
| 31/12/02 bal c/d 120  Profitable 360  480 | 01/01/02 bal b/f 360  31/12/02 lessee 120  480 |
| 31/12/03 lessee 120 | 01/01/03 bal b/f 120 |
| 31/12/04 bal c/d 160 | 31/12/04 lessee 160 |
| 31/12/05 lessee 160 | O1/01/05 bal b/f 160 |

ROYALTY PAYABLE A/C

|  |  |
| --- | --- |
| Dr ₦ | Cr ₦ |
| 31/12/01 sub-lease 200 | 31/12/01 lessor 200 |
| 31/12/02 sub-lease 280 | 31/12/02 lessor 280 |
| 31/02/03 sub-lease 600 | 31/12/03 lessor 600 |
| 31/02/04 sub-lease 640 | 31/12/04 lessor 640 |
| 31/02/05 sub-lease 800 | 31/12/05 lessor 800 |

SUB-LEASE A/C (CHINWETA’S) A/C

|  |  |
| --- | --- |
| Dr ₦ | Cr ₦ |
| 31/12/01 bank 600  ----  600 | 31/12/01 royalties payable 200  Short workings-for  sublease 400  600 |
| 31/12/02 bank 600  ----  600 | 31/12/02 royalties payable 260  Short workings-for  sublease 320  600 |
| 31/12/03 bank 600 | 31/12/03 royalties payable 600 |
| 31/12/04 bank 600  Short workings-for  sublease 40  640 | 31/12/04 royalties payable 800  ----  800 |
| 31/12/05 bank 600  Short workings-for  sublease 200 800 | 31/12/05 royalties payable 800  ----  800 |

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Why are short workings recoverable shown as an asset and short workings allowable as a liability in the statement of financial position?

The excess of Minimum Rent over actual royalty is known as short-working. Therefore, question of short-working will only arise when the actual royalty is less than the Minimum Rent. Short-workings which are recoupable will appear in the assets side of the Balance Sheet as a current asset.

**Recoupment of Short-working:**

Usually, in a royalty agreement, a further provision is included about the recoupment of short-working, i.e., the lessor allows the lessee the right to carry forward and set off the short-working against the excess or surplus of royalties over the Minimum Rent in the subsequent years.

In order words, the lessor promises to adjust or return the excess which was charged in the first few years out of excess earned in the later or subsequent years. The right is known as the recoupment of short working.

**It can be presented in the following manner:**

(a) Fixed;

(b) Floating.

**(a) Fixed:**

If the lessor or landlord agrees to compensate the losses which were incurred in the first few years (say, three or four years) the same is known as fixed, i.e., if any short-working falls beyond this period, the same cannot be reimbursed.

**(b) Floating:**

If the lessor or landlord agrees to compensate the loss which were incurred in the first few years, in the next or following or subsequent three or four years, the same is known as floating as the same can be adjusted in any year if short-working arises, i.e., each year’s short-working will have to be adjusted against the excess royalties earned in the subsequent years accordingly.

 in this respect the short-workings which are not recovered within the stipulated period should be treated as irrecoverable, and, hence, should be transferred to Profit and Loss Account of the year in which the same is lapsed. The recoupable part of short-working is shown in the asset side of the Balance Sheet. Provision to be made for Short-workings

It has already been stated above that recoupable short-working appears in the assets side of the Balance Sheet as a current asset on the assumption that the same will be recouped in future. But it is uncertain. Sometimes, it may not be possible for the lessee to recoup the amount of short-working due to many factors although he has got the legal right to recoup.

From the standpoint of conservatism a provision should be made for such short-workings against Profit and Loss Account in that particular year when such short-working appears. It is needless to say that provisions for short-working will appear in the liabilities side of the Balance Sheet.

Whereas short-workings (recoupable) will appear in the assets side of the Balance Sheet. Consequently, un-recoupable part of the short-workings will be adjusted against such provision and not against Profit and Loss Account. The balance of provision, if any, should be credited to Profit and Loss Account.

**Short-working and Minimum Rent—their relationship:**

It has already been explained earlier that when the actual royalty (calculated on the basis of a fixed rate to total quality) is less than the amount of the minimum fixed amount (i.e., Minimum Rent) short-working arises. In short, short-workings arises only when actual royalty is less than the Minimum Rent i.e.,

Short-working = Minimum Rent – Actual Royalty

Or, Minimum Rent = Actual Royalty + Short-working

However, in the case of landlord, the amount of Minimum Rent is equal to Actual Royalty Receivable plus the short-workings, i.e.,

Minimum Rent— Actual Royalty Receivable + Short-working

It must be remembered that the landlord is entitled to get the Minimum Rent or Actual Royalties, whichever is higher, (after adjusting the amount of Short-workings, if any.)

Ground Rent — Sometimes the Lessee is to pay an additional fixed rent in addition to the minimum rent which is known as Ground Rent or Surface Rent.