INVESTMENT ACCOUNTS(3hours)

Investment Accounts

Professional firms, companies, and individuals often invest in shares, debentures, and government bonds. To properly record such investments, a separate Investment Account is normally maintained.

Fixed Interest Securities

Fixed interest securities are investments that yield a fixed rate of interest, such as:

- Government bonds (e.g., Treasury Bills, Treasury Bonds).
- Debentures.
- Preference shares with fixed dividends.

These securities pay interest on a nominal (face) value at a predetermined rate, usually half-yearly or annually.

When accounting for fixed-interest securities, distinguish between:

1. **Capital element** – the cost or value of the investment.
2. **Revenue element** – interest received or accrued.

This distinction is important because **interest is investment income**, while the purchase price represents the investment itself.

Investment Account: An investment account is normally maintained for each investment or class of investment.

Key Features of Fixed Interest Securities

1. Interest is calculated on the face value, not the purchase price.
2. Quotations may be:
    - Cum-interest: Price includes interest accrued up to the date of transaction.
    - Ex-interest: Price excludes accrued interest; buyer pays separately for interest accrued.
3. Accrued Interest: When securities are bought/sold between interest dates, the buyer pays the seller the interest accrued from the last interest date up to the purchase date.

Important Terms Used in Fixed Interest Securities and Examples

(a) Nominal value

This is the face value of the security.

For example:

10% UGX 10,000,000 Government Bond

The nominal value = UGX 10,000,000.

(b) Interest rate

This is the stated percentage payable on the nominal value.

In the example above:

Interest rate = **10%**

(c) Interest

Interest is calculated on the **nominal value**, not necessarily the amount paid to purchase the investment.

For example:

Nominal value = UGX 10,000,000

Rate = 10%

Annual interest:

10% × 10,000,000 = **UGX 1,000,000**

(d) Market value

This is the price at which the security is bought or sold in the market.

It may be different from its nominal value.

For example, a bond with a nominal value of UGX 10,000,000 may be purchased for UGX 9,500,000.

(e) Cum-interest

Cum-interest means that the purchase price includes the interest that has accrued up to the date of the transaction.

Therefore, when a security is purchased **cum-interest**, part of the amount paid represents:

1. The cost of the investment; and
2. Accrued interest.

These two amounts should be separated in the accounting records.

Example

On 1 July 2026, a student purchases a bond with a face value of Shs 100,000 bearing interest at 10% per annum. The bond is purchased for Shs 105,000, including interest accrued for three months.

Required: Calculate the cost of the investment and the accrued interest.

Solution

Annual interest = Shs 100,000 × 10% = Shs 10,000

Accrued interest for three months:10,000 x 3/12 =Shs2,500

Cost of the investment:105,000 - 2,500 =Shs 102,500

Details	Amount (Shs)
Total purchase price	105,000
Less: Accrued interest	(2,500)
Cost of investment	**102,500**

The buyer pays Shs 105,000, but only Shs 102,500 represents the cost of the investment. The remaining Shs 2,500 is accrued interest, which is accounted for separately because it relates to the period

(f) Ex-interest

Ex-interest means that the quoted purchase or sale price excludes accrued interest.
The accrued interest is dealt with separately.

Example

On 1 October 2026, a student purchases a bond with a face value of Shs 100,000 bearing interest at 12% per annum. The bond is purchased at an ex-interest price of Shs 98,000. Interest has accrued for three months since the last interest payment.

Required: Calculate the accrued interest and the total amount payable.

Solution

Annual interest: 100,000 x 12% =Shs }12,000
Accrued interest for three months: 12,000 x 3/12=Shs 3,000

Details	Amount (Shs)
Ex-interest purchase price	98,000
Add: Accrued interest	3,000
Total amount payable	**101,000**

Since the bond is purchased ex-interest, the quoted price excludes accrued interest. The buyer therefore pays Shs 98,000 for the investment and Shs 3,000 separately as accrued interest, making a total payment of Shs 101,000.

(g) Accrued interest

Accrued interest is interest that has been earned by the holder but has not yet been received.
For example, if a 10% bond has a nominal value of UGX 12,000,000:
Annual interest:
10% × UGX 12,000,000
= **UGX 1,200,000**
If three months' interest has accrued:
UGX 1,200,000 × 3/12
= **UGX 300,000**
The UGX 300,000 is accrued interest.

Accounting Entries for Fixed Interest Securities

The major transactions requiring accounting entries are:

i. Purchase of investments;
ii. Receipt of interest;
iii. Accrued interest;
iv. Sale of investments;
v. Profit or loss on disposal; and

vi. Closing balance of investments.

1. Accounting Treatment of Fixed Interest Securities

When accounting for fixed interest securities, distinguish between:

- ✓ **Capital element** – the cost or value of the investment.
- ✓ **Revenue element** – interest received or accrued.

This distinction is important because **interest is investment income**, while the purchase price represents the investment itself.

2. **Investment Account:** An investment account is normally maintained for each investment or class of investment.

A simple investment account may have the following format:

Date	Particulars	Nominal Value	Cost/Amount	Date	Particulars	Nominal Value	Cost/Amount
	Debit side				**Credit side**		
	Bank – purchase				Bank – sale		
	Balance b/d				Balance c/d		

The exact presentation may vary depending on whether the investment is being maintained at:

- Cost;
- Market value;
- Nominal value; or
- Another prescribed measurement basis.

Note: The main focus should be on **recording purchases, sales, interest, and accrued interest correctly**.

3. Accounting Entries for Fixed Interest Securities

The major transactions requiring accounting entries are:

1. Purchase of investments;
2. Receipt of interest;
3. Accrued interest;
4. Sale of investments;
5. Profit or loss on disposal; and
6. Closing balance of investments.

Accounting Treatment of Fixed Interest Securities (Summary for you)

(a) On Purchase of Securities

- Purchase Price (Ex-interest):
  - Debit Investment Account with cost of investment.
  - Debit Interest Receivable (if interest accrued is paid to seller).
  - Credit Bank.
- Purchase Price (Cum-interest):

- Total paid = Cost + Accrued Interest.
- Split into two parts:
  - Debit Investment Account with cost only.
  - Debit Interest Receivable with accrued interest.
  - Credit Bank with total paid.

(b) On Sale of Securities

- Sale Price (Ex-interest):
  - Debit Bank with sale proceeds + interest received.
  - Credit Investment Account with cost portion.
  - Credit Interest Income with accrued interest.
- Sale Price (Cum-interest):
  - Split into Sale Proceeds (cost portion) and Interest (income portion).

(c) On Receiving Interest

- Debit Bank.
- Credit Interest Income (P&L).

(d) Closing Adjustment (if accrued interest exists):

Dr. Interest Receivable A/c

Cr. Interest Income A/c

(e) At the End of the Accounting Period

- Investments are shown in the **Balance Sheet at cost** (unless market value is lower and the firm follows conservatism).
- Interest accrued but not yet received is treated as **Interest Receivable (Asset)**.

1. PURCHASE OF INVESTMENT

When an investment is purchased, the investment account is debited.

Basic entry

Dr. Investment Account

Cr. Bank/Cash Account

Illustration 1: Purchase without accrued interest

On 1 January 2026, ABC Ltd purchased 10% Government Bonds with a nominal value of UGX 20,000,000 for UGX 19,000,000. Calculate the purchase price of the bond.

solution

Account	Debit (UGX)	Credit (UGX)
Investment Account	19,000,000	–
Bank Account	–	19,000,000

The investment is recorded at the purchase amount of **UGX 19,000,000**.

2. RECEIPT OF INTEREST: This Interest received represents investment income.

Accounting entry

Dr. Bank/Cash Account

Cr. Investment Income/Interest Income Account

Illustration 2

ABC Ltd receives annual interest of 10% on UGX 20,000,000

Interest:

10% × UGX 20,000,000

= **UGX 2,000,000**

Account	Debit (UGX)	Credit (UGX)
Bank	2,000,000	–
Investment Income	–	2,000,000

The UGX 2,000,000 is recognised as **investment income**.

3. ACCRUED INTEREST

Interest may have accrued at the end of an accounting period but may not yet have been received.

Accounting entry

Dr. Accrued Interest Account

Cr. Investment Income Account

When the interest is subsequently received:

Dr. Bank Account

Cr. Accrued Interest Account

Cr. Investment Income Account — where appropriate for the current period's interest.

Illustration 3: A company owns **10% UGX 30,000,000 bonds**.

Annual interest:

10% × UGX 30,000,000

= **UGX 3,000,000**

At year-end, three months' interest is outstanding.

Accrued interest:

UGX 3,000,000 × 3/12

= **UGX 750,000**

At end of year entry

Account	Debit (UGX)	Credit (UGX)
Accrued Interest	750,000	–

Account	Debit (UGX)	Credit (UGX)
Investment Income	–	750,000

The firm therefore recognises **UGX 750,000 as income earned**, even though the cash has not yet been received.

4. **PURCHASE CUM-INTEREST:** When an investment is purchased **cum-interest**, the amount paid includes:

Cost of investment + accrued interest

Therefore: **Total amount paid = Investment cost + Accrued interest**

The two elements must be separated.

4. Investment Account Format (Ledger Style)

Investment Account (Fixed Interest Security)

Date	Particulars	Nominal Value	Interest	Cost	Date	Particulars	Nominal Value	Interest	Cost
Dr. Side (Dr. Purchases)					Cr. Side (Cr. Sales/Disposals)				

- Nominal Value = Face Value of securities.
- Interest = Accrued or received.
- Cost = Actual purchase or sale price.

Note:

Always **separate capital (investment cost)** from **income (interest)** when recording investment transactions.

Summary of journal entries

Transaction	Debit	Credit
Purchase of investment	Investment Account	Bank
Interest received	Bank	Investment Income
Accrued interest	Accrued Interest	Investment Income
Sale of investment	Bank	Investment Account
Profit on disposal	Investment Account	Profit on Disposal
Loss on disposal	Loss on Disposal	Investment Account
Purchase cum-interest	Investment + Accrued Interest	Bank
Sale cum-interest	Bank	Investment + Interest Income

DISTINGUISHING CAPITAL AND REVENUE ELEMENTS

This is a key concept in investment accounting.

Capital Element	Revenue Element
Purchase of investment	Interest received
Sale of investment	Accrued interest
Cost of investment	Investment income
Investment disposal profit/loss	Interest earned

Example

A firm purchases bonds for UGX 20,000,000 and receives UGX 2,000,000 interest.

- **UGX 20,000,000** → investment/capital element
- **UGX 2,000,000** → investment income/revenue element

Illustration 4

On 1 April 2026, a company purchased 10% UGX 20,000,000 bonds at 95 cum-interest.
Interest is payable annually on 31 December. Calculate the total cash paid for the bond and show the accounting entry

Step 1: Calculate the purchase price

95% × UGX 20,000,000 =UGX 19,000,000

Step 2: Calculate accrued interest

The seller has held the investment from 1 January to 31 March.

Three months' interest: UGX 20,000,000 × 10% × 3/12 = UGX 500,000

Step 3: Calculate total amount paid

UGX 19,000,000 + UGX 500,000 = UGX 19,500,000

Therefore:

Cost of investment = UGX 19,000,000
Accrued interest = UGX 500,000
Total cash paid = UGX 19,500,000

Accounting entry

Account	Debit (UGX)	Credit (UGX)
Investment Account	19,000,000	–
Accrued Interest Account	500,000	–

Account	Debit (UGX)	Credit (UGX)
Bank	–	19,500,000

The **UGX 500,000 is not part of the investment cost**. It represents interest that accrued before the company purchased the bonds.

5. **PURCHASE EX-INTEREST:** When an investment is purchased **ex-interest**, the quoted price excludes accrued interest.

The accrued interest is therefore paid separately.

Illustration 5

A company purchases **10% UGX 20,000,000 bonds at 95 ex-interest** on 1 April. Interest is payable on 31 December.

Investment cost: 95% × UGX 20,000,000 =**UGX 19,000,000**

Accrued interest: UGX 20,000,000 × 10% × 3/12 = **UGX 500,000**

Total cash paid: UGX 19,000,000 + UGX 500,000 = **UGX 19,500,000**

6. **SALE OF FIXED INTEREST SECURITIES:** When an investment is sold:

Dr Bank/Cash Account

Cr Investment Account

The difference between the carrying amount and proceeds may result in a **profit or loss on disposal**, depending on the accounting basis being used.

Illustration 6: Sale of investment

ABC Ltd purchased bonds for **UGX 19,000,000**.

The bonds were later sold for **UGX 21,000,000**.

Accounting entries

Account	Debit (UGX)	Credit (UGX)
Bank	21,000,000	–
Investment	–	19,000,000
Profit on disposal	–	2,000,000

Therefore:

Profit on disposal = UGX 2,000,000

7. **SALE CUM-INTEREST**

When an investment is sold **cum-interest**, the amount received includes:

1. The selling price of the investment; and
2. Accrued interest.

These amounts should be separated.

Illustration 7

A company sells **10% UGX 30,000,000 bonds at 105 cum-interest** on 30 September.

Interest is payable on 31 December.

Step 1: Calculate selling price
105% × UGX 30,000,000:
UGX 31,500,000
Step 2: Calculate accrued interest
The company held the bonds for nine months:
UGX 30,000,000 × 10% × 9/12
= **UGX 2,250,000**
Step 3: Total amount received
UGX 31,500,000 + UGX 2,250,000
= **UGX 33,750,000**
Therefore:

- Sale proceeds = UGX 31,500,000
- Accrued interest = UGX 2,250,000
- Total cash received = UGX 33,750,000
-

INVESTMENT ACCOUNT:
On 1 January 2026, XYZ Ltd purchased **10% UGX 40,000,000 Government Bonds at 95**.
Interest is payable annually on 31 December.
On 30 September 2026, XYZ Ltd sold the bonds at **102 cum-interest**.
Assume the investment was purchased on 1 January, immediately after the previous year's interest payment.
Required: Prepare:

i. Investment Account;
ii. Interest Income Account; and
iii. Calculate the profit on disposal.

Solution
Step 1: Purchase cost: 95% × UGX 40,000,000= UGX 38,000,000
Step 2: Sale price: 102% × UGX 40,000,000 = UGX 40,800,000
Step 3: Accrued interest on sale
Nine months' interest: UGX 40,000,000 × 10% × 9/12 = UGX 3,000,000
Step 4: Total cash received
UGX 40,800,000 + UGX 3,000,000 = UGX 43,800,000
Investment account

Date	Particulars	UGX	Date	Particulars	UGX
Jan 1	Bank – purchase	38,000,000	Sept 30	Bank – sale proceeds	40,800,000
			Sept 30	Profit on disposal	2,800,000
	Total	**38,000,000**		**Total**	**43,600,000***

The investment account records the **investment sale proceeds excluding accrued interest**. The accrued interest is treated separately as investment income.
Profit on disposal: UGX 40,800,000 − UGX 38,000,000 = **UGX 2,800,000**
Interest Income Account
Annual interest:
UGX 40,000,000 × 10% = UGX 4,000,000
Interest earned for nine months:
UGX 4,000,000 × 9/12
= **UGX 3,000,000**
Therefore: **Investment interest income = UGX 3,000,000**

Worked out Example 1 (Done in class)
On 1st Jan 2024, Mr. James purchases 10,000 12% government bonds of Shs. 100 each at 95 (cum-interest).

- Interest is payable half-yearly on 30th June and 31st Dec.

Other transactions:

1. 1st Jan 2024: Purchased the bonds (cum-interest).
2. 1st April 2024: Purchased another 5,000 bonds of Shs. 100 each at 96 (ex-interest).
3. 30th June 2024: Received half-yearly interest.
4. 1st Oct 2024: Sold 8,000 bonds at 98 (cum-interest).
5. 31st Dec 2024: Received remaining half-yearly interest.

Step 1: Key Information (Summary)

- Nominal Value (Face Value): Shs. 100 × No. of bonds.
- Interest Rate: 12% p.a. → 6% every 6 months.
- Interest Basis: Always on the nominal value held during the period.
- Cum-interest: Price includes accrued interest → must separate cost and interest.
- Ex-interest**:** Buyer pays cost + accrued interest separately.

Step 2: Journal Entries (Summary)

- **1st Jan (Purchase, Cum-interest)**
- Cost of bonds (10,000 × 95) = 950,000
- Accrued interest (for 6 months, Jul–Dec 20X0) = 10,000 × 100 × 12% × 6/12 = 60,000
- Total paid = 1,010,000

Dr. Investment A/c 950,000
Dr. Interest Receivable A/c 60,000
Cr. Bank A/c 1,010,000

2. **1st Apr (Purchase, Ex-interest):**

- Cost of bonds (5,000 × 96) = 480,000
- Accrued interest (Jan–Mar, 3 months) = 5,000 × 100 × 12% × 3/12 = 15,000
- Total paid = 495,000

Dr. Investment A/c 480,000
Dr. Interest Receivable A/c 15,000
Cr. Bank A/c 495,000

3. **30th Jun (Interest Received):**
   - Total nominal value held = 15,000 bonds × 100 = 1,500,000
   - Half-yearly interest = 1,500,000 × 6% = 90,000

   Dr. Bank A/c 90,000
   Cr. Interest Income A/c 90,000
4. **1st Oct (Sale, Cum-interest):**
   - Sale of 8,000 bonds at 98 = 784,000
   - Accrued interest (Jul–Sep, 3 months) = 8,000 × 100 × 12% × 3/12 = 24,000
   - Total received = 808,000

   Dr. Bank A/c 808,000
   Cr. Investment A/c 784,000
   Cr. Interest Income A/c 24,000
5. **31st Dec (Interest Received):**
   - Nominal value still held = 7,000 bonds × 100 = 700,000
   - Half-yearly interest = 700,000 × 6% = 42,000

   Dr. Bank A/c 42,000
   Cr. Interest Income A/c 42,000

Step 3: Investment Account (Ledger Form)
Investment in 12% Govt. Bonds A/c

Date	Particulars	Nominal Value	Interest (Shs.)	Cost (Shs.)	Date	Particulars	Nominal Value	Interest (Shs.)	Cost (Shs.)
Jan 1	To Bank (Purchase, cum-interest)	1,000,000	60,000	950,000	Oct 1	By Bank (Sale, cum-interest)	800,000	24,000	784,000
Apr 1	To Bank (Purchase, ex-interest)	500,000	15,000	480,000	Dec 31	Balance c/d	700,000		646,000
Total		1,500,000	75,000	1,430,000	**Total**		1,500,000	24,000	1,430,000

Step 4: Interest Income Account (P&L)

Date	Particulars	Amount

Date	Particulars	Amount
Jan 1	By Investment (Accrued Interest)	60,000
Apr 1	By Investment (Accrued Interest)	15,000
Jun 30	By Bank (Interest Received)	90,000
Oct 1	By Investment (Accrued Interest on Sale)	24,000
Dec 31	By Bank (Interest Received)	42,000
Total Interest Income (P&L)		**231,000**

At the end of the year:

- **Investment shown in Balance Sheet** = Shs. 646,000 (cost of unsold 7,000 bonds).
- **Interest Income (P&L)** = Shs. 231,000.

Exercise one.

A company purchased **UGX 100,000,000 nominal value of 12% bonds at 90 cum-interest on 1 April 2026**. Interest is payable annually on 31 December.

The company subsequently sold **UGX 40,000,000 nominal value of the bonds at 108 cum-interest on 30 September 2026**.

Required:

1. Calculate the cost of the investment purchased.
2. Calculate the accrued interest included in the purchase.
3. Calculate the total cash paid.
4. Calculate the selling price of the bonds.
5. Calculate the accrued interest on sale.
6. Calculate the total cash received.
7. Calculate the profit or loss on the portion sold.
8. Prepare the Investment Account.
9. Prepare the Interest Income Account.
10. Determine the closing investment balance.