

The purpose of accounting

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What you need to know

By the end of this topic you should be able to:

1. **Tell book-keeping and accounting apart, and explain the difference.** Book-keeping is the detailed, day-to-day recording of a business's financial transactions. Accounting takes those records and turns them into financial statements, then analyses, interprets and communicates the results.
2. **State why a business measures its profit or loss:** for example, to see whether the owner is earning a return on the money invested, to compare this year's performance with earlier years, to judge whether the owner's drawings are reasonable, and to judge whether the business can grow.
3. **Explain how accounting supplies information for monitoring progress and making decisions:** the owner or managers use the financial statements to check how the business is doing and to plan what to do next.

This is the first topic in the syllabus, and it is tested with a one-mark multiple-choice question near the start of Paper 1. The ideas also help you write the "explain" and "advise" answers in Paper 2.

Understand it

Two jobs, two people

Picture a small shop. Every day it sells goods, buys stock, pays wages and banks cash. Someone has to write each of these down, in the right book, with the date and the amount. That is **book-keeping**, and the person who does it is the **book-keeper**.

Once a year (or once a month), someone takes all those records and asks: how much profit did the shop make? What does it own and owe? Is it doing better or worse than last year? What should the owner do next? That is **accounting**, and the person who does it is the **accountant**.

So book-keeping **records**, and accounting **summarises, analyses, interprets and communicates**. Accounting cannot start until the book-keeping is done, and it is only as good as those records: if an invoice is left out, the profit figure will be wrong.

What the book-keeper does

The book-keeper handles each transaction as it happens, which is why book-keeping is **daily and routine**:

- entering source documents (invoices, credit notes, receipts) in the **books of prime entry**: the sales journal, purchases journal, sales returns and purchases returns journals, the general journal, the cash book and the petty cash book;
- **posting** those entries to the **ledger accounts** using double entry, for example writing a credit sale in the customer's account in the sales ledger;
- **balancing** the ledger accounts and **extracting a trial balance** to check the arithmetic.

Every one of these is a recording job. Even a journal entry to adjust an account, or a cheque written into the bank column of the cash book, is book-keeping.

What the accountant does

The accountant works **periodically** (at the end of each month or year) and uses the book-keeper's records to:

- **prepare the financial statements**: the income statement, which measures profit or loss for the period, and the statement of financial position, which lists the assets, liabilities and capital at the end of it;
- **analyse and interpret** them, for example by working out ratios and comparing figures with earlier years;
- **communicate** the results in reports that the owner or managers can understand;
- **give advice** that helps them make decisions.

	Book-keeping	Accounting
Main job	Recording financial transactions	Measuring profit, then analysing, interpreting and communicating
How often	Every day, as transactions happen	Periodically (month or year end)
Examples	Journals, cash book, petty cash book, ledger accounts, trial balance	Income statement, statement of financial position, ratios, reports, advice
Depends on	Source documents	Accurate book-keeping records

A quick test for any task: **does it write down what happened, or does it work out what it means?** Writing it down is book-keeping. Working out what it means is accounting.

Why measure profit or loss?

Profit is the amount by which income is more than expenses over a period; a **loss** is the amount by which expenses are more than income. The income statement measures it. The owner wants to know it for several reasons:

- **A return on the investment.** The owner put money (capital) into the business. A profit shows the business is rewarding that investment; a loss shows it is not.
- **Comparing performance.** This year's profit can be set against last year's, a target, or a similar business, to see whether things are getting better or worse.
- **Setting drawings.** A sole trader lives on what they take out of the business (drawings). If drawings are more than the profit, the owner's capital shrinks, so the profit figure tells the owner how much can sensibly be taken out.
- **Growth.** Profit kept in the business can pay for new equipment or a larger shop, and a lender will look at profits before lending. So profit shows whether the business can afford to expand.
- **Planning.** Knowing which activities earn a profit helps the owner decide what to keep, change or stop.

Profit is **not** the same as cash. A business can make a profit and still have little money in the bank (for example, if customers have not paid yet). So measuring profit does not tell you how much cash is available; the cash book does that. Nor is profit used to check the bank statement (that is bank reconciliation) or to decide dividends for a sole trader, who has no shareholders.

Information for monitoring and decisions

The whole point of the records is to be **used**. Financial statements give the owner or managers a summary they can act on:

- **Monitoring progress:** comparing profit, sales and expenses with earlier periods shows trends. If expenses are growing faster than sales, something needs attention.
- **Making decisions:** the figures help managers decide, for example, whether to raise selling prices, cut an expense, buy a new non-current asset, take out a loan, or open a new branch.

In this topic the user to keep in mind is the **owner or management** of the business: the accountant analyses the financial statements so that the people running it can manage it well. (Other people, such as banks and suppliers, also use accounting information; you meet them later in the course.)

Financial statements do **not** exist to work out the day-to-day details, such as how much is owed to one supplier, how much cash the owner took, or whether the bank statement agrees with the cash book. Those answers come from the ledgers, the cash book and the bank reconciliation, which are all part of book-keeping.

Key facts and formulas

There is no formula list in the IGCSE Accounting exam, so everything here must be learnt.

Formula	Status
Book-keeping = the detailed recording of financial transactions, day to day	Learn it
Accounting = using those records to prepare financial statements, then analysing, interpreting and communicating the information	Learn it

Formula	Status
Profit = income – expenses (a negative answer is a loss)	Learn it
Book-keeping tasks: books of prime entry, posting to ledgers, balancing accounts, trial balance	Learn it
Accounting tasks: income statement, statement of financial position, ratios, comparisons, reports and advice	Learn it
Purposes of measuring profit: return on investment, comparing performance, setting drawings, ability to grow, planning	Learn it

How to do it

We have 32 tagged questions for this topic from 2021 to 2025, all one-mark multiple-choice questions from Paper 1 (22 different, as some appear on two or three paper variants). Each tests one of four things.

Question type	Questions
Sort tasks into book-keeping or accounting	13
Choose the purpose of accounting information for monitoring and decisions	7
Choose the correct statements about book-keeping and accounting	6
Choose a purpose of measuring profit or loss	6

1. Sort tasks into book-keeping or accounting (13 questions)

The question lists four tasks and asks which one a book-keeper (or an accountant) would do, or which is **not** a book-keeping entry.

1. **Read the stem twice** and underline "not" if it is there. "Which task will **not** be performed by a book-keeper?" is asking for the one accounting task.
2. **Label each option** B (recording) or A (preparing statements, analysing, reporting). Use the lists in "Understand it".
3. **Pick the odd one out.** Usually three options are one kind and one is the other.

Variations you will meet:

- **Which item is prepared by a book-keeper?** A cash book, petty cash book, journal or ledger account is book-keeping. An income statement, appropriation account or statement of financial position is accounting.
- **Trial balance.** Extracting balances from the ledger to make a trial balance is still book-keeping: it checks the records, it does not interpret them.

- **Entries into a statement.** "Expenses entered in the income statement" sounds like recording, but it is preparing a financial statement, so it is accounting, **not** a book-keeping entry.
- **Which task does the accountant do?** Look for "analyses", "interprets", "compares", "report" or "decision". A monthly report on profitability is an accountant's task.
- **"What is the main function of book-keeping?"** Recording information. Communicating, interpreting and summarising information are accounting.
- **Examples of book-keeping (numbered list).** Tick each numbered action that records a transaction in a journal, cash book or ledger, and leave out any that prepare a financial statement.

2. Choose the purpose of accounting information for monitoring and decisions (7 questions)

The question asks why a trader prepares financial statements, how the trader uses them, or why the accountant analyses them.

1. **Look for the option about using the information:** monitoring or comparing performance, making decisions about the future, or providing information for the managers.
2. **Reject options that are book-keeping jobs** in disguise: finding the amount owed to suppliers or by customers, calculating drawings, checking the bank statement, recording each transaction twice, proving that debits equal credits.
3. **Reject options about principles or the owner's private affairs**, such as "to apply the business entity principle" or "to record changes to the owner's personal wealth".

Variations you will meet:

- **"What is the purpose of accounting?"** The answer combines preparing financial statements **and** providing information for decisions. An option that only mentions one outside user, such as the bank manager, is too narrow.
- **"Why does the accountant analyse the financial statements?"** To give information to the **managers**, who run the business. Customers, suppliers and the government are not the reason.

3. Choose the correct statements about book-keeping and accounting (6 questions)

The question gives statements (as options or as a numbered list) and asks which are correct.

1. **Test each statement against the definitions.** Book-keeping = recording, daily. Accounting = measuring profit, preparing statements, analysing and communicating, periodically, using the book-keeping records.
2. **Watch for swapped words.** "Book-keeping involves communicating financial data" and "Accounting is the recording of financial transactions" are both false: the jobs have been swapped.
3. **For a numbered list**, mark each statement true or false first, then find the option that matches your set exactly.

Variations you will meet:

- **Who does what.** A statement such as "the book-keeper writes up the ledger accounts and the accountant prepares the financial statements" is correct. If the book-keeper is said to prepare financial statements, or the accountant to write up journals or the trial balance, it is wrong.
- **Timing and dependence.** "Accounting is done periodically rather than daily" and "accounting uses (relies on) the book-keeping records" are true.

4. Choose a purpose of measuring profit or loss (6 questions)

The question asks why a trader calculates profit, or how the owner knows the investment is paying off.

1. **Look for the option that uses the profit figure:** comparing with previous years, judging whether drawings are reasonable, judging whether the business can grow, showing a return on the owner's investment.
2. **Reject options that confuse profit with cash or liquidity:** "how much cash is available", "liquidity", "working capital", "bank account no longer overdrawn".
3. **Reject options that are only a step towards finding profit,** such as "to know the total expenses": you need the expenses to calculate profit, but knowing them is not why you calculate it.
4. **Reject options that belong to other topics:** interest on a loan, provision for doubtful debts, bank reconciliation, inventory valuation, employee productivity, dividends to shareholders (a sole trader has none).

Variations you will meet:

- **"How would the owner know he is getting a return on his investment?"** Because the income statement shows a **profit for the year**. Rising drawings or more working capital do not prove it.
- **Sole trader questions.** Keep the business type in mind: only a limited company pays dividends to shareholders.

Worked examples

The bold codes show where marks are earned, as in Cambridge mark schemes. The number is how many marks.

- **B1** mark for a correct result on its own, with no method needed.

Example 1

Which task would be carried out by an accountant rather than a book-keeper? **[1]**

A entering credit purchases in the purchases journal
B balancing the account of a credit customer
C comparing this year's gross profit with last year's
D recording a cash sale in the cash book

A, B and D all record transactions or keep accounts in order: book-keeping. C compares results between years, which is analysis: accounting. **Answer C B1**

Example 2

Which statements about book-keeping and accounting are correct? **[1]**

1 The book-keeper posts entries from the sales journal to the customers' accounts. 2 The accountant compares this year's profit with last year's. 3 The book-keeper decides whether the business should buy a new delivery van. 4 The accountant writes up the petty cash book each day.

A 1 and 2 B 1 and 4 C 2 and 3 D 3 and 4

Statement 1 is true (posting is recording). Statement 2 is true (comparing results is analysis). Statement 3 is false (advising on a decision is accounting). Statement 4 is false (writing up the petty cash book is daily recording). The true set is 1 and 2. **Answer A B1**

Example 3

Maria is a sole trader. Her income statement for the year shows a profit for the year of \$18 400. During the year she took drawings of \$21 000.

(a) State **two** reasons why Maria needs to measure her profit for the year. **[2]**

(b) Explain what the figures above suggest about Maria's drawings. **[2]**

(c) Explain **one** difference between the work of Maria's book-keeper and the work of her accountant. **[2]**

(a) Any two of: to know whether she is earning a return on the capital she invested **B1**; to compare her performance with previous years **B1**; to decide how much she can take as drawings; to judge whether the business can afford to expand.

(b) Her drawings were more than her profit, by $21\,000 - 18\,400 = 2\,600$ dollars **B1**, so her capital will fall by \$2600 and she should take less out of the business **B1**.

(c) The book-keeper records each financial transaction as it happens, in the books of prime entry and the ledger **B1**, whereas the accountant uses those records at the end of the year to prepare the financial statements and analyse the results **B1**.

Example 4

Leon owns a shop. His accountant gives him these figures.

	Year 1	Year 2
Revenue	\$120 000	\$150 000
Expenses (including cost of sales)	\$96 000	\$135 000

(a) Calculate Leon's profit for each year. [2]

(b) Explain how this information helps Leon to monitor the progress of his business and make a decision. [3]

(a) Year 1: $120\,000 - 96\,000 = 24\,000$ **B1**. Year 2: $150\,000 - 135\,000 = 15\,000$ **B1**.

(b) Comparing the two years shows that revenue rose by \$30 000 but profit fell by \$9000 **B1**, because expenses rose by \$39 000, faster than revenue **B1**. Leon can use this to decide to look for ways to cut his expenses, or to review his selling prices, before the next year **B1**.

Common mistakes

- **Calling the trial balance or a journal entry "accounting"**. Anything that records or checks the records, including extracting a trial balance and making journal entries, is book-keeping. The accounting options are the ones that prepare statements, analyse, report or advise.
- **Being fooled by "entered in the income statement"**. Putting figures into a financial statement is preparing it, which is accounting, even though the question uses the word "entered".
- **Missing the word "not"**. Several questions ask which task is **not** book-keeping, or which is **not** an example. Read the stem again before choosing.
- **Mixing up a step with a purpose**. Examiners reported that most candidates chose "to know the total expenses" as the reason a trader calculates profit. Total expenses must be known **before** profit can be calculated, so they are a step towards it, not a purpose of it. The purposes are what the owner does with the profit figure, such as checking that drawings are not too high.
- **Treating profit as cash**. Measuring profit does not tell the owner how much cash is available, and it is not how the business checks its bank statement or liquidity.
- **Picking an outside user**. When a question asks why the accountant analyses the statements, the answer is to inform the **managers** (or owner), not customers, suppliers or the government.
- **Choosing an answer from another topic**. Bank reconciliation, provision for doubtful debts, loan interest and the business entity principle are real accounting ideas, but they are not purposes of measuring profit or of preparing financial statements.
- **Forgetting the business type**. A sole trader has no shareholders, so "dividends to shareholders" cannot be the reason a sole trader calculates profit.

How to get the marks

- **Multiple choice** gives one mark for the correct letter only. For a numbered list, decide on every statement before looking at the options, then choose the option that matches exactly.
- **"State"** needs a short answer with no explanation: one purpose of measuring profit per mark, such as "to compare performance with previous years".
- **"Explain"** a difference needs **both sides**: what book-keeping does **and** what accounting does, joined with "whereas". Saying only "book-keeping is recording" earns at most half the marks.

- **Use accounting words:** record, post, ledger, books of prime entry, trial balance for book-keeping; prepare, financial statements, analyse, interpret, communicate, decision for accounting.
- **Link to the business in the question.** If the question is about a sole trader, talk about the owner, capital and drawings, not shareholders.
- **When you use figures,** say what they show (a rise, a fall, drawings above profit) and what the owner should do about it.

Quick check

1. Which of these is prepared by an accountant: a petty cash book, a sales ledger, a statement of financial position or a general journal?
2. State whether each task is book-keeping or accounting: (a) posting the purchases journal total to the purchases account; (b) calculating the current ratio; (c) writing a report advising the owner whether to open a second shop; (d) extracting a trial balance.
3. A trader's revenue was \$84 000 and her expenses were \$91 500. Calculate her profit or loss, and state one thing the result tells her.
4. Give two reasons why a sole trader calculates the profit of the business.
5. Explain why a business that has made a profit might still be short of cash.

Answers

1. The statement of financial position. The other three are records kept by the book-keeper.
2. (a) Book-keeping (posting to the ledger). (b) Accounting (analysis). (c) Accounting (communicating information for a decision). (d) Book-keeping (checking the ledger records).
3. $84\,000 - 91\,500 = -7500$, so a loss of \$7500. It tells her she is not getting a return on her investment this year (or that her expenses are too high for her level of sales), so she needs to act.
4. Any two of: to see whether the owner is earning a return on the capital invested; to compare performance with earlier years; to judge whether drawings are at a sensible level; to judge whether the business can afford to grow.
5. Profit compares income with expenses, but income includes credit sales that customers may not have paid for yet, and cash may have gone on things that are not expenses, such as buying non-current assets or drawings. So profit and cash are different figures.

Past questions to try

- 0452/13/M/J/23 Q1: the main function of book-keeping.
- 0452/12/F/M/24 Q1: true and false statements about book-keeping and accounting.
- 0452/11/M/J/23 Q1: why the accountant analyses the financial statements.
- 0452/12/F/M/23 Q2: how an owner knows the investment is earning a return.