

The Purpose of Accounting and the Accounting Equation



Syllabus topics 1.1–1.2 · Paper 1 (Multiple Choice) and Paper 2 (Structured Written Paper)

For the Cambridge IGCSE Accounting 0452 syllabus, exams in 2027, 2028 and 2029

Syllabus statements covered in this chapter

Syllabus ref.	What you must be able to do
1.1	Explain the difference between book-keeping and accounting
1.1	Explain the purposes of measuring business profit and loss
1.1	Explain the role of accounting in providing information for monitoring progress and decision-making
1.2	Understand assets, liabilities and owner's equity (capital), and classify items correctly
1.2	State the accounting equation and rearrange it to find a missing figure
1.2	Apply the accounting equation: the effect of transactions, the statement of financial position, and profit from changes in capital

What is inside

1. Concept notes, the accounting cycle, model layouts (equation table, bank account, statement of financial position), 8 worked examples
2. Exam skills for Paper 2; common mistakes from the examiner report
3. 20 Paper 1 style multiple-choice questions, explained
4. Two Paper 2 style questions (20 marks each) with full mark schemes and answer layouts
5. Quick-reference table, "I can" checklist

How to read these notes

red = key term green = definition

1 = one mark in the mark scheme · **OF** = own-figure mark

★ **Exam tip:** Accounts are always laid out the same way. Learn the **layouts** in this chapter (headings, dates, details, single and double total lines): in Paper 2 many marks are for presentation as well as figures. Money is shown in £.

Independent Notes Bazar notes for the Cambridge IGCSE Accounting (0452) syllabus; not endorsed by or affiliated with Cambridge University Press & Assessment. Cambridge IGCSE is a trademark of Cambridge University Press & Assessment. All questions are original exam-style questions (not past-paper questions); all layouts are drawn by us. Businesses, people and figures in the questions are invented for practice.

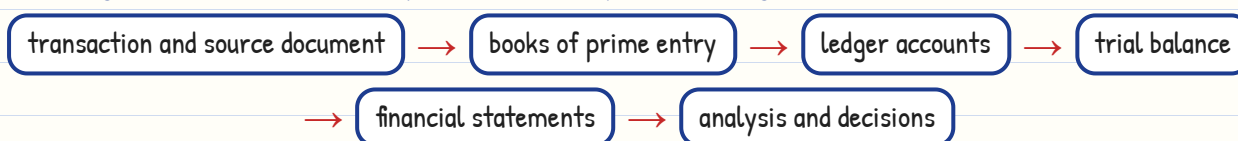
1.1 The purpose of accounting

Every business takes part in **transactions**: exchanges of goods, services or money between the business and someone else, such as buying inventory, selling to a customer or paying wages. Accounting records these transactions and turns them into useful information.

Book-keeping and accounting

	book-keeping	accounting
meaning	the detailed recording of the financial transactions of a business	using the book-keeping records to prepare financial statements, and then analysing and interpreting them to provide information for decision-making
done by	a book-keeper (or the owner of a small business)	an accountant , a trained specialist
main tasks	entering source documents (invoices, receipts, bank statements) in the books of prime entry ; posting to the ledger ; balancing the accounts	preparing the statement of profit or loss and the statement of financial position ; calculating and interpreting ratios; advising the owner on profits, cash flow, finance and planning; tax returns
nature	routine and day-to-day; follows set rules	needs judgement and skill; looks back (results) and forward (plans)

Book-keeping comes **first**: accounting depends on it. Records can be kept **manually** (written books) or **digitally** (accounting software, which totals and posts automatically), but the stages are the same.



The accounting cycle: the first three stages are book-keeping (Chapters 2-4); the later stages are accounting.

The purposes of measuring business profit and loss

Profit is the amount by which income (from selling goods and services) is more than the expenses of the business for a period; a **loss** is the amount by which expenses are more than income. Profit or loss is calculated in the **statement of profit or loss**, usually for a year. Measuring it allows the owner:

- to see whether the business is **successful** and whether he or she is getting an adequate **return on the capital invested** (compared with, say, saving the money in a bank);
- to judge whether the business can **continue** in the future (is it sustainable?) and to **compare** results with previous years and with similar businesses;
- to decide how much can safely be taken out as **drawings**, and how much profit can be kept in the business to help it **grow**;
- to calculate the **tax** due and meet the requirements of the tax authorities;
- to support an application for a **loan**: banks and other lenders want evidence of profits before lending; and to show possible partners or buyers what the business is worth.

Accounting information for monitoring progress and decision-making

Accounting **communicates** financial information. **Monitoring progress** means comparing results over time or against targets: is profit rising, are expenses under control, is there enough money in the bank, are

customers paying on time? **Decision-making** means using the information to choose what to do next.

<i>user</i>	<i>what they want to know</i>	<i>a decision it helps with</i>
owner (and managers)	profit, expenses, cash and bank balances, value of the business	expand or not; raise prices or cut costs; buy a new non-current asset; how much to take as drawings
bank and other lenders	profit, ability to repay and pay interest, other loans, assets as security	whether to lend, how much and at what rate
suppliers (trade payables)	whether the business pays its debts on time; its liquidity	whether to sell goods on credit and the credit limit
government / tax authorities	profit for the year	the tax to be paid
possible partners or investors	profitability and the value of the business	whether to invest or join the business

Users and the interpretation of financial statements are covered fully in Chapters 20 and 21.

Worked example 1: book-keeper or accountant?

Shreya runs a gift shop and employs a part-time book-keeper. State who would normally carry out each task: (a) entering sales invoices in the sales journal; (b) preparing the statement of financial position; (c) balancing the account of a supplier; (d) advising Shreya whether she can afford to open a second shop; (e) recording a bank transfer received from a customer; (f) comparing this year's profit with last year's and explaining the change.

Book-keeper (recording): **(a), (c), (e)**. Accountant (preparing statements, interpreting, advising): **(b), (d), (f)**. The book-keeper records **what has happened**; the accountant explains **what it means** and what to do next.

Worked example 2: explain (model answer)

Kofi owns a car-washing business. Explain **two** reasons why it is important for Kofi to calculate the profit of his business. [4]

1. Kofi can see whether the business is **successful** ①: by comparing this year's profit with last year's, he can tell whether his decisions (for example a price rise) have worked and whether he earns a fair return on the capital he has invested ①.
2. Profit shows how much Kofi can take out as **drawings** ①: if he takes more than the profit, his capital falls and the business may not have enough money to replace equipment or pay its debts ①.

For "explain", state the reason and then develop it ("so ...", "because ..."). Other valid reasons: a bank needs proof of profit for a loan; profit is needed to work out tax.

★ **Exam tip:** In Paper 1, watch for options that describe **book-keeping** tasks (recording, posting, balancing) when the question asks what an **accountant** does (preparing and interpreting statements, advising).

1.2 The accounting equation

Assets, liabilities and owner's equity

The **business entity** idea: the business is treated as **separate** from its owner. So the money the owner puts in is something the business **owes back** to the owner.

term	definition	examples
assets	resources owned by, or amounts owed to, the business	premises, machinery, motor vehicles, inventory, trade receivables, bank, cash
liabilities	amounts owed by the business to people outside the business (not the owner)	trade payables, bank loan, bank overdraft, other payables (expenses owing)
owner's equity (capital)	the amount the business owes to its owner: the owner's investment in the business, including profits kept in it	money or assets the owner puts in (capital introduced) plus profits, less drawings and losses

Non-current assets: assets bought to be used in the business for more than one year and not for resale: premises, land and buildings, machinery, fixtures and fittings, office equipment, motor vehicles.

Current assets: cash and other assets that are expected to be turned into cash within one year: inventory, trade receivables, other receivables, bank, cash.

Non-current liabilities: amounts owed that are due for repayment after more than one year: a bank loan or mortgage repayable in, say, 2031.

Current liabilities: amounts owed that are due for repayment within one year: trade payables, other payables, **bank overdraft** (repayable on demand).

★ **Exam tip:** **Trade receivables** are customers who owe the business for goods bought on credit (an **asset**). **Trade payables** are suppliers the business owes for goods bought on credit (a **liability**). A **bank** balance is an asset; a **bank overdraft** is a current liability.

The accounting equation

Every asset of the business was provided either by the **owner** (capital) or by **someone else** (liabilities). So the total of the assets must always equal the total of capital plus liabilities:

$$\text{assets} = \text{capital} + \text{liabilities}$$

$$\text{capital} = \text{assets} - \text{liabilities} \quad \text{liabilities} = \text{assets} - \text{capital}$$

$$\text{closing capital} = \text{opening capital} + \text{capital introduced} + \text{profit} - \text{drawings} \quad (\text{a loss is subtracted})$$

The equation always balances because of the **dual aspect** of every transaction: each transaction has **two effects of equal value**. Either both sides change by the same amount, or one asset (or liability) rises while another falls by the same amount.

Worked example 3: finding a missing figure

- (a) Assets £45 000, liabilities £12 500: capital = $45\,000 - 12\,500 = \text{£}32\,500$.
- (b) Capital £28 000, liabilities £9 600: assets = $28\,000 + 9\,600 = \text{£}37\,600$.
- (c) Assets £51 200, capital £38 750: liabilities = $51\,200 - 38\,750 = \text{£}12\,450$.
- (d) A trader has: equipment £8 000, motor van £15 000, inventory £3 200, trade receivables £1 900, cash £650, trade payables £4 300, bank loan £10 000. Assets = £28 750; liabilities = £14 300; capital = $28\,750 - 14\,300 = \text{£}14\,450$.

Applying the equation: the effect of transactions

Amara Osei opens **FixIt**, a phone-repair business, on 1 March 2026. The table shows the two effects of each transaction and the equation after it (in £). Red figures are decreases.

Worked example 4: effect of transactions on the accounting equation

transaction	assets	capital	liabilities	$A = C + L$ after
1 Mar 1 pays £12 000 of her savings into a business bank account	+12 000 bank	+12 000 capital	no effect	$12\,000 = 12\,000 + 0$
2 Mar 3 buys equipment £4 500, pays by bank transfer	+4 500 equipment -4 500 bank	no effect	no effect	$12\,000 = 12\,000 + 0$
3 Mar 5 buys spare parts (inventory) £2 800 on credit from Techparts	+2 800 inventory	no effect	+2 800 trade payables	$14\,800 = 12\,000 + 2\,800$
4 Mar 8 bank loan of £5 000 received, repayable 2029	+5 000 bank	no effect	+5 000 bank loan	$19\,800 = 12\,000 + 7\,800$
5 Mar 12 pays Techparts £1 800 by bank transfer	-1 800 bank	no effect	-1 800 trade payables	$18\,000 = 12\,000 + 6\,000$
6 Mar 20 takes £600 from the business bank for personal use	-600 bank	-600 drawings	no effect	$17\,400 = 11\,400 + 6\,000$
7 Mar 25 repairs using parts costing £400; customers pay £1 000 into the bank	-400 inventory +1 000 bank	+600 profit	no effect	$18\,000 = 12\,000 + 6\,000$

- 1 capital introduced: an asset and capital both rise. 2 one asset swapped for another: totals unchanged. 3 bought on credit: an asset and a liability both rise.
- 4 a loan is a liability (non-current, repayable after more than a year). 5 paying a liability: an asset and a liability both fall.
- 6 drawings (money or goods taken from the business by the owner for private use) reduce assets and capital; they are **not** a business expense. 7 a profit of $1\,000 - 400 = \text{£}600$ belongs to the owner, so it **increases capital**. (Paying an expense, such as rent, would reduce assets and capital.)

Profit or loss from changes in capital

Capital rises with profit and capital introduced, and falls with drawings and losses. If the records are not complete, rearrange to find the profit:

profit for the year = closing capital – opening capital + drawings – capital introduced
(a negative answer is a **loss**; each capital figure = assets – liabilities at that date)

Worked example 5: profit from the change in capital

On 1 January 2026 Lena's business had assets of £54 000 and liabilities of £13 500. On 31 December 2026 it had assets of £71 300 and liabilities of £18 900. During the year Lena took drawings of £9 600 and paid in extra capital of £3 000. Calculate the profit for the year.

opening capital = $54\,000 - 13\,500 = \text{£}40\,500$; closing capital = $71\,300 - 18\,900 = \text{£}52\,400$

increase in capital = $52\,400 - 40\,500 = \text{£}11\,900$

profit = $11\,900 + 9\,600 \text{ (drawings)} - 3\,000 \text{ (capital introduced)} = \text{£}18\,500$

Check: $40\,500 + 3\,000 + 18\,500 - 9\,600 = 52\,400 \checkmark$. Drawings are **added back** because they reduced capital but are not a loss; capital introduced is **taken off** because it raised capital but is not a profit.

The statement of financial position

The **statement of financial position** is a statement of the assets, liabilities and capital of a business at a particular date. It is the accounting equation set out in full: **total assets = total capital and liabilities**.

Amara's statement at the end of March (from Worked example 4) is the model layout:

Amara Osei	
<i>statement of financial position at 31 March 2026</i>	
	£
Assets	
<i>Non-current assets</i>	
equipment	4 500
<i>Current assets</i>	
inventory	2 400
bank	11 100
	13 500
Total assets	18 000
Capital and liabilities	
<i>Capital</i>	
capital introduced	12 000
plus profit for the year	600
	12 600
less drawings	600
	12 000
<i>Non-current liabilities</i>	
bank loan	5 000
<i>Current liabilities</i>	
trade payables	1 000
Total capital and liabilities	18 000

- Heading: the **owner's name**, then "statement of financial position **at** [date]": it shows the position on **one day**.
- **Assets**: non-current first, then current assets in order of liquidity (inventory, trade receivables, other receivables, bank, cash).
- Items in the first £ column; each **section total** in the second column after a single line.
- **Capital**: opening balance (or capital introduced) **plus profit, less drawings** = closing capital.
- Then non-current liabilities and current liabilities.
- The two totals agree and are **double-ruled**: $18\,000 = 12\,000 + 5\,000 + 1\,000$.

Worked example 6: preparing a statement of financial position

Ravi Patel owns Patel Cycles. At 31 December 2026 his balances were: premises £60 000, fixtures and fittings £7 500, motor vehicle £14 000, inventory £9 300, trade receivables £2 650, bank £4 180, cash £370, trade payables £5 860, other payables £420, bank loan repayable in 2031 £20 000. His capital on 1 January 2026 was £67 220; profit for the year was £16 900 and drawings were £12 400. Prepare the statement of financial position at 31 December 2026.

Ravi Patel
statement of financial position at 31 December
2026

	£	£
Assets		
<i>Non-current assets</i>		
premises	60 000	
fixtures and fittings	7 500	
motor vehicle	14 000	
		81 500
<i>Current assets</i>		
inventory	9 300	
trade receivables	2 650	
bank	4 180	
cash	370	
		16 500
Total assets		98 000
Capital and liabilities		
<i>Capital</i>		
opening balance		67 220
plus profit for the year		16 900
		84 120
less drawings		12 400
		71 720
<i>Non-current liabilities</i>		
bank loan (repayable 2031)		20 000
<i>Current liabilities</i>		
trade payables	5 860	
other payables	420	
		6 280
Total capital and liabilities		98 000

Classify first: non-current assets = premises, fixtures and fittings, motor vehicle; current assets = inventory, trade receivables, bank, cash; the loan is repayable after more than a year, so it is non-current; trade and other payables are current.

Check with the equation: assets £98 000 – liabilities £26 280 = capital £71 720, the same as 67 220 + 16 900 – 12 400. If your two totals do not agree, look first for an item in the wrong section or added instead of subtracted.

The equation in the ledger (a first look at Chapter 2)

In practice each asset, liability and capital item has its own **ledger account**, drawn as a **T-account**: the left side is the **debit (Dr)** side and the right side is the **credit (Cr)** side. Money **coming into** the bank is debited; money **going out** is credited. The **details** column names the **other** account affected.

Worked example 7: Amara's bank account for March 2026

Use the bank transactions of Worked example 4 (numbers 1, 2, 4, 5, 6 and 7) to write up Amara's bank account. Balance it on 31 March and bring the balance down on 1 April.

Amara Osei bank account					
Dr					Cr
date	details	£	date	details	£
2026 Mar 1	capital	12 000	2026 Mar 3	equipment	4 500
Mar 8	bank loan	5 000	Mar 12	Techparts	1 800
Mar 25	sales	1 000	Mar 20	drawings	600
			Mar 31	balance c/d	11 100
		18 000			18 000
Apr 1	balance b/d	11 100			

- Add each side: Dr 18 000, Cr 6 900. The difference, **11 100**, is entered on the **smaller** side as **balance c/d** (carried down), so both totals are 18 000, ruled level with a single line above and a double line below.

- The balance is then entered on the **opposite** side below the totals as **balance b/d** (brought down) on the next day. A **debit** balance on the bank account is an **asset**: it is the £11 100 bank figure in Amara's statement of financial position.

Worked example 8: advise (model answer)

Amara keeps her own book-keeping records. Her business is growing and she is thinking of paying an accountant to prepare her financial statements. Advise Amara whether she should employ an accountant. Justify your answer by giving arguments for and against. [5]

For: an accountant is trained, so the financial statements are more likely to be **accurate** and correctly laid out ①; the accountant can **interpret** the results and advise her, for example on whether to borrow to expand ①; Amara saves **time** to spend on repairs and customers ①; a bank is more likely to accept statements prepared by an accountant for a loan or tax return.

Against: the accountant's **fees** are an expense that reduces profit ①; she would still need to keep accurate book-keeping records, because the accountant relies on them; she would understand less about her own business figures and depend on someone else.

Recommendation: Amara should employ an accountant, because the business is growing and better information for decisions such as borrowing is worth more than the fee; she should continue the book-keeping herself to keep the cost down ①.

Marking pattern used in Paper 2 "advise" questions: up to 3 marks for each side, up to 4 for arguments in total, and 1 mark for a recommendation that follows from your arguments. Either decision can score full marks if it is justified.

Exam skills for Paper 2

Layouts and headings

- Give every account and statement a **heading**: the business or owner's name, then the account name ("bank account") or the statement title with its date. A statement of financial position is "**at** 31 December 2026"; a statement of profit or loss is "**for the year ended** 31 December 2026".
- Use the **section headings** (Assets, Non-current assets, Current assets, Capital and liabilities, Capital, Non-current liabilities, Current liabilities) and **total each section**.
- Where a layout is printed in the question you may not need every line; do not invent extra items to fill it.

Dates, details and totals in ledger accounts

- Write the date (month and day; the year at the top) on every line. In the details column write the name of the **other** account in full: "balance c/d", "balance b/d", "trade payables", never "bbd" or "TP".
- Totals go on the **same line** on both sides, with a single line above and a double line below; the balance b/d goes **below** the totals on the opposite side.

Workings, own figures and written answers

- **Show your workings** (e.g. capital = 45 000 – 12 500 = 32 500). If an earlier figure is wrong, a correct method still earns the **own-figure (OF)** marks later.
- **Explain:** make a point, then develop it. **Advise** (usually 5 marks): arguments for, arguments against, then a clear **recommendation** that follows from them. A one-sided answer, or no recommendation, loses marks.

Common mistakes that lose marks

- **Abbreviations** in accounts and statements: "bbd" for balance b/d, "NP" for profit for the year, "TR" for trade receivables, "MV" for motor vehicles are not accepted. Write terms in full.
- **Wrong classification:** a **bank overdraft** is a **current** liability, not a non-current one; a loan repayable after more than a year is non-current. Drawings and profit for the year belong in the **capital** section only, never among the assets or liabilities.
- **Missing totals** for the sections of a statement, or showing capital as **one figure** instead of opening balance + profit – drawings.
- **Signs in the equation:** when assets rise and liabilities **fall**, capital rises by the **sum** of the two changes. Many candidates subtracted the decrease in liabilities from the increase in assets.
- **Book-keeper vs accountant:** the book-keeper records and balances; the accountant prepares, interprets and advises. Answers that mix up the two roles score little.
- **Advise questions** with no clear recommendation, or arguments that are not about the business in the question.

Paper 1 style multiple-choice questions

20 questions, 1 mark each. Choose one answer, A, B, C or D. Answers with explanations follow the questions.

1. Which task is part of book-keeping?

- | | |
|--|---|
| A entering sales invoices in the sales journal | B advising the owner whether to open a new branch |
| C interpreting the profit for the year | D planning how to finance new premises |

2. A trader employs a book-keeper. Why might the trader also use an accountant?

- A to file the purchase invoices in date order
- B to record payments in the cash book
- C to prepare the financial statements and advise on how to improve profit
- D to post the totals of the books of prime entry to the ledger

3. What are liabilities?

- | | |
|---|---|
| A resources owned by the business | B amounts owed by the business to people outside the business |
| C the amount the owner has invested in the business | D money received from selling goods |

4. Which is a current asset?

- | | | | |
|------------|-------------|------------------|---------------------|
| A premises | B bank loan | C trade payables | D trade receivables |
|------------|-------------|------------------|---------------------|

5. Which is a non-current liability?

- | | |
|------------------|---------------------------------------|
| A bank overdraft | B a bank loan repayable in four years |
| C trade payables | D other payables |

6. Which is the accounting equation?

- | | |
|---|---|
| A $\text{assets} = \text{capital} + \text{liabilities}$ | B $\text{assets} + \text{liabilities} = \text{capital}$ |
| C $\text{capital} = \text{assets} + \text{liabilities}$ | D $\text{liabilities} = \text{assets} + \text{capital}$ |

7. A business has assets of £64 000 and liabilities of £15 500. What is the capital?
- A £15 500 B £64 000 C £79 500 D £48 500
8. A business has capital of £30 000 and liabilities of £8 200. What are its total assets?
- A £21 800 B £30 000 C £38 200 D £8 200
9. A trader buys inventory on credit. What is the effect on the accounting equation?
- A assets increase and liabilities increase B assets increase and capital increases
C assets decrease and liabilities decrease D there is no effect on any total
10. The owner takes £500 from the business bank account for personal use. What is the effect?
- A assets ↓, liabilities ↓ B assets ↓, capital ↓
C assets ↑, capital ↓ D capital ↓, liabilities ↑
11. A business pays a supplier (a trade payable) by bank transfer. What is the effect?
- A assets ↑, liabilities ↓ B assets ↓, capital ↓
C assets ↓, liabilities ↓ D no effect
12. A business buys a delivery van and pays by bank transfer. What happens to its total assets?
- A they increase B they decrease
C they increase, and liabilities increase D they do not change
13. Why is it important for a trader to measure the profit or loss of the business?
- A to judge whether the business is successful and gives an adequate return on capital
B to find out how much money is in the bank account
C to record the transactions of the business
D to make sure that every transaction has a source document
14. Who would mainly use a trader's financial statements to decide whether to lend money to the business?
- A customers B a bank C the tax authority D employees
15. A business makes a profit. What is the effect on the accounting equation?
- A liabilities increase B capital decreases
C assets decrease D capital increases
16. A trader's capital was £25 000 on 1 January and £31 000 on 31 December. Drawings were £7 000 and no capital was introduced. What was the result for the year?
- A profit £6 000 B loss £1 000
C profit £13 000 D profit £38 000
17. During a year a business's assets increased by £9 000 and its liabilities decreased by £2 000. There were no drawings and no capital introduced. What was the profit for the year?
- A £11 000 B £7 000 C £9 000 D £2 000

18. Which statement about capital is correct?

- A capital is an asset of the business
 B capital is reduced by profit
 C capital is increased by drawings
 D capital is the amount the business owes to its owner

19. Which shows a non-current asset and a current liability?

	<i>non-current asset</i>	<i>current liability</i>
A	inventory	bank loan repayable in 2030
B	machinery	trade payables
C	trade receivables	bank overdraft
D	motor vehicles	bank loan repayable in 2030

20. Which transaction does **not** change the total assets of a business?

- A the owner pays her own money into the business bank account
 B goods are bought on credit
 C cash is withdrawn from the business bank account for use in the business
 D a supplier is paid by bank transfer

Answers and explanations

1 A · 2 C · 3 B · 4 D · 5 B · 6 A · 7 D · 8 C · 9 A · 10 B · 11 C · 12 D · 13 A · 14 B · 15 D · 16 C · 17 A · 18 D · 19 B · 20 C

- A. Recording in a book of prime entry is book-keeping; B, C and D are the accountant's work.
- C. Preparing statements and advising need an accountant; A, B and D are book-keeping.
- B. A describes assets, C describes capital, D is income.
- D. Customers will pay within a year. A is non-current; B and C are liabilities.
- B. Repayable after more than a year. A, C and D are current liabilities.
- A. Assets are financed by the owner (capital) and by others (liabilities).
- D. $64\,000 - 15\,500 = 48\,500$.
- C. $30\,000 + 8\,200 = 38\,200$.
- A. Inventory (asset) rises; trade payables (liability) rise.
- B. Bank falls; drawings reduce capital.
- C. Bank falls and trade payables fall by the same amount.
- D. Van up, bank down by the same amount: one asset swapped for another.
- A. B is found from the bank account; C and D are book-keeping tasks.
- B. A lender wants evidence of profit and the ability to repay.
- D. Profit belongs to the owner, so capital (and assets) rise.
- C. $31\,000 - 25\,000 + 7\,000 = 13\,000$. B subtracts the drawings.
- A. Change in capital = $+9\,000 - (-2\,000) = 11\,000$. B wrongly subtracts.
- D. Business entity: the business owes capital to the owner. It is not an asset.
- B. A has a current asset; C has a current asset; D has a non-current liability.
- C. Cash up, bank down by the same amount. A, B raise assets; D lowers them.

Paper 2 style questions

Total: 40 marks. Full mark schemes and answer layouts follow each question.

Question 1 [20 marks]

Priya Nair owns Nair Flowers, a florist's shop. She keeps her own book-keeping records and uses an accountant at the end of each year.

- (a) Explain the difference between book-keeping and accounting. [2]
- (b) State **three** reasons why it is important for Priya to calculate the profit of her business. [3]

The following balances were taken from Priya's books at 30 June 2026.

	£		£		£
shop fittings	8 600	bank	3 470	bank loan (repayable 2030)	6 000
delivery van	11 400	cash	240	drawings for the year	9 800
inventory	1 950	trade payables	2 160	profit for the year	14 260
trade receivables	1 280	other payables	310	capital at 1 July 2025	14 010

- (c) Calculate Priya's capital at 30 June 2026 using the accounting equation. Show your workings. [2]
- (d) Prepare Priya's statement of financial position at 30 June 2026. [8]
- (e) Priya is thinking of borrowing a further £9 000 from her bank to buy a second delivery van so that she can deliver to hotels. Advise Priya whether she should do this. Justify your answer by giving arguments for and against. [5]

Mark scheme

- (a) book-keeping is the detailed recording of financial transactions (in books of prime entry and ledger accounts) 1; accounting uses these records to prepare financial statements and interpret them to help decision-making 1
- (b) any three 1 1 1: to see whether the business is successful; to judge the return on her capital; to compare with previous years / other florists; to decide how much she can take as drawings; to see whether the business can continue; for tax purposes; a bank will want to see it before lending (accept other valid reasons)
- (c) assets 26 940 – liabilities 8 470 1 = £18 470 1 OF

Mark scheme

(d) one mark per badge; headings and the title should be present; amounts must be in the correct section.

Priya Nair		
statement of financial position at 30 June 2026		
	£	£
Assets		
<i>Non-current assets</i>		
shop fittings	8 600	
delivery van	11 400	
		20 000
<i>Current assets</i>		
inventory	1 950	
trade receivables	1 280	
bank	3 470	
cash	240	
		6 940
Total assets		26 940
Capital and liabilities		
<i>Capital</i>		
opening balance	14 010	
plus profit for the year	14 260	
	28 270	
less drawings	9 800	
	18 470	
<i>Non-current liabilities</i>		
bank loan (repayable 2030)	6 000	
<i>Current liabilities</i>		
trade payables	2 160	
other payables	310	
		2 470
Total capital and liabilities		26 940

- (e) **for** (max 3): more deliveries / hotel customers mean higher revenue and profit; the van is a non-current asset that will be used for several years; she keeps her own bank balance for day-to-day payments rather than using it on the van; **against** (max 3): interest must be paid, which reduces profit; liabilities rise from £8 470 to £17 470, almost as much as her capital of £18 470; repayments use money from the bank (only £3 470) / the hotels may not buy enough flowers; max 4 for arguments; recommendation that follows from the arguments, e.g. borrow only if hotel orders are agreed in advance

Question 2 [20 marks]

Tomás Ruiz owns Ruiz Print, a printing business. His financial year ends on 31 May.

- (a) Explain why the accounting equation always balances. [2]
- (b) Complete the table to show the effect of each transaction in May 2026 on the assets, liabilities and capital of the business. Write the amount with + (increase) or - (decrease), or "no effect". [5]

transaction	assets	liabilities	capital
1 bought a printer for £3 200 on credit from Inkwell Limited			
2 paid rent of £450 by bank transfer			
3 paid £2 000 of his savings into the business bank account			
4 repaid £1 000 of the bank loan by bank transfer			
5 took printing paper costing £150 from the business for his own use			

(c) On 1 May 2026 the business bank account had a debit balance of £2 760. Bank transactions in May were: May 4 rent paid £450; May 9 capital paid in £2 000; May 18 bank loan repaid £1 000; May 22 sales received £1 640; May 27 drawings £700. Prepare the bank account for May 2026. Balance the account and bring down the balance on 1 June 2026. [5]

Tomás Ruiz bank account					
date	details	£	date	details	£

(d) At 1 June 2025 the business had assets of £38 600 and liabilities of £11 200. At 31 May 2026 it had assets of £45 900 and liabilities of £9 850. During the year Tomás took drawings of £8 400 and introduced capital of £2 000. Calculate the profit for the year ended 31 May 2026. [4]

(e) Tomás wants to take £4 000 from the business bank account in June 2026 to pay for a family holiday. Advise Tomás whether he should do this. Justify your answer. [4]

Mark scheme

- (a) every transaction has two effects of equal value (dual aspect) 1; so the total of the assets always equals capital plus liabilities / all assets are provided by the owner or by others 1
- (b) one mark per correct row (A = assets, L = liabilities, C = capital): 1 A +3 200, L +3 200, C no effect 1; 2 A -450, L no effect, C -450 1; 3 A +2 000, L no effect, C +2 000 1; 4 A -1 000, L -1 000, C no effect 1; 5 A -150, L no effect, C -150 (drawings) 1

Mark scheme

(c) capital (1); sales (1); rent (1); bank loan and drawings (1); balance c/d and balance b/d £4 250 (1) OF

Tomás Ruiz bank account					
date	details	£	date	details	£
2026 May 1	balance b/d	2 760	2026 May 4	rent	450
May 9	capital	2 000	May 18	bank loan	1 000
May 22	sales	1 640	May 27	drawings	700
			May 31	balance c/d	4 250
		<u>6 400</u>			<u>6 400</u>
Jun 1	balance b/d	4 250			

- (d) opening capital $38\,600 - 11\,200 = 27\,400$; closing capital $45\,900 - 9\,850 = 36\,050$; $36\,050 - 27\,400 + 8\,400 - 2\,000 = \text{profit } £15\,050$
- (e) **for** (max 2): the profit of £15 050 is more than £4 000, so the business has earned it; drawings are his reward for running the business / he needs a break; **against** (max 2): the bank balance would fall from £4 250 to £250, too little to pay rent, Inkwell Limited (£3 200) and loan repayments; capital falls and less money is left to run or expand the business / he may need an overdraft, which costs interest; max 3 for arguments; justified recommendation, e.g. take a smaller amount or wait until customers have paid

Quick-reference table

Item	Key point
book-keeping	detailed recording: books of prime entry, ledger, balancing (book-keeper)
accounting	preparing and interpreting financial statements; advice (accountant)
why measure profit	success, return on capital, comparison, drawings, survival, tax, lenders; monitoring and decisions
assets	owned by / owed to the business; non-current and current (inventory, receivables, bank, cash)
liabilities	owed to outsiders; non-current (long-term loan), current (payables, overdraft)
capital (owner's equity)	owed to the owner; + capital introduced + profit - drawings - loss
accounting equation	assets = capital + liabilities (dual aspect: two equal effects per transaction)
profit from capital	closing capital - opening capital + drawings - capital introduced
statement of financial position	"at" a date; total assets = capital + non-current + current liabilities
T-account	Dr left, Cr right; balance c/d on the smaller side, totals level, balance b/d below

"I can" checklist

- | | |
|--|---|
| ☐ explain book-keeping vs accounting | ☐ show the effect of a transaction on A, L and C |
| ☐ give reasons for measuring profit and loss | ☐ prepare a statement of financial position |
| ☐ explain how accounting helps monitoring and decisions | ☐ calculate profit from changes in capital |
| ☐ define and classify assets, liabilities, capital | ☐ write up and balance a ledger account |
| ☐ use and rearrange the accounting equation | ☐ advise with for, against and a recommendation |