

**Business from the Idea to the Seasoned Offering:  
Accounting and Financial Statements Reflecting Business Activities**

Stephen P. Moehrle  
Associate Professor of Accounting  
University of Missouri – St. Louis  
One University Boulevard  
St. Louis, MO 63121  
(314) 516-6142  
Fax (314) 516-6420  
Email: [moehrle@umsl.edu](mailto:moehrle@umsl.edu)

Pamela S. Stuerke  
Assistant Professor of Accounting  
University of Missouri – St. Louis  
One University Boulevard  
St. Louis, MO 63121  
(314) 516-6132  
Email: [stuerkep@umsl.edu](mailto:stuerkep@umsl.edu)

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**Abstract**

In this paper, we describe a concept for teaching introductory accounting in a way that draws students deeply into the discussion and provides students with frame of reference for the economic substance of the business. Essentially, we take accounting education from bookkeeping to holistic active business learning including how the financial statements build to reflect the business. As a result, student enjoyment and learning in the course increases dramatically.

The concept teaches the total business process with an emphasis on the information that reflects the business. To this end, students conceive the business, contemplate the logistical issues around business development, and conceive the transactions of the business. Simultaneously, the students learn how economic events enter the accounting records and how the resulting financial statements reflect the business. The business grows from the idea, through the financing, investing, and operating activities and the financial statements grow to reflect these activities. Throughout this process, student learning of the way numbers get to the financial statements and what the numbers mean has increased dramatically.

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*See the business events. See the financial statements develop to reflect the events. How are the financial statements reflecting the economic reality?*

In this article, we describe a concept for teaching an introductory course in business and/or accounting that focuses on financial statements. This concept is appropriate for both the first accounting course in an undergraduate curriculum and the accounting core course in an MBA program. In this course, the students observe and participate in developing the business and financial statements together from the business idea through financing the business, investing in the operating infrastructure, and finally conducting the operating activities. This ordering follows the natural sequence of events and matches the sections of the cash flows statement. Each transaction is motivated by events that would normally occur in a new business. The financial statement effect of each transaction is presented so that, at any point, what would appear on the financial statements is evident to the students. The professor can either use a prepackaged set of business transactions (e.g., Parkside Business presented later in this article) or allow the students to create the business idea and “build” the business in class.<sup>1</sup>

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<sup>1</sup> The professor can also use a simple narrative case, such as “Another Improbable Occurrence” (Andrews, 1974, pp. 369-370), as an introductory exercise.

Essentially, we take accounting education from the bookkeeping focus to holistic active learning about business and the way the financial statements build and continue to reflect the business.

There are several advantages to using this concept in an introductory course. First, this concept focuses on the financial statements, and how events and transactions are reflected in the statements. Focusing on the financial statements is a way to keep students' attention on one of the main purposes of financial accounting: the creation of information in a useful format. This focus helps students understand the connection between business events and financial reporting.

Second, use of this concept provides students with a frame of reference for understanding accounting within a business. This frame of reference emphasizes the connections between the activities of a business and financial statements that capture those activities. It clarifies the way events are reflected in financial statements, which is particularly valuable for students who will not ultimately pursue accounting as a career. When students immediately see the way specific transactions change the financial statements, the benefit of understanding accounting becomes clearer.

A third advantage of this concept is flexibility. It allows the professor to adapt the materials and course coverage to students' needs and interests without sacrificing content or rigor. It also allows for coordination of topics with

coverage in other courses, and works well in a situation where students are enrolled in other specific courses at the same time. Business disciplines that coordinate well with an accounting course taught using this concept include finance, marketing, management, and strategy.

Finally, students are engaged by use of this concept. The use of entrepreneurial settings appeal to students of all backgrounds, and the use of a small business allows for transactions that students can easily conceptualize. In our various experiences using this concept, students enter into the development of this “imaginary” business as if they were the owners. Students who have business work experience contribute from their experiences. Overall, the class engagement and participation improves dramatically.

### ***DESCRIPTION OF THE CONCEPT***

The classic accounting spreadsheet (see Exhibit I below) is used to record the transactions. After every transaction, students analyze the spreadsheet information to see the financial statements reflecting the burgeoning business. If classic debit/credit-type accounting mechanics are within the scope of the course, students would be asked to record journal entries from their spreadsheet information and then post the entries to a general ledger. However, these formal accounting procedures are optional when this concept is used for the course. If financial statement analysis is within the scope of the course, students can be

asked to conduct periodic financial statement analysis, ranging from common-size and simple ratio analysis to DuPont-type analysis.

INSERT EXHIBIT I HERE (Accounting spreadsheet)

The course begins with the development of the business idea. Once the business idea is crystallized, logistical issues related to bringing the idea to fruition are considered. These include the form of organization, any necessary operating infrastructure, zoning concerns, and filing requirements, among others. Typical business activities for a new company are then identified and discussed. The resulting transactions are analyzed and financial statements are simultaneously developed to reflect these activities. The financing activities start with proprietor contributions. The investing activities begin with site preparation. Quickly, the business needs additional financing. As a result, we study the logistics and mechanics of bank financing and then the accounting that reflects these financing activities.

Once the pre-business events are complete and the business is ready to open, we get to operating activities. Here, students study employee compensation, selling activities, and the related costs of the sales. Eventually, the business reaches profitability and identifies growth opportunities. This leads to capital budgeting decisions and alternative financing solutions. From there,

students dictate where the business goes. Common business events include initiating manufacturing activities in addition to the existing retailing activities, establishing supply chains, leasing infrastructure, hiring additional employees and initiating benefits, going public, and making acquisitions. Exhibit II contains examples of possible events that the Professor can encourage the students to consider.

INSERT EXHIBIT II HERE (Economic Events)

For each economic event, we use the following three steps:

1. We prepare some depiction of the economic event (e.g., we have pictures of the park and the building to accompany the lease of the shop). The goal here is to ensure that the students are seeing the business first and then seeing how the financial statements reflect the business.
2. The students prepare the financial statements for the business in worksheet form (see exhibit I). We subtotal the spreadsheet frequently to see what would be reported at that time on the balance sheet, the income statement, and the statement of cash flows. Hence, the students see the business grow and then see the financial statements reflect the economic events.<sup>2</sup>
3. Discuss whether and how the financial statements are reflecting the economic

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<sup>2</sup> Depending on the scope of the course, journal entries, a ledger, and or formal financial statements may or may not be required.

reality.

As discussed earlier, the professor can either allow the students to formulate their business in class or use the following setting of a classic retail and service business. Regardless of the choice, the professor should find that students enjoy the frame of reference brought to their thinking by the use of the real world business setting. If students are allowed to create and develop their own business, the professor should require them to consider the many business issues that arise (e.g., zoning, inventory method choice, capital budgeting, hiring, etc.) as part of the inception of a new business.

The following is an application of this concept. The application serves two purposes. First, if the Professor prefers a more structured class style, this illustration can be used in class and students will have a nice frame of reference. Alternatively, the application can be viewed as a demonstrative example of the course concept. With the as an example, the Professor can choose to allow the students to conceive a different business while still adhering to the processes demonstrated.

### ***PARKSIDE BICYCLE***

Doug and Beth Roberts and Brian and Polly Graham are neighbors and avid bicycle riders. They have a wonderful park a block from their houses with a paved, 6-mile bike path, running through beautiful wooded scenery. They enjoy

riding their bikes there and are certain that many others do as well because the bike path is usually crowded. However, when their bicycles need repairs, or they wish to purchase bicycle accessories or new bicycles, the couples have to drive 15 miles to the nearest bicycle shop.

The couples believe that a business opportunity exists. They feel that there is a high probability that a bicycle shop that borders the park would be profitable. Thus, they have decided to start this business. The business plan is that the shop will offer new bicycles as well as parts and repair services. The day-to-day operation of the shop will be conducted by the currently under-employed Doug and Brian. The couples will all work the busy weekend days. The name of the business will be Parkside Bicycle Sales and Service.

After writing up the formal business plan<sup>3</sup>, the couples begin by capitalizing the business, the first financing activity of the business. The initial capitalization of the business will be contributions from the founding proprietors of \$10,000 per person, or a total of \$40,000. Their ownership will be signified by 4,000 shares of common stock sold for \$10 per share, so each person will own 1,000 shares or 25% of the business. The cash is placed in the newly setup Parkside Bicycle Sales checking account at the nearby Bank of America branch.<sup>4</sup>

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<sup>3</sup> Development of this business plan can be assigned, if it is within the scope of the course.

<sup>4</sup> This transaction allows discussion of the business entity as separate and distinct from its owners.

1. *Parkside Bicycle Sales began operations on January 2, 2000 with a stock issuance. Parkside sold 4,000 shares of no par value stock for \$10 cash per share.*

### ***Examples of Economic Events Subsequent to Initial Business Financing***

The business now has operating capital that can be used to acquire the necessary operating infrastructure. The first step is to make arrangements to rent the building that will house the shop. The owners have identified a wonderful shop space. The space formerly housed a family-owned bakery, but is currently unoccupied, as a large grocer moved into the area and drove the bakery out of business.<sup>5</sup> Since the bakery was previously there, the owners are confident that the property is zoned “commercial”, which means that the local government has already authorized the conduct of a business from the building. Further, the building has excellent flooring and paint, and is in “move in” condition, so no leasehold improvements will be required at this time when the owners are especially concerned about cash management and cash flow. They learn the name of the building owner, call the owner, and learn of the terms of the lease, which they readily accept.

2. *On January 2, 2000, Parkside pays the rent on the building. The rent is*

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<sup>5</sup> Depending on the scope of the course, the professor can choose to discuss the microeconomics of business ownership using the bakery as a catalyst for the discussion.

*\$6,000 per year and must be prepaid on the first day of each year.*

The next business activity is to acquire bike racks, other showroom equipment, a sales counter, and a cash register. Beth Roberts made a similar purchase for her employer, so she suggests that the company go to Taylor Fixtures, Inc. This company sells the infrastructure in bundle form (neon signs, shelving, cash register) and she found their pricing to be the lowest in the industry. The owners confirm Beth's points by obtaining prices from two of Taylor Fixtures' competitors.

Another attractive feature of Taylor Fixtures, Inc. is that they offer credit to Parkside. The \$12,000 will be due in 60 days. This is attractive to the owners because they only have \$40,000 in the Parkside checking account. Thus, they can use the \$12,000 for other purposes for a few months. This is the concept of using vendor financing of the business.

- 3. On January 2, 2000, Parkside purchased equipment for the showroom from Taylor Fixtures, Inc. (an investing activity). The total cost of the equipment was \$12,000. Parkside bought the equipment on credit. The equipment has an expected useful life of 10 years.*

While obtaining the showroom equipment on credit has helped the owners with cash flow, the owners agree that they are going to need more cash to finance the purchase of bicycles to have for sale. Therefore, the owners go to the Bank of

America and apply for a business loan. They present their business plan to the Loan Officer (Mr. Phil Cantlend) and point out that they have a total of \$40,000 invested in the business. Mr. Cantlend would prefer to loan money to an established business with a track record of profits and a solid balance sheet. However, he likes the business plan and is comfortable with the work ethic and integrity of the owners. In addition, the Federal and State Governments currently offer tax incentives for banks to provide financing to first-time business owners. Thus, he agrees to give them a \$40,000 loan. The rate on the loan will be 12%, a high interest rate in the current economic environment. However, the bank priced the loan high to reflect the incremental risk of lending to a new business<sup>6</sup>

4. *On January 4, 2000, Parkside received a 3-year \$40,000 12% bank loan that pays interest semi-annually on June 30 and December 31 of each year.*

Doug and Beth and Brian and Polly are very relieved. They were not sure that Mr. Cantlend was going to give them the loan. If he had denied the loan, they may have had to make additional capital contributions to the business from their personal savings accounts so that they could acquire bikes to sell. Not only do they not have to contribute additional cash, but they also have enough money to buy a large assortment of bikes for the showroom. This will be very helpful as

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<sup>6</sup> Lender incentives and risks and the related pricing of debt may be discussed, if it is within the scope of the course.

they seek to provide exactly what each customer desires. The owners all ride Schwinn bikes and feel that these are the best value, so they call Schwinn to see how much Schwinn would charge per bike. Schwinn's commercial sales staff offers them a price of \$140 per bike which is \$60 less than the usual retail price. Polly, who is doing the negotiating for the owners, counters that for that price they will sell Schwinn bikes, but they will offer other types of bikes as well. This was a good negotiating ploy by Polly, as Schwinn calls back and offers to sell the bikes for \$100 per bike if the shop agrees to offer exclusively Schwinn bikes.<sup>7</sup>

5. *On January 5, 2000, Parkside purchased 100 bikes at a cost of \$100 per bike from Schwinn. The purchase was made on account. This is new bike inventory to be resold.*

With the new bikes in the showroom, the owners were ready to open the doors and cross their fingers! Their marketing efforts to date have been limited to signs announcing the shop's opening and conversations with fellow bikers at the park. Their first customers are members of a bicycle club that they have gotten to know over their years bicycling in the park<sup>8</sup>

6. *On January 9, 2000, Parkside performed service on the bicycles maintained by the Spinners Bicycle Club (an operating activity). A total of 200 bikes were repaired. The total revenue for the repairs was \$4,000. Spinners paid*

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<sup>7</sup> Here the professor can bring in the concept of negotiation and relative bargaining position.

<sup>8</sup> This is an opportunity to discuss the concept of business development and marketing.

*\$2,000 cash and will pay the rest in 30 days.*

The owners decided that, since they have adequate cash in the checking account, they will begin paying off their account payable to Schwinn. They hope that Schwinn will view them as a healthy business and good shop, and will continue to provide them with the terms that they offer their best commercial customers.

7. *On January 15, 2000, Parkside paid Schwinn \$8,000 towards the outstanding balance owed to Schwinn.*

The first sale of bicycles was to a local daycare. Sitter Daycare Co asked for credit terms, and the owners of Parkside agreed. They were very glad to do so because they trust Mrs. Bay B. Sitter, the owner of the daycare. Further, they hope to do more business with Mrs. Sitter, so they want to have a very friendly relationship.

8. *On January 18, 2000, Parkside sold 10 bikes to the Sitter Daycare Co. for \$200 per bike on credit. Payment for the bicycles will be due in 30 days.*

9. *On January 24, 2000, Parkside received a \$1,000 check in the mail from the Sitter Daycare in partial payment of their outstanding account.*

Near the end of the first month of business, the electric bill arrived in the mail.

The bill is dated January 25, 2000 and must be paid in 30 days. The owners plan

to pay the bill on February 20.<sup>9</sup>

10. *On January 28, 2000, Parkside received the electric bill for the month totaling \$250.*

### ***End of the Period Accounting***

Depending on the scope of the course, the end of the period work can involve a full closing (e.g., trial balance, adjusting journal entries, post-closing trial balance, closing entries, financial statements, and reversing entries) or simply another subtotaling of the accounting spreadsheet. Adjusting journal entries should at least be discussed and recorded on the spreadsheet to demonstrate their relevance<sup>10</sup>. In addition, closing entries can be demonstrated by subtotaling the earned capital column.

### ***CONCLUSION/SUMMARY***

In this paper, we have described a concept for teaching introductory accounting that has improved our students' enjoyment and learning dramatically. The concept emphasizes the holistic business in an active learning environment. It focuses on the direct relationship between business activities and the financial

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<sup>9</sup> Accounts payable as a source of business financing may be discussed at this point.

<sup>10</sup> i.e., Accrued amounts, cost expirations, or value changes that have occurred but are not reflected in the accounting records because no specific transaction signaled the need for an entry. This is another opportunity to discuss different types of economic events, especially those that occur simply due to the passage of time.

statements. After completing this process, students will understand at a very deep level why business transactions occur, how they are observed and analyzed, and how they are reflected by financial statements.

The strength of the concept lies in the personal participation and the resulting frame of reference that is developed. When students are actively engaged in and thinking about the economic event, they quickly come to understand the transactions including how they get to the financial statements and how these financial statements then reflect the whole of these transactions. When students watch the financial statements build, they come to view financial statements not as a black box of numbers, but as a highly useful summary of the many business transactions that have occurred (and that in this case – they have watched occur).

**References**

Andrews, W. T. 1974. "Another Improbable Occurrence." *Accounting Review*  
(April): 369-370.



- 6. Perform service - charge  
\$4,000, receive \$2,000 cash  
and a promise to pay the  
balance later
  
- 7. Paid \$8,000 on earlier bike  
purchase
  
- 8. Sold 10 bikes on credit
  
- 9. Received \$1,000 from  
earlier purchase of bikes
  
- 10. Received the electric bill for  
the month just ended

^  
Statement  
of  
Cash  
Flows





\$4,000, receive \$2,000 cash  
and a promise to pay the  
balance later

7. Paid \$8,000 on earlier bike  
purchase

8. Sold 10 bikes on credit

9. Received \$1,000 from  
earlier purchase of bikes

10. Received the electric bill for  
the month just ended

^  
Income  
Statement

**Exhibit II: Economic Events (choose any or all):**

**First month**

- Logistic of starting a business (form or organization, plan, required filings)
- Initial business financing (financing activity)
- Operating site acquisition (investing activity)
- Operating infrastructure acquisition (investing activity)
- Additional financing – bank loan (financing activity)
- Inventory acquisition / specific identification inventory (operating activity)
- Employee costs (salaries, wages, FICA taxes, other)
- Selling activities and related costs (operating activity)
- Payment of utilities other business costs (operating activity)
- Income tax expense

**Subsequent months, quarters, or years:**

- Contingent losses (e.g., reserve for bad debts, warranties, etc.)
- Inventory write-downs
- Product costing
- Taxes (accounting for taxes for financial reporting purposes; tax compliance)
- Switch from specific identification to LIFO (why, how accounted for at time of switch, how accounted for ongoing)
- Ratio analysis of business (DuPont Model)
- Calculate earnings per share
- Leasehold improvements
- Contingent liabilities (e.g., warranties)
- Internal controls evaluation (review and documentation)

- Initiating manufacturing operations
- Supply chain / operations management
- A capital budgeting decision
- Acquire additional property, plant, and equipment (capitalize; set up depreciation schedule)
- A revolving credit line negotiation with the bank collateralized by inventory
- Financing decision (bank loan, bonds, stock)
- Audit for external stakeholders benefit
- Lease versus buy decision
- Operating lease treatment
- Sale of productive assets
- Employee benefits (paid vacation, defined benefit and/or defined contribution pension plan; stock options, other)
- Hire executive (considerations; executive compensation)
- Extraordinary loss (e.g., Factory fire)
- Major expansion (Capital budgeting)
- Bonds versus initial public offering of stock
- Issue bonds (How priced by market; discount/premium; amortization table)
- Issue stock (Market microstructure considerations; pricing; accounting; investor relations; analysts following; value considerations (price to earnings ratio, market/book, etc.))
- Capital lease treatment (possibly sale/leaseback)
- Use of excess cash (Free cash flows discussion; finance growth, pay down debt, pay dividends, buyback shares)
- Split shares / Issue stock dividend
- Investments in securities
- Acquisition of over 50% of company (M&A analysis/ Accounting for intercompany

investment)

- Seasoned offering of stock
- Getting sued
- Restructuring efforts
- Change in accounting principal