

**ENTREPRENEURS NEED ACCOUNTING TOO: THE CASE  
FOR INCLUDING FINANCIAL AND MANAGERIAL  
ACCOUNTING IN AN ENTREPRENEURSHIP CURRICULUM**

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# **ENTREPRENEURS NEED ACCOUNTING TOO: THE CASE FOR INCLUDING FINANCIAL AND MANAGERIAL ACCOUNTING IN AN ENTREPRENEURSHIP CURRICULUM**

## **INTRODUCTION**

It used to be a standing joke among many business students: “Why should I learn accounting; I can always hire someone to handle that for me!” Currently, higher education, inside and outside the realms of business schools, is in the throws of a love affair with entrepreneurship, and we are again hearing that old saw from the students. However, if it was a faulty argument years ago for marketing and finance students, it is doubly-wrong for entrepreneurship students. Entrepreneurs need accounting knowledge and understanding more than any other non-accounting major.

## **THE NATION EMBRACES ENTREPRENEURSHIP**

Over the past decade, the United States has looked towards entrepreneurship as a solution to a variety of problems, including unemployment, growth and innovation. Many American residents will start a business or organization over their lifetime.<sup>1</sup> While the popular press often focuses on the failure rate of these new ventures, the amazing fact is that many will survive, some will grow and prosper, and a small percentage will become organizations of a sufficient scale to hire a lot of employees and add meaningfully to the economy. As such, the desire of government to foster entrepreneurship on the part of the citizenry is not misplaced, even though the targeted incentives governments use to foster entrepreneurship may be faulty.

## **HIGHER EDUCATION'S RESULTANT LOVE AFFAIR WITH ENTREPRENEURSHIP**

While the government reviews regulations and devises incentives to foster entrepreneurship, the business education industry has also taken notice. Over the last decade, hundreds of new entrepreneurship programs have sprung up in business schools, liberal arts colleges and community colleges.<sup>2</sup> Unfortunately, in most cases, these new entrepreneurship programs have focused on the superficial aspects of entrepreneurship, such as innovation and creativity, while avoiding the basic skills that will help the future entrepreneur to succeed in creating a viable business or organization.

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<sup>1</sup> 30% of American residents have started businesses, with an additional 31% considering starting a business. These statistics do not include not-for-profit organizations. *Westlaw*, March 23, 2009

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<sup>2</sup> St. Louis University identifies 224 college and university entrepreneurship programs. Based on the authors' experiences in higher education in the Central New York Region, that number is probably understated by at least 100%.

Teaching entrepreneurship means developing the skills in students to build sustainable enterprises. Programs that focus on the next cool phone app or software development are product-development programs; there is no emphasis on the underlying enterprise. The skills that make an existing organization grow and succeed are the very skills that are required for the new entrepreneurial venture to move from idea to sustainable enterprise. A strong entrepreneurship program must include the basics in strategy, marketing, finance, organizational behavior, and of course, accounting.

Many entrepreneurs, in their inability to understand financial and managerial accounting, potentially doom themselves when undertaking their new venture. In creating a business plan, many entrepreneurs fail to properly develop the financial projections that will determine investors' and bankers interest in participating in the venture. Most new start-ups fail not because of poor innovation and creativity of the proprietor's ideas, but due to failure to properly develop a company's revenue projections and costs, which therein identify the appropriate capitalization necessary to succeed.

### **TEACHING ENTREPRENEURSHIP**

There seems to be two categories of entrepreneurship education out there among higher education institutions. The majority focuses on the exciting but superficial aspect of doing something new; it is a much smaller proportion of entrepreneurship programs that focus on building the sustainable enterprise. Successful entrepreneurship programs require accounting education and understanding to build that sustainable enterprise. How does an entrepreneur create a business plan and develop a viable corporate strategy without understanding financial and managerial accounting?

Conversely, many accounting programs do not focus on entrepreneurship as part of their core curriculum. Most financial and managerial accounting classes are not designed with the entrepreneurship major in mind. The majority of accounting students usually have an option to take entrepreneurship, or small business management, as a business elective; however, accounting majors are usually not required to take either. One resulting question then becomes "How does an accountant perform any type of assurance or tax services if they do not understand the entrepreneur's vision?" That vision must be explicit in GAAP terms.

Accounting and entrepreneurship instructors must each integrate the other's topics into their coursework. Once the accountant understands the organization's strategy and vision, the optimal academic scenario is to incorporate a class, or two, that combines students from both an accounting and entrepreneurship background in a course on start-up ventures. As a result, these two diverse majors can see how the other functions and get used to working together. It is very important that neither the entrepreneurial student, nor the business program, draw artificial boundaries between their discipline and that of the rest of the business curriculum.

## **THE FOCUS ON BUSINESS PLANS**

Much of the focus of entrepreneurship courses is the transition of tentative idea to viable business plan. Students are taught to build business plans through a methodology that is fairly consistent across institutions:

1. Executive summary
2. Product or service description
3. Customer, marketing and pricing analysis
4. Competitive analysis
5. Legal structure
6. Organizational structure
7. Capital investments needed
8. Working capital needed
9. Pro forma financial statements

Two things become readily apparent to students as they prepare their business plans: they don't have enough spare resources to hire professional accounting support, at least initially, and they need to develop pro forma financials as part of the business plan.

Without basic financial accounting skills, how do students have the ability or knowledge to prepare the income statement, balance sheet, and statement of cash flows on a pro forma basis? These pro formas tell the story of the business idea in numbers, and investment professionals usually turn to the pro forma financial statements in the business plan immediately after reading the Executive Summary.

## **THE ROLE OF TAXATION FOR ENTREPRENEURS**

One of the major reasons most start-ups fail to optimize their maximum potential and endanger their new venture is due to the owner's lack of understanding of the intricacies of the U.S. tax system. The Federal government, through the Internal Revenue Code, dictates how income and payroll will be taxed. Also, state and local governments, with a few exceptions, determine how income, sales, and *ad valorem* (i.e., property) transactions will be taxed by the jurisdiction in which the entity resides or conducts business. Many entrepreneurs fail to understand, especially with respect to payroll and sales taxes, is that the owner acts as a fiduciary responsible for those taxes. For example, if sales and or payroll taxes are not remitted to the appropriate government agency, then the fiduciary (i.e., the business owner) is held personally liable. Without a basic understanding of the various tax systems throughout the U.S., even the best financial and managerial plans of any entrepreneur can become fatally derailed.

## **SELECTING THE CORRECT BUSINESS ORGANIZATION**

Starting a business is always a risky venture. Creating an entity to complement your business strategy is a difficult task for any entrepreneur. Which entity is best for an owner's needs? Entrepreneurs need to look at issues of liability, and also from a business, accounting, or tax perspective. Is it best to form a corporation, LLC, Subchapter S corporation, partnership, or sole proprietorship? Understanding business organizations is just as important as understanding financial and managerial accounting. Therefore, when designing an accounting class for entrepreneurs and accountants, is it best to include a component that identifies the virtues of different entities depending on the entrepreneur's specific tax and liability situation.

## **GENERAL LEDGER SOFTWARE**

Entrepreneurs may rely on their accountant for advice on important technological tools. One of these tools, which is required early in the new ventures life, is the software package to use in accounting for the organization's transactions. It is important for an entrepreneur to understand the nature and purpose of their accounting software package. The major two providers of accounting software packages for small and start-up enterprises are QuickBooks and Peachtree. Firms in a specialized industry may need some specially-designed software package.

## **UNDERSTANDING AND EVALUATING RESULTS OF THE NEW VENTURE**

We have already discussed how important financial accounting is in developing the pro formas in the business plan, however; accounting is primarily a reporting and tracking methodology. The actual results of the entrepreneur's venture will need to be reported in a GAAP-compliant manner.

## **THE ROLE OF MANAGERIAL ACCOUNTING IN MANAGING A SMALL START-UP**

Some educators ask, "Is financial accounting sufficient for the entrepreneur?" We have already represented that, in addition to a basic understanding of financial accounting, especially how the three financial statements are related, an entrepreneur needs a cursory understanding of taxation.

We would also like to posit that a basic understanding of managerial accounting is also necessary for the budding entrepreneur. Whether the initial offering is a product or a service, the entrepreneur needs to understand his or her cost structure in order to compete effectively and profit.

## **CONCLUSION**

Students learning to be entrepreneurs, whether in college for the first time, or returning to college after beginning a career or being in the military, need basic accounting skills. These skills can only be obtained through college-level course work in accounting. While most of these students will never sit for the CPA exam, the success of their new ventures rides on their ability to correctly describe their business and evaluate its performance using traditional accounting methods.