Operational Definitions

Created by Mark Ira Lefkowitz
mark@thelemonadegame.com

What is the purpose of a balance sheet?

The purpose of a balance sheet is to organize your money so you can keep track of it or in the business world it is a snapshot of a moment in time of how a company is doing with regard to its monetary values and its outstanding obligations or debts. The difference is the equity (the amount left over after the obligations have been or will be satisfied) To know what the NET WORTH of the individual or company is!

What is an ASSET?
An Asset is something of value that can get posted on your balance sheet. There are many examples of what constitutes an asset. Here are some that may show up on your balance sheet: CASH, REAL ESTATE, INVENTORY, CARS, FURNITURE, AC-COUNTS RECEIVABLE, even INTELLECTUAL PROPERTY, GOODWILL, or the value of your BRAND plus much more!

There is ***Hierarchy*** as well. This means certain assets have a more important value than others. For example cash is higher up the chain than raw inventory as it can be converted into a different asset much easier. Sometimes an asset can lose value such as a receivable that is uncollected after a year. or a boat, or worse..an outdated computer.

To Me, I call a great/smart asset a ***R.I.D.E Asset***. That is an asset that collects RENT instead of paying it, or/generates INTEREST instead of paying it, or creates DIVIDENDS that can be reinvested to create further income, and builds positive EQUITY over time (which I call DELTA EQUITY) due to changes in value!

Operational Definitions Continued

What is a LIABILITY?

A Liability is an obligation, a debt, a responsibility, or in simple terms something owed to another that gets posted on your balance sheet. This is important to MEASURE how we are doing and growing.

There are many examples of what constitutes a liability. Here are some that may show up on your balance sheet: SHORT TERM Loans (generally those that are payable in less than one year. Many obligations may be included here such as credit card debt, interest payments, and borrowed money. LONG TERM LOANS are debts payable over 1 year and may include school loans, mortgages, car loans, and many other instruments of longer term debt.

Accounts payable are another entry and include things like when a vendor grants you credit for supplies, materials, services and other obligations. Normally these are very short term and less than a month.

Then there are those dreaded TAXES which may show up in many different forms such as income tax, city tax, state tax, sales tax, payroll tax, real estate taxes and even special assessments inluding supplementals, and even IRMA (income related medicare adjustment) tax if you make too much money when on Medicare, There are more.

Leases and rental agreements due to others are also liabilites. In this case you have a responsibility to pay monthly installments such as rent for your apartment, house, car, equipment, or land. The terms may change over time the expense may be tied to some index or other ratio (like inflation) or under cost of living adjustments (C.O.L.A)

Many times there may be obligation due and owing such as an attorney that requires a retainer and has not completed his/her work. Or perhaps you accept money for a services agreement, but have not completed the work. Called UNEARNED REVENUE.

Also include deposits held such as a security deposit that are due and payable and returnable to others. Furthermore, service contracts such as equipment maintenance agreements, such as pool chemical service or things like the pesticide company.

There is hierarchy here too. Taxes especially governmental, payroll, wages are usually a higher priority than accounts payable. Nonetheless each and every obligation is important and individuals must take note of their debt and the ratio of that debt to the assets held. This can determine the solvency of a person or company to handle their debts, responsibilities, and obligations when compared to income.

What is EQUITY?

Equity is what is left over when you have an asset that is held or sold and you pay off or expect to pay off) your obligation or liabilities. This is what is yours and that amount is called your equity or sometimes refereed to as owner's equity. There is a certain value based on the value of the asset minus the obligation owed. This is important to MEASURE and to take note of the change in value of that asset.

The best entrepreneurs and investors are very aware of this and the speed of change. My mentor Marshall Thurber would often say. "Great leaders make predictions" So True! And I add that brilliant financial leaders make ***accurate*** predictions. This is the key "Is your equity working for you?" IF I make an accurate prediction what will the asset be worth in 3 years? How much will I owe? AND here it is DRUMROLL what will be my change in Equity?

If that asset were to increase in value based on several conditions such as market conditions, supply and demand, cyclical change, structural change, inflation, cash flow, and much more, we want to be fully cognizant. In the same breath the liability may be shrinking (called amortization) or growing based on interest being assessed .
How will this effect the future value (FV) of both the asset and the liability. GOLDEN NUGGETT here. Based on this what is the EQUITY now and in the future!

This is the secret of aquring wealth. Simply put you are in the equity building business! Point to yourself and say " I am In the equity building business" Remember every dollar that hits your pocket should be considered to be invested in such a fashion to increase your equity now and in the future. This is called DELTA EQUITY and measures the change in equity over a period of time. The better you develop your skill set in this endeavor and utilize other tools. These tools are leverage, compounding, capital accumulation, data collection, time, timing, and your education. Master these and the faster you will aquire wealth.

This leads us to understanding the ration R.O.E. Return on Equity. This is much differtent than return on Investment. As we play the lemonade game we will learn just how this effects your decision to buy, sell, dispose, refinance, and other metrics that will help you learn thsi most important ratio.

Finally, as we play the lemonade game you will notice other journal entries in this section. For example original investment. This is how much we put into our venture at the start. In the lemonade game we save up $2.00 from allowance and other chores and we post that into cash.

But we are out of balance because as we sart our business and brand our Lemonade Stand we must create a journal entry in Equity for " Original Investment" and post the $2.00 there. Now we are back in balance with $2.00 in cash in assets, and $2.00 in equity for our start up. Note there are no liabilities yet.

Later as we borrow money and have a lemonade sale there will other equities such as " Revenues to Date" after we take in all our cash and money collected and subtract the cost of the materials from inventory (Known as the C.O.G.S cost of goods sold) this will be posted in revenues to Date. That will demonstrate our gross profit and gross profit magins

Continuing after that we will expand, and pay bills from that revenue and also subtract those bills from cash in the asset column. This will keep us in perfect balance. Those expenses will help us understand our Net Profits, Net Profit Margins, and net operating income.

At some point we will close out the month, the quarter, or the year and all those revenues will be shifted to RETAINED EARNINGS. This is important in us keeping ttrack of our money.

AND Lastly as our enterprize grows we may issue shares of stock to investors that wnat to invest in us and our venture. This will posted as COMMON STOCK PAR and ADDITIONAL PAID IN CAPITAL which will help us grow as we go public. This expansion and purchasing other lemonade statnds is really a metaphor for you becoming fabulously wealthy!! Keeping track of this growth rate and the time is the SECRET! This is called our DELTA EQUITY and measures your rate of growth.