Time to pay bills, protect intellectual property, purchase insurance, amortize the loan, and roll up the earnings.

1) Remember the 4 guys from the football team that bought their lemonade on credit. Well, they took off to college, moved away, and didn't pay their debt owed to you. You have to write this off as bad debt and post the loss on your balance sheet. To post this subtract $2.00 from ***AR*** Account Receivable. On your balance sheet subtract $2.00 from revenues to date as non payment of money due to you is an expense!

Note: Receivables are generally due on a short term basis of 30 days or less. The passage of time makes those debts owed to you less likely to collect and less valuable. After 90 days they may only be worth a portion of the original face amount. Even if you add interest or late fees the value goes down because they may be non-collectable. They may be worth 50% of the original amount or worse. After a year they may not have much value at all. This is called aging your receivables. Each month you must send out statements and make the attempt to collect and reconcile their relative value with your balance sheet.

2) After such strong sales you decide to payoff your loan to Mom. To post this subtract $4.00 from cash to pay off the principal on your note. This is called amortization or in Latin "***the killing of*** the debt". You must also subtract $4.00 from short term loans in liabilities to balance out the transaction. In real life this would be very smart if your loans have a high interest rate. (Luckily, for us in our story the interest was only hugs.) However, in reality interest on credit cards can exceed 24% APR (Annual Percentage Rate). Interest payments to a lender are generally never recaptured and out flowing expensive money that never comes back. Extremely high rates are called usury and can drain profits, cash flow, and effect the bottom line of investments drastically.

3) You decide that your lemonade recipe and brand are so strong and recognizable that it is time time to file for a patent and document/protect your intellectual property. To complete this add a journal entry for Intellectual Property. Subtract $2.00 from cash and add $2.00 to Intellectual Property in assets. That patent and trademark have value as an asset! You will leverage that brand name and secret recipe later as you expand into other cities.This is a fine investment for future sales growth, and possibly selling shares in your company to buy other lemonade stands.

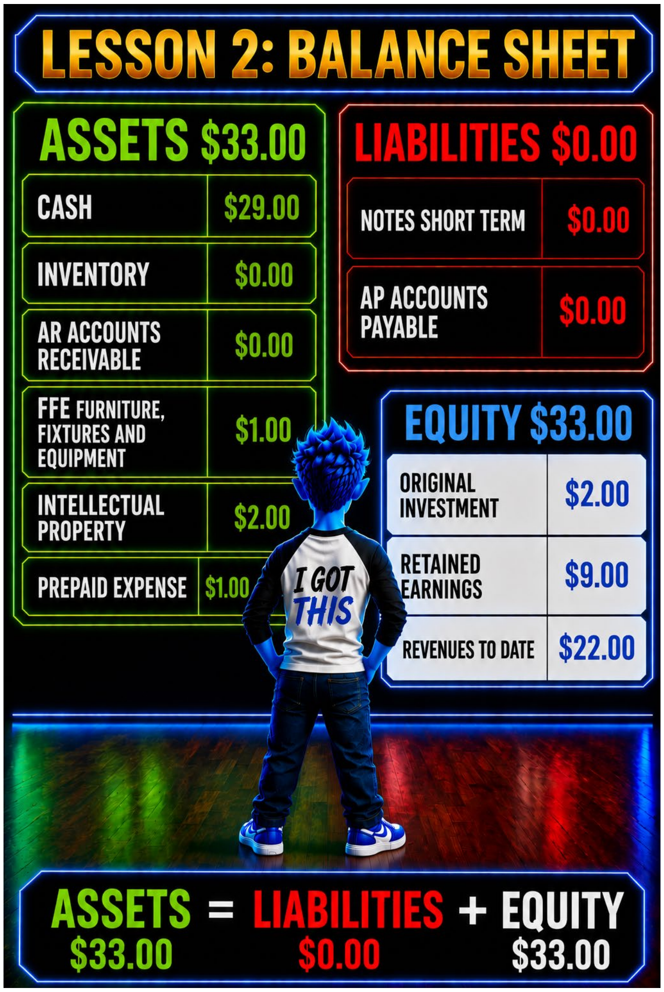
4) Having insurance is an important part of protecting your assets and some degree of personal liability. You call three respected insurers to compare rates and coverage. You ask many questions to make sure you property is covered and that you are personally shielded from accidental injury to others. You agree to a policy that seems adequate and they have a discount if you pay for the first year of coverage plus you prepay for the second year to receive a discount. The total price for each year is $1.00.

To post this ***subtract $2.00 from cash t***o pay $1.00 for this years coverage, and to Prepay $1.00 for next years coverage (if you decide to renew.) Add a journal entry for prepaid expenses in the asset column and add $1.00 to that entry. You must also subtract $1.00 from earnings to date for the expense of this years insurance and to balance the $2.00 removed from cash.

NOTE: Next years Prepaid insurance is an asset because if you cancel the second year you will get reimbursed or pro rated for the unused portion. It is also an expense for this years coverage. Hence the reason it is posted in two places.

After paying off the loan to Mom's loan, writing off the receivables that are no longer collectable, investing in your intellectual property, and purchasing insurance, your balance sheet should look like this.

Scroll down to see if your Balance Sheet matches the sample below



Balance Sheet
Lesson 2 after expenses

Balance Sheet
with earnings rolled up
(to retained earnings)
and lesson 2 closed out