the Science of Economic
—FREEDOM—

SPECIAL REPORT

Balance Sheet Basics

Brought to you by Mercer Advisors

What you're worth equals your freedom.

Your balance sheet reflects your assets and your liabilities. It is a summary of your net worth. When we talk about the achievement of economic freedom, it is the balance sheet that will provide the security, income and peace of mind for those who achieve it. We want to build our balance sheet. We want it healthy and strong. Most people are not in the habit of creating or reviewing their assets and liabilities. That is a mistake. We want to change that with this report.

Let's start with some terms and understanding. Balance sheets are organized by listing your assets first. The most liquid assets at the top and descending to more illiquid assets. Liquidity is a key word. Cash is the most liquid asset, whether it is in your pocket or the bank, it is available today for use. Illiquid assets are those that require finding a buyer. Real estate is an example of an illiquid asset, but there are many others. Some additional examples would be a loan to a family member, minority business interests and speculative investments.

The other side of the balance sheet are your liabilities. Debts owed by you. Debts can be classified as debt against an asset such as a real estate loan or an automobile. There are also debts that are unsecured. Credit card debt is an example of unsecured debt. Most unsecured debt would be considered bad debt. This could be because it caries high interest payments or has no tax advantages.

Key terms and understanding

Balance sheet: A summary of your net worth that reflects your assets and your liabilities.

Liquid assets: Assets that can be quickly converted to immediate funds with little to no impact on its value. (e.g. cash, shares of stock, CDs, etc.)

Illiquid assets: Assets that cannot easily be converted to immediate funds without a substantial loss in value. (e.g. real estate, automobiles, etc.)

Liabilities: Debts that are owed by you to others. (e.g. loans, credit cards, interest, etc.)

Good debt: Characterized by either a tax deductibility or upside potential. (e.g. mortgage, business loan, student loan, etc.)

Bad debt: Characterized by no tax benefit or upside potential. (e.g. high interest rate loans, spending above ones means, etc.)

Balance Sheets

In general, we want to build up our assets and reduce our liabilities. Therefore, it is critically important to know where you are today in order to visualize a path forward. Once you have created your balance sheet you will know how to improve it. Improvements can come in a variety of ways. Saving money every month adds to the asset side of your balance sheet. Adding to your retirement accounts is another way. A positive change in value to your investments or real estate also adds to your balance sheet. Paying down debt is another way of building your balance sheet by reducing your liabilities.

A balance sheet does not need to be reviewed or updated monthly or quarterly. It is an annual exercise, and something that you can do at the end of the year. This sets a baseline for updating your annual financial goals. It is very easy to determine what you need to do once you have an updated balance sheet. It is also a great tool to help you work with your spouse, your tax advisor or your financial planner on to make changes and improvements. A balance sheet also is important when working on your estate plan.

This is a personal financial document. You are managing it. It is important to be honest with yourself on the valuation of your assets. People sometimes over value an asset because they believe it is worth more then fair market value. You should use this test for asset valuation — What would the asset sell for today if I had to sell it?

Balance sheets don’t have to be extremely detailed. For example, you don’t list the individual securities you own on your balance sheet. There may be just an entry for your brokerage account rather then listing the specific securities. A balance sheet is usually just one page in length.

A Few tips about Balance Sheets

1. Reviewing and updating your balance sheet is an annual exercise and can be done at the end of the year.
2. Be honest about the valuation of your assets. Value your assets as if you had to sell it today?
3. Balance sheets don’t have to be extremely detailed, they’re usually just one page.

Filling out your Balance Sheet

At the top of your balance sheet begin listing your taxable assets, and then calculate the sum of the value of these assets on a specific date. All the categories of assets and liabilities should reflect values as of the same date.

Taxable liquid assets: These are accounts where you are receiving a 1099 IRS form, which reflects any interest, dividends or capital gains on your taxes.

- Cash and equivalents: This is the category for cash at home or in a local bank, including checking and savings balances and CDs.
- Mutual funds: This would be the total of any mutual funds that are held in a taxable account outside of a brokerage company.
- Brokerage accounts: The total value of your brokerage account as of a specific date. This would include the total value of all securities.

Retirement account assets: This includes all accounts that are sheltered from taxes until you withdraw monies.

- Defined contribution plans such as 401(k) or 403(b) accounts
- Defined benefit pension assets
- IRAs
- Roth IRAs
- Annuities
- Health savings accounts

Notes, loans to others

Other illiquid securities not readily marketable

Business interests

Real estate

Liabilities: Understand that your liabilities are offsets against your assets. There are good debts and bad debts. Good debts are usually characterized by either tax deductibility or upside potential of the asset. Mortgage debt would be an example of good debt. You can write off all or a portion of the interest and you have the upside potential of the real estate asset. A business loan would be another example of good debt. That interest would be tax deductible and the business could thrive and grow in value. Student loan debt if it gave you the opportunity to reach your career goals would be a third example.

Bad debt is characterized by no tax benefit, or high interest rate loans, or spending above ones means. Most people can determine what debt is good or bad, and take the necessary actions to pay down the bad debt and use the good debt to their advantage.

Your Balance Sheet

To complete the balance sheet process, fill out the form we have provided. Once you have your balance sheet completed we can discuss how this can help you reset your goals and take charge of your future.

Personal Balance Sheet for: ____ Statement Date: ____________

ASSETS	AMOUNT
Liquid assets	
Cash, bank accounts	
Mutual funds	
Brokerage accounts	
Retirement accounts	
401k, 403b	
IRAs	
Roth IRAs	
Annuities	
Other pension assets	
Cash Value Life insurance	
Illiquid Assets	
Notes, loans to others	
Other Illiquid securities not readily marketable	
Business interests	
Real estate	
Other Personal Assets (list below)	
Total Assets:	

LIABILITIES	AMOUNT
Debt	
Mortgages	
Car loan	
Business loans	
Student loans	
Personal loans	
Credit card	
Other Payables (list below)	
Total Liabilities:	

Now, lets determine your net worth by subtracting your total assets from your total liabilities.

(Assets – Liabilities = Net Worth)

TOTALS	AMOUNT
Total Assets	
Total Liabilities	
Total Net Worth:	

Congratulations.

Now that you have completed your balance sheet you have accomplished another milestone on your journey toward economic freedom.

No matter how big or how small this may look today, you are in a better position to chart your course to your destination. Let's answer some questions about where you are today to better help you in clarifying your next steps.

1. What is the one area of the balance sheet you want to improve the most?

2. What liability should you be focused on retiring if any? (Hint, the highest interest loans that are not tied to an appreciating asset.)

3. Are you building your retirement assets at the fastest pace possible? (Are you maximizing your 401(k) contributions? Can you add a Roth IRA as well?)

4. Do you have three months of expenses (cash flow) in short-term reserves?

5. Are there any loans that you could refinance at a lower interest rate?

6. Are there any assets that should be sold, gifted or disposed of? (Get rid of the junk.)

7. Are most of your assets working towards your goal of economic freedom?

If you have answered these questions, then you are now in a position to revisit your goals.

The next step on your path to economic freedom

Learn how to set reachable goals to help you reach economic freedom in our next special report, "Goal setting: Create your plan for Economic Freedom."

Download this and other resources at ScienceofEconomicFreedom.com

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