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The Accounting Equation and Redemption

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Abstract

The accounting equation has been used, to some degree, for centuries. It was first documented in publication more than 400 years ago. The accounting equation is a powerful tool for determining the value of a business to its owners. Using this same valuation model, the story of redemption may be clearly presented, including the basis for valuing each individual.

Key Words: accounting equation, accounts, debit, credit, T account, value, redemption

Introduction

Record keeping in the form of accounting has been in existence almost since the beginning of this world's existence. The Bible is full of examples indicating the presence and/or occurrence of accounting. A few examples of accounting and recording in the Bible (NIV) follow.

- Genesis 14 tells of Abraham giving 1/10th of everything to Melchizedek (how would he know how much was 1/10 without record keeping?).
- Genesis 41 recounts that Joseph stored up so much grain that *he stopped keeping records*.
- Exodus 38 gives an accounting of the materials used to build the Tabernacle, which were *recorded* at the command of Moses by the Levites.
- Malachi 3 warns against robbing God and admonishes us to bring our tithes into the storehouse (again, record keeping is required).
- Matthew 25 contains the parable of the talents, in which the three servants were required to give an accounting when the Master returned.

In some form, accounting has been present throughout all societies and nations as they have developed. The system that has served accounting for more than 400 years was initially known as the "Venetian method (Luca Pacioli, n.d.)." It was used by Italian merchants to account for their various business ventures and transactions. In 1494 Luca Pacioli, an Italian priest and math professor, Published a book entitled *Suma de Arithmetica, Geometrica, Proportioni et Proportionalita*, which translates to *The Collected Knowledge of Arithmetic, Geometry, Proportion and Proportionality* (Luca Pacioli, n.d.). This book was the first to document and publish the double-entry accounting system that is still in use today.

The Accounting Equation

The accounting equation, the basis for all "double entry" bookkeeping, is a very simple equation that states:

$$Assets = Liabilities + Owners^{1} Equity.$$

The equation is simple, but powerful and it provides the model for valuing a business that is utilized by virtually all of the developed nations in the world.

While there is a more formal definition of an asset, in layman's terms it may be defined as something of value owned by a company that will be used to generate revenue or create value at some point in the future. Again, while there is a more formal definition, in layman's terms a liability is an obligation that must be paid at some future date. Presumably, it became a liability of the company because it arose from the purchase of an asset or a service that will be used or has been used by the company in its revenue-generating process.

Owner's Equity represents the measured value of the company to the owner or owners. It is easily understood by a relatively simple algebraic manipulation of the accounting equation.

$$Assets = Liabilities + Owner^{1} s\ Equity$$
$$Assets - Liabilities = Liabilities - Liabilities + Owner^{1} s Equity$$
$$Assets - Liabilities = Owner^{1} s Equity$$

The restated accounting equation clearly shows that Owner's Equity is the net value of the company's assets remaining after paying the company's liabilities. So the accounting equation enables an individual to measure the value of the company to the owner(s).

A for-profit business exists to generate profits. Income (or revenue) generated by the business will increase Owner's Equity, while expenses incurred by the business will decrease Owner's Equity. Presumably, in the normal course of business, revenues will exceed expenses, and the resulting Net Income will increase the value of the company to the owner(s).

Operationalizing the Accounting Equation

Double entry bookkeeping was originally designed to improve the accuracy of the accounting records. The thought process was that a number entered two times had a decreased probability of being entered incorrectly twice. While the accounting equation creates the "balance" so frequently discussed (balancing the books), it doesn't really provide the mechanics for a double entry system.

Those mechanics occur through a series of "accounts," usually one account for each asset, liability, equity, revenue, and expense. Each account has a balance (or total for the account). In keeping with the balance of the accounting equation, assets are assigned a *Debit* (*Dr.*) balance. Liabilities and Owner's Equity are assigned a *Credit* (*Cr*.) balance. By applying the debits and credits to the accounting equation, debits will now equal credits when the equation (and underlying accounting records) are in balance.

To illustrate how the system works, assume that the owner of the company invested $10,000 in the company on the first day the business was in operation. The accounting entry to record this transaction as it would appear in the records of the business is shown below. Notice that the debit is in the left column and the credit is in the right column. Two columns are always used: the left column for debits, and the right column for credits.

Date		Description	Post Ref.	Debit	Credit
Jan.	1	Cash		10,000	
		Owner's Equity			10,000

Because *Cash* is an asset account, which has a debit balance, recording a debit to cash will increase the cash balance. Similarly, because *Owner's Equity* is an Equity account, and has a credit balance, recording a credit to the owner's equity will increase the owner's equity balance. Examples of how the accounts for *Cash* and *Owner's Equity,* including the recording of this transaction, would appear in the accounting records of the business are shown below.

Cash					Acct. No.	101
Date		**Description**	**Post Ref.**	**Debit**	**Credit**	**Balance**
Jan.	1	Beginning Balance				0
	1	Cash Received From Owner		10,000		10,000

Owner's Equity					Acct. No.	301
Date		**Description**	**Post Ref.**	**Debit**	**Credit**	**Balance**
Jan.	1	Beginning Balance				0
	1	Investment by Owner			10,000	10,000

You will notice that the "balance" column doesn't make a distinction between a debit and credit balance

You will notice that the "balance" column doesn't make a distinction between debt and credit balance for the account. In many of the old, hand-posted accounting systems, this distinction was achieved by using black to indicate a debit balance, while red was the color used to indicate a credit balance.

Following this format, notice what happened to the cash account (shown below) when the business spent more money than it actually had to pay its creditors and employees. After these payments, the cash account had a credit balance—it was overdrawn. This situation may very well have been the origin of the phrase "in the red." Similarly, when a company's total liabilities exceed its total assets, it is in the red-it is technically bankrupt.

Cash					**Acct. No.**	101
Date		**Description**	**Post Ref.**	**Debit**	**Credit**	**Balance**
Jan.	1	Beginning Balance				0
	1	Cash Received From Owner		10,000		10,000
	5	Received Cash From Customers		250,000		260,000
	10	Paid Creditors			200,000	60,000
	15	Paid Employee Payroll			70,000	10,000

The "T Account"

The account format shown above has been in use for centuries. However, it is cumbersome to write when attempting to informally represent an account. Accountants, and especially accounting professors, for decades have used an abbreviated form know as a T Account. In the T Account, the debits appear on the left-hand side of the T, and the credits appear on the right-hand side of the T. Referring back to the $10,000 deposit made by the owner at the beginning of the year, it would be represented in T Accounts as follows.

Cash

Beg. Bal.	0		
Owner Deposit	10,000		
	10,000		

Owner's Equity

		Beg. Bal.	0
		Owner Deposit	10,000
			10,000

The Concept of Value in the Bible

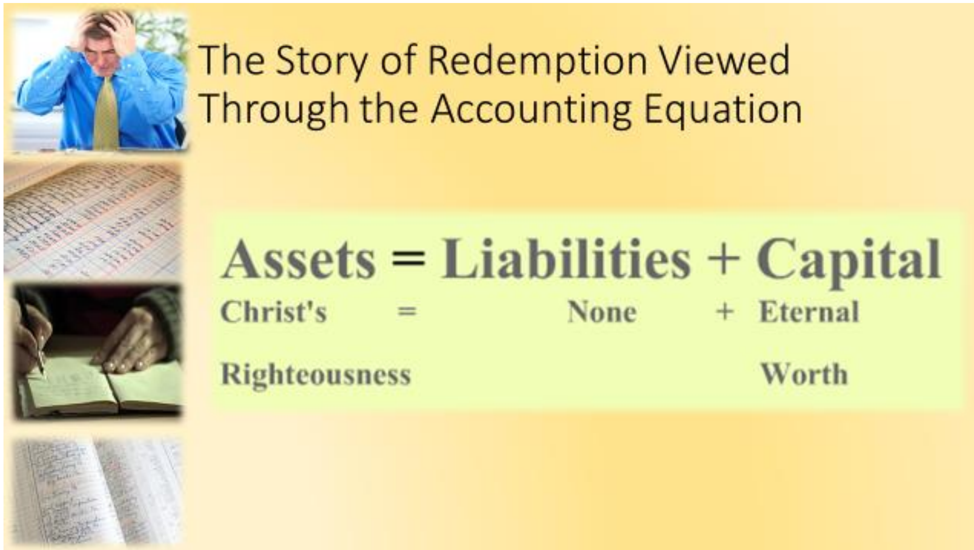
Multiple references are made in the Bible to the use of balances to provide a fair value.

- Revelation 6:5 depicts the rider on the black horse holding a pair of balances (KJV).
- Leviticus 19:36 admonishes the Israelites to have just balances and weights (KJV).
- Psalm 62:9 states that lowborn men are but a breath, the highborn are but a lie; if weighed on a balance, they are nothing; together they are only a breath (NIV).
- Isaiah 40:12 asks who has weighed the mountains on the scales or the hills in a balance (NIV). Fairness and/or honesty was crucial in scales and balances. Proverbs 16:11 states that honest scales and balances are from the Lord (NIV).

The memorable metaphor of using scales or balances to measure or value a person is present in Daniel's interpretation of the handwriting on the wall. In Daniel 5, verse 27, when Daniel is interpreting the handwriting for Belshazzar, he stated that "You have been weighed on the scales and found wanting (NIV)." The King James Version translates the interpretation as "Thou are weighed in the balances and art found wanting."

Using the Accounting Equation as a Model for Measuring Value

The concept of balance and owner's equity representing value or worth of the company may also be used as a metaphorical model for describing and valuing people – both ourselves and others. But in describing and ultimately assigning value to an individual, the perspective used when employing this model will produce extremely different perspectives and values.



The secular society perspective looks only at the external attributes to assign value to an individual. The external attributes might include social status, wealth, deeds/works, popularity (or star power), education, and career. Based on these attributes, society either formally or informally assigns a value to an individual. A homeless person is worth very little, while a movie star or accomplished and published scientist is accorded of having high value.

Individuals perform these valuations on themselves too. This has been occurring for millennia. Luke 8 (NIV) contains two examples. In verses 9—13, Jesus told the parable that contrasted the Pharisee and the tax collector. The Pharisee prayed thanking God that he was not like other men: robbers, evildoers, adulterers—or even tax collectors. In verses 18—25, as part of his conversation with Jesus about being saved, the Rich Ruler stated that he had kept the commandments since childhood, implying that he was already a very good person.

The Pharisee's self-valuation, if shown in a *T Account*, might look like the *T Account* below. His personal assessment was that he was a very holy man. He probably even felt that God was obligated to admit him to heaven.

Pharisee's Worth

Keeps the Commandments	No known sins
Doesn't commit robbery	
Doesn't commit adultery	
Doesn't collect taxes	

Many Christians living today, even members of our church, behave the same way that the Pharisee and Rich Ruler did. They create personal *T Accounts* valuing themselves that frequently look like the *T Account* below.

Christian's Worth

I'm Vegan	Occasionally eat sugar
I'm Sexually Chaste	
I don't wear jewelry (not even a wedding band)	
I study my SS lesson every day	
I pay tithe on everything	
I don't wear make-up	

The problem with the secular perspective, and the source of self-satisfaction when performing a self-valuation, is that the evaluators are comparing (or judging) one person based on another person. It is a ranking process based exclusively on external observations. In Chapter 13 of *Christ Object Lessons*, Ellen White states that the Pharisee is ". . . satisfied with a religion that has to do only with outward life (151)."

I Samuel 16:7 succinctly contrasts the secular perspective with God's perspective. It states that ". . . The Lord does not look at the things man looks at. Man looks at the outward appearance, but the Lord looks at the heart (NIV)." When using God's model for valuing mankind, we all fall woefully short. According to Romans 3:23 (KJV), ". . . all have sinned, and fall short of the glory of God . . ." From God's perspective, our individual *T Accounts* will look similar to the one shown below.

Our Worth from God's Pespective	
Love our Family	**Liars**
Hold a steady job	**Impure Thoughts**
	Gluttons
	Selfish & Self-Centered
	Skim on our taxes
	Mistreat or Ignore Others

What is very clear from this visual representation is that, viewed from the appropriate perspective, our personal negative attributes (or liabilities) are far more numerous than our personal positive attributes (or assets). To use the old expression, we are in the "red," Or stated more accurately, out of balance. We are bankrupt. Isaiah 64:6 states it very clearly when it says that ". . . all our righteous acts are like filthy rags (NIV)."

The Good News

While the accounting equation and *T Account* clearly show our bankrupt value from God's perspective, they also provide a platform for explaining and illustrating the story of our redemption. The four Gospels tell the story of Christ's sacrifice for all of us.

On our own, our personal work bleeds red. The parallel of our bankrupt value (in the red) and the deep red stains of sin depicted in Isaiah 1:18 ". . . Though your sins are like scarlet, they shall be as white as snow; though they are red as crimson, they shall be like wool. (NIV)"

The third chapter of Titus concisely tells us that

> ". . . But when the kindness and love of God our Savior appeared, he saved us, not because of righteous things we had done, but because of his mercy. He saved us through the washing of rebirth and renewal by the Holy Spirit, whom he poured out on us, generously through Jesus Christ our Savior, so that, having been justified by his grace, we might become heir having the hope of eternal life (verses 4—7, NIV)."

Our balance has been more than restored by the sacrifice of Jesus. Our true value to God may now be seen in the revised *T Account* below.

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