

**CHRISTOPHER MILLER CONSULTING**  
Excellence in Management Accounting

## **BALANCE SHEET PRESENTATION**

*Presentation matters. Never more so than with a balance sheet, the key statement of financial position of a business. It is not merely a passive report, a statement of only historical interest. Far from it; it is a foundation on which future actions are based. The wisdom of those actions will be determined (obviously) by the numerical values. However, it will also (and less obviously) be determined by the presentation, in particular the format of the information. The format needs to reflect key conceptual insights if stakeholders are to be enabled to make optimal decisions.*

### **KEY CONCEPT: THE BUSINESS**

The concept of the business is at the heart of first world economic success. And yet it is possible to gain a Master of Business Administration degree without being called upon to define it.

Dictionaries don't help. Either they offer an evasive and circular definition ("buying and selling, trade") or they are old-fashioned ("habitual occupation, profession, trade"), having failed to keep up with the evolution of the concept.

We can identify some things that a business is not. It is not an entity. Entities - companies and trusts, for example - are legal constructs. They commonly support the conduct of a business - and are essential to large scale business - but they are not businesses.

So let us bring the definition up to date: *a business is an established and self-sustaining set of relationships, including inter-dependencies, entered into by equity investors, financiers, employees, customers and suppliers for economic purposes and is of realisable value.*

Government has taken to conducting activities in entities similar to those used by businesses and furthering the analogy by presenting financial reports in business formats. However, the underlined clause of the definition makes clear that most government activities are not businesses.

### **KEY CONCEPT: DOUBLE ENTRY BOOKKEEPING**

Double entry bookkeeping is one of the highest achievements of the western intellectual tradition. It wasn't applied at all in Communist countries; it is scarcely applied in third world ones. There is a direct link between its application and economic success. Its importance is under-recognised; it is nothing less than the foundation of first world economic success.

Its attraction to bookkeepers is obvious: the unbreakable rule that there must be two aspects, equal and offsetting, to every entry reduces clerical error. But there is much more to it than that; it reflects two fundamental concepts:

Firstly: that every balance in a statement of financial position is capable of validation by reference to objective external evidence (except equity balances, which are the net of all other balances),

Secondly: that ownership – proprietorship or equity – is separate from the business.

Thus it takes the conceptual leap that breaks a business free from its ownership and so reflects that it has separate and continuing existence.

### **KEY CONCEPT: FUNDS EMPLOYED/FUNDS SUPPLIED**

Money is fungible, which is an absolute attribute. Thus a dollar does not know whence it came nor whither it goes. Nevertheless, when the concept of the business is grasped and double entry bookkeeping applied, balance sheet items can be divided into just two basic categories:

Firstly: balances that arise in the conduct of the business,

Secondly: balances that arise in the funding of the business.

These have simple names: Funds Employed and Funds Supplied. In accordance with the concept of double entry bookkeeping, these are numerically equal and offsetting.

Many balance sheets continue to reflect a convention that arose in the nineteenth century: that external assets (sometimes) and external liabilities (always) should be divided into current and deferred components, with a dividing date line precisely one year from balance date. For banks, it has been recognised this gives far too limited a presentation of gapping risks. But industrials continue to apply it.

When gapping information is required, it can better be displayed by way of note; displaying it on the face of the balance sheet results in an inferior presentation. It also clutters and overloads the format of the balance sheet, limiting its capacity to display other information.

Thus, adoption of the key concept of Funds Employed/Funds Supplied is a timely opportunity to drop that outmoded convention.

## IMMEDIATE BENEFITS

A worked example shows immediate benefits from this approach.

**Attachment A** is the BHP Billiton consolidated balance sheet as at 30 June 2007 as published by the company.

**Attachment B** is the same information but reflecting the key concept of double entry bookkeeping by displaying credit balances in brackets. This removes ambiguity from the display.

**Attachment C** still presents the same amounts but ignores the distinction between current and deferred assets and liabilities. (The current and deferred information that could be read off Attachments A and B could be reassembled and displayed by way of note. However this would be a limited display; fuller disclosure of the gapping position would require information not reflected in those attachments.)

**Attachment D** adopts the Funds Employed/Funds Supplied format.

**Attachment E** shows examples of key analytical information that can be taken directly off the Funds Employed/Funds Supplied format. In particular, the:

Rate of Return on Funds Employed and the  
Gearing Ratio.

These allow key insights into financial performance (how profitability the business is employing its funds) and financial risk (risk due to gearing).

## FURTHER BENEFITS

The key concept of the business can be tied directly to the Funds Employed in the business. This is the case when intangible assets (reflected within Funds Employed) are valued at the amount that makes Funds Employed equal to the value of the business.

BHP Billiton market capitalisation as at 30 June 2007 was some US\$165 billion (2006 - US\$118 billion). **Attachment F** shows the balance sheet restated for analytical purposes as if this amount were reflected in the accounts of the company. In the BHP Billiton case, the rapid increase in the market capitalisation of the business in light of strong profitability is highlighted, as is low gearing. (This analysis suggests that the rate of return on market capitalisation is surprisingly high and the business may be under-gear.)

Advances in financial theory follow clarification of key concepts – discarding the old and irrelevant and adopting the more insightful. In this case, the Funds Employed/Funds Supplied format makes clear the insight of Modigliani and Miller – that the financial risk of the business is not a function of its funding structure. (This is not strictly true; increasing borrowings increase the risk of default that may be fatal even when only technical.)

**BHP Billiton**  
**Consolidated Balance Sheet**  
**as at 30 June 2007**  
**Step One: As per the Published Accounts**

	2007 US\$M	2006 US\$M
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and equivalents	1,937	776
Trade and other receivables	4,689	3,831
Other financial assets	952	808
Inventories	3,296	2,732
Assets held for sale		469
Other	213	160
<b>Total current assets</b>	<b>11,087</b>	<b>8,776</b>
<b>Non-current assets</b>		
Trade and other receivables	810	813
Other financial assets	1,016	950
Inventories	113	93
Investments in jointly controlled entities	4,924	4,299
Property, plant and equipment	36,705	30,985
Intangible assets	615	683
Deferred tax assets	2,810	1,829
Other	88	88
<b>Total non-current assets</b>	<b>47,081</b>	<b>39,740</b>
<b>Total assets</b>	<b>58,168</b>	<b>48,516</b>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Trade and other payables	4,724	4,053
Interest bearing liabilities	1,352	1,368
Liabilities held for sale		192
Other financial liabilities	512	544
Current tax payable	2,102	1,358
Provisions	1,259	1,067
Deferred income	300	279
<b>Total current liabilities</b>	<b>10,249</b>	<b>8,861</b>
<b>Non-current liabilities</b>		
Trade and other payables	145	169
Interest bearing liabilities	9,291	7,648
Other financial liabilities	595	289
Deferred tax liabilities	1,822	1,592
Provisions	5,601	4,853
Deferred income	547	649
<b>Total non-current liabilities</b>	<b>18,001</b>	<b>15,200</b>
<b>Total liabilities</b>	<b>28,250</b>	<b>24,061</b>
<b>Net assets</b>	<b>29,918</b>	<b>24,455</b>
<b>EQUITY</b>		
Share capital - BHP Billiton Limited	1,221	1,490
Share capital - BHP Billiton Plc	1,183	1,234
Share premium account	518	518
Treasury shares held	(1,457)	(418)
Reserves	473	306
Retained earnings	27,729	21,088
<b>Total equity attributable to members of BHP Billiton Group</b>	<b>29,667</b>	<b>24,218</b>
Minority interests	251	237
<b>Total equity</b>	<b>29,918</b>	<b>24,455</b>

**BHP Billiton**  
**Consolidated Balance Sheet**  
**as at 30 June 2007**  
**Step Two: Display Credit Balances in (Brackets)**

	2007 US\$M	2006 US\$M
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and equivalents	1,937	776
Trade and other receivables	4,689	3,831
Other financial assets	952	808
Inventories	3,296	2,732
Assets held for sale	0	469
Other	213	160
<b>Total current assets</b>	<b>11,087</b>	<b>8,776</b>
<b>Non-current assets</b>		
Trade and other receivables	810	813
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<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Trade and other payables	(4,724)	(4,053)
Interest bearing liabilities	(1,352)	(1,368)
Liabilities held for sale	0	(192)
Other financial liabilities	(512)	(544)
Current tax payable	(2,102)	(1,358)
Provisions	(1,259)	(1,067)
Deferred income	(300)	(279)
<b>Total current liabilities</b>	<b>(10,249)</b>	<b>(8,861)</b>
<b>Non-current liabilities</b>		
Trade and other payables	(145)	(169)
Interest bearing liabilities	(9,291)	(7,648)
Other financial liabilities	(595)	(289)
Deferred tax liabilities	(1,822)	(1,592)
Provisions	(5,601)	(4,853)
Deferred income	(547)	(649)
<b>Total non-current liabilities</b>	<b>(18,001)</b>	<b>(15,200)</b>
<b>Total liabilities</b>	<b>(28,250)</b>	<b>(24,061)</b>
<b>Net assets</b>	<b>29,918</b>	<b>24,455</b>
<b>EQUITY</b>		
Share capital - BHP Billiton Limited	(1,221)	(1,490)
Share capital - BHP Billiton Plc	(1,183)	(1,234)
Share premium account	(518)	(518)
Treasury shares held	1,457	418
Reserves	(473)	(306)
Retained earnings	(27,729)	(21,088)
<b>Total equity attributable to members of BHP Billiton Group</b>	<b>(29,667)</b>	<b>(24,218)</b>
Minority interests	(251)	(237)
<b>Total equity</b>	<b>(29,918)</b>	<b>(24,455)</b>

**BHP Billiton**  
**Consolidated Balance Sheet**  
**as at 30 June 2007**

**Step Three: Ignore the Distinction Between Current and Deferred**

	2007 US\$M	2006 US\$M
<b>ASSETS</b>		
Cash and equivalents	1,937	776
Trade and other receivables	5,499	4,644
Other financial assets	1,968	1,758
Inventories	3,409	2,825
Assets held for sale	0	469
Other	301	248
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Trade and other receivables	0	0
Other financial assets	0	0
Inventories	0	0
Investments in jointly controlled entities	4,924	4,299
Property, plant and equipment	36,705	30,985
Intangible assets	615	683
Deferred tax assets	2,810	1,829
Other	0	0
<hr/>		
<b>Total assets</b>	<b>58,168</b>	<b>48,516</b>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Trade and other payables	(4,869)	(4,222)
Interest bearing liabilities	(10,643)	(9,016)
Liabilities held for sale	0	(192)
Other financial liabilities	(1,107)	(833)
Current tax payable	(3,924)	(2,950)
Provisions	(6,860)	(5,920)
Deferred income	(847)	(928)
<hr/>		
Trade and other payables	0	0
Interest bearing liabilities	0	0
Other financial liabilities	0	0
Deferred tax liabilities	0	0
Provisions	0	0
Deferred income	0	0
<hr/>		
<b>Total liabilities</b>	<b>(28,250)</b>	<b>(24,061)</b>
<b>Net assets</b>	<b>29,918</b>	<b>24,455</b>
<b>EQUITY</b>		
Share capital - BHP Billiton Limited	(1,221)	(1,490)
Share capital - BHP Billiton Plc	(1,183)	(1,234)
Share premium account	(518)	(518)
Treasury shares held	1,457	418
Reserves	(473)	(306)
Retained earnings	(27,729)	(21,088)
<b>Total equity attributable to members of BHP Billiton Group</b>	<b>(29,667)</b>	<b>(24,218)</b>
Minority interests	(251)	(237)
<b>Total equity</b>	<b>(29,918)</b>	<b>(24,455)</b>

**BHP Billiton**  
**Consolidated Balance Sheet**  
**as at 30 June 2007**

**Step Four: Reclassify as Funds Employed and Funds Supplied**

	2007 US\$M	2006 US\$M
Trade and other receivables	5,800	4,892
Inventories	3,409	2,825
Trade and other payables	(4,869)	(4,222)
Deferred income	(847)	(928)
Net tax payable	(1,114)	(1,121)
Provisions	(6,860)	(5,920)
Property, plant and equipment	36,705	30,985
Assets held for sale	0	277
Investments in jointly controlled entities	4,924	4,299
Intangible assets	615	683
<b>FUNDS EMPLOYED</b>	<b>37,763</b>	<b>31,770</b>
Share capital - BHP Billiton Limited	(1,221)	(1,490)
Share capital - BHP Billiton Plc	(1,183)	(1,234)
Share premium account	(518)	(518)
Treasury shares held	1,457	418
Reserves	(473)	(306)
Retained earnings	(27,729)	(21,088)
<b>Total equity attributable to members of BHP Billiton Group</b>	<b>(29,667)</b>	<b>(24,218)</b>
Minority interests	(251)	(237)
<b>Total equity</b>	<b>(29,918)</b>	<b>(24,455)</b>
Cash and equivalents	1,937	776
Other financial assets	1,968	1,758
Interest bearing liabilities	(10,643)	(9,016)
Other financial liabilities	(1,107)	(833)
<b>Total external finance</b>	<b>(7,845)</b>	<b>(7,315)</b>
<b>FUNDS SUPPLIED</b>	<b>(37,763)</b>	<b>(31,770)</b>

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**as at 30 June 2007**  
**Step Five: Analysis**

	2007	2006
<b>Rate of Return on Funds Employed</b>	US\$M	US\$M
Net Profit After Tax	13,496	10,534
Funds Employed (at year end)	37,763	31,770
- Percentage (Based on Funds Employed at Year End)	35.7%	33.2%
<b>Gearing Ratio</b>	US\$M	US\$M
Total Equity	(29,918)	(24,455)
Total External Finance	(7,845)	(7,315)
- Percentage of Funds Supplied by Shareholders	79.2%	77.0%
- Percentage of Funds Supplied by External Financiers	20.8%	23.0%



**BHP Billiton**  
**Consolidated Balance Sheet**  
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**Analysis: Tying Funds Employed to the Value of the Business**

	2007	2006
	US\$M	US\$M
Trade and other receivables	5,800	4,892
Inventories	3,409	2,825
Trade and other payables	(4,869)	(4,222)
Deferred income	(847)	(928)
Net tax payable	(1,114)	(1,121)
Provisions	(6,860)	(5,920)
Property, plant and equipment	36,705	30,985
Assets held for sale	0	277
Investments in jointly controlled entities	4,924	4,299
Intangible assets	135,948	94,465
<b>FUNDS EMPLOYED (MARKET CAPITALISATION)</b>	<b>173,096</b>	<b>125,552</b>
Share capital - BHP Billiton Limited	(1,221)	(1,490)
Share capital - BHP Billiton Plc	(1,183)	(1,234)
Share premium account	(518)	(518)
Treasury shares held	1,457	418
Reserves	(135,806)	(94,088)
Retained earnings	(27,729)	(21,088)
<b>Total equity attributable to members of BHP Billiton Group</b>	<b>(165,000)</b>	<b>(118,000)</b>
Minority interests	(251)	(237)
<b>Total equity</b>	<b>(165,251)</b>	<b>(118,237)</b>
Cash and equivalents	1,937	776
Other financial assets	1,968	1,758
Interest bearing liabilities	(10,643)	(9,016)
Other financial liabilities	(1,107)	(833)
<b>Total external finance</b>	<b>(7,845)</b>	<b>(7,315)</b>
<b>FUNDS SUPPLIED</b>	<b>(173,096)</b>	<b>(125,552)</b>
<b>Rate of Return on Market Capitalisation</b>		
Net Profit After Tax	13,496	10,534
Funds Employed (at year end)	173,096	125,552
- Percentage (Based on Funds Employed at Year End)	7.8%	8.4%