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On the Definitions of Income, Expenses and Profit in IFRS

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Notes

The same logic is fundamental to the Modigliani–Miller theorem in financial economics.

Revenue and gains are subsets of income. Hence, for example, revenue could be defined, consistently with the Framework, as ‘a particular type of increase in economic benefits that arises in the course of ordinary activities in the form of inflows or enhancements of assets or decreases in liabilities and results in an increase in equity’ (DRSC, EFRAG and CNC, 2007).

The same is true for US GAAP (FASB, 1984, 1985).

For example, expenses under Definition 2 would be: Expenses are decreases in equity, excluding distributions to equity participants.

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There is again a connection here with Hicks, whose third and final definition of profit is expressed in real terms, thereby implicitly making the distinction between profit and capital maintenance.

The Framework does not express a preference for either financial or physical capital maintenance, and in principle it allows either.

IAS 1's Basis for Conclusions suggest that the IASB is actually willing but unable.

The term ‘other reserves’ is used here to mean reserves relating to other comprehensive income, as defined in IAS 1.

In this definition, ‘transactions with owners in their capacity as owners’ replaces ‘contributions from equity participants’, presumably because ‘transactions’ embraces both contributions and distributions, and because equity participants could transact in alternative roles, such as that of employees. If profit is defined simply as income less expenses, then both of these definitional complexities go away, enabling a less wordy definition.

Interestingly, it is defined correctly as a change in equity rather than as a change in net assets.

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