What is revenue?

At first glance, this question may seem like it has an easy answer: revenue is (hopefully) the biggest number in a company's statement of profit or loss, and one of the main metrics by which to assess a company's performance during the year. Both of these statements are probably true for most companies, but sometimes it is unclear as to what exactly should be included in this very important number.

The requirement to present revenue on the face of the statement of profit or loss comes from paragraph 82 of IAS 1 *Presentation of Financial Statements*, which states: "*In addition to items required by other IFRSs, the profit or loss section or the statement of profit or loss shall include line items that present the following amounts for the period: (a) revenue, presenting separately interest revenue calculated using the effective interest method.*"

IAS 1.34 explains that "*an entity undertakes, in the course of ordinary activities, other transactions that do not generate revenue, but are incidental to the main revenue-generating activities*." Although the context of this guidance in IAS 1 is in relation to the offsetting of income and expenses, the reference is relevant in that it notes that there may be activities undertaken by an entity which do not generate revenue but may be incidental to revenue-generating activities. The standard thus distinguishes between revenue-generating activities, and activities that are incidental to revenue-generating activities. However, IAS 1 does not elaborate further on what 'revenue' means, so we must turn to other standards for guidance.

IFRS 15 *Revenue from Contracts with Customers* defines 'revenue' as "*income arising in the course of an entity's ordinary activities*", whereas 'income' is defined by the same standard as "*increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants.*" The definition of income in IFRS 15 comes from the Conceptual Framework for Financial Reporting

("the Framework"), but the revised Framework (2018) no longer addresses the various types of income in the same manner as its predecessor did. The IASB explained its reasoning around the change in BC4.96 as follows "*…The rest of the discussion in the 2010 Conceptual Framework referred to various types of income and expenses, for example, revenue, gains and losses. That material was not included in the 2018 Conceptual Framework. The material was originally included to emphasise that income includes revenue and gains and that expenses include losses. The Board decided that that emphasis is now unnecessary and the implication that the Conceptual Framework defines subclasses of income and expenses is unhelpful. The Board does not expect the removal of that material to cause any changes in practice.*" Notwithstanding the removal of this discussion from the conceptual framework, it remains clear that the IASB considers revenue to be a subset of the broader concept of income, and it is therefore necessary to consider the circumstances under which the income arises in order to determine whether the income should be classified as revenue.

The terms 'ordinary activities' and 'main revenue-generating activities' are not formally defined in current IFRSs, which means that judgement is required to determine whether the income arises from ordinary activities. Some companies take the broad view that the term revenue is all-encompassing and includes any income that is not extraordinary in nature. Whilst the current version of IAS 1 explicitly prohibits the presentation of any items of income or expense as extraordinary items (paragraph 87), there is merit in considering the definitions that were contained in some older standards to understand what is meant by the concept of "ordinary activities". An earlier version of IAS 8 (1993) contained the following explanation:

> "*Extraordinary items are income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly. Ordinary activities are any activities which are undertaken by an enterprise as part of its business and such related activities in which the enterprise engages in furtherance of, incidental to, or arising from these activities. … Virtually all items of income and expense included in the determination of net profit or loss for the period arise in the course of the ordinary activities of the enterprise. Therefore, only on rare occasions does an event or transaction give rise to an extraordinary item. Whether an event or transaction is clearly distinct from the ordinary activities of the enterprise is determined by the nature of the event or transaction in relation to the business ordinarily carried on by the enterprise rather than by the frequency with which such events are expected to occur. Therefore, an event or transaction may be extraordinary for one enterprise but not extraordinary for*

another enterprise because of the differences between their respective ordinary activities. For example, losses sustained as a result of an earthquake may qualify as an extraordinary item for many enterprises. However, claims from policyholders arising from an earthquake do not qualify as an extraordinary item for an insurance enterprise that insures against such risks."

Following this guidance, while a company may undertake both 'core' and 'non-core' business activities, to the extent that any related non-core activity is incidental to or arises from its core activities, it would still be considered an ordinary activity, and any income arising therefrom should be classified as revenue.

Others have taken the view that the concept of 'ordinary activities' refers only to the core business activities of an entity, and thus a distinction between core and non-core business activities is established for purposes of making a demarcation between revenue and 'other income'. The concepts of core and non-core business activities are also not formally defined in the standards, which means that judgement is still required to make this distinction.

A further aspect to consider is that IFRS 15 is a 'residual' standard, in that it only applies to revenue from contracts with customers that is not dealt with in other standards. This does not mean that the term 'revenue' applies only to income that has been accounted for in accordance with IFRS 15. For example, a property company that earns rental income from its tenants would account for such income in terms of IFRS 16 *Leases*, rather than by applying IFRS 15. However, if property rental is an ordinary activity of that company, it would still classify the rental income as revenue for the purposes of IAS 1.

It is evident from the above discussion that there is no definitive answer to the question of what constitutes revenue. However, it is important that management applies its judgement in this regard in a consistent and transparent manner in order to provide information that is both relevant and reliable to the users of the company's financial statements.

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