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# Financial Assets and Liabilities of Islamic Banks under the IFRS Regime (A Case Study of CIMB Islamic and Maybank Islamic)

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ABSTRACT

Islamic banking faces a fundamental challenge in balancing its adherence to distinctive Shariah principles with the imperative of global financial integration and standardization, particularly concerning International Financial Reporting Standards (IFRS). This study addresses the concern that IFRS compliance might inadvertently violate Shariah principles. Using a practical lens, this research examines the financial statements of two prominent Malaysian Islamic banks, CIMB Islamic and Maybank Islamic, both operating under the IFRS framework. The study aims to ascertain the extent of their IFRS compliance, analyze their financial performance under this regime, and investigate the impact of crises on their liquidity. Finally, it provides recommendations to stakeholders, including the banks and the Malaysian government, regarding the implications of the IFRS framework for Islamic banking



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# INTRODUCTION

## *Study Background*

The International Financial Reporting Standard (IFRS) is a standard created by the International Accounting Standards Boards (IASB) to provide standards for preparing financial statements for companies worldwide. Companies can produce high-quality, comparable and transparent financial reports used by investors in the world capital markets and other interested parties (stakeholders). Many countries in Europe, Asia, Africa, Oceania and America are implementing IFRS. International Accounting Standards/IAS are compiled by four major world organizations, namely the International Accounting Standards Agency (IASB), the European Community Commission (EC), the International Accounting Standards Organization (EC), the International Accounting Standards Organization (IASB), and the European Union. International Capital Markets (IOSOC) and the International Accounting Federation (IFAC). (Deloitte, 2021)

IFRS is prepared based on principles-based standards. The advantage of principles-based standards over rule-based standards is that companies can implement accounting standards according to their unique characteristics so that the resulting financial reporting will better reflect the company's value. IFRS uses the concept of fair value to replace the previous measurement concept, namely, historical cost, which is considered no longer relevant and cannot keep up with the development of increasingly advanced accounting standards. The use of fair value is considered the most appropriate and relevant concept for the preparation of the financial statements of a company or business entity because it can describe the market value that occurred at that time, increasing transparency. Until now, IFRS has been widely used worldwide; more than 100 countries have used it, including; Korea, Canada and Argentina (2011), United States (2014). While Malaysia has adopted IFRS since January 2012. (Shafii & Zakaria, 2013)

In the case of Malaysia, the adoption of IFRS certainly has an impact on the Islamic Financial Institution, which continues to proliferate in this country. Including Islamic Banks, Takaful and re-Takaful operators, development financial institutions that participate in the Islamic Bank's scheme.

Meanwhile, prior to adopting IFRS, in 2011, the Malaysian Accounting Standard issued a new standard in financial reporting called the Malaysian Financial Report Standard (MFRS). This MFRS framework, although later attempted to converge the IFRS framework fully, there are still some differences in the standard of application, in the case of assets, for example in the case of Assets for sale, the MFRS standard stated that requires such assets to be measured at fair value fewer costs to sell in another side IFRS stated that measurements are required according to IFRS no.5(Deloitte, 2009)

Furthermore, along with the development of Islamic Financial Institutions in Malaysia, the issue of shariah compliance emerged in Islamic Bank financial reporting on the assets and liabilities side.

***Problem statement***

Islamic Banking is faced with the challenge between adhering to the distinctive Shariah Issues in Specific IFRS: One of the characteristics of their operations and expanding business through deeper integration into the global financial markets. While Islamic Bankings are eager to comply with and conduct their businesses following Islamic principles, they also have to ascertain an international accounting and financial standardization to be part of the global financial markets. Islamic Banking is concerned about whether being compliant with IFRSs would violate any Shariah principles.

Furthermore, it is interesting to analyze the financial statements of Islamic Banking in Malaysia which adheres to the IFRR Regime. It can be seen practically how shariah issues owned by Islamic banks can be involved in the IFRS framework.

***Objective***

Therefore, the aim of this study is:

1. To examine the financial statement of two Islamic Banks in Malaysia (CIMB and Maybank Islamic), which adheres to the IFRS framework. Examine-in this case is the extent to which they fulfil the principles of IFRS
2. In addition, this paper also analyzes the financial performance of the two Islamic banks that adhere to the IFRS regime
3. See if there is any impact of the crisis on the liquidity of the two banks
4. Provide recommendations to stakeholders, the Bank and the Malaysian Government regarding the various findings that emerged in this study related to the IFRS framework

***Scope of this study***

This study is limited to two financial statements of Islamic Banks in Malaysia, adherents of the IFRS regime, namely Maybank Islamic and CIMB Malaysia; the financial statements used in this study are the financial statements of 2020. The analysis of financial statements only focuses on Assets and Liabilities.

***The Research GAP***

The research gap lies in the critical tension between the need for global standardization and the requirement for strict Shariah compliance for Islamic Financial Institutions (IFIs). While IFIs in Malaysia aim to integrate into international markets by adopting International Financial Reporting Standards (IFRS) and the converged Malaysian Financial Reporting Standards (MFRS), there remains significant uncertainty about whether "fair value" measurements and specific asset treatments, such as IFRS No. 5, align with unique Shariah principles. This creates a compliance dilemma where Islamic banks must navigate a "gray area" of financial reporting. They attempt to meet the transparency requirements of global capital regimes while staying true to the religious essence of their operations.

**THEORETICAL REVIEW**

***Some Theoretical framework***

***IFRS principles***

According to IFRS, the classification of financial assets is based on measurement, namely amortized cost, fair value through other comprehensive income (FVOCI) and fair value through profit or loss (FVPL). Each financial asset needs to be categorized for measurement purposes based on the 'business model test' and 'solely' test of principal and interest payments (SPPI). If an asset passes both tests, it will be: categorized as amortized cost or FVOCI; otherwise, it will be considered FVPL. (Securities and Exchange Commission, 2011)

Testing a business model according to IFRS must follow the standard steps as follows:

1. Classify the required financial assets into separate groups or portfolios according to the way they are managed
2. Identify the objectives that the entity uses in conducting its business to manage each grouping or portfolio;
3. Based on the objective, classify each group or portfolio as 'held to collect' 'held to collect and to sell' or 'other'.Sementara SPPI gives rise to cash flows solely payments of principal and interest (SPPI) on the principal amount outstanding on a specified date with a basic lending arrangement.

The classification of financial assets under the business model and SPPI is as follows:

1. Amortized cost; Few examples of financial instruments that are likely to be classified and accounted under amortized cost according to IFRS 9 include trade receivables, loan receivables with 'basic' features, investments in term deposits at standard interest rates, investments in government bonds.
2. The criteria under this amortized cost are: first, the asset must be held to collect its contractual cash flows rather than sell the asset to realize any capital gain. Second, the asset of contractual cash flow must represent SPPI at a specific date.
3. Fair value through other comprehensive income, under this classification asset, must be obtained criteria as follows; first, the business model's objective is achieved by collecting contractual cash flows and selling financial assets. Second, it must be represented SPPI.

The business model test classification and the SPPI are Fair value through profit and Loss (FPLV). This classification includes any financial asset held for trading purposes and includes derivatives unless part of a properly designated hedging arrangement. Financial assets recognized in the FVPL category must be measured at fair value, with all changes recorded through profit or loss. (Dedy et al., 2018)

Furthermore, the classification of financial liabilities according to IFRS is as follows:

1. Financial liabilities at fair values through profit or loss (FLTPL), i.e. all that includes financial obligations that arise for trading purposes and all derivatives that are not part of the hedging arrangement. Examples are currency swaps (not designated in a hedging relationship), Commodity futures/options contracts (not designated in a hedging relationship).

2. Financial liabilities measured at amortized cost, the purpose of this category is Financial liabilities not held for trading; these liabilities should be classified at amortized cost. Examples such as types of liabilities are accounts payable, bank loans etc.

***Shariah issues on IFRS***

Some of the shariah issues that appear in IFRS include the following:(Shafii & Zakaria, 2013)

1. Issue related to concerning insurance as stated in IFRS 4 contract no. 10, which states the definition of insurance, includes a contract between an insurer and a participant in which the insurer agrees to cope with any unforeseen possibilities that occur in the future. This issue may be beyond the understanding of Takaful which is generally understood in the context of IFI. However, according to Pricewaterhouse Cooper, the definition presented by IFRS is still relevant for issues related to Takaful even though the operational models of the two are different.
2. Issues regarding financial disclosure IFRS 7 requires disclosing significant financial instruments and quantitative and qualitative information that appears, including the specified minimum disclosures about credit risk, liquidity risks, and market risk. The shariah issue that appears in this context is that some IFI's may not disclose that interest rate sensitivity or those related to it are not charged or included in the interest.
3. Issues about the financial instrument in IFRS 9. A financial asset shall be measured at fair values unless measured at amortized cost. The use of interest rate as the discount rate may not be allowed in some jurisdictions

***Financial statement Analysis***

In general, financial statement analysis uses three approaches, namely: Horizontal Analysis, Vertical Analysis and Ratio Analysis(Statement et al., 2020)

Horizontal analysis analyses the percentage increase or decrease contained in various accounts of comparative financial statements. Based on the horizontal analysis, we can find out the amount of each item in the last year's report compared to items in the previous financial report.

Each increase and decrease per post will be listed, including the percentage increase and decrease. So, we can conclude that horizontal analysis is an analysis that compares two reports, namely the current year's financial statements, with the previous financial statements. This horizontal analysis can compare three years and more than the comparative reporting period.

While Vertical Analysis Vertical analysis is an analysis carried out by comparing the relationship between each element of the financial statements with the total accounts in a single financial report.

While Ratio Analysis So understanding the meaning of financial ratios is an index that connects two accounting numbers and is obtained by dividing one number by another number A summary of the company's financial ratio analysis is presented in the following table:

Table1. Financial Ratio's Analysis

| Ratio | Formula |
|---|---|
| Profitability Ratio:<br>Return on Asset (ROA) | <br>Net income/ Total assets |
| Liquidity ratio:<br>Loan to deposit ratio | <br>Loan and advances/ customer deposit |
| Leverage ratio :<br>Deposit to total asset | <br>Total deposit/ total assets |
| Efficiency Ratio<br>OPINTA | <br>Operating income/ total assets |

***Related study***

Several studies related to the adoption of IFRS in financial statements, among others, as done by Shahbub Alam with the topic of IFRS adoption in the Bangladesh banking sector, which aims to compare the implementation of IFRS in the banking sector in Bangladesh, both conventional banking and Islamic banking with finding that the adoption and application scenarios of IFRS in the banking sector is the satisfactory level and adoption of IFRS offered various benefits, but a complete implementation of IFRS by Islamic banks has been proven to violate the shariah principles genuinely.

Meanwhile, the study of Assets and Liabilities in Islamic banking was carried out by (Belouafi 1993), among others, with the aim of the study being to consider the Assets and Liabilities structure and instruments in Islamic banking, with the result that some indicators of assets and liabilities owned by Islamic Banks are better than those of Islamic Banks. conventional Bank. This is supported by the characteristics of profit sharing and transparency owned by the Islamic Bank.

Therefore there is no specific study that tries to analyze the implementation of IFRS by Islamic Banks, especially in terms of assets and liabilities. This study tries to fill that gap.

This Research Will following the Conceptual Framwork Below:

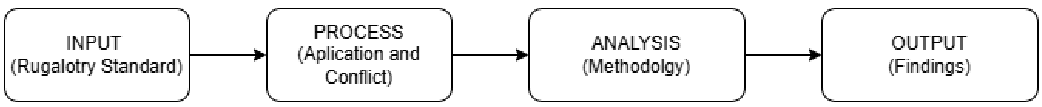


**Figure 1. Conceptual Framework**

## METHODOLOGY

This paper uses the qualitative method in nature, but quantitative calculations will be carried out in several parts of the paper. Conceptually, this study will follow the following path:

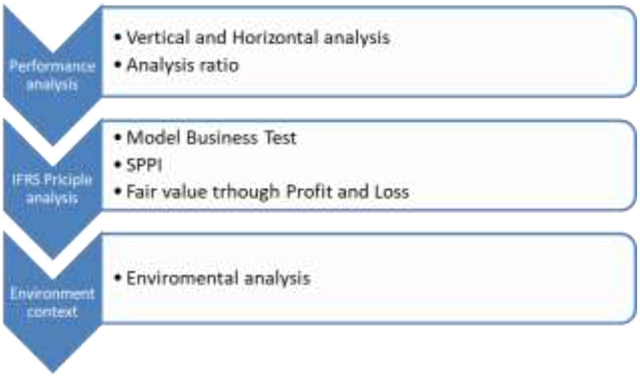


**Figure 2. Research Path**

## RESULTS AND DISCUSSION

### *Analysis financial performance Maybank Islamic dan CIMB Islamic*

### *Analysis Vertical*

Appendix 3 and 4 show the financial calculations of CIMB and Maybank vertically and horizontally. The table shows that on the Financial assets side of Maybank banks Financing and advances dominates the portion of the company's assets, at 80%, followed by Cash and cash equivalents. If we look at the notes provided by Bank CIMB's auditors, the most significant portion of CIMB's financing is another financing, for homeownership financing with a total of RM 87 Billion.

The proportion of contracts in the homeownership financing program in a row is: Murabahah, Bai consisting of Ba'i bitamal ajil, Bai al-inah and bai al-dayn And the last in a small portion is the Musharakah contract. The use of a musharakah contract in financing homeownership is known as a Diminishing Musharakah contract.

Likewise, for other financing items with total financing of RM 114 Billion, Murabahah dominates the financing contract, then Bai and Musharakah contracts.

The large portion of *Murabahah* and *Bai financing* in Maybank Islamic's Total financial and advance provides a large portion of profit margin for the Bank. However, on the other hand, it is necessary to provide a profit reserve that is intended if there is a potential for bad loans or defaults from customers. The portion of this reserve in MayBank's financial statement is quite large, amounting to RM 89 billion, bringing MayBank's gross financing and advance to RM 192 billion as a whole.

Meanwhile, compared with CIMB Islamic from vertical calculations, the results are more or less the same as Maybank that Financial and advances also dominate the asset portion of the company by 73%, followed by Cash and cash equivalents.

Furthermore, if we look at the auditor's notes for CIMB notes seven, that in advance financing and others financing, the proportion of others financing also dominates, followed by homeownership financing. However, the proportion of contract use is different from that carried out by Maybank Islamic. CIMB prefers to use the Tawaruq financing contract instead of murabahah, so it affects the provision of an expected credit loss from financing, which is relatively small compared to Maybank Islamic. CIMB also avoids using Musharakah contracts in its financing so that there is no provision of profit-sharing margin for CIMB.

The similarity, when viewed from the financing structure, the two banks are both more focused on retail and consumer financing compared to corporations and syndications or financing for working capital participation, investment projects using Musharakah contracts.

While the vertical analysis of the company's liabilities for Maybank Islamic, it was found that deposits from other customers occupy the most significant portion on the liabilities side. In general, when compared with its large portion of the financing, the Bank's performance is excellent in the intermediary function between surplus funds and those requiring funds through financing.

Suppose it is seen from the auditor's notes number 14 that deposits from customers are the most significant portion of the liabilities of Maybank Islamic. In that case, the specifications are as follows: Murabaha deposit with a six-month feature and comes mainly from Business enterprises. This means that Maybank can attract cheap funds from the public so that it is not too heavy to burden the company's finances for margin payments.

While at CIMB, the most significant portion in terms of Liabilities is also occupied by Deposit customers at 88%. Such a significant portion is obtained from the same composition as May Bank Islamic's with different proportions. So it can be concluded that the Bank has succeeded in collecting cheap funds from the public.

### *Analysis Horizontal*

In the financial statements of Maybank Islamic, On the asset side, there is a relatively large decrease in Cash and cash equivalents, by - 54% with comparison data in 2019, while at CIMB Islamic, it has increased by 63% in the same year. This shows that from 2019 to 2020, Maybank Islamic allocates its Cash for financing purposes due to an increase on the financing side. Moreover, based on the vertical analysis above, Maybank Islamic also has reserved for potential defaults that are pretty large; this means that in 2019 to 2020, there will be a significant increase in non-performing financing at Maybank Islamic. Whereas in CIMB Islamic, it is the opposite.

### *Ratio Analysis*

The calculation of the ratio of the two banks is presented as follows:

Table. 2 Ratio Analysis

| RATIO | CIMB | MAYBANK |
|---|---|---|
| Profitabilitas Ratio (ROA) | 1% | 2% |
| Liquidity ratio (LTA) | 88% | 123% |
| Leverage ratio (DTA) | 85% | 89% |
| Efisiensi Ratio (OPINTA) | 3% | 3% |

All financial ratios of the two banks show almost the same amount. Interm of Profitability, both CIMB and Maybank have not shown the ability to generate income from the number of assets they have, this is due to the large portion of *murabahah* financing on their asset side, namely long-term murabahah financing for homeownership and another murabaha financing, with a tenor of 10 years or more.

Meanwhile, from the liquidity ratio, it can be seen that Maybank, with assets larger than CIMB, can finance a more significant portion of their financing than CIMB and the portion of their Time Deposits total assets that is approximately the same.

In line with their low profitability, the ability of the two banks to generate operational income from the assets they have is also still relatively small, which means that the financial performance of these two banks is not efficient enough.

***IFRS Principal Analysis***

Switch to analysis using IFRS principles. In the financial analysis section, IFRS stipulates the following rules:

1. Measurement using two approaches Contractual cash flow only generates principal and interest payments (also colloquially referred to as the 'SPPI test'), as well as Business models for managing financial assets
2. Results determine whether the investment is recorded: At fair value through profit or loss At fair value through other comprehensive income (OCI) (with or without recycling) At an amortized cost
3. The classification requirements are applied to the financial statements of the asset as a whole without separating the embedded or derivative ones

Meanwhile, on the financial liabilities side, the following rules apply:

1. Profit and losses on liabilities specified in FVPL arising from changes in own credit risk are recorded in OCI and are never recycled. Unless recognizing such fair value changes in OCI would create or enlarge an accounting mismatch in the P&L
2. . Derivative segregation rules are maintained for financial liabilities.

The following presents the fulfilment of IFRS standards from May Bank Islamic and CIMB Islamic, based on the analysis of financial statements and notes provided by the auditor:

Table. 3 The Fulfilment of IFRS Standards

| Asset | IFRS standard requirement | Impact | Liabilities | IFRS Standard requirement | Impact |
|---|---|---|---|---|---|
| **Trading Liabilities** | V | Low | Cash and Cash equivalent | V | High |
| **Derivatives liabilities for risk management** | V | Medium | Trading assets | V | Low |
| **Deposit due to customers** | V | High | Derivatives asset for risks management | V | High |
| **Debt securities issues** | | | Loans and advances to Bank | V | High |
| **Provisions** | V | Low | Loan and advance to customers | V | Medium |
| **Deferred tax liabilities** | V | Medium | Investments securities | V | High |
| | | | Current tax assets | V | Medium |
| | | | Property, plant and equipment | V | Medium |
| | | | Intangible assets | V | Medium |
| | | | Deferred tax assets | V | Medium |

Sources: Data proceed by the authors

CIMB and Maybank Islamic, in their financial reporting, have met the requirements of the IFRS standard, but the impact arising from the application of this IFRS standard is different. From Low-Medium and High. Low impact if the standard is met but does not affect the performance of assets or liabilities based on the above measurement principles. Meanwhile, high impact is the part that must be fulfilled and impacts the company's performance both in terms of assets and liabilities.

***Compliance and Complexity Regarding IFRS Adopion***

1. IFRS 9 Implementation (Asset Classification) The banks successfully categorized assets based on the Business Model Test and SPPI Test (Solely Payments of Principal and Interest).
   High Impact
   a. Cash & Cash Equivalents: These are "High Impact" because they must pass the SPPI test to be measured at amortized cost.
   b. Derivatives & Investments: These are "High Impact" because they require Fair Value measurement (FVPL or FVOCI), which adds volatility to the financial statements.
   c. Loans/Financing to Banks: This is high impact due to the credit risk assessment models required by IFRS 9.

Low Impact

ading Liabilities & Provisions: While these must be reported, the standard treatment is similar to previous practices, causing less disruption to reported figures.

2. The Compliances Summaries as follow:

Table 4. The Compliance Summaries of Applying IFRS Standard

| **Balance Sheet** | **IFRS Compliance Status** | **Impact** | **Reason For Impact** |
|---|---|---|---|
| Cash and Equivalent | Compliant | High | Liquidity Reporting |
| Deposit Customers | Compliant | High | Liquidity requiring strict Classification |
| Investment Securities | Compliant | High | Valuation Volatility |

| | | | |
|---|---|---|---|
| Loans and Financing | Compliant | High | Impacted by Expected Credit Loss |
| Trading Asset | Compliant | High | Fair Values Standar |

***Analysis Environment***

If we look at the Income Gap from 2019 to 2020, for May Bank Islamic, we will get an income gap of RM – 999.971 Billion while for CIMB Islamic RM -294,528. This minus income gap is caused by the current situation in the form of disruption due to the Covid-19 pandemic. This crisis has caused a liquidity crisis in the banking sector. In the ratio analysis above, the liquidity ratios of the two banks are relatively low.

The Earnings of the two Banks, it can be calculated that CIMB Islamic Earnings decreased by RM -33 and Maybank Earnings by RM -311. As banks experienced a decline in earnings, they could not give higher rates of return comparable to conventional deposits, hence the exposure to the rate of return (RoR) risk. Failure to give higher RoR results in the deposit outflow, which raises the financing-deposit ratio.

The implications of the minus income gap for banks are: The Bank cannot raise the profit rate to accommodate the overall cost of funds. If it does, the BBA/Murabaha contract turns invalid; The Bank will lose deposits when the Islamic deposit rate (rd) small than conventional interest rates (id); when it losses deposits and is forced to acquire money market funds at a higher cost, Bank earning further drops, To prevent the deposit movement to conventional banks, the Islamic deposit rates were raised using Bank's capital to compete with interest rates. By doing so, the Bank faces Displaced Commercial Risk (DCR). To mitigate DCR, the Profit Equalization Reserve (PER) was instituted. PER serves to fill the gap between rd and id.

**CONCLUSIONS AND RECOMMENDATIONS**

This study found that all standards in IFRS were met by the two banks, both CIMB and MAY Islamic Bank. However, standards are not fulfilled with a high impact equally for financial assets and liabilities.

Overall performance analysis is still quite good, but some ratios are still below performance. And the effect of the crisis that occurred turned out to have a significant enough effect on the Bank's liquidity, as evidenced by the Income Gap and decline in Earnings in two observation periods (2019 -2020)

*Recommendations*

Therefore we recommend the following:

1. For CIMB and BIMB, not only focus on financing in terms of the current crisis but more focus on improving the quality of financing and raising low-cost funds
2. Focus more on collecting retail funds from consumers (not companies or governments) with a lower fixed rate of return than the current one.
3. Focus on medium-term murabahah financing (between 5 years)
4. For the government, it is necessary to consider making sharia accounting standards that can accommodate the interests of Islamic Bank financial statements, especially for sensitive issues, considering that not all compliance with IFRS standards produces a high impact.
5. Company and Government must immediately prepare steps to mitigate market risk from the emergence of an Income Gap.

## FURTHER STUDY

Future research may expand the sample to include more Islamic banks across different regions and examine other impacts of IFRS adoption, such as risk management, performance, and Shariah compliance.

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