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FINANCIAL REPORTING AND PROFITABILITY IN ISLAMIC BANKS APPLYING IFRS: A QUANTITATIVE STUDY OF KEY ACCOUNTING INDICATORS

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Abstract:
This article is devoted to investigate how key financial indicators reported in IFRS-based financial statements affect the profitability of Islamic banks. Using data from five leading Islamic banks - Al Rajhi Bank, Bank Islam Malaysia (BIMB), Dubai Islamic Bank (DIB), Kuwait Finance House (KFH), and Maybank Islamic Malaysia - over the period 2015 to 2024, a multiple linear regression model is applied with Return on Assets (ROA) as the dependent variable. The selected indicators include fee-based income, Islamic financing margin (IFM), Return on Equity (ROE), and the Equity-to-Asset Ratio. The results show that ROE and capital strength are strongly associated with higher profitability, while fee-based income and financing margins show significant negative effects. These findings highlight the importance of internal capital efficiency in IFRS-reporting Islamic banks and offer insights into how profitability is reflected in their financial disclosures.

Keywords: Islamic banking, IFRS, financial reporting, profitability, ROA, ROE, regression analysis, accounting indicators, equity efficiency, fee-based income, Islamic financing margin.

Introduction

The global expansion of Islamic banking has intensified the need for transparent and standardized financial reporting. Among the available frameworks, the International Financial Reporting Standards (IFRS) have emerged as the most widely used by Islamic financial institutions worldwide. According to the Asian-

Oceanian Standard Setters Group (AOSSG), 49% of jurisdictions with Islamic financial institutions apply IFRS as their primary reporting framework, compared to 14% that follow AAOIFI standards exclusively. The remaining 37% implement hybrid or local systems (AOSSG, 2022).

This widespread adoption of IFRS reflects a growing effort to align Islamic banking practices with globally accepted accounting standards, particularly in markets such as Malaysia, Turkey, Saudi Arabia, and Indonesia. While AAOIFI Financial Accounting Standards (FAS) are more explicitly designed to reflect the legal and ethical structure of Islamic financial contracts in line with Shariah, IFRS offers broader international credibility and facilitates comparability across borders. IFRS-based reporting enhances transparency, attracts global investors, and supports regulatory consistency. However, since IFRS was originally developed within the context of conventional finance, additional interpretive and structural efforts are often required by Islamic banks to accurately represent Shariah-compliant contracts, their principles and nature within this framework. This challenge highlights the need for careful adaptation when applying IFRS to Islamic banking practice.

Among the various aspects of financial reporting, profitability remains one of the most closely watched dimensions in assessing the performance and stability of Islamic banks. Within the IFRS framework, profitability is primarily communicated through key financial indicators presented in the annual reports, including ratios such as return on equity, income distribution, and capital structure. These indicators do not only reflect the financial health of institutions but also inform stakeholder decisions and regulatory expectations. This article focuses on how such profitability metrics are reported and what their patterns reveal about the performance of Islamic banks operating under IFRS standards.

Methodology

To evaluate the determinants of profitability in IFRS following Islamic banks, a multiple linear regression model was constructed using financial data extracted from the audited annual reports of five prominent institutions: Al Rajhi Bank (Saudi Arabia), Bank Islam Malaysia (BIMB), Dubai Islamic Bank (DIB), Kuwait Finance House (KFH), and Maybank Islamic Malaysia. The dataset comprises 50 observations spanning the period from 2015 to 2024, offering a consistent and comparative view of their financial performance under the IFRS framework across different regions.

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Results

This multiple linear regression analysis investigates the relationship between key internal financial indicators and Return on Assets (ROA), which is used as the dependent variable to measure profitability. The model incorporates four independent variables that are widely disclosed in IFRS-based financial statements and are considered significant in evaluating bank performance. These variables, along with the rationale for their selection and references to prior empirical and statistical research supporting their significance, are outlined in the table below (Table 1):

Table 1. Justification of Selected Financial Indicators for Profitability Analysis in Islamic Banks

Variables	Formula	Relevance	Academic Support
Fee-based income / Total income	Fee-based Income / Total Income × 100	Captures income diversification. Helps assess reliance on non-financing revenue under IFRS reporting.	(Hasan, M. and Dridi, J., 2010); (Rosly, S.A. and Abu Bakar, M., 2003)
IF income / Total income (IFM)	Islamic Finance Income / Islamic Finance Volume × 100	Measures profitability of Islamic financing activities. Useful to compare performance across different product mixes.	(Ismail, A.G., Shahimi, S. and Ahmad, S., 2015); (AAOIFI, 2015)
Return on Equity (ROE)	Net Income / Shareholders' Equity × 100	Indicates how efficiently the bank generates profit from its equity. Key metric under IFRS.	(Samad, A. and Hassan, M.K., 2000); (IFSB, 2023)
Equity-to-Asset Ratio (%)	Total Equity / Total Assets × 100	Reflects capital strength and solvency. Important for understanding equity-based stability in Islamic banks.	(AAOIFI, 2010); (IFSB, 2023)

Table 2. Results of Multiple Linear Regression Analysis on Determinants of ROA in Islamic Banks Operating under the IFRS Framework

Regression Statistics Section	
Multiple R	0,996314858
R-squared	0,992643296
Adjusted R-squared	0,991989366
Standard Error	0,098601243
Observations (n)	50

Analysis of Variance (ANOVA)

	df	SS	MS	F	Significance F (p-value of F-statistic)
Regression	4	59,03195952	14,75798988	1517,96733	2,33546E-47
Residual (Error)	45	0,437499234	0,009722205		
Total	49	59,46945875			

	Coefficients	Standard Error	t-Statistic	p-Value	Lower 95% Confidence Interval	Upper 95% Confidence Interval	Lower 95% Confidence Interval	Upper 95% Confidence Interval
Y-intercept	-1,1045775	0,118687	-9,306652	4,70002E-12	-1,34362509	-0,86552981	-1,34362509	-0,86552981
Fee based income-total income	-0,0087640	0,002775	-3,158258	0,002833777	-0,01435307	-0,00317498	-0,01435307	-0,00317498
IF income-total income (IFM)	-0,0022720	0,000845	-2,687575	0,010051859	-0,00397464	-0,00056933	-0,00397464	-0,00056933
ROE	0,13851588	0,003301	41,95938	1,0035E-37	0,13186695	0,14516482	0,13186695	0,14516482
Equity-to-Asset Ratio (%)	0,10840790	0,006960	15,57577	9,606E-20	0,09438968	0,12242613	0,09438968	0,12242613

The above implemented regression model demonstrates an exceptionally strong fit, with an R-squared value of 0.9926, indicating that approximately 99.26% of the variation in ROA is explained by the selected independent variables. The adjusted R-squared of 0.9919 further confirms the robustness of the model after accounting for the number of predictors. The F-statistic of 1517.97 and its extremely low significance level ($p < 2.34 \times 10^{-47}$) affirm the overall statistical significance of the model.

Table 3. Regression coefficients and their interpretations

Variables	Coefficient	p-value	Interpretation
Fee-based income-to-Total income Ratio	**−0.00876**	**0.0028**	**Statistically significant negative effect: greater reliance on fee income slightly reduces ROA.**
IF income-to-IF volume Ratio	**−0.00227**	**0.0101**	**Statistically significant: suggests margin compression may reduce ROA.**
ROE	**+0.1385**	**1.0035e-37**	**Extremely significant: the strongest positive predictor of ROA, highlighting the importance of equity efficiency.**
Equity-to-Asset Ratio	**+0.1084**	**9.606e-20**	**Highly significant: a stronger equity base supports more stable and profitable operations.**

The above-mentioned findings suggest that **internal capital strength and shareholder return efficiency** are the primary drivers of profitability in Islamic banks operating under IFRS. In particular, **ROE** and the **Equity-to-Asset Ratio** exhibit strong, positive, and highly significant relationships with ROA, supporting the view that well-capitalized banks with effective equity utilization tend to achieve higher profitability. On the other hand, the **negative associations** of **Fee-based income** and **Islamic financing income** with ROA indicate that non-core income sources and intensive financing margins may not translate into improved profitability. These effects may reflect operational inefficiencies, risk-pricing challenges, or limitations in diversifying sustainable income streams.

Discussion

The negative associations of Fee-based income and Islamic financing income with ROA suggest that reliance on non-core revenue or margin-driven financing does not always result in higher profitability. In the case of fee income, this may be due to its unstable nature, potential inefficiencies, or the limited scalability of such revenues in Islamic banks. Similarly, high financing income relative to volume may reflect margin compression, risk-pricing challenges, or increased costs associated with structuring and managing Shariah-compliant contracts under IFRS reporting requirements.

Conclusion

This article explored the financial determinants of profitability in Islamic banks that report under the IFRS framework, using panel data from five leading Islamic banks over the 2015–2024 period. Through multiple regression analysis, the results revealed that capital structure and equity efficiency - measured through ROA and Equity-to-Asset Ratio - are consistently strong and positive predictors of bank profitability. In contrast, reliance on fee-based income and intensive Islamic financing margins showed significant but negative associations with ROA, suggesting potential structural inefficiencies or cost burdens tied to non-core revenue streams. These findings underscore the importance of capital adequacy and efficient equity deployment for Islamic banks operating within globally recognized reporting frameworks like IFRS. At the same time, they highlight the need for Islamic banks to critically assess the sustainability and risk dynamics of their income sources. As Islamic banking continues to evolve globally, greater alignment between Shariah principles and financial reporting efficiency will be essential for long-term stability and investor confidence.

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