ISWGNA Task Force on Islamic Banking

Islamic Bank Income Statement and Balance Sheet

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I. Income and expense PSIFIs

CP07	Return on assets (ROA)
	Net income (before extraordinary items, taxes, and Zakat)
	Total assets
CP08	Return on equity (ROE)
	Net income (before extraordinary items, taxes, and Zakat)
	Equity
CP09	Net profit margin
	Net income (before extraordinary items, taxes, and Zakat)
	Gross income
CP10	Cost to income
	Operating costs
	Gross income

I. Income and Expense Statements

- Income and expense statements can be constructed in diverse ways
  - National Accounts
  - Conventional bank income statement
  - Islamic bank income statement
    - per *PSIFI Compilation Guide*
    - per *AAOIFI*
- Country standards and formats vary – might significantly differ from the options above
  - Differences should be described in metadata

1(a) – National accounts

- Goal – Isolate current *transactions* that generate revenue, incur expenses, and create net operating income
- Used to measure sales of goods and services of aggregate banking subsector with other sectors and the production of banks within the Gross Domestic Product (GDP)
  - GDP is a "flow" measure of production and income occurring in a specific time period
- *Nontransactions changes in revenues, expenses, and income* are excluded – gains/losses on securities, exchange rate changes, catastrophic losses, etc. These are reported elsewhere in the integrated accounts
  - Thus differs from financial accounting income statements (IFRS, AAOIFI, national GAAP)

National Accounts Format

- Transactions revenues of banks (Gross income)
  - Interest received
  - Fees
  - Commissions
  - Sales of goods and services
  - Other operating income
- Transactions expenses of banks
  - Interest paid
  - Purchases of goods and services
  - Salaries
  - Rent, utilities, etc.
  - Other operating expenses
- Net income (Operating income = Revenues – Expenses)
  - *FSI Compilation Guide* ¶6.26 recommends FSIs using "operational income" before extraordinary events and taxes.

Implications

- Net income = revenues – expenses

  Interest paid is an expense
- Interest income and income expense cannot be netted because the counterparties are different
- (Net income/gross income) + (expenses/gross income) = 100%
- The national income basis enhances analysis of how financial sector variables relate to other macroeconomic activities

1(b) – Conventional bank income statement

- Most commonly available. Published by individual banks.
- Highlights the major function of attracting deposits in order to use the funds to extend credit.
  - Attract funds by paying interest or providing safekeeping and current account services
  - Earn interest income by extending credit to customers
- Accounts highlight *Net interest* as the main source of revenue. (line 2 of next slide)

Format of conventional bank income statement

	Representative Income Statement of a Conventional Bank	
Line		Formula
1	Revenue	
2	Net interest income	3 – 4
3	Interest receipts	
4	Interest payments	
5	Noninterest income	
6	Total Revenue	2 + 5
7	Expense	
8	Total Expense	9 + 10
9	Noninterest expense (Salaries, purchases, all other)	
10	Provisions for loan loss	
11	Income before income tax	6 – 8
12	Income tax	
13	Net Income	11 – 12
14	Dividends	
15	Retained earnings	13 – 14

INCOME STATEMENT BASED ON IMF'S FSI TEMPLATE

(Like slide 8 with additional detail)

Covers conventional and Islamic banks, usually based on supervisory data

1.	Interest income
	(i) Gross interest income
	(ii) Less provisions for accrued interest on nonperforming assets
2.	Interest expense
3.	Net interest income (= 1 minus 2)
4.	Noninterest income
	(i) Fees and commissions receivable
	(ii) Gains or losses on financial instruments
	(iii) Prorated earnings
	(iv) Other income
5.	Gross income (= 3 plus 4)
6.	Noninterest expenses
	(i) Personnel costs
	(ii) Other expenses*
7.	Provisions (net)
	(i) Loan loss provisions
	(ii) Other financial asset provisions
8.	Net income (before extraordinary items and taxes) (= 5 minus (6+7))
9.	Extraordinary items
10.	Income tax
11	Net income after tax (= 8 minus (9 +10))
12.	Dividends payable
13.	Retained earnings (= 11 minus 12)

Implications

- *Net interest income* is the top-line series
  - Interest receipts and payments are each shown gross, then netted to show *net interest income*
  - Interest payments are shown separately from other expenses
- *Other revenues* are added to *Net interest income* to get *Total revenues*
- *Expenses (which exclude interest)* are subtracted from *Total revenues* to get *Net income before taxes*
- The income statement is not limited to transactions – it includes items such as gains and losses on holdings of financial instruments, write downs, catastrophic losses.
  - Inclusion of holding gains and losses defines operational income differently from that used in the national accounts

1(c) – Islamic bank income statement

- As shown in 2011 *PSIFI Compilation Guide,* the accounts are broadly analogous to those of conventional banks
- Income is reflected in three ways
  - Net income from jointly funded accounts (for *unrestricted* PSIA) parallels net interest income for conventional banks
  - Net income from *restricted* PSIA (revenues and expenses are off-income statement)
  - Other revenues and expenses (parallels revenues and expenses conventional banks)
- Next slide shows the component detail of *Net income from jointly funded assets* based on *2011 PSIFI Compilation Guide ,* pp. 37-38.
- The following slide 3 synopsizes the full Islamic bank income statement

Islamic bank revenue from jointly funded assets per *PSIFI Compilation Guide*

	Components of Revenue from Jointly Funded Assets	
Line		**Formula**
1	**Net Income from Jointly Funded Assets**	2 – 6a + 7
2	Revenue from Jointly Funded Assets **(UPSIA)**	3 – 4– 5
3	Revenues by type of income	3a – 3b
3a	By type of income	
3b	*less* Provisions for accrued income on non-performing assets	
4	*less* Financing and nonfinancing costs	4a + 4b
4a	Provisions for sub-standard or bad financing	
4b	Other costs	
5	*less* Transfer to Profit Equalization Reserve (PER)	
6	*Memo: Income available to IAH and bank (UPSIA)*	*6a + 6b*
6a	Income distributed to IAH*	
6b	Income available to bank from unrestricted revenues*	
7	Bank share in restricted investment income **(RPSIA)** *	

Income statement for an Islamic bank

per *PSIFI Compilation Guide*

	Representative Income Statement of Islamic Bank	
Line		**Formula**
1	**Net Income from Jointly Funded Assets**	2 – 6a + 7
2	Total revenues from Jointly Funded Assets (UPSIA)	3 – 4 – 5
3	Revenues	
4	*less* Financing and nonfinancing costs	
5	*less* Transfer to Profit Equalization Reserve (PER)	
6	*Memo: Income available to unrestricted IAH and bank (UPSIA)*	*6a + 6b*
6a	Income distributed to IAH	
6b	Income available to bank	
7	Bank share in restricted investment income (RPSIA)	
8	**Other Income**	
9	Fee-based income	
10	Other Income	
11	**Total Gross Income**	1 + 8
12	**Expenses**	
13	Salaries and other operating expenses	
14	Depreciation and other provisions	
15	**Net income before taxes and zakah**	11 - 12
16	Taxes	
17	Zakah	
18	**Net income after taxes and zakah**	15 – 16 – 17

Implications

- Revenue for jointly funded assets (UPSIA) is a net concept broadly analogous to net interest income component for conventional banks.
- *2011 PSIFI Compilation Guide* "Conventional interest income earned is replaced with profit/rent from each financing type" (Table 4.1, p. 39)
  - Calculation is parallel for gross revenues (conventional) and total gross income from jointly funded assets;
  - Expenses (interest for conventional banks; profit distributions for IFIs) are subtracted in similar manner.

INCOME STATEMENT
(AAOIFI STANDARD)

1	Income
2	Deferred sales
3	Investments
	Less
4	Return on Unrestricted Investment Accounts before Bank's Share as a Mudarib
5	Bank's Share as a Mudarib
6	Return on Unrestricted Investment accounts Before Zakat
7	Bank's Share in Income from Investment (as a Mudarib and as fund owner)
8	Bank's Income from its own Investments
9	Bank's Share in Restricted Investment Profit as Mudarib
10	Bank's Fees as an Investment Agent for Restricted Investments
11	Revenue from Banking Services
12	Other Revenues
13	Total Bank Revenue
14	Administrative and General Expenditures
15	Depreciation
16	Net Income (loss) Before Zakat and Tax
17	Provision for Zakat
18	Net Income Before Minority Interest
19	Minority Interest
20	Net Income

Balance Sheet
Example: Consolidated Balance Sheet Per IMF FSI Template

14. Total assets (= 15+16 = 31)	**23. Liabilities (= 28 +29)**
15. Non-financial assets	24. Currency and deposits
16. Financial assets (=17 to 22)	(i) Customer deposits
17. Currency and deposits	(ii) Interbank deposits
18. Loans (after specific provisions)	(ii.i) Resident
(i) Gross loans	(ii.ii) Nonresident
(i.i) Interbank loans	(iii) Other currency and deposits
(i.i.i) Resident	25. Loans
(i.i.ii) Nonresident	26. Debt securities
(i.ii) Non-interbank loans	27. Other liabilities
(i.ii.i) Central bank	28. Debt (= 24+25+26+27)
(i.ii.ii) General government	29. Financial derivatives
(i.ii.iii) Other financial corporations	30. Capital and reserves
(i.ii.iv) Nonfinancial corporations	(i) Narrow capital (funds contributed by owners + retained earnings)
(i.ii.v) Other domestic sectors	
(i.ii.vi) Nonresidents	**31. Balance sheet total (=23+30 = 14)**
(ii) Specific provisions	
19. Debt securities	
20. Shares and other equity	
21. Financial derivatives	
22. Other assets	

Balance Sheet

- The balance sheet of an Islamic bank closely parallels conventional balance sheets with three notable changes.
- *Nonfinancial assets* – Islamic financial instruments often generate income through sale or lease of underlying goods.
  - The Islamic bank must have legal ownership of the underlying assets even if for only an instant – during which period the bank incurs all the risks and rewards of holding the asset.
  - "Non-Financial Assets Related to Sales, Lease, and Equity Financing" includes all assets linked to Islamic financial contracts with customers; they could be volatile and different in behavior from other nonfinancial assets
  - "Other nonfinancial assets" records all other types of nonfinancial assets such as property, plant, and equipment and inventories.
- These two items sum to Nonfinancial assets as reported in the SNA framework; it is recommended an "*of which*" line be added for Non-Financial Assets Related to Sales, Lease, and Equity Financing.

Treatment of nonfinancial assets under contract

- Holding Gains and Losses – While under possession of the bank the assets could experience holding gains or losses, which should be recorded in the SNA revaluation account.
- Regular income on the contract – A contract might specify the price for the underlying good creating a net profit for the bank.
- For SNA purposes, it could be difficult to disentangle types of flows (trading gains, fees, holding gains)

Accounting Issue – Per *IFRS 15 Revenue from Contracts with Customers*, the gain or loss on nonfinancial assets is recorded as income using a 5-step model as the conditions of the contract are met. The AAOIFI is examining whether financial contracts with customers involving delivery of goods should go through an IFRS 15 review before being treated as a financial instrument – there is no current information which way the decision might go nor the implications for the bank income statement and balance sheet.

Profit Equalization Reserve

- Under a profit-sharing model, an Islamic bank can withhold part of the IAH's (depositors) net profits as part of a PER – Profit Equalization Reserve, which will be shown in equity as "PER Allocated to Shareholders."
- Under SNA accrual rules, the net profits for IAH (including amounts transferred in PER) should be treated as distributed; the PER component is subsequently treated as a separate transaction to reinvest funds into the reserve. The IAH have equity ownership in the PER held by the bank; to be treated in the SNA as a component of the bank's equity.

Quasi-equity; Puttable financial instruments

- *Quasi-equity* – Per AAOIFI, returns to IAH can be presented in a separate quasi-equity section below bank liabilities, but before equity.
- The IFRS treat such positions as "puttable financial instruments" that must be classified based on their substance either as a liability or as equity – this is the recommended treatment for SNA.

Memo: CONSOLIDATED STATEMENT OF BALANCE SHEET (AAOIFI STANDARD)

21	**Assets:**	
22	Cash and Cash Equivalent	
23	Sales **Receivables**	
24	Investments:	
25		Investment securities
26		Mudaraba financing
27		Musharaka investments
28		Participations
29		**Inventories**
30		Investment in real estate
31		Assets for rent
32		Istisna'a
33		Other investments
34		
35		Total investments
36	Other Assets	
37	Fixed Assets (net)	
38	**Total Assets**	

39	**Liabilities, Unrestricted Investment Accounts, Minority Interest and Owners' Equity**	
40	Liabilities:	
41		Current accounts and saving accounts
42		Current accounts for banks and financial institutions
43		Payables
44		Proposed dividends
45		Other liabilities
46		Total liabilities
47	**Equity of Unrestricted Investment Account Holders**	
48	Minority interest	
49	**Total Liabilities, Unrestricted Investment Accounts, and Minority Interest**	
50	Owners' Equity	
51		Paid-up capital
52		Reserves
53		Retained earnings
54		Total owners' equity
55		**Total liabilities, Unrestricted Investment Accounts, and Minority Interest and Owner's equity**