

Shariah Compliance of Housing Finance Practices in Sri Lanka: A Review

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Article Info	Abstract
<p>Keywords: housing finance, diminishing musharakah, AAOIFI standards, Islamic financial institutions</p>	<p>Housing finance is becoming a dynamic and useful financial tool for buying a residence. People usually take out a home loan or housing finance to buy a house, flat or plot of land for building, renovating or extending and repairing an existing house. The study aims to examine whether the practices of Islamic financial institutions are compliant with AAOIFI standards or not. This study employs a qualitative method, utilizing primary data sources, and selects two Islamic financial institutions as samples. Some specific aspects of the diminishing Musharakah contract, such as partnership, liabilities, sale, Ijara and promise were compared with AAOIFI standards. This study examined the housing finance services of a selected Islamic financial institution based on specific aspects of reducing Musharakah. Results revealed that the selected Islamic financial institutions are mostly compliant with AAOIFI standards. At the same time, some of the practices of housing finance that reduce Musharakah fail to comply with AAOIFI standards, such as obligations & stand pointing promise on an Ijarah contract.</p>
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1. Introduction

In the recent modern context of the business world, across about the world's business types, Islam guides people towards wealth distribution and systematic social structures to ensure the universal care for all humans in need (Muslehuddin, 2010). The almighty Allah encourages the whole human community for the fair and justifiable wealth distribution in the way of charity to the poor and needy people (Fisol et al., 2020). The Quran clearly directs towards a strengthened and sustainable life with a well-deserved mechanism. As the Quran verse stated,

“They will ask thee as to what they should spend on others. Say: “Whatever of your wealth you spend shall [first] be for your parents, and for the near of kin, and the orphans, and the needy, and the wayfarer, and whatever good you do, verily, God has full knowledge thereof” (Qur’an, 2:215).

The Maqasid al-Shariah aim to act for the benefit of humanity and save people from harmful circumstances and activities (Khan, 2023; Nooraslinda, 2013). Therefore, economics and finance should also surround human beings in their daily lives. Although finance and accounting have been around for a long history rather than alternative finance, which makes human trouble, harmful which leads them to stress and out of life. Islamic finance as an alternative way to the

interest-bearing and harmful techniques plays a crucial role in determining the deserved life of the people with belief to make legality in Shariah. According to the Islamic guidelines, considering public interest (Maslahah), Islamic banking and finance (alternative finance and banking) should enhance their product development in order to meet the financial needs of society (Fisol et al., 2020; Khan et al., 2025). Accordingly, recently, several numbers of products and services are offered by Islamic banking institutions including loans, collecting checks and drafts, transferring money, providing guarantees, dealing in foreign exchange and assisting the client to invest (AAOIFI, 2008).

Furthermore, Islamic banks and financial institutions provide all common commercial banking services within the Shariah framework, mainly involving the prohibition of interest (riba) which is a fundamental difference from conventional banks. In Islam, all forms of injustices are not acceptable such as interest (riba), gambling (maysir) and uncertainty (gharar) (Dinc, 2017; Jahan & Nairoos, 2020). In worldwide, Islamic banks operate in three type of jurisdictions-those where the entire financial system is Shari'ah compliant, for examples; Iran and Sudan and Muslim-majority countries (e.g., Malaysia, UAE, Egypt, Pakistan) function with a dual banking system both Islamic and conventional banks; and Muslim minority countries (such as Sri Lanka, USA, Canada and Australia) have Islamic banking and Islamic financial operations have been allowed to operate under certain conditions with no separate central bank regulations (Habib, 2018).

Early in the decade, Islamic banking is practiced in more than 750 Islamic financial institutions in 105 countries adopting and offering Islamic banking and financial products and services (Novikov et al., 2020). In terms of the Sri Lankan context, the first Islamic banking operation was introduced by Amana Investment Ltd in 1997, primarily targeting the Muslim community as a private sector, which has now been becoming one of the emerging financial sectors in Sri Lanka (Thomas, 2001). Islamic financial institutions in Sri Lanka currently provide a wider level of financial services with different types of institutions, including fully-fledged Islamic banks, Islamic banking windows in traditional banks, Islamic financial windows in finance and leasing companies, Islamic capital markets, Takaful institutions, education and training providers, and Islamic microcredit services (Jahan & Nairoos, 2021). Moreover, the growth of Islamic banking products has been offered since the establishment of Islamic financial institutions, which support the creation of new products in order to compete with conventional products. As a result, a number of products and services are newly introduced. Islamic banking and financial industry are good supportive sectors for the development of Sri Lanka's economic development where there are so many products and services offered across the country. Murabaha, Diminishing Musharakah and ijara are the leading and demanded products rather than other normal banking operations. Importantly, after the COVID-19 pandemic and severe economic crisis, it is believed by the researchers that the demand for the leasing facilities and diminishing Musharakah has been increased as several customers seek IFIs to gain financing for their accommodation and residence purposes (Rifas et al., 2023). Islamic banking products are majorly consumed by the Muslims compared with non-Muslims who are the majority communities as they adequately some religious adjectives.

Housing finance is one of the major financial services offered by the Islamic financial institutions (Wati et al., 2017). Ijarah is the first step of the housing finance system which leads to a compensation for the use of the benefits of the goods or places. Examples of the application of this contract are the rental of a house for living, or an agreement to use a business space for a certain period of time (Olivia et al., 2025).

A number of products are offered for housing finance such as Bai Bithaman Aajil (BBA) which is a sale on a deferred payment, Musharakah Muthanaqisah (MM), which means diminishing partnership contract, and Ijarah and Tawarruq (Amana, 2022). The conventional financial system is practiced based on the interest based-loans, while Islamic financial institutions are operated according to shariah principles. Among the products, two of them are mostly applied for housing finance in Sri Lanka's financial market namely Diminishing Musharakah and Bai

Bithaman Aajil (BBA) (deferred payment) (Rahman, 2013). However, some misunderstandings about MM contact are addressed by some scholars (Noordin, 2008; Finance & Abdullah 2018; Al-Saidi & Al-Hamdi, 2020; Hasan & Ali, 2021; Al-Mutairi, & Rahman, 2022; Noor & Mohd Ali, 2023) that MM practices are non-compliance with shariah in selected Islamic financial institutions. They further claim that it is similar to conventional interest-based loan, and it provides some detailed information on how Islamic housing finance compares to conventional loans and the similarities between them.

On the other side, Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is one of the recognized guidelines for the Islamic financial institutions and their products and services. AAOIFI across the world all Islamic products and service providers should have to follow some guidelines which are based on the Islamic Law. Further, Sri Lanka is a Muslim minority country, IFIs have been offering a wider level of products and services since its establishment in 1997 (Nafees, 2020). Thus, it is to be confirmed whether the financial institutions practiced in Sri Lanka offer those products and services under shariah law. Therefore, the above statements on diminishing Musharakah or Musharakah Muthanaqisah have been made by the researchers to determine how Islamic financial institutions provide housing finance facilities in Sri Lanka, and whether those practices comply with AAOIFI standards. Therefore, this study has been designed to show how the MM products offered in Sri Lanka comply with the shariah perspective. Accordingly, this study has been especially undertaken to explore the answer to the research questions in order to solve the research problem of this study, do housing finance facilities of Islamic financial institutions comply with the AAOIFI standards? and How do Islamic financial institutions in Sri Lanka offer housing finance facilities? According to the study, the main aim is to study the housing finance facilities of Islamic financial institutions complying with the AAOIFI standards.

Research Concepts

Housing finance

Although a home is a fundamental unit of society, the capital required per dwelling is so large that only a few individuals can raise it from their own savings as the shelter is one of the basic needs of human beings (Bhagat, 2021). The accommodation needs are fulfilled by various methods such as constructing a house or renting or buying from others, as there is a great need and scope for the purpose of constructing a house. Human beings are unable to go forward towards unbearable stages before completing their food, water, warmth, and residence and its related needs (McLeod, 2018). According to Abraham Maslow (1943, 1954), people are continuously encouraged to reach particularly fundamental needs and some of them take precedence over others.

The “housing finance” or “Home Loan” means finance for buying or modifying a property (Usman, 2008; Adade et al., 2022). The purpose of a housing finance system is to provide the funds that homebuyers need to purchase their homes as they wish (Kettell, 2011; Fikse & Aalbers, 2020). Similarly, housing finance is what allows for the production and consumption of housing, and it refers to the money that is used to build and maintain the nation’s housing stock. However, it also refers to the money that is needed to pay for it in the form of rents, mortgage loans and repayments (Haron & Azmi, 2009; Khan, 2023). These arrangements are made for the community based on their inability to purchase or gain ownership due to their poor situation or poverty at a time for their accommodation needs (Ahmid, 2025). In terms of home financing, recently, several products have been offered to the customers by the Islamic financial institutions such as Bai biththaman al-Aajil (BBA) Financing, Musharakah Mutanaqisah, Istisna, Murabahah, Ijarah Mausufah fi Zimmah, Ijarah Muntahiyah Bi al-Tamliq and Tawarruq (Rahman,2014).

Housing finance in conventional banks

In conventional financial institutions, housing finance is a common model of purchasing a house or residence, where a housing loan is simply providing a loan or making financial arrangements to the customer across the world. The product is designed based on interest, which is charged to the customer during over the period of repayment (Nooraslinda, 2013). According to Khan et al., 2014, a mortgaged loan is provided for two different cases, namely residential and commercial purpose, in which the residential loan could be applied for home purchasing or construction duties, even though a commercial loan is given for the purpose of establishing or purchasing various ways purposes like shopping malls, hotels, and restaurants (Grubbauer & Mader, 2021). However, the loans or financial arrangements provided by the financial institutions are not interested in make sure that the finance is used for the ultimate objective. This lack of supervising practice will make the customer lead to the debtor to spend the money for different purposes rather than building or renovation of the house or residence mentioned. Thomas (2001) illustrated that in the process of mortgage finance at conventional, the income and wealth are not equally distributed among them. Therefore, it creates conflict, less confidence, and stress accordingly.

Musharaka Muthanaqisah (Diminishing Partnership)

While literally, the word Musharakah means sharing or mingling (Osmani & Abdullah, 2013), technically it is a joint enterprise formed for conducting some business in which all partners share the profit and loss according to a specific agreed ratio of their contributions (Khan, 2023; Grubbauer & Mader, 2021). The Musharakah Muthanaqisah partnership (MM) is derived from two words: Musharakah and Mutanaqisah. Musharakah originally comes from the word “sha-ra-ka” which refers to joint, bind and be a part of. Al-Musharak or al-Shirkah is a joint membership in a particular activity (Bhagat, 2021). In terms of its applicability in transactions, Musharakah is normally understood as profit and loss sharing compared to Mudarabah which only refers to profit sharing. Muthanaqisah which is derived from the word, “na-qa-sa” means reduce, decrease, diminish or decline (Maulana, 2021), Muthanaqisah individually cannot be a declining state or decreasing amount of any activity. When these two words are into a single phrase, the term Musharakah Muthanaqisah called diminishing Musharakah literally refers to a declining profit and loss sharing (Bondinuba et al., 2020). Further, the house financing concept is provided by IFIs based upon the principles of Musharakah/Shirkat ul Milk (Joint ownership). According to AAOIFI Shari’ah standard 12, the scholars and the independent bodies in the field of Islamic banking and finance have designed financial and deposit products using Shari’ah-compliant contracts (AAOIFI, 2015). Musharakah Muthanaqisah (MM) is also one of the products suggested for financing purposes, and it is a concept invented by the scholars from Musharakah (partnership) according to the nominate contracts (Hasan & Zubair 2012; Aalbers et al.,2020). According to the AAOIFI, “Musharakah Muthanaqisah is a form of partnership in which one of the partners promises to buy the equity share of the other partner gradually until the title to the equity is completely transferred to him. This transaction starts with the formation of a partnership, after which buying and selling of the equity take place between the two partners. Therefore, the partnership contract should not include buying and selling. In other words, the buying partner is allowed to offer only a promise to buy. This promise should be independent of the partnership contract. In addition, the buying and selling agreement must be independent of the partnership contract. It is not permitted that one contract be entered into as a condition for concluding the other.” (AAOIFI, 2008, Shari’ah Standard No.12, 5/1, p.217).

According to Iqbal and Mirakhor (2011), diminishing Musharakah is a form of equity partnership between IFI and the client, where a customer requests IFI for financing to purchase an asset, and IFI participates in the ownership of asset by contributing required finance, where a certain portion (e.g.20%) must be contributed by the customer. Total equity of bank is divided into units of smaller amounts which are purchased by the client via installments (Ali et al., 2015; Escobar & Grubbauer, 2020). As a mode of financing, the client who is one of the partners

promises to buy the equity share of the other partner (IFI) gradually until the title of the equity is completely transferred to him. Buying and selling of equity units must be independent of the partnership contract and must not be stipulated in partnership contract. Generally, IFIs rent out its share to the client and earn rentals. Any profit accruing on property is distributed among the co-owners according to an agreed ratio, while losses are shared in proportion of equity (Dinc, 2017; Fernandez & Aalbers, 2020).

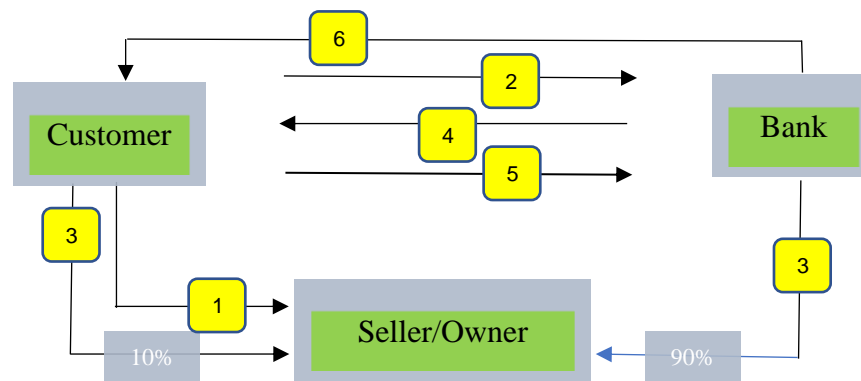


Figure 1. Diminishing Musharakah Structure for Home Financing

Source: (ISRA (2016). *Islamic Financial System- Principles & Operations (2nd Ed.)*, Malaysia: Kuala Lumpur, p. 253.

1. The customer identifies the property and gets the price quotation from the seller/ owner of the property
2. The customer requests the bank for financing. The customer and the bank enter into a diminishing Musharakah arrangement
3. The customer and the bank jointly purchase the property. Further, the customer pays 10 percent of the price and the bank pays the remains portion of 90 percent.
4. The bank rents its portion of the property to the customer.
5. The customer pays the rental amount along with an additional fee to gradually purchase the bank's ownership stake in the property.
6. At the end of the rental period, the partnership will be terminated with the customer owning full portion of the property (100% of the property) and the title transferred to the customer.

2. Research Method

To reach the objective of the study which is to study the housing finance facilities of Islamic financial institutions in Sri Lanka complying with the AAOIFI standards within the boundary of Islamic shariah, this study adopts the qualitative method. In order to examine the shariah compliance of housing finance practices with AAOIFI standards of Islamic financial institutions in Sri Lanka. As the study is designed that the practices of housing finance are complied with shariah AAOIFI standard, this study involves mainly secondary and primary data that are collected from two Islamic financial institutions, namely Amana bank PLC (fully-fledged Islamic bank) and Al-Falah (an Islamic window of LOLC finance & leasing company). Primary data was collected from the managers, credit officers & other related employees such managers, executive staff, employees were conducted via the structured personal communications; Purposive sampling technique was employed; interviewees were selected based on their post and designation, the assigned section in which they work from both institutions. The number of staffs members was not selected with the same proportion due to the expertise and availability of the interviewees, and the experts for the

interview were selected out of the institutions too. This approach led to the study finishing the data collection process quickly. Similarly, the secondary data is collected from the AAOIFI’s standard-2015, handbills, leaflets of Amana bank PLC and Al-Falah (LOLC), likewise, relevant articles, related textbooks, annual reports, websites and journal articles are referred as well. After collecting the information, the researchers analyze it using content analysis based on the research objectives that the compare how the practices of IFIs according to the AAOIFI guidelines for practical operations.

3. Result and Discussions

Sri Lankan Islamic banking and financial industry is familiar with shariah standard such as AAOIFI, IFSB, IIRT, the compliance of housing finance practices in Sri Lankan Islamic financial institutions with AAOIFI standards. The diminishing Musharakah products in Sri Lanka are offered for housing finance with different identifications.

Institution	Offered products for housing finance
Amana bank PLC	Musharakah Muthanaqisah
LOLC Al-Falah	Musharakah Muthanaqisah, and Bai’ Bithaman Ajil (BBA)

Table 1. Islamic Housing Finance Products Offered by Selected Financial Institutions in Sri Lanka

Generally, Housing finance predominantly employs Musharakah Muthanaqisah (Diminishing Musharakah) & Murabaha. In Sri Lanka, Amana Bank PLC offers only Musharakah Muthanaqisah contract for housing finance while LOLC Al-Falah offers both Murabaha and Musharakah Muthanaqisah. However, though the practice of Murabaha contract for housing finance is very rare, Musharakah Muthanaqisah is significantly familiar and famous for housing finance (BM, personal communication Feb 15, 2024). Hence, the researchers focus only diminishing Musharakah product for housing finance in by IFIs in Sri Lanka. Housing finance services are examined according to some particular features of diminishing Musharakah such as partnership, promise, rental & sale. The figure 2 consists of sub-titles and describes those clearly.

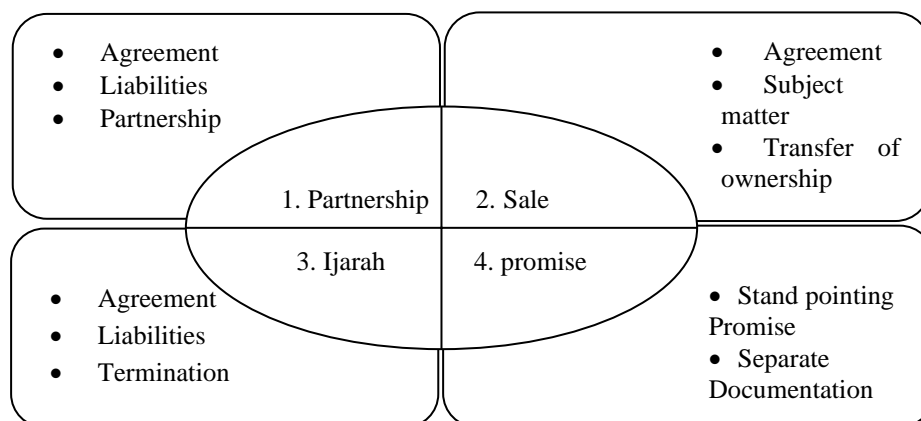


Figure 2. Key Components of Diminishing Musharakah for Housing Finance

Source: Authors’ Creation from the Data.

Partnership

The partnership contract system of the selected Islamic financial institutions was analyzed according to AAOIFI standards, focusing on the partnership agreement, liabilities & diminishing partnership. There is several evidence from the Quran and sunnah that emphasize the importance of legal business transactions, which are the hub of any partnership agreement. Surah Al-Nisa 4 verse number 12 explains as below; "...But if more than two, they share in a third...". According

to the verse, while referring to inheritance, it implicitly indicates the permissibility of shared ownership and partnership in assets, which forms the basis for Musharakah. Similarly, Surah Saad 38 verse number 24 says, "...and verily, many partners oppress one another, except those who believe and do righteous deeds, and they are few." This verse really acknowledges the existence of the partnerships and guides towards fairness and righteousness in kinds of dealings, which is essential for partnership agreements in Islamic finance (Mohammed, 2024). Accordingly, a Hadeeth narrated by Abu Hurairah (RA) that: "*Allah says: I am the third of the two partners as long as they do not cheat each other; if one cheats the other, I withdraw myself from them.*" (Sunan Abu Dawood, 3383). This Hadith directly endorses the idea of partnership and stresses the need for honesty and fairness between the partners in their agreed business journey, which is the foundation of any agreement including Musharakah Muthanaqisah.

Partnership Agreement

According to the standard, (AAOIFI, 2015, Shariah standards no.12, 5, p.346), the customer & bank must contribute the capital for housing finance. The contribution may be in the form of cash or tangible assets that can be converted into a monetary value; as the equity of the financial institutions partner decreases, the equity of the other customer partner increases (Usmani, 2008). Accordingly, although Amana Bank PLC provides 70 percent of capital and their customer provides 30 percent of the capital (EM1, personal communication Feb 18, 2024), LOLC Al-Falah offers maximum level of capital for house financing considering their risk managing margin. In terms of acceptency, it is permissible for the financial institution to enter into a partnership contract with non-Muslims or conventional banks and financial institutions to carry out operations acceptable by Shariah principles. Finally, both banks are contributing with the different ratio of capital with following AAOIFI standards (EM1, personal communication Feb 16, 2024)

Liabilities

Liabilities are considered into two types at Amana Bank PLC namely operational costs and ownership costs. Operational costs include maintaining expenses of the asset and etc. while the ownership costs include the legal payments, tax payables as well as. In the liabilities, customers are taking responsibility for the operational costs while the bank will get the responsibility of the ownership costs. Regarding it, LOLC Al-Falah and Amana bank PLC follows the same procedures, where the liabilities are not only bear by single party (customer or bank) as mentioned in the AAOIFI standard that it is not permissible for one party to bear all the cost of the maintenance of the subject matter in the partnership. According to the AAOIFI (2015, Shariah standards no.12, 5/2, p.347), in terms of capital, under the liabilities, each partner must contribute part of the capital, and it is permitted for either of the partners to rent or to lease the share of the other partner for a specified amount and for a duration, in which case each partner will remain responsible for the periodical maintenance of his share on a timely basis. Here both banks are practicing in accordance with Shariah standard (EM2, personal communication Feb 17, 2024;).

Diminishing Partnership

According to the AAOIFI standards, in diminishing partnership, the customer or the bank is not allowed to withdraw of any share from their capital before the matured period (prematurely) which have already been invested for the investment except a valid sale (AAOIFI, 2015, Shariah standards no.12, 5/2, p.347). However, both the bank and the customer are offering a facility (towards convenience or avoiding harm) to withdraw some portion of the total share of them in the capital through a sale contract, where if the customer wants to get back his/her share from the investment, he/she can sell (transferring ownership to another) the particular portion of the share to the bank (Usmani, 2008), followed by the bank providing the amount to the customer; thus, the project is not allowed to stop through this sale contract and the other partner is permitted to stay

continuously with the diminishing Musharakah contract (M2, personal communication Feb 18, 2024).

Promise

There are several terms used for promise. However, the most common word is wa'ad. Allah uses this word in Quran in order to explain the concept of promise. For an example the word wa'ad and some other related words such wa- 'a-da mau'id, mi'ad, mau'ud and wa'id are repeated 147 times in the Quran (Mohamad, 2024). Wa'ada as a verb means to predict, promise or threaten. While wa'ad or 'idah as the infinitive or noun of wa'ada carries the meaning of a promise, threat, prediction, and provision (from God) (Razil, 2008). According to the Quran, *“even if there were a Quran with which the mountains were made to pass away, or the earth were travelled over with it, or the dead were made to speak thereby; nay! The commandment is wholly Allah's, have not yet those who believe known that if Allah please He would certainly guide all the people? And (as for) those who disbelieve, there will not cease to afflict them because of what they do a repelling calamity, or it will alight close by their abodes, until the promise of Allah comes about; surely Allah will not fail in (His) promise.”* (Al-Quran 13:31). This verse emphasizes Allah's power of promise and control over all things. Here, the promise system of the selected Islamic financial institutions was subjected to analysis with AAOIFI standards by stand pointing promise & separate documentation.

Stand pointing promise

Based on the AAOIFI standards. It is permissible for one of the partners to give a binding promise that entitles the other partner to acquire, on the basis of a sale contract. (AAOIFI, 2015, Shariah standards no.12, 5/7, p.348). Further, the buying partner (customer) is allowed to promise regarding the assets which will be bought by the company according to the promise (AAOIFI, 2015, Shariah standards no.12, 5/2, p.347). The members purchase shares of the property in a single equity pool. So that, once a member accumulates adequate shares, the bank or the financial company purchases a residence or house that is provided to the member who is paying the rental proportionally (Nafees, 2020). This buy happens based on the customer promise which is not considered for any other matters. Thus, according to the discussions with the bankers, it has been noticed by the authors that, the Amana bank is comply with the Standards of promise system, they are accepting the promise from the customer only for purchasing the asset. The customer also giving a promise to buy a particular asset. However, LOLC Al-Falah is not comply with this matter. Because, they getting promise from their customers for asset purchasing as well as late payment also. Because if the customers fail to pay the settlements on time, the late payment will be made by them. (EM3, personal communication Feb 17, 2024).

Separate documentation

The AAOIFI stated that in promise system, the document must be independent where as it is not permitted that one contract cannot be entered into as a condition for concluding the other (AAOIFI,2015, Shariah standards no.12, 5/2, p.347). They, Amana PLC, have separate document for the promise, and it leads and is independent of the partnership contract. LOLC Al-Falah use a document namely undertaking' as a promise document, and it is also an independent document where there is no any conditional to another (M1, personal communication Feb 17, 2024). Accordingly, both financial institutions are seriously complied with AAOIFI standards for having a separate document for the promise which is the unique and significant in the housing finance agreement in IFIs. It is noted that the promise in any contract made in the Islamic Financial Institutions have utmost good faith between the banker and customers.

The shariah plays a crucial role in providing shariah banking products and services (Ghazaly, 2016). The ijarah contract has been practicing as an alternative for conventional leasing system for those who want to start a business, especially for the customers who do not yet own capital of

goods, because customers can lease these goods through Islamic banks. Therefore, it becomes more attractive for customers than other contracts such as Mudharabah and Musharakah (Maulana, 2021; Putra & Hasanah, 2018). In addition, in Islamic banking customers do not have any obligation to charge with submitting collateral, it makes it more convenient for customers and entrepreneurs who want to start their businesses (Kurniawan & Syahrani, 2021). In the present study, the Ijarah system of the selected Islamic financial institutions were subjected to analysis with AAOIFI standards by agreement, liabilities, termination and others.

Agreement

Both institutions which are taken to this study follow the AAOIFI standards on following the Ijarah agreement as mentioned (AAOIFI,2015, Shariah standards no.9, 2/1, p.238). There may either be a separate lease contract for each transaction, in a specific written document signed by the two parties, or alternatively the two parties may exchange notices of offer and acceptance by referring to the terms and conditions contained in the master agreement (AAOIFI, 2015, Shariah standards no.9, 2/1, p.238). Although the lease rental may be in cash or in kind (good) or benefit (service), it must be specified, either as a lump sum covering the duration of the Ijarah contract or by instalments for parts of the duration. It may also be for a fixed or variable amount, according to what the designated method the both parties agree upon (AAOIFI,2015, Shariah standards no.9, 5/2/1, p.238). Amana banks PLC have a separate document namely usage document for entire leased period in the Ijarah agreement, where the rental payment must be in cash form and the amount is mostly fixed. However, the customer is able to choose a method of payment either be fixed or variable. In case of LOLC AL- Falah, it uses a document called 'usage fee' document for an Ijarah Agreement which is a separate lease contract for each transaction with process of offer and acceptance and it never be a condition for any transaction. Like Amana PLC, rental payments are acceptable in cash form which is almost fixed, and sometimes they offer a structured payment method for some customers according to their requests (M1, personal communication Feb 19, 2024). On the other hand, Amana bank does not have a separate lease contract for each transaction and it has one lease document for entire leased period. It also acceptable because it has separated lease documents for each transaction, is not a compulsory condition in AAOIFI standards.

Liabilities

The insurance expenses are must be borne by the lessor who, the lessor, may take out permissible insurance on it whenever possible, and such insurance expenses must be borne by the lessor. The lessee should be using the asset in a suitable manner or in conformity with common practice and comply with conditions which are acceptable in sharia. He must also avoid causing damage to the leased asset by misuse through misconduct or negligence (AAOIFI,2015, Shariah standards no.9, 5/1, p.243). In Amana, insurance for particular asset is fully responsible for the customer, similarly the insurance expenses are borned under the customer's responsibility in LOLC AL Falah. Both institutions are providing the insurance responsibility for their customers while the bank is not responsible. According to the AAOIFI standard, the insurance expenses must be borne by the lessor. (M2, personal communication Feb 18, 2024).

Termination

Although it is permissible to terminate the lease contract by mutual consent, it is not permissible for one party to terminate it except in case of force majeure. The lessor may stipulate that the Ijarah contract be terminated if the lessee does not pay or fails the rental on time. Ijarah contract does not terminate with the death of either party thereto, however, the heirs of the lessee may terminate the contract. The both parties may terminate the Ijarah contract before it begins to operate (AAOIFI,2015, Shariah standards no.9, 7/2, p.248). On the practitioner's hand, Amana PLC, according to their practices, once the customer fails to pay the rental on time, it will lead to terminate the lease agreement. At the same time there is a

clean room to continue further if the customer dies, his or her heirs or nominee, the person who signed as a guarantor have entitlement to continue the above contract or he or she can also terminate accordingly. According to any situations that leads the contract to be terminated before it begins to run, it also permissible with the mutual consent of the both parties. On the other hand, LOLC Al-Falah, if the customer fails to pay the rentals on time, the bank provides an opportunity for 6 months, he or she should be paid within that period. In terms of failure of the payment during the time period provided, the bank will make necessary action to send a notice on document namely LOT (Letter of Termination). If the customer does not response that the banker will terminate the agreement. Moreover, Even though both institutions terminate the agreement with their mutual consent. At the same time if the particular customer dies, the nominee or the hires are able to continue the agreement. Therefore, the termination system of the agreement in the both institutions comply with AAOIFI standards (EM5, personal communication Feb 17, 2024).

Sale

Islam allows freedom to people to exchange their properties in terms of shariah. The Quran commands that the properties should be purchased or sold according to a valid sale. *“O ye who believe! Do not devour your property among yourselves unlawfully but let there be among you trade by mutual consent”* (04:29). The word sale is translated into Arabic is Bay, which is literally means exchange (Mubadala) and applies to sale and purchase. Sale (Bay’) is commonly used contract in the market. It covers activities ranging from the ordinary day-to-day sale and purchase of necessities to the sale of shares in the stock market and international trade among nations. Further, according to Quran Allah clearly states the significant fact of sale contract must be free from Riba, *“Allah has permitted trade (bay’) and forbidden usury (2:275)*. Here the sale contract system of the selected Islamic financial institutions was subjected to analysis with AAOIFI standards by sale Agreement, subject matter & transfer ownership.

Sale Agreement

Some arguments on a sale contract that in the view of Hanafi jurists they skip some pillars of a sale contract that the parties of sale contract and subject matter of a contract. However majority of Fiqh schools argue that there are three pillars they are expression (sighah), which includes offer and acceptance, the contracting parties (al-’aqidan), and the subject matter (mahal al-’aqd) or the property on which a sale contract is concluded. According to the AAOIFI standards the sale agreement must be independent of the partnership contract (AAOIFI, 2015, Shariah standards no.12, 5/1, p.347). Based on that, both banks are having a separate document for sale contract (EM2, personal communication Feb 17, 2024).

Subject Matter

The subject matter of thing or the thing sold (mubee’) is the principal object of a sale contract. Generally, people consume them to use and get benefit from them. There are some conditions related to the subject matter of a contract. The subject matter should be a valuable property, it should be existed at the time of the sale except at Salam and Istisna contract, also it must be deliverable, further, it should be known to the purchaser by sight or description. if the property sold by description, the buyer has the right to cancel the contract after seeing the object if it is not in accordance with the description. Based on the AAOIFI standards, the selling asset may be divided or undivided format of shares. (AAOIFI, 2015, Shariah standards no.12, 5/8, p.348). Here both are following the different systems. Amana bank divides the asset into shares and LOLC Al-Falah is not divide it. But it is permissible in AAOIFI standards. So here both institutions are complied with AAOIFI standards (EM3, personal communication Feb 17, 2024).

Transfer Ownership

There some options are available for transferring the ownership of the property promise to sell or by accelerating the payment of the remaining amount of rental or by paying the market value of the leased property. Or promise to give it as a gift for no consideration, promise to give it as a gift, contingent upon the payment of the remaining instalments. In practice Amana bank transferring the ownership as a gift while LOLC Al-Falah giving it according to the agreed ratio. These two systems are complied with the AAOIFI standards (M2, Feb 17, personal communication 2024). It can be easily understandable through a table 2 bellow.

Aspect	Amana Bank PLC		LOLC Al Falah	
	Compliance	Non-compliance	Compliance	Non-compliance
Partnership				
Agreement	√		√	
Liabilities	√		√	
Diminishing partnership	√		√	
Promise				
Stand pointing promise	√			√
Separate documentation	√		√	
Ijarah				
Agreement	√		√	
Liabilities		√		√
Termination	√		√	
Sale				
Agreement	√		√	
Sale subject matter	√		√	
Transfer ownership	√		√	

Table 2. Compliance of Diminishing Musharakah Housing Finance Practices with AAOIFI Standards
Source: Authors' Creation

4. Conclusions

According to the findings and conclusion, the following recommendations are made, *first*, Islamic Financial Institutions should strictly follow all the regulation issued by the AAOIFI standards, even it is the guidance in all their practices and publication in order to make the practices fully compliant with AAOIFI's regulations and to cater public confidence. *Second*, Both parties must understand the contract including their rights and responsibilities. Customers need to be informed by the bankers on their rights and responsibilities. Failure to have the necessary information may lead to injustice to customers which is an act that should be avoided. To promote Islamic banking, universities and other research organizations and institutes should start academic programs and research in the area of Islamic banking, Takaful and Islamic finance in order to train the youth and provide the required human resource to Islamic banking and finance industry. This will also help in educating the masses at large. *Third*, the Islamic financial institutions should have some well-educated and talented employers to describe the Islamic financial practices of their products and services for the customers. *Fourth*, Ensure greater compliance with Islamic legal regulatory requirements since it was found to be performance enhancing. This would ultimately translate to significant positive effect on performance via substantial increases in returns. *Fifth*, Create the working environment whereby the AAOIFI members are allowed to become actively involved in monitoring and overseeing the operations of Islamic financial institutions.

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