



Assessing Shariah Compliance: An Analysis of Ijārah Financing Practices in Sri Lanka's Islamic Banking Sector against AAOIFI Standards

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Abstract. This study critically examines the extent to which Ijārah financing practices in Sri Lanka's Islamic banking sector conform to the principles delineated in the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) Shariah Standard No. 9. Employing a qualitative, descriptive, and exploratory methodology grounded in a comprehensive literature review, this study synthesises information from peer reviewed journals, regulatory reports, and institutional documents. It establishes AAOIFI standards as the benchmark for compliance and systematically analyzes Sri Lankan practices, identifying key areas of convergence and divergence. The findings reveal a significant reliance on institutional-level Shariah governance, in the absence of a robust national regulatory framework. The analysis further uncovered critical gaps, particularly in the operational mechanics of Ijārah products, which may functionally resemble conventional financing in some instances, thereby raising concerns about adherence to the higher objectives of Islamic law (Maqāṣid al-Sharī'ah). This study provides a comparative perspective on international best practices. It offers strategic recommendations for policymakers and financial institutions to enhance Shariah compliance, strengthen transparency, and foster sustainable growth in the Sri Lankan Islamic finance industry.

Keywords: Islamic finance, Ijārah, AAOIFI, Shar'iah compliance, Maqāṣid al-Sharī'ah.

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INTRODUCTION

The concept of Islamic banking started getting a systematic shape around the mid-20th century as part of the Islamic revival around the world (Memon et al., 2025; Shabana, 2023) and has extended to Sri Lanka, creating a dedicated and fast-growing financial segment. The modern evolution of Islamic banking in the country began in 1997 when Amana Investment Limited was established and later developed into a fully fledged PLC (Alshammari et al., 2023; Minaz et al., 2023; Mohammed Minhaj & Ghalia, 2025). Today, the Islamic finance sector comprises several Islamic banking windows within conventional financial institutions and dedicated non-banking financial institutions (Hilmy & Saujan, 2025). Such growth is especially notable

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considering that Sri Lanka is a non-Shar'iah jurisdiction, an attribute that poses certain challenges to its regulatory and operationalisation requirements.

The legal framework governing Islamic finance in Sri Lanka has developed primarily through modifications to the existing conventional banking legislation (Abdullah & Hassan, 2023; Amuda & Al-Nasser, 2024). However, this process has not yet resulted in the establishment of a comprehensive and independent legal framework, specifically for Islamic banking. Historically, this has led to legal challenges such as double taxation and double stamp duty, which could potentially hinder the growth of the industry if not addressed with appropriate legal and institutional support (Jayabodhi et al., 2020; Thabith & Mohamad, 2021). Despite these obstacles, there is a significant demand for Islamic banking services that extend beyond the country's two million Muslims to include an increasing number of non-Muslims attracted to the ethical, asset-based, and interest-free principles of Islamic finance (Ansari et al., 2025; Ibrahim et al., 2024). This widespread appeal highlights the necessity for a transparent and robust Shar'iah compliance framework to foster and maintain public trust.

Ijārah is a term used in Arabic to mean lease or rent (Angraeni & Primadhany, 2022; Fayyad, 2023; Munawarah et al., 2024). As such, Ijārah is one of the most basic and universal financing contracts in Islamic finance (Angraeni & Primadhany, 2022; Kamal, 2024). It may be defined as an agreement between a lesser (bank) and a lessee (customer) to transfer the usufruct, or the right to use a substantial asset and make a profit from the use of the asset over a limited time to the lessee in exchange for an agreed rent or ujah (Angraeni & Primadhany, 2022; Fayyad, 2023; Kamal, 2024; Munawarah et al., 2024). Most importantly, this transaction does not resemble an interest-based loan (ribā) in that it is an asset-based transaction: the bank buys a real (non-consumable) asset and leases it (Tahira Ifraq, 2024). The bank continues to own its assets during the lease period. The lease transfers the benefit of the asset, not the asset itself, and is compensated for as such (Al-hakim et al., 2024; Fayyad, 2023; Merrill, 2020).

An increasingly prevalent and innovative application of this contract is the Ijārah Muntahia Bil Tamlīk (IMBT), which translates to "lease ending with ownership" (Al-hakim et al., 2024; Angraeni & Primadhany, 2022). This hybrid contract integrates a conventional Ijārah lease with a distinct independent promise (wa'd) from the bank to transfer ownership of the asset to the lessee upon the conclusion of the lease term (Busni et al., 2022). This structure offers a Shar'iah-compliant alternative to traditional hire-purchase agreements and mortgages, enabling customers to ultimately acquire ownership of the assets they lease. The theological

legitimacy of IMBT hinges on maintaining a clear distinction between the lease contract and the subsequent sale or gift of an asset (Asep Dadang Hidayat et al., 2023; Fathurohman et al., 2023). This separation ensures that the transaction is not simply a pre-arranged sale from the very beginning of the lease contract.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is a non-profit-making organisation established in 1991 (Kabiru, 2023; Mahar et al., 2024). It is based in Bahrain and is the leading international non-governmental organisation to set standards and communicate them in the field of Islamic finance all over the world (Yahuza, 2023). As per its mandate, the organisation determines that every financial activity performed in the member institutions of the organisation adheres to Shar'iah principles, thus promoting transparency, reliability, and consistency in the industry (El-Halaby et al., 2021; Hassan & Raza Rabbani, 2022). Since its establishment, AAOIFI has released over 100 standards across Shariah, accounting, auditing, ethics, and governance, and these standards have become the standard framework for Islamic financial institutions globally (Bechihi & Nafti, 2025; Mnif & Tahari, 2020).

These standards were formulated through a rigorous scholarly process that integrates classical Islamic jurisprudence (fiqh) with contemporary financial innovations. This comprehensive methodology has established AAOIFI as a preeminent reference for a diverse array of stakeholders, including central banks, regulators, financial institutions, and legal firms, across more than 45 countries (Bechihi & Nafti, 2025; Mnif & Tahari, 2020). Owing to its extensive adoption and scholarly consensus-building approach, AAOIFI Shariah Standard No. 9 on Ijārah serves as the authoritative and objective framework for this research to assess compliance with Sri Lankan banking practices.

PROBLEM STATEMENT

Despite the rapid development of the Islamic banking industry in Sri Lanka and the emergence of Ijārah financing as a practice, the corpus of scholarly literature has not provided a thorough evidence-based study of the topic which would comply with International Standardisation Organisation practices. However, Saleem et al., (2022) a recent paper did study an "intense debate" among practitioners regarding the Shariah-suitability of Ijārah for financing vehicles noting that it was "relatively undeveloped" as a product, but did not actually perform a principle-by-principle audit against a particular standard. This leaves a substantial gap, as no

previous research has systematically measured the exact practices of Sri Lankan institutions against the detailed conditions of the AAOIFI Shariah Standard No.9. The absence of a nationally legislated system of governance according to Shar'iah, which is characteristic of other jurisdictions such as Malaysia, makes such an audit essential. This study uses the AAOIFI standards as an objective comparative tool to provide a detailed, principle-based assessment of the degree of compliance, as opposed to just commentary. The eventual results will be discrete zones of divergence and will form an empirical base under which future regulatory and institutional reforms can be based on strengthening the credibility and integrity of the Islamic finance sector in Sri Lanka.

This study aims to address this significant gap by pursuing the following objectives: to critically assess the extent to which the Ijārah financing practices of Islamic banks in Sri Lanka align with AAOIFI Shariah Standard No. 9 and to identify the primary compliance gaps and challenges within the Sri Lankan context. Furthermore, it offers strategic recommendations for enhancing regulatory and institutional frameworks through a comparative analysis of international best practices.

LITERATURE REVIEW

AAOIFI Shariah Standard No. 9 establishes a systematic approach to the legitimate application of Ijārah contracts in a shar'iah-compliant manner (El-Halaby et al., 2021; Hassan & Raza Rabbani, 2022). The main characteristic feature of the standard is the separation of the right to use the asset from its ownership (El-Halaby et al., 2021; Hassan & Raza Rabbani, 2022; Raja, 2021). In the current practice of Islamic banking, it is stipulated that the lessor, being an Islamic bank, should have legal and constructive ownership of leased objects during the entire lease term (Al-hakim et al., 2024; Fayyad, 2023). Consequently, the bank has absolute liability for all risks and responsibilities linked to ownership (Abdul et al., 2020). The operating lease includes all significant costs related to maintaining the asset as well as any liability to loss or damage of the asset that is not the fault of the lessee (Iswanaji et al., 2022). In contrast, lessees pay only for the maintenance and repair necessary for the ongoing functional use of the asset (Mohamed et al., 2024a). This difference in risk allocation is one of the most critical differentials from traditional leasing, which typically places liability on the lessee for all maintenance and insurance costs.

This standard delineates the specific criteria for leased assets. It must be a tangible, valuable, and non-consumable item that ensures its physical integrity throughout the lease period (Saleem & Mansor, 2020; Tuychiev & Sori, 2025). Consequently, consumable items, such as food, fuel, or money, are unqualified for inclusion in an Ijārah contract (Abdullah & Hilmy, 2019). Additionally, the intended use of leased assets must be a permissible (ḥalāl) activity in accordance with the ethical principles of Islamic finance (Abozaid & Khateeb, 2023).

For the hybrid contract of Ijārah Muntahia Bil Tamlik (IMBT), the main focus of the standards is the separation of multiple contracts (Busni et al., 2022; Fathurohman et al., 2023). The promise (wa'd) to transfer ownership to the lessee at the expiry of a term should be isolated and independent of the leasing contract (Hassan et al., 2023a; Nurhayati & Hasan, 2022). A change in legal title may only occur when the lease term expires by means of a new separate transaction, for example, a gift, token sale, or a nominal purchase (Al-hakim et al., 2024; Fayyad, 2023; Hassan et al., 2023b). The contract must be devised in such a manner that it cannot be criticised as a mere legal stratagem (ḥīlah) to legitimise a prohibited predetermined sale and purchase. The inability to conform to Shar'iah rules makes an Islamic financial product no different from a conventional interest-based loan, which is one of the criticisms of Islamic banks (Islam, 2024).

Ijārah is a pivotal contract in Islamic finance and is subject to extensive scholarly and practical discourse globally. The primary issue of debate concerns the functional equivalence of the Islamic financial lease Ijārah Muntahia Bil Tamlik (IMBT) with conventional finance leases (Busni et al., 2022). Critics contend that merely altering terminology does not render a transaction Shar'iah compliant if the underlying economic substance and risk allocation remain analogous to conventional practices (Angraeni & Primadhany, 2022). The pricing of Ijārah products is particularly controversial, as some scholars have criticised the practice of benchmarking rental rates to conventional interest rates, such as the LIBOR, arguing that this practice fails to establish a substantive distinction between the two financing modes (Fayyad, 2023; Kamal, 2024; Mansoor, 2020).

Diverse global accounting standards have led to diverse accounting practices. Although the AAOIFI has formulated a comprehensive set of standards, many Islamic financial institutions in various countries follow the International Financial Reporting Standards (IFRS) established by the International Accounting Standards Board (IASB) (Nurunnabi, 2021; Cac et al., 2023). This creates “dual-compliance” (Pkwy et al., 2024; Prather-Kinsey et al., 2022).

IMBT, an Islamic version of financial leasing, is considered under IFRS, based on its economic substance over its legal form. Therefore, from the beginning, lease assets are recorded on lessees' balance sheets (Busni et al., 2022; Merrill, 2020). In contrast, Financial Accounting Standard (FAS) No. 9 provides guidelines for treating IMBT as a financial lease, closer to an operating lease (Morshed, 2024; Siddiqui et al., 2022a). As a result, the leased asset remains under the ownership of the lessor and is kept on the lessor's balance sheet until the lessor transfers ownership to the lessee. This difference in accounting practices reveals a larger global issue of applying Islamic finance in a competitive field while remaining true to the principles on which it was founded. The challenges faced by Sri Lanka are not unique but are part of a broader, global discourse on the reconciliation of Islamic financial principles with conventional regulatory and accounting frameworks (Hilmy et al., 2022).

Although the current study is inadequate with respect to scholarly literature on Islamic banking in Sri Lanka, only a limited number of studies provide a framework for the research problem. Previous studies have mainly focused on historical development, jurisprudence, and problems faced by the industry in non-Shariah jurisdictions. Such research has always attributed the lack of a proper legal or institutional framework as a major hindrance to the full potential of the industry. However, they also emphasise significant market potential, underlining the positive attitude and demand of Muslim and non-Muslim customers who are interested in the moral features of the given products.

A recent study found that Ijarah is one of the leading Islamic financial products in Sri Lanka, where 80% of Ijārah facilities for vehicles are reportedly concentrated (Abdullah & Hassan, 2023). The study further suggested that though the practice of IMBT widely adopted, the practice is "relatively undeveloped" and highly debated among industry practitioners on its Shar'iah compliance. The study provides a clear empirical starting point, but it does not perform an in-depth, principle-by-principle comparison of actual practices with an international benchmark such as the AAOIFI standards. This study aims to contribute to the existing literature by systematically connecting the general criticisms contained in the literature to specific provisions relating to AAOIFI Shariah Standard No. 9.

METHOD

The research method used in this study was a qualitative, descriptive, and exploratory approach that relied on a comprehensive literature review of available materials. This study used a

descriptive approach. As Saunders et al. (2009) emphasised, a descriptive approach is used when the researcher has a fundamental understanding of the research problem, which in this case is informed by existing critiques of Ijārah practices in Sri Lanka. This study also takes an exploratory approach, as no prior research has systematically assessed Ijārah practices in Sri Lanka against the AAOIFI Shariah Standard No. 9. This study synthesises data from various credible published sources, including academic literature, theses, conference proceedings, regulatory reports from the Central Bank of Sri Lanka (CBSL), and institutional documents such as annual reports from key Islamic financial institutions and product descriptions. The available data limitation is a significant obstacle to carrying out further stages. It has come to our knowledge that while institutional reports mentioning Shariah governance are available, they lack detailed reports such as product-specific reports and Shariah auditing reports. Consequently, the discussion of particular practices is based on conclusions drawn from publicly available product descriptions and scientific criticisms. The principal analytical technique used was content analysis by systematically comparing the documented and inferred practices with the fundamentals of AAOIFI Shariah Standard No. 9. In an IMBT contract, this leads to a systemic, objective assessment oriented toward the respective criteria in terms of the ownership responsibilities of the lessor, type of asset being leased, lease rate methodology, and separation of contracts.

RESULTS

Ijārah financing is a well-established and popular product offered by Islamic banking institutions in Sri Lanka. Vehicle financing is the most common type of financing, comprising approximately 80% of all Ijārah facilities provided by Islamic financial institutions (Abdullah & Hassan, 2023). This estimation indicates strong market demand for the product. Other applications include home financing and leasing industrial machinery and equipment (Hilmy, Ilma, et al., 2021; Hilmy, et al., 2021). Institutions such as the People's Leasing & Finance PLC (through its Al-Safa Islamic window) and the MCB Islamic Banking Division offer Ijārah products with competitive features aimed at attracting a wide range of customers (Ijarah – Vehicle and Machinery – MCB Srilanka, n.d; E futures, 2024). Product descriptions highlight several features, such as variable rates and a repayment period extended up to seven years (Farah et al., 2019; Muneeza et al., 2019). Islamic financial institutions offer home financing through their ijarah contracts. For example, while LOLC Al-Fahah and People's Leasing As Shafa use IMBT contracts for home financing, others, such as Amana Bank, use a Diminishing

Mushārah structure, which is a partnership-based model (Abdullah & Hassan, 2023; Hilmy, Jahan, et al., 2021). However, specific contract details are not explicitly stated in the public-facing materials.

Reporting Research Results

Lessor's Ownership and Risk-Bearing

The AAOIFI standard requires that the bank, as the owner of the leased asset, undertake all the risks associated with ownership, including the costs of major maintenance and insurance (Abdul et al., 2020). However, product descriptions are lacking in the available literature, as are publicly verifiable details on how these ownership risks are managed and who primarily bears the costs. A common critique of contemporary Islamic banks is that they incorporate this type of ownership-related cost into rental payments, effectively transferring risk from the banking side to the customer's hand while maintaining a technical "legal" distinction (Ahmed et al., 2025; Saiti et al., 2017). If this practice is widespread in Sri Lanka (Hilmy, Jahan, et al., 2021; Mohamed et al., 2024b), it would be a significant functional deviation from the AAOIFI standard, which clearly emphasises genuine risk-sharing (Accounting and Auditing Organization for Islamic Financial Institutions, n.d.). However, this issue is not limited to Sri Lanka. Other jurisdictions such as UK-based financial institutions mitigate their ownership risks by having the client agree to a separate service agreement, making them responsible for maintenance and insurance, a practice that is functionally similar to conventional finance (Amin, 2021; Alkhedhairi, 2023).

Rental Rate Structure

The "variable rate" for Ijārah products is a notable concern. According to the principles stipulated in the AAOIFI standard, although the rental rate may be linked to a benchmark, the contract must include a clear formula for measuring the maximum and minimum limits which should be agreed upon by both parties at the beginning of the contract (Mukhlisin & Hudaib, 2025). The preliminary rental period must be fixed at the time of signing, and if it has any floating rate, it must be specified to know the formula and be transparent (Abdurrahman & Muhajirin, 2024; Fayyad, 2023). The lack of explicit information on how these variable rates are benchmarked complicates a definitive assessment of compliance and questions the underlying structure of the floating rate. Abozaid (2016) contends that linking rental rates with conventional interest benchmarks introduces "gharar kaseer" (excessive uncertainty), which can render the transaction impermissible from a Shar'iah perspective unless mitigated, for

example, by applying caps and floors to the rental rates. This phenomenon has also been observed in other jurisdictions. For example, some Ijārah transactions in the UK calculate the rental fee by referencing a conventional benchmark, such as LIBOR (Court, 2022; Haskew, 2021), which critics argue results in no substantive difference between Islamic and conventional financing.

Separation of Contracts in IMBT

In Sri Lanka, the Ijarah Muntahia Bittamleek (IMBT) finance product offered by Islamic financial institutions such as Amana Bank PLC, a fully fledged Islamic Bank, and Islamic banking windows such as As-Safa People's leasing, An-noor Islamic Banking Unit of Bank of Ceylon, and LOLC Al-Falah generally operate in line with AAOIFI Shariah Standard No. 9 (Hilmy, et al., 2021). Promotional materials typically state that ownership of a leased asset is transferred at the end of the lease period through hibah (gift) or sale at a nominal price (Abdullah & Hilmy, 2019). In Sri Lanka, the ownership of leased assets is generally transferred through gifts at the end of IMBT tenure (Abdullah & Hassan, 2023; Thabith & Mohamad, 2021). However, actual legal contracts are not publicly disclosed, making it difficult to verify whether the ownership transfer is structured as a separate, non-binding promise, as required by AAOIFI, or linked to the lease agreement itself without separation. The literature reveals that both agreements were signed at their inception, blurring the line between leasing and selling (Thabith & Mohamad, 2021). This practice mirrors concerns in Malaysia and Indonesia, where the contractual separation between lease and sale is sometimes only nominal, resembling conventional hire-purchase agreements (Aleraiq & Asutay, n.d.; Sheng-Yi, 1984; Simbolon et al., 2023).

On the other hand, countries like Bahrain, which adhere to the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), became mandated through stringent regulatory requirements and public exposure drafts, structured IMBT according to the standards, and are being audited by regulators periodically (Akbar & Mansah, 2024; Al-Sulaiti et al., 2018). As Sri Lanka lacks specific legislation for Islamic banking, the implementation of AAOIFI standards in Sri Lanka is voluntary and subject to the discretion of each bank's internal Shariah Supervisory Board (Abdullah & Hassan, 2023; Thabith & Mohamad, 2021). Therefore, the Central Bank of Sri Lanka does not have any explicit requirement that imposes step-by-step contract structures for IMBT; instead, it prioritises compliance with the country's general legal rulings. This will lead the IMBT transaction in Sri Lanka may remain "asset-

based" rather than genuinely "asset-backed" (Khaled, 2011), whereby legal title retained by the bank until the final payment, and ownership transfer occurring only on paper (Siddiqui et al., 2022b). Furthermore, although Amana Bank and some Islamic windows in Sri Lanka declared that they are aligned with AAOIFI standards, the lack of transparency and regulatory enforcement, particularly in IMBT transactions, led to potential structural deviations from the standard, rendering their compliance status challenging to ascertain.

DISCUSSION

The results of the compliance checklist generally explore the alignments of IMBT with AAOIFI standards, except for some areas, such as risk-sharing and the benchmarking of leasing rates, where a certain level of ambiguities is being observed by the researchers, and these have significant implications when considered using the lens of Maqasid al-Shar'iah. The main objective of Islamic finance is to provide financial solutions by embracing justice, fairness, and transparency and to prevent unfair and unlawful activities. The objectives of the AAOIFI standards were also designed to accomplish the higher objectives of Shariah (Maqasid al-Shar'iah) and consider the public interest (Maslaha). Thus, AAOIFI standards are structured by ensuring that all financial transactions are supported by real assets and genuine risk-sharing.

It has been observed that IFIs in Sri Lanka transfer all risks, whether they are associated with ownership or usage of leased assets on lessees alone, and the benchmark of rentals against conventional interest rates implies the imitation of conventional leasing using Shariah-compliant terminology. This raises the fundamental concern that although the economic substance of IMBT is a completely different phenomenon from conventional leasing, it fails to uphold the spirit and ethical objectives of Shariah. Islamic finance is not only dedicated to providing diversified financial products, but also to adhering to strict Shariah compliance in all modernised financial products rather than imitating conventional finance which will have the same outcome on the global economic surface. Therefore, the current ambiguities in the practice of IMBT have questioned the credibility and honesty of the Islamic finance industry in Sri Lanka. This problem is not merely restricted to non-compliance with IMBT, but also leads to criticism of whether the sector is fulfilling its ethical mandate to offer a truly Shariah-compliant and socially responsible financial system.

Comparative Perspective with International Practices

The aforementioned challenges are not limited to the Islamic finance sector in Sri Lanka. Similar issues are observed in the global context of the implementation of Shariah-compliant standards in diverse regulatory environments. However, jurisdictions such as Malaysia, a global leader in Islamic finance, employ systematic approaches not only in IMBT but also in financial practices because of its robust, centralised regulatory framework.

In Malaysia, where the centralised Shariah governance approach is in practice, the central bank (Bank Negara Malaysia: BNM) issues binding verdicts and operational guidelines on all Shariah matters related to financial services. This centralised approach with legal enforceability to Shariah rulings ensures compliance of entire operations and maintains the smooth functioning of the industry, reducing inconsistencies and enhancing stakeholder confidence. By stark contrast, Sri Lanka is a non-Islamic state that enables Islamic finance in a country without any national-level enforcement of Shariah matters. Shariah governance is a voluntary and institutional-level arrangement, whereby each IFIs establishes its own Shariah Supervisory Board (SSB), providing oversight to its specific institution. This is a micro-level Shariah governance system that provides crucial compliancy services, but it is insufficient to ensure uniformity across the entire financial system and lacks sufficient legal authority to enforce compliance at the macro level. Thus, the findings of this study further states that there is "no legislation in Sri Lanka that legally enforces the individual Islamic financial products and contracts on Shariah compliance manner at macro level".

Implications and Strategic Recommendations for Key Stakeholders

The findings of this study highlight the ambiguity and lack of transparency in certain areas of IMBT in Sri Lanka. The benchmark of Ijarah rental for interest rates is not unique to the Sri Lankan context. It is a common issue in Islamic finance and has been criticised by scholars and researchers in the field. Other issues, such as lack of transparency in ownership transfer and bearing expenses of leased assets, must be rectified by an industry that compares international practices. Therefore, regulators of the financial system of Sri Lanka should restructure its current status to ensure the sustainable and credible growth of Sri Lanka's Islamic finance industry.

The central authority should comprise a national-level Shariah governance system to mandate compliance with AAOIFI standards in IFIs. Policymakers and the Central Bank of Sri Lanka (CBSL) should undertake proactive measures to fortify the regulatory framework. A pivotal

action would be the establishment of a national Shariah board endowed with statutory authority as it is in Malaysia; otherwise, a special separate law or act governing Islamic banking should be passed in parliament. This board is tasked with issuing authoritative and legally binding rulings or a newly enacted Islamic banking Act, thereby standardising practices, minimising legal ambiguities, and bolstering the stability and integrity of the entire financial system. Furthermore, the CBSL or Act should consider mandating the adoption of AAOIFI standards by all licenced Islamic financial providers to increase public confidence.

Furthermore, the findings emphasise the necessity of enhanced collaboration among various Islamic financial institutions, including banks, windows, and leasing companies. Through cooperative efforts, these entities can standardise products, exchange best practices, and formulate unified strategies to address existing regulatory ambiguities. Such collective action would not only bolster the industry's reputation, but also enhance its resilience and facilitate growth.

CONCLUSION

This study offers a critical evaluation of Ijārah financing practices in Sri Lanka in line with the internationally recognised AAOIFI Shariah Standard No. 9. It was found that the demand and growth of the Islamic banking sector in Sri Lanka are viable, but Ijārah practices face Shariah compliance challenges. The most significant challenge is the lack of public transparency due to the non-availability of a national-level Shariah Supervisory Board which controls and monitors all transactions of Ijarah practices from a regulatory perspective. Although the institutional-level Shariah governance framework operates in Sri Lanka at the micro level, the absence of national and macro-level Shariah regulations will prevent ambiguity and boost public confidence. This situation creates systemic risk by allowing for inconsistencies in practice and lack of public transparency. The analysis further identifies specific ambiguities in practice, such as rental rates being benchmarked against conventional indices, and the lack of publicly available information on how ownership risks are managed. These ambiguities effectively imitate conventional financing and undermine the ethical substance of Islamic finance, which causes the status of Islamic finance in the country to fail to accomplish the higher objectives of Islamic law. By relying on secondary data, this study provides a robust foundation for future research. To definitively validate and expand upon these findings, future studies should consider conducting semi-structured interviews with Sri Lankan Islamic

banking practitioners, regulators, and Shariah scholars to gain first-hand accounts of the operational realities and interpretations of the AAOIFI standards. Additionally, a detailed contract-level analysis of IMBT products, including a review of their legal documentation, is necessary to provide a definitive assessment of their compliance with AAOIFI rules on risk-bearing, ownership transfer, and rental rate benchmarking. Cross-jurisdictional studies comparing Sri Lanka with other non-Shariah jurisdictions or mature markets such as Malaysia would also offer valuable insights into alternative regulatory and operational models for enhancing compliance.

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