



SHARIAH COMPLIANCE IN CONSTRUCTION
PROCUREMENT WITH SPECIFIC REFERENCE TO
CONTRACT FORMATION

BY

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ABSTRACT

This study examines the current practice in construction procurement with specific reference to contract formation and appraises the practice in terms of its compliance with the *Sharī'ah*. The scope of the study is to identify and describe the key processes, procedures, requirements, conditions and activities related to the formation of construction contracts – specifically on offer and acceptance – through the conventional way and assess whether the identified activities are *Sharī'ah* compliant or otherwise. The methodology employed comprises: literature review, focus group discussion and semi-structured interviews. Experts, in the areas of construction procurement, construction contract, *Sharī'ah* law, *Fiqh* and *Usul Fiqh* and *Fiqh mu'āmalah*, are the key resource persons for the study. The findings of this study suggest that most of the aspects in the practice of offer and acceptance in the formation of conventional construction contract are considered to be *Sharī'ah* compliant. There are only two aspects which are considered to be non-*Sharī'ah* compliant, therefore need to be improved i.e. the way site investigation is carried out and taking conventional insurance. The outcome of the study is considered significant in terms of enhancing understanding of the Islamic commercial transactions in the area of construction procurement in relation to contract formation.

ملخص البحث

تكشف هذه الدراسة عن التطبيقات المعاصرة لبناء الشراء مع مصدر محدد لأشكال العقد وتقدير تطبيقاته، ومراعاته للشريعة الإسلامية. تهدف الدراسة إلى تحديد ووصف مقدمات الإجراءات والوثائق والمتطلبات والشروط والنشاطات المتعلقة بأشكال عقود الشراء وبنائها، ولا سيما في العرض والقبول، عبر طريقة عادية، والتأكد فيما إذا كانت النشاطات المحققة وفق الشريعة الإسلامية أو خلاف ذلك. والمنهجية المستخدمة في دراستنا هذه تتضمن ما يأتي: الدراسات السابقة، ومناقشات جماعية مركزية، ومقابلات فردية، والمهارة في مجال بناء الشراء، وبناء العقود، والشريعة والقانون، والفقه وأصول الفقه، وفقه المعاملات التي تعد كلها مفاتيح مهمة في دراسة الأشخاص. وخرجت نتائج الدراسة بنتيجة مفادها أن معظم هذه العناصر أعلاه تراعي الشريعة الإسلامية؛ ولهذا تحتاج إلى التحسين مثلاً في مجال الاستثمار وطريقته التي تنقل وتأخذ التأمينات العادية. تعد نتائج هذه الدراسة مهمة جداً في عمليات تحسين الفهم للأمور التجارية الإسلامية في مجال التحصيلات البناءة وعلاقتها بأشكال العقود.

APPROVAL PAGE

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DECLARATION

I hereby declare that this thesis is the result of my own investigation, except where otherwise stated. Other sources are rightly acknowledged by references and bibliography as appended

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SPECIFIC REFERENCE TO CONTRACT FORMATION

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TABLE OF CONTENTS

Abstract.....	ii
Approval Page.....	iv
Declaration.....	v
Declaration of Copyrights.....	vi
Acknowledgements.....	vii
Dedication	viii
List of Tables.....	xiii
List of Figures.....	xv
List of Cases.....	xv
List of Statutes.....	xvi
List of Abbreviations	xvii
CHAPTER 1: INTRODUCTION TO THE RESEARCH	1
1.1 Introduction.....	1
1.2 Statement of the research problem	1
1.3 Aim and objectives of the research.....	6
1.4 Scope of the research	7
1.5 Impetus and the significance of the research	8
1.6 The concept and definitions	11
1.7 Structure of the thesis	12
1.8 Papers in support of this thesis	15
CHAPTER 2: THE CONCEPT OF <i>SHARĪAH</i> COMPLIANT AND ITS APPLICATION IN COMMERCIAL TRANSACTIONS IN MALAYSIA	17
2.1 Introduction	17
2.2 The religion of Islam	18
2.2.1 Definition of Islam.....	18
2.2.2 The revelation and development of Islam	21
2.2.3 Islam in Malaysia	26
2.3 The <i>Sharī'ah</i>	32
2.3.1 Definition of the <i>Sharī'ah</i>	32
2.3.2 Objectives and importance of the <i>Sharī'ah</i>	36
2.3.3 Definition of <i>Fiqh</i>	36
2.3.4 Distinctions between the <i>Sharī'ah</i> and <i>Fiqh</i>	40
2.3.5 Sources of the <i>Sharī'ah</i>	42
2.3.6 Rulings in the <i>Sharī'ah</i>	44
2.3.7 Different <i>madhāhib</i> in the <i>Sharī'ah</i>	44
2.3.8 Four main <i>madhāhib</i> in the <i>Sharī'ah</i>	48
2.4 The concept of <i>Sharī'ah</i> compliant.....	51
2.4.1 Definition of the concept of <i>Sharī'ah</i> compliant	51
2.4.2 The principles to apply the concept of <i>Sharī'ah</i> compliant in commercial transactions	54
2.5 The application of the concept of <i>Sharī'ah</i> compliant in commercial transactions in Malaysia	57

2.6	The application of the concept of <i>Sharī'ah</i> compliant in the Malaysian construction industry	62
2.7	Summary	64

CHAPTER 3: FORMATION OF CONTRACTS UNDER THE MALAYSIAN

	LAW AND <i>SHARĪ'AH</i>	65
3.1	Introduction	65
3.2	The Malaysian law of contract	65
	3.2.1 Definition of contract under the Malaysian law	65
	3.2.2 Sources of the Malaysian law of contract	66
3.3	Formation of contract under the Malaysian law of contract	68
	3.3.1 The elements of formation of contract	69
	3.3.2 Revocation of offer and acceptance	77
3.4	The <i>Sharī'ah</i> law of contract	79
	3.4.1 Definition of contract under the <i>Sharī'ah</i>	79
	3.4.2 Sources of the <i>Sharī'ah</i> law of contract	82
3.5	Formation of contract under the <i>Sharī'ah</i>	83
	3.5.1 Definition of formation of contract under the <i>Sharī'ah</i>	83
	3.5.2 The elements of formation of contract	84
	3.5.3 Revocation of offer and acceptance	99
3.6	Brief history of <i>Sharī'ah</i> compliant contract in commercial transactions	101
3.7	Summary	106

CHAPTER 4: FORMATION OF CONVENTIONAL CONSTRUCTION CONTRACTS AND *SHARĪ'AH* COMPLIANT CONSTRUCTION CONTRACTS WITH SPECIFIC REFERENCE TO THE PRACTICE OF OFFER AND ACCEPTANCE

	107	
4.1	Introduction	107
4.2	Definition of construction contract	108
4.3	Overview of the current contract practices for construction works in Malaysia	109
	4.3.1 Systems of tendering and procurement	109
	4.3.2 Parties and activities involved in construction supply and delivery chain	113
	4.3.3 The non-existent of the subject matter during the time of the contract ..	114
	4.3.4 Price determination	115
	4.3.5 Standard forms of contract	117
4.4	Formation of conventional construction contract	119
	4.4.1 Offer and acceptance in the formation of conventional construction contract	119
4.5	<i>Sharī'ah</i> compliant construction contract	129
	4.5.1 <i>Istiṣnā'</i> as <i>Sharī'ah</i> compliant construction contract	129
	4.5.2 The application of <i>Istiṣnā'</i> contract for construction works	133
	4.5.3 Other contracts which involve non-existent of subject matter and their differences with <i>Istiṣnā'</i> contract	136
4.6	Formation of <i>Sharī'ah</i> compliant construction contract	138
	4.6.1 The practice of offer and acceptance	139
4.7	Comparison between the practices of offer and acceptance in the formation of conventional construction contract and <i>Sharī'ah</i> compliant construction contract	142

4.8	Summary	148
CHAPTER 5: RESEARCH METHODOLOGY		152
5.1	Introduction	152
5.2	Aim, objectives and scope of the research	152
5.3	Research strategy	153
5.4	The research model	155
	5.4.1 Methods of data collection	158
	5.4.1.1 Literature review	159
	5.4.1.2 Focus group discussion	163
5.5	Data analysis	174
5.6	Summary	176
CHAPTER 6: ANALYSES, RESULTS AND DISCUSSION OF FINDINGS		177
6.1	Introduction	177
6.2	Analyses and results of the focus group discussion	177
	6.2.1 The process and procedure of tendering / making an offer	178
	6.2.2 The requirements and conditions to make an offer	181
	6.2.3 The process and procedure of acceptance	188
	6.2.4 The requirements and conditions of acceptance	189
	6.2.5 Recommendations to make aspect which is found not in compliance with <i>Shari'ah</i> as <i>Shari'ah</i> compliant	194
6.3	Semi-structured interview as additional method employed to mitigate shortcomings and validate results	196
	6.3.1 Semi-structured interview #1	199
	6.3.1.1 Analyses and results	200
	6.3.2 Semi-structured interview #2.....	203
	6.3.1.2 Analyses and results	205
6.4	Discussion of the research findings	211
	6.4.1 <i>Shari'ah</i> compliance in the practice of offer and acceptance: the appraisal	211
	6.4.2 <i>Shari'ah</i> compliance in the practice of offer and acceptance: the recommendations for solutions	221
6.5	Summary	223
CHAPTER 7: CONCLUSION		226
7.1	Conclusion	226
7.2	Limitation of the study	231
7.3	Recommendations for further research	231
BIBLIOGRAPHY		233
APPENDICES		248
	APPENDIX A: Form of Tender (PWD 203B).....	248
	APPENDIX B: Letter of Acceptance (PWD 203D).....	259
	APPENDIX C: List of items under the processes, procedures, requirements, conditions and activities of formation of conventional construction contracts and <i>Shari'ah</i> compliant construction contract	265
	APPENDIX D: Handout for focus group discussion	275
	APPENDIX E: List of the experts	263
	APPENDIX F: Questions for focus group discussion	266

APPENDIX G:	Transcription of focus group discussion	269
APPENDIX H:	Transcription of semi-structured interview #1.....	279
APPENDIX I:	Questionnaire for semi-structured interview #2	282
APPENDIX J:	Validation in semi-structured interview #2.....	287
APPENDIX K:	Papers in support of this thesis	296

LIST OF TABLES

<u>Table No.</u>		<u>Page</u>
1.1	Number and value of construction contracts awarded since year 2000 until June 2007	3
2.1	Islamic historical development periods	26
2.2	Chronology of development of Islam in Malaysia	31
2.3	Sources of the <i>Shari'ah</i>	43
2.4	<i>Fiqh</i> rulings under the <i>Shari'ah</i>	44
3.1	Five possibilities in dealing with subject matter	94
3.2	Types of options in the <i>Shari'ah</i>	101
3.3	<i>Shari'ah</i> compliant contracts in Islamic banking, insurance and finance and capital markets	104
3.4	Elements of formation of contract under the Malaysian law	105
3.5	Elements of formation of contract under the <i>Shari'ah</i>	106
4.1	Standard forms of contract commonly used in Malaysia	118
4.2	Items in the Form of Tender according to their classifications of the clauses	122
4.3	Project Cost Limits of Civil Work Contractor	124
4.4	Items in the Letter of Acceptance according to their classifications of the clauses	127
4.5	Differences between the contracts of <i>Salam</i> and <i>Istisna'</i>	137
4.6	Difference between <i>Ijarah</i> and <i>Istisna'</i> contracts	137
4.7	Differences between <i>Ju'ala</i> and <i>Istisna'</i> contracts	138
4.8	Items that need to be specified during offer and acceptance in order to avoid <i>gharar</i>	142
4.9	Preliminary assumptions on <i>Shari'ah</i> compliance in the formation of conventional construction contract	149
5.1	Conceptual clusters of the units of analysis	175
6.1	Experts' appraisal on <i>Shari'ah</i> compliance of the process and procedure of tendering	179
6.2	Experts' appraisal on <i>Shari'ah</i> compliance of tender documentation fee	181

<u>Table No.</u>		<u>Page</u>
6.3	Experts' appraisal on <i>Shari'ah</i> compliance of the requirement for the tenderers to do their own site investigation	184
6.4	Experts' appraisal on <i>Shari'ah</i> compliance of the condition to withdraw tender	186
6.5	Experts' appraisal on <i>Shari'ah</i> compliance if only one witness is in presence during contracting	190
6.6	Experts' appraisal on <i>Shari'ah</i> compliance of putting the acceptance of the offer in writing and the activity of signing contract	191
6.7	Experts' appraisal on <i>Shari'ah</i> compliance of depositing performance bond	193
6.8	Experts' appraisal in semi-structured interview #1 on <i>Shari'ah</i> compliance of taking insurance	201
6.9	Experts' appraisal in semi-structured interview #1 on <i>Shari'ah</i> compliance if only one witness is in presence during contracting	202
6.10	Validation of the appraisal of <i>Shari'ah</i> compliance in the practice of offer and acceptance in the formation of conventional construction contract	206
6.11	Validation made by the experts on the recommendations in order to make aspects which are found to be non- <i>Shari'ah</i> compliant as <i>Shari'ah</i> compliant	209
6.12	The differences and similarities between the researcher's preliminary assumptions and the experts' appraisal	212
6.13	The outcome of the appraisal of <i>Shari'ah</i> compliance in the practice of offer and acceptance	214
6.14	Differences between <i>takaful</i> and conventional insurance	223
7.1	The processes, procedures, requirements, conditions and activities in the practices of offer and acceptance in formation of conventional construction contract and <i>Shari'ah</i> compliant construction contract	228
7.2	<i>Shari'ah</i> compliance in the practice of offer and acceptance in the formation of conventional construction contract	229

LIST OF FIGURES

<u>Figure No.</u>		<u>Page</u>
1.1	Interdependency of the chapters	14
2.1	Components of the <i>Shari'ah</i> and divisions of <i>Fiqh</i>	41
3.1	Legal capacity of contracting parties under the <i>Shari'ah</i>	88
3.2	Conditions for a valid subject matter	93
4.1	Types of systems of construction procurement	111
4.2	Basic model of <i>Istisna'</i> contract as practiced by financial institutions in financing construction works	134
5.1	The research model	157
5.2	Stages involved in conducting the content analysis for the literature review	160
5.3	The process involve in conducting focus group discussion	163
6.1	The methods used and their relations to the subjects of research	198
6.2	Flowchart of the stages involved to get the research findings	224

LIST OF CASES

Tan Mooi Liang v. Lim Soon Seng & Ors [1974] 2 MLJ 60
Bahger Singh v. Chanan Singh [1961] MLJ 328
Song Bok Yoong v. Ho Kim Poui [1968] 1 MLJ 56
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Mohori Bibee v. Dharmodas Ghose [1903] 1 LR 30 Cal. 539 (P.C).
Tan Hee Juan v. The Boon Keat [1934] FMSLR 96

LIST OF STATUTES

Age of Majority Act 1971
Constitution of Malaysia
Contracts Act 1950 (Act 136)
Government Contracts Act 1949 (Act 120)
The Mejele (Ottoman Civil Code)

LIST OF ABBREVIATIONS

Art.	Article
BIMB	Bank Islam Malaysia Berhad
CE	Common Era
CIDB	Construction Industry Development Board
DBB	Design-bid-build
e.g	for example
etc	and so forth
et al	and others
FGD	Focus group discussion
FSMP	Financial Sector Master Plan
i.e	meaning of what written before
IBS	Islamic Banking System
KAED	Kulliyyah of Architecture and Environmental Design
KLIA	Kuala Lumpur International Airport
MENA	Middle Eastern and North African
n.d	no date
PKK	Contractor Service Center
PWD	Public Works Department
SAC	<i>Shari'ah</i> Advisory Council
s.a.w	Sallallahu 'alaihi wa salam (Praise be upon him)
SPTF	Interest-Free Banking System
s.w.t	Subhanahu Wa Ta'ala (Praise be to Allah and the Most High)

CHAPTER 1

INTRODUCTION TO THE RESEARCH

1.1 INTRODUCTION

This research concerns *Shari'ah* compliance in construction procurement focusing on contract formation in terms of offer and acceptance. This chapter sets out the scene of the study and the tone for the following chapters. It introduces the research by highlighting the following:

- (a) The statement of the research problem
- (b) The aim and objectives of the research
- (c) The scope of the research
- (d) The impetus, significance and the expected outcome of the research
- (e) The concept and definitions
- (f) The thesis structure

1.2 STATEMENT OF THE RESEARCH PROBLEM

Construction has been defined as the activity of erecting buildings and other structures (Maclean and Scott, 1995). The construction processes involve the commissioning, design, management and assembly of resources (Khairuddin, 2002) and the outcome is the result of applying and interpreting the meaning of a written instrument i.e. a contract (Singh, 2002a). Therefore, the formation of a contract is a momentous event in procuring construction as a contract sets out, at the beginning, the involved parties' rights,

requirements, responsibilities, remedies and liabilities in relation to the construction works undertaken.

In Malaysia, the practice of construction contracts is governed by the Contracts Act 1950 (Act 136). In addition to that, contracts which involve the Federal Government and Governments of the states are governed by the Government Contracts Act 1949 (Act 120). In the Malaysian construction industry, it is common for the clients and players to use standard forms of contract which have been published by public and private bodies. The construction industry players may use these standard forms of contract as they were originally published or amend them according to their needs or the needs of the projects. Regardless of the types of forms of contract they use, the Construction Industry Development Board (CIDB) recorded that more than 37,000 government and private construction contracts worth more than RM 380 billion were awarded to contractors between year 2000 and June 2007 (see Table 1.1). Notwithstanding the value of those contracts, there is no known literature has been found which discusses whether the practices involved in the formation of these worth billions construction contracts comply or otherwise with the *Shari'ah*.

Table 1.1
Number and value of construction contracts awarded between year 2000 and June 2007

Year	Total Number of Project	Total Project Value (RM million)	Government Project		Private Project	
			Total Number	Value (RM million)	Total Number	Value (RM million)
2000	4,411	50,297.11	1,661	24,340.20	2,750	25,956.91
2001	5,155	51,800.68	2,573	26,412.95	2,582	25,387.73
2002	5,394	48,261.69	2,643	24,780.45	2,751	23,481.24
2003	4,519	49,015.71	1,465	19,945.63	3,054	29,070.08
2004	4,911	52,952.00	1,216	14,270.34	3,695	38,681.66
2005	5,493	53,514.05	1,411	16,745.41	4,082	36,768.64
2006	5,314	55,098.86	1,512	20,562.92	3,802	34,535.94
2007 (June)	1,827	19,530.52	724	7,816.43	1,103	11,714.09
TOTAL	37,024	380,470.62	13,205	154,874.33	23,819	225,596.29

(Source : CIDB, 2007)

The *Sharī'ah* has been defined by Mohamad Akram (2006) as the Islamic teaching and system as guidance to regulate all human actions in *'ibādah* (personal worship to God) and *mu'āmalāt* (mutual dealings). Under the *Sharī'ah*, what is good and bad is determined by *Al-qurān* and *Al-sunnah*, as well as *ijtihād* (human reasoning) in the absence of definite and explicit answers from both textual sources (Haron Din, Hassan Salleh, Sulaiman Yasin, sidi Ghazalba, 2003; Mohamad Akram, 2006). The objective of the *Sharī'ah* (*maqāṣid al- Sharī'ah*) is to secure the benefits of people and prevent people from harm (Mohamad Akram, 2006) regardless of their race, religion, geography and sex as expressed in Al-Qur'an (*al-'Anbiyā'*:107):

And We have not sent you forth (O Muhammad s.a.w) but as a mercy to all the worlds.

In this verse, the phrase "all the worlds" refers to all the inhabitants of the world (Sheikh Abdullah, 2006).

Therefore, viewing the *Sharī'ah* in its broader context, even though it is a part of Islam, the *Sharī'ah* is not only for Muslims, but it is for everybody. Thus, practising the *Sharī'ah* is not only obeying Allah s.w.t. and to be safe in the Hereafter, but it is a human necessity in present life, while leaving *Sharī'ah* will make us lose out and suffer both in this world and in the Hereafter. For this reason, the researcher believes that by having construction contracts which the formations are in compliance with the *Sharī'ah*, it will secure the involved contracting parties' rights as well as help Muslims to abide by the *Sharī'ah* rules in their professions.

Commercial transactions, inclusive of the exchange of commodities, buying, selling, pawn, mortgage, lending, hire, leasing, debt, etc., are included as one of the branches of *mu'āmalah* under the *Sharī'ah* (Faizah, 1995; Abdurrahman, 1999). However, commercial transactions under the *Sharī'ah* are differ from the conventional commercial transactions in the sense that they are not solely intended to gain individual profits but most importantly, they are to fulfil an obligation towards Allah s.w.t as well as to secure the benefits of people and to prevent people from harm. Consequently, a commercial contract which is in compliance with the *Sharī'ah* underlines the elements of justice, accountability and transparency, thus it is compatible to be used both by Muslims and non-Muslims.

In Malaysia, the application of Islamic commercial dealing is well-known in the areas of banking, insurance and the capital market.¹ The materialization of the Islamic

¹ See Table 3.3 at page 104 for the list of various *Shari'ah* complaint contracts in which are commonly known in Islamic banking and finance.

Banking Act 1983 and the Takaful Act 1984 led to the establishment of the Islamic financial system in Malaysia (Nik Norzrul, Mohamed Ridza, and Megat Hizaini, 2003; Bank Negara Malaysia, 2005). With the support from the government, Malaysia is now becoming a global hub for Islamic finance. It is reported that Malaysia is the largest *sukūk* (Islamic bond) insurer in the world (Yong, 2007). Islamic banking in Malaysia is also the largest in Asia (Yong, 2007) with assets amounting to RM147 billion (US\$43.8 billion) for the year ending 2007 (Berita Harian, 30 January 2008).

Banking and financial systems play important roles in the economic structure thus, affecting other sectors of the economy. In relation to the construction industry, such systems affect the way building and facilities are procured. As the project funding is of critical importance to construction procurement and may be obtained from banks and financial institutions, the infusion of *mu'āmalah* into the banking and financial systems enable the industry to use *Sharī'ah* compliant options. For example, banks and other financial institutions frequently employ *istiṣnā'* contract to finance construction projects (Nik Norzrul, Mohamed Ridza & Megat Hizaini, 2003). The Kuala Lumpur International Airport (KLIA) and the New Pantai Expressway projects are examples of infrastructure projects that used Islamic financing and Islamic debt securities (Mohd Daud, 2006; Khairuddin, 2007). In addition, statistics from Bank Negara Malaysia show that, until December 2007, loans from Islamic banking schemes amounting to RM 4.38 billion had been provided for the construction sector (Bank Negara Malaysia, 2009).

While the use of *Sharī'ah* compliant banking and finance products has become so common in the construction industry, clients are still continuing to use the conventional

mode in contracting out construction works to consultants, contractors and suppliers (Khairuddin, 2007) in which the compliance of such practices with the *Sharī'ah* is still in question. At present, there is no legislation or directive that governs or instructs the formation of construction contracts to be in conformity with the *Sharī'ah*. Indeed, the *Sharī'ah* at the moment does not constitute as one of the applicable sources in the Malaysian construction law (Singh, 2002b). Notwithstanding the current position of the *Sharī'ah* in the legal system, the application of the *Sharī'ah* in construction contract is in its infancy (Khairuddin, 2008a, 2008b). Efforts are currently underway to promote and infuse the *Sharī'ah* into the current practice of construction procurement (Khairuddin, 2008a, 2008b; Siti Nora Haryati & Khairuddin, 2008a, 2008b, 2008c). Therefore, this study attempts to examine the current practice in construction procurement with specific reference to contract formation and to appraise the practice in terms of its compliance with the principles of the *Sharī'ah*.

1.3 AIM AND OBJECTIVES OF THE RESEARCH

The study aims to examine the current practice of construction procurement with specific reference to contract formation and appraise the practice in terms of its compliance with the *Sharī'ah*. The focus of the study is on the practice of the offer and acceptance during the formation of contracts as offer and acceptance are the most essential elements for a contract to be formed. The objectives of the study are: