

**Shari'ah Standard No. (11)**

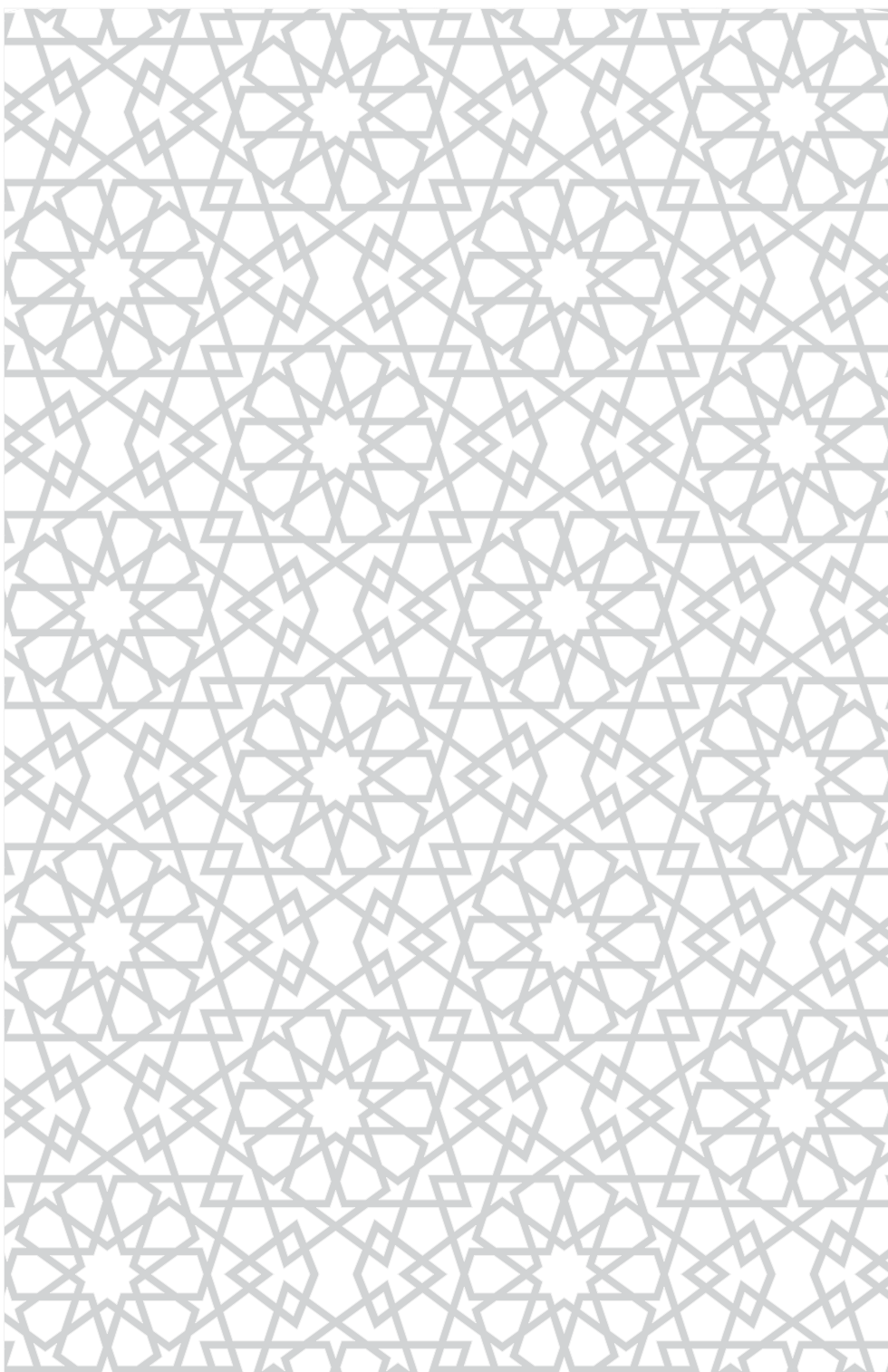
# **Istisna'a and Parallel Istisna'a**

**(Revised Standard)**



# Contents

<b>Subject</b>	<b>Page</b>
<b>Preface</b> .....	295
<b>Statement of the Standard</b> .....	296
1. Scope of the Standard .....	296
2. Istisna'a Contract .....	296
3. Subject-Matter of, and Guarantees in, Istisna'a.....	298
4. Changes to Istisna'a Contract.....	302
5. Supervision of the Execution of an Istisna'a Contract .....	304
6. Delivery and Disposal of the Subject-Matter.....	305
7. Parallel Istisna'a .....	307
8. Date of Issuance of the Standard .....	308
<b>Adoption of the Standard</b> .....	309
<b>Appendices</b>	
<b>Appendix (a):</b> Brief History of the Preparation of the Standard.....	310
<b>Appendix (b):</b> The Shari'ah Basis for the Standard.....	313
<b>Appendix (c):</b> Definitions.....	319



***IN THE NAME OF ALLAH, THE ALL-MERCIFUL, THE MOST MERCIFUL***

All praise be to Allah, the Lord of all the worlds, and blessings and peace be upon our master, Muhammad, and his household and all his companions

## **Preface**

The objective of this standard is to explain the Shari'ah rulings and limitations applicable to Istisna'a and parallel Istisna'a transactions in respect to concluding an Istisna'a contract, the subject-matter of Istisna'a and changes to the contract. The standard also explains issues relating to the execution of the contract and the supervision of its execution.

## Statement of the Standard

### 1. Scope of the Standard

The standard covers Istisna'a and parallel Istisna'a transactions whether the Institution is acting as an ultimate purchaser or is acting as a manufacturer or as a builder for construction.<sup>(1)</sup>

### 2. Istisna'a Contract

#### 2/1 Conclusion of an Istisna'a contract at the time of contracting or after the bilateral promise

2/1/1 It is permissible that the Institution and a customer conclude an Istisna'a contract before the Institution assumes title to the subject-matter to be sold to the customer or to the materials from which the subject-matter will be produced (manufactured or constructed).

2/1/2 It is permissible for the Institution to benefit from any price offers or quotations that the customer has obtained from other dealers or suppliers to assist it in the evaluation of expenses and the computation of prospective profit.

2/1/3 It is not permissible that the Institution's role in the Istisna'a be that of a financial intermediary between a buyer and a third party, especially if the buyer has become unable to meet his obligations toward such a third party, and this prohibition applies whether such a role would take place before or after the commencement of the work. [see item 4/2/2]

---

(1) The Arabic term "Istisna'a" applies to both manufacturing and construction, and there is no convenient term in English that covers both manufacturers and builders. Therefore, the term "manufacturer" will be used in this standard to designate a party acting as manufacturer or contractor in an Istisna'a contract, and the term 'subject-matter' will be used to designate the goods or buildings that are the subject-matter of the contract.

## **2/2 Form and conditions of an Istisna'a contract**

- 2/2/1 A contract of Istisna'a is binding on the contracting parties provided that certain conditions are fulfilled, which include specification of the type, kind, quality and quantity of the subject-matter to be produced. Moreover, the price of the subject-matter must be known and, if necessary, the delivery date must be determined. If the subject-matter does not conform to the specification agreed upon, the customer has the option to accept or to refuse the subject-matter.
- 2/2/2 Since a contract of Istisna'a is binding, the parties to the contract are inevitably bound by all obligations and consequences flowing from their agreement. In other words, the contracting parties need not to renew an exchange of offer and acceptance after the subject-matter is completed. This is different from the promise in a contract of Murabahah, which requires the signature of a sale contract through a new offer and acceptance by the parties when possession of the items to be sold is taken by the Institution.
- 2/2/3 It is not permitted for the manufacturer to stipulate in the contract of Istisna'a that he is not liable for defects.
- 2/2/4 It is not permissible to conclude Istisna'a contracts or processes of Istisna'a in a manner that makes it a legal device for a mere interest-based financing. Examples are a transaction in which the Institution buys items from the contractor on a cash payment basis and sells them back to the manufacturer on a deferred payment basis at a higher price; or where the party ordering the subject-matter to be produced is the manufacturer himself; or where one third or more of the facility in which the subject-matter will be produced belongs to the customer. All the circumstances mentioned above would make the deal an interest-based financing deal in which the subject-matter never genuinely changes hands, even if the deal is won through competitive bidding. This rule is intended to avoid sale and buy back transactions (*Bay' al-'Inah*).

### **3. Subject-Matter of, and Guarantees in, Istisna'a**

#### **3/1 The rulings concerning al-Masnoo'**

3/1/1 An Istisna'a contract is permissible only for raw materials that can be transformed from their natural state by a manufacturing or construction process involving labour. Therefore, Istisna'a is valid only in so far as the supplier has agreed to provide a subject-matter that is manufactured or constructed.

3/1/2 It is permissible that a contract of Istisna'a be concluded for the production of a subject-matter having unique descriptions according to the requirement of the ultimate purchaser even if such a subject-matter has no substitutes in the market, provided the subject-matter is subject to specification. Similarly, it is permissible that the subject-matter of a contract of Istisna'a be items that have perfect substitutes in the market, and can be substituted for one another in fulfilling an obligation, because they share common characteristics by virtue of the process of manufacture or construction. This rule applies whether the items to be produced are intended for consumption or for use with their substance kept intact.

3/1/3 It is not permissible that the subject-matter of an Istisna'a contract be an existing and identified capital asset. For example, it is invalid for the Institution to conclude a contract to sell a particular designated car or factory on the basis of Istisna'a. This is because Istisna'a is a sale contract applicable to items that are identified by specification, not by designation. Unless the items are completely or partially delivered, the ultimate purchaser has no prior right (in the event that the supplier is declared bankrupt or insolvent) over a third party to the items that are the subject-matter of the contract while they are still in the process of being produced and have not yet been delivered to him. In addition, the ultimate purchaser cannot be regarded as the owner of the materials in the possession of the manufacturer for the purpose of producing the subject-



matter of the contract, unless the manufacturer has previously undertaken, as a guarantee for the completion of the work, that such materials will only be used for the order of the ultimate purchaser.

- 3/1/4 The contract of Istisna'a may be concluded with a condition that the production shall be carried out by the Institution using its own resources, in which case it has to abide by this condition and has no right to assign the process of production to another entity.
- 3/1/5 It is permissible for the manufacturer to fulfil his obligation in an Istisna'a contract by using items produced by his own resources or items produced by other parties that existed before the contract was concluded. The latter option is, however, only valid if the ultimate purchaser did not stipulate that the manufacturer should use his own resources. However, this rule should not be used as a device for deferment of consideration (the price and the commodity) of a sale of a subject-matter that is to be delivered in the future based on its specification as given by the seller, but which are not intended to be produced.
- 3/1/6 The manufacturer is under an obligation to produce the subject-matter according to specification and within the period agreed upon or within such reasonable time as the nature of the work may permit, in accordance with accepted practice that is recognised by experts.
- 3/1/7 The parties may agree on a period during which the manufacturer will be liable for any defects or the maintenance of the subject-matter. They may also leave the determination of liability relating to defects and maintenance to customary practice.
- 3/1/8 It is permissible to draw up an Istisna'a contract for real estate developments on designated land owned either by the ultimate purchaser or the contractor, or on land in which either of them

owns the usufruct. This is permissible because the contract involves the construction of specified buildings that will be built and sold according to specification and the contract of Istisna'a in this case does not concern a particular identified place (i.e. the land).

### **3/2 Price and guarantees of Istisna'a contract**

3/2/1 It is a requirement that the price for an Istisna'a contract be known at the conclusion of the contract, in which case it can be in the form of cash or tangible goods or the usufruct of an asset for a particular duration, whether such usufruct is related to an asset other than the subject-matter or to the subject-matter itself. The use of usufruct of the subject-matter itself as consideration for an Istisna'a contract is relevant to situations when a government offers a preferential contract giving usufruct to the builder or manufacturer for a particular duration, commonly known as Build Operate Transfer (BOT).

3/2/2 The price of an Istisna'a contract may be deferred or paid in instalments within a certain period of time, or if delivery of the subject-matter is to be made in stages a portion of the price may be paid immediately while the balance is paid by instalments according to the stages of delivery. It is also permissible to connect payment with the stage of completion of the work, (such that a payment is made at the end of each stage), provided the stages of this type of work are by custom subject to specification and their identification will not lead to dispute.

3/2/3 If the process of manufacture or construction is divided into phases, or payment is designed according to the stage of completion of the work, then the manufacturer or contractor is entitled to request that the ultimate buyer make payment accordingly for each stage that has been carried out according to specification.

- 3/2/4 It is permissible that the price of Istisna'a transactions vary in accordance with variations in delivery date. There is also no objection to a number of offers being subject to negotiation, provided that eventually only one offer will be chosen for concluding the Istisna'a contract. This is to avoid uncertainty and lack of knowledge that may lead to dispute.
- 3/2/5 A contract of Istisna'a cannot be drawn up on the basis of a Murabahah sale, for example, by determining the price of Istisna'a on a cost- plus basis.
- 3/2/6 If the actual costs incurred by the Institution to bring the subject-matter to completion are substantially less than the estimated costs or the Institution secures a discount from the party with whom it contracted on a Parallel Istisna'a basis to acquire the subject-matter in order to fulfil its contractual obligation, the Institution is not obliged to give a discount to the ultimate purchaser and the latter is not entitled to the amount or part thereof the Institution has gained over the estimated costs. The same rule applies conversely when the actual costs of production are substantially greater than the estimated costs.

### **3/3 Guarantees**

- 3/3/1 It is permissible for the Institution, acting either in the capacity of the manufacturer or of the ultimate purchaser, to give or demand accordingly 'Arboun as a guarantee, which will either be part of the price, if the contract is fulfilled, or forfeited, if the contract is rescinded. However, it is preferable that the amount forfeited be limited to an amount equivalent to the actual damage suffered.
- 3/3/2 In an Istisna'a contract, it is permissible for the Institution, whether acting in the capacity of manufacturer or in the capacity of the ultimate purchaser, to demand guarantees that it considers sufficient to secure fulfilment of its rights against

an ultimate purchaser or a manufacturer. It is also permissible for the institution, when acting in the capacity of an ultimate purchaser, to give guarantees requested by the manufacturer, which can be in a form of a mortgage, personal guarantee, assignment of rights, a current account, or an investment account or consent to blocking withdrawal from an account.

#### **4. Changes to Istisna'a Contract**

##### **4/1 Amendments, changes and introduction of new conditions**

4/1/1 It is permissible, after the conclusion of an Istisna'a contract, for the manufacturer and the ultimate purchaser to agree on amending the manufacturing or construction specifications previously agreed upon or introducing additional specification requirements on condition that the price is adjusted accordingly and a reasonable period for the execution of the new requirements is granted. It is also permissible to state in the contract that the consideration for amendments or introduction of additional requirements shall be determined and added to the original price as per the expert opinion, custom or an identified price index which preclude any uncertainty that may potentially lead to dispute.

4/1/2 The ultimate purchaser cannot oblige the manufacturer to introduce modifications and changes to the subject matter of an Istisna'a contract without the consent of the manufacturer.

4/1/3 It is not permissible for amendments and changes to the contract to be agreed on the basis that an additional sum will be paid in consideration for an extension of the period of payment. However, a rebate for pre-payment is permissible provided it is not stipulated at the conclusion of the contract.

##### **4/2 Intervening contingencies (force majeure)**

4/2/1 It is permissible, by way of agreement of the contracting parties or arbitration or judicial procedure, to amend the contract price

of an Istisna'a contract upwards or downwards, as a result of intervening contingencies (force majeure). This rule must be read together with item 4/1/3 above.

- 4/2/2 It is permissible for the Institution to replace a contractor and enter into an Istisna'a contract with a customer to complete a project which had been started by the previous contractor of such a customer. In this case, an assessment of the project should be undertaken on the basis of the existing status of the project. The cost of this assessment is chargeable to the account of the customer, in which case all outstanding debts, if any, that arise from the incomplete Istisna'a contract shall be the personal responsibility of the customer. The parties may after this conclude a new Istisna'a contract for the remaining work. The Institution is not bound to deal with the previous contractor. Rather, the Institution has the right to stipulate that the work needed to complete the project will be carried out by any means it deems fit.
- 4/2/3 In the case of constructing buildings or public utilities on land owned by the ultimate purchaser, it is permissible to stipulate that the ultimate purchaser has the right to perform the contract of Istisna'a at the expense of the manufacturer if the latter fails to perform the contract or to complete the work within a particular period of time, and that this performance will be effected from the date the manufacturer halted the work.
- 4/2/4 If the contractor is unable to continue to discharge his obligation, the ultimate purchaser (the owner of the land) is not entitled to acquire ownership of the incomplete building structures or utilities that are already in place without giving consideration to the contractor. However, this rule depends on the cause of the failure to continue the work. If the failure to perform is due to the misconduct of the contractor, the ultimate purchaser is liable only for the value of the building structure and the builder is liable to compensate the ultimate purchaser for any actual

damage or loss he suffered. If the failure to perform is due to the misconduct of the ultimate purchaser, the contractor is entitled to the value of the work he has completed and compensation for any damage or loss. However, if the failure to perform has not been caused by either of them, the ultimate purchaser is liable only for the value of the building structure that is already in place and neither of them has any responsibility to pay compensation for the loss or damage the other party had suffered. [see item 4/2/3]

4/2/5 It is permissible that a contract of Istisna'a includes a clause to the effect that if any additional conditions are inserted into the contract at a later date as a result of directives of the relevant authorities, and these additional conditions lead to extra expenses that cannot, by virtue of the terms of the contract, be borne by the manufacturer because they were not in the original contract as signed or there is no law making such payment compulsory, the extra expenses will be borne by the ultimate purchaser.

## **5. Supervision of the Execution of an Istisna'a Contract**

- 5/1 It is permissible for the seller and purchaser to appoint technically experienced consulting firm to represent it in determining whether the subject-matter conforms to the contractual specification, and to advise the Institution as to whether payment for the subject-matter, or delivery or acceptance of it, under the terms of the contract, should take place, and they should adhere to its resolutions
- 5/2 It is permissible for the Institution, when acting as the manufacturer, to draw-up an independent and separate contract of agency appointing the ultimate purchaser as an agent of the Institution to supervise the manufacturing or construction process so as to ensure that the items produced conform to contractual specification.
- 5/3 It is permissible for the manufacturer and the ultimate purchaser to agree on the party who will bear the additional costs of supervision of an Istisna'a contract.



## **6. Delivery and Disposal of the Subject-Matter**

- 6/1 The manufacturer is discharged from liability if the subject-matter is delivered to either the ultimate purchaser or to a person appointed by him or if the ultimate purchaser is enabled to exercise full control over the subject-matter.
- 6/1/1 If the condition of the subject-matter does not conform to the contractual specifications at the date of delivery, the ultimate purchaser has the right to reject the subject-matter or to accept it in its present condition, in which case the acceptance constitutes satisfactory performance of the contract. It is also permissible for the contracting parties to agree on acceptance of a subject-matter that fails to conform to the specification even if such an arrangement involves a price discount.
- 6/1/2 If the seller offers to deliver a better quality, then the purchaser shall accept his conditions, provided that the seller shall not charge any additional amounts for the better quality, which may be considered one of the ways in which a contract is ethically fulfilled, unless the quality specified in the contract is particularly pursued by the purchaser.
- 6/2 It is permissible that delivery of the subject-matter takes place before the due date, on condition that the subject-matter meets the specifications agreed upon, in which case the ultimate purchaser is obliged to accept the subject-matter. If the ultimate purchaser is unwilling to take delivery of the subject-matter, the rule on this point depends on whether or not there is justification for this refusal. If there is a good reason for the rejection of the subject-matter, the ultimate purchaser shall not be obliged to accept it. If there is not a good reason for rejecting it, then the ultimate purchaser will be obliged to accept the subject-matter.
- 6/3 The delivery of the subject-matter may take place through constructive possession, by enabling the ultimate purchaser to take control over the subject-matter after the production process is completed. At this

point, the liability of the manufacturer in respect of the subject-matter comes to an end and the liability of the ultimate purchaser begins. If after enabling the ultimate purchaser to take control over the subject-matter any loss or damage subsequently occurs to the subject-matter without any proof of negligence or misconduct on the part of the manufacturer, then the ultimate purchaser is liable. This is therefore the demarcation line between the liabilities of the two parties: the liability of the manufacturer and the liability of the ultimate purchaser.

- 6/4 If the ultimate purchaser refuses to accept the subject-matter without a good reason after he is enabled to take possession, the subject-matter will remain in the possession of the manufacturer on a trust basis, in which case the manufacturer will not be liable for loss or damage that occurs to it, unless such loss or damage is a result of negligence or misconduct on the part of the manufacturer. The ultimate purchaser bears the expenses for the safe keeping of the subject-matter.
- 6/5 It is permissible to state in a contract of Istisna'a that the manufacturer will act as the agent of the ultimate purchaser to sell the subject-matter if there is a delay on the part of the purchaser in taking delivery of the subject-matter within a particular period of time. In this case, the manufacturer will sell the subject-matter on behalf of the ultimate purchaser and, after deducting the agreed contract price, the balance, if any, will be returned to the purchaser. If the price obtained is less than the contract price, the manufacturer shall have a right of recourse to the ultimate purchaser for the recovery of the remaining balance. In addition, the ultimate purchaser will bear the expenses incurred in selling the subject-matter.
- 6/6 It is permissible for the contract of Istisna'a to include a fair penalty clause stipulating an agreed amount of money for compensating the ultimate purchaser adequately if the manufacturer is late in delivering the subject-matter. Such compensation is permissible only if the delay is not caused by intervening contingencies (force majeure). However, it is not permitted to stipulate a penalty clause against the ultimate purchaser for default on payment. [see item 2/1/2 of the Shari'ah Standard No. (3) on Procrastinating Debtor]



- 6/7 It is not permissible to sell the subject-matter prior to taking either actual or constructive possession of it [see item 6/4]. However, it is permissible to conclude an Istisna'a contract to sell an item on the basis of description or specification that is similar to an item to be acquired from a manufacturer, and this is called *Istisna'a Muwazi*: Parallel Istisna'a [see item 7].
- 6/8 It is permissible for the Institution acting in the capacity of ultimate purchaser to appoint, after taking possession of the subject-matter, the manufacturer as an agent to sell the subject-matter to latter's customers on behalf of the Institution. This agency is permissible whether it is carried out free of charge, or for consideration either in the form of a fixed fee or a particular percentage of the sale price, on condition that the contract of agency and the contract of Istisna'a were not entered into in connection with each other.

## **7. Parallel Istisna'a**

- 7/1 It is permissible for the Institution to buy items on the basis of a clear and unambiguous specification and to pay, with the aim of providing liquidity to the manufacturer, the price in cash when the contract is concluded. Subsequently, the Institution may enter into a contract with another party in order to sell, in the capacity of manufacturer or supplier, items whose specification conforms to the wishes of that other party, on the basis of parallel Istisna'a, and fulfil its contractual obligation accordingly. This is permissible on condition that the delivery date stipulated in the parallel (sale) contract must not precede that stipulated in the original purchase contract, and, moreover, the two contracts should remain separate from each other. [see item 3/1/4]
- 7/2 It is permissible for the Institution, acting in the capacity of the producer or supplier, to conclude an Istisna'a contract with the aim of selling such items to the customer on a deferred payment basis, and to enter into a Parallel Istisna'a contract on an immediate payment basis with a manufacturer or builder to acquire such items as per the specifications in the first contract and sell them to the customer. This

is permissible on condition that the two contracts should remain separate and, moreover, be subject to the matters set out in item 3/1/4.

- 7/3 As a result of concluding an Istisna'a contract in the capacity of a producer or supplier, the Institution must assume liability for ownership risk and maintenance and insurance expenses prior to delivering the subject-matter to the ultimate purchaser (the customer). Moreover, the Institution is not permitted, in the Parallel Istisna'a contract concluded with the manufacturer, to transfer to the latter the risk arising from its obligations towards the customer.
- 7/4 It is not permissible to make any contractual link between the obligations under two contracts (the contract of Istisna'a and the contract of Parallel Istisna'a) when they are concluded. Therefore, it is also not permissible for a party to an ordinary Istisna'a contract (I) to withdraw his contractual obligations or delay delivering the subject-matter of the contract because the obligation under Parallel Istisna'a did not take place or (II) to increase the price of the goods to be delivered because of an increase in the cost of goods in the Parallel Istisna'a. However, there is no restriction on the right of the Institution to stipulate conditions and requirements when concluding a Parallel Istisna'a contract as a purchaser, including a penalty clause similar to, or different from, that which the customer has stipulated in the first Istisna'a contract in which the Institution is the supplier.

#### **8. Date of Issuance of the Standard**

This Standard was issued on 29 Safar 1422 A.H., corresponding to 23 May 2001 A.D.

## **Adoption of the Standard**

The Shari'ah Standard on Istisna'a and Parallel Istisna'a was adopted by the Shari'ah Board in its meeting No. (6) held on 25-29 Safar 1422 A.H., corresponding to 19-23 May 2001 A.D.

In its meeting No. (8) held in Makkah Al-Mukarramah on 28 Safar - 4 Rabi' I, 1423 A.H., corresponding to 11-16 May 2002 A.D., the Shari'ah Board readopted a resolution to reformat the Shari'ah rules for Istisna'a and Parallel Istisna'a in the form of a Shari'ah standard.

## **Appendix (A)**

### **Brief History of the Preparation of the Standard**

In its meeting No. (5) held in Makkah Al-Mukarramah on 8-12 Ramadan 1421 A.H. corresponding to 4-8 December, 2000 A.D., the Shari'ah Board decided to give priority to the preparation of the a Shari'ah rules for Istisna'a and Parallel Istisna'a.

On Monday 11 Shawwal 1420 A.H. corresponding to 17 January 2000 A.D., the Fatwa and Arbitration Committee recommended to the Shari'ah Board the commissioning of a Shari'ah consultant to prepare a juristic study and an exposure draft on the Shari'ah Rules for Istisna'a and Parallel Istisna'a.

In its meeting held in Bahrain on 21-23 Muharram 1421 A.H., corresponding to 26-28 April 2000 A.D., the Fatwa and Arbitration Committee discussed the exposure draft of the Shari'ah Rules for Istisna'a and Parallel Istisna'a and asked the consultant to make amendments in light of the comments made by the members.

In its meeting No. (4) held in Abu Dhabi, United Arab Emirates on 14 Sha'ban 1421 A.H. corresponding to 10 November 2000 A.D., the Fatwa and Arbitration Committee discussed the exposure draft and made some relevant amendments.

The revised exposure draft of the Shari'ah Rules was presented to the Shari'ah Board in its meeting No. (5) held in Makkah Al-Mukarramah on 8-12 Ramadan 1421 A.H. corresponding to 4-8 December 2000 A.D. The Shari'ah Board made further amendments to the exposure draft of the standard and decided that it should be distributed to specialists and interested parties to obtain their comments in order to discuss them in a public hearing.

A public hearing was held in Bahrain on 4-5 Dhul-Hajjah 1421 A.H., corresponding to 27-28 February 2001 A.D. The public hearing was attended by more than thirty participants representing central banks, Institutions, accounting firms, Shari'ah scholars, academics and others who are interested in this field. Members of the Shari'ah Studies Committee responded to the written comments that were sent prior to the public hearing as well as to the oral comments that were expressed in the public hearing.

The Fatwa and Arbitration Committee held its meeting No. (5) in Bahrain on 15 Dhul-Hajjah 1421 A.H., corresponding to 10 March 2001 A.D., to discuss the comments made about the exposure draft. The committee made the necessary amendments in light of both the written comments that were received and oral comments that took place in the public hearing.

The Shari'ah Board in its meeting No. (6) held in Al-Madinah Al-Munawwarah on 25-29 Safar 1422 A.H., corresponding to 19-23 May 2001 A.D., discussed the amendments made by the Fatwa and Arbitration Committee, and made necessary amendments. The standard was adopted in the name of Shari'ah Rules for Istisna'a and Parallel Istisna'a. Some paragraphs were adopted by the unanimous vote of the members of the Shari'ah Board while the other paragraphs were adopted by the majority vote of the members, as recorded in the minutes of the Shari'ah Board.

The Shari'ah Board decided in its meeting No. (7) held in Makkah Al-Mukarramah on 9-13 Ramadan 1422 A.H. corresponding 24-28 November 2001 A.D. to reformat all Shari'ah rules in the form of standards and a committee was formed for this purpose.

In its meeting No. (8) held in Al-Madinah Al-Munawwarah on 28 Safar - 4 Rabi' I 1423 A.H. corresponding to 11-16 May 2002 A.D., the Shari'ah Board adopted the reformatting of the Shari'ah Rules for investment and Financing No. (4) on Istisna'a and Parallel Istisna'a in the name of Shari'ah Standard No. (11) on Istisna'a and Parallel Istisna'a without any substantial changes in the content.

The Shari'ah Standards Review Committee reviewed the standard in its meeting held in Rabi' II 1433 A.H. corresponding to March 2012 A.D.

in the State of Qatar, and proposed after deliberation a set of amendments (additions, deletions, and rephrasing) as deemed necessary, and then submitted the proposed amendments to the Shari'ah Board for approval as it deemed necessary.

In its meeting No. (4) held in Al-Madinah Al-Munawwarah, Kingdom of Saudi Arabia on 27-29 Sha'ban 1436 A.H. corresponding to 14-16 June 2015 A.D., the Shari'ah Board discussed the proposed amendments submitted by the Shari'ah Standards Review Committee. After deliberation, the Shari'ah Board approved necessary amendments, and the standard was adopted in its current amended version.

## Appendix (B)

### The Shari'ah Basis for the Standard

#### Legitimacy of Istisna'a Contract

The legitimacy of Istisna'a is based on the request of the Prophet (peace be upon him) that a pulpit (a platform) for preaching and a finger ring be manufactured for him.<sup>(2)</sup> An Istisna'a contract is also permissible on the basis of the principle of Istihsan (Shari'ah approbation), the general principles of contracts and transactions and the objectives of Shari'ah. The Istisna'a is a binding contract and not a mere promise. The International Islamic Fiqh Academy has issued a resolution in support of the legitimacy of Istisna'a.<sup>(3)</sup>

#### Istisna'a Contract

- The basis for it not being permissible that the role of the Institution remain as a mere financier for a deal concluded between the supplier and the ultimate purchaser is that this would lead to involvement in a Riba transaction which makes the Istisna'a contract a mere cover-up and not a real Istisna'a.
- The basis for stating that an Istisna'a contract is binding is the view of Imam Abu Yusuf, as stated in the "*Majjalat Al-Ahkam Al-'Adliyyah*", (known in English by the name the Mejlle), that the manufacturer has spent money in order to manufacture and to deliver according to specification. If the ultimate purchaser has a right to refuse the manufactured goods, then the manufacturer will incur losses.

---

(2) The Hadith in which the Prophet (peace be upon him) requested the manufacture of finger ring has been related by Al-Bukhari and Muslim: "*Sahih Al-Bukhari*" [5: 220]; and "*Sahih Muslim*" [3: 1655]). The Hadith in which the Prophet (peace be upon him) requested the manufacture of a pulpit for preaching has been related by Al-Bukhari in his "*Sahih*" [2: 908].

(3) International Islamic Fiqh Academy Resolution No. 65 (3/7).



- The basis for the impermissibility of the manufacturer including a defect exclusion clause in an Istisna'a contract is that a valid Istisna'a is a sale of specified goods to be delivered in the future and exclusion of liability as to defects is valid only in the sale of particular identified goods. This prohibition of excluding liability as to defects in Istisna'a is one feature that makes it different from an ordinary sale.
- The basis for the impermissibility of drawing up Istisna'a contracts or procedures in a way that appears to be a mere interest-based financing is the need to avoid involvement in a Riba transaction, a potential Riba or 'Inah sales.

**Subject Matter of, and Guarantees in, an Istisna'a Contract**

- The basis for the impermissibility of concluding an Istisna'a contract for items that are not manufactured or constructed is that items that are not the subject of transformation by manufacture or construction by man, that is natural things such as animals, fruits and vegetables, are not by definition covered by the term Istisna'a which means a sale of materials on condition that they be subjected to transformation by a manufacturing or construction process.
- The basis for the permissibility of concluding an Istisna'a for manufactured items that either have or do not have equivalents in the market is because it is normal for people to deal in these kinds of item. As a principle, rules that are based on customary practice will change whenever such customary practice is changed. Therefore, any customary transaction that is subject to specifications may be a subject-matter of Istisna'a, regardless of whether it is for use or consumption.
- The basis for not allowing the subject-matter of Istisna'a to be a specific identified item is that an Istisna'a contract involves a sale for future delivery based on a specification. Therefore, if the items to be sold are specific identified items, the transaction involves selling identified items that the seller does not own, which is prohibited by the saying of the Prophet (peace be upon him): *"Do not sell what you own not".*<sup>(4)</sup>

---

(4) The Hadith has been related by Al-Tirmidhi in his *"Sunan"* [3: 534], edited by Ahmad Shakir; and Al-Albani, *"Irwa' Al-Ghalil"* [5: 132].



Again, items to be manufactured or constructed do not yet exist and thus cannot be specific and identified. The non-existent item is to be produced and delivered later and this constitutes a non-monetary obligation of the supplier.<sup>(5)</sup>

- The basis for the permissibility of a stipulation by the ultimate purchaser that the manufacture be carried out by the Institution itself is because this stipulation does affect the purpose of the contract. Rather, this condition is relevant in this contract because the ultimate purchaser may be interested in the items that are produced by a particular supplier due to this supplier's distinguished competence in manufacturing or construction and the quality of the items manufactured or constructed by this supplier.
- The basis for the permissibility of the manufacturer presenting to the ultimate purchaser either what he has produced or what other parties have produced, if the ultimate purchaser did not stipulate to the contrary, is because this satisfies the purpose of the contract. This is the case because the items are being delivered according to the specifications that are laid down in the contract.
- The basis for the permissibility of stipulating a time-period during which manufacturer remains liable for any manufacturing or construction defects is that such a stipulation serves the purpose of the contract. This is because the ultimate purchaser wants to use the subject-matter and this is not possible unless the subject-matter is free from defects.
- The basis for the requirement that the price be known is to remove any lack of knowledge and uncertainty that may lead to dispute.
- The basis for the permissibility in Istisna'a of payment on deferred terms or on an instalment basis is that labour (i.e. transformation and added value) is an important part of the items to be sold and this makes the transaction similar to a leasing contract in which it is permissible for the rentals to be paid on a deferred or instalment basis without this being considered as a sale of debt for debt which is prohibited. The same ruling applies to Istisna'a.

---

(5) See: *"Majallat Al-Ahkam Al-'Adliyyah"*, article (158).

- The basis for the permissibility of offering a difference in the price for an Istisna'a contract relating to a difference in the date of delivery is that Istisna'a is analogous to an Ijarah contract. The fuqaha have stated that it is permissible to give a labourer in Ijarah an option regarding wages depending on whether the worker finishes the work in one day or in two days. The hirer may say two dinars if the worker finishes in one day or one dinar if he finishes in two days. Istisna'a is similar to this. There is a resolution issued during the Al Baraka Annual Forum supporting this ruling.<sup>(6)</sup>
- The basis for not allowing a contract of Istisna'a to be drawn up on the basis of a Murabahah sale, for example, by determining the price of Istisna'a on a cost- plus basis, is because the subject-matter of Murabahah should be something already in existence, the cost of which is known and which is owned prior to the conclusion of a Murabahah sale. An Istisna'a contract, on the other hand, is concluded prior to ownership of the subject-matter, because (I) it is a sale based on a specification giving rise to a future obligation, and (II) the actual cost will be known only after the completion of the work, and, (III) the price in a contract of Istisna'a should be known when the contract is concluded.
- The basis for deciding that the Institution is not obliged to give a discount when the actual costs of the manufacture are substantially greater than the estimated costs or when it secures a discount from the manufacturer is because the Istisna'a contract and Parallel Istisna'a contract are independent in terms of obligation and effects. The Shari'ah Supervisory Board of the Kuwait Finance House has issued a Fatwa in this respect.<sup>(7)</sup>
- The basis for the permissibility of the Institution acquiring all necessary guarantees is that these guarantees secure its rights and this request does affect the purpose of a contract.

#### **Changes to an Istisna'a Contract**

- The basis for the impermissibility of extending the date of payment in return for consideration is because that is Riba.

---

(6) See: Resolution No. (13/7).

(7) *"Al-Fatawa Al-Shar'iyyah Fi Al-Masa'il Al-Iqtisadiyyah"*, Fatwa No. (447).

- The basis for the permissibility of discounting for unconditional earlier payment is the saying of the Prophet (peace be upon him) in the case of Ubay Ibn Ka'b (may Allah be pleased with him) and his debtor: "*Write off a portion of your debt*".<sup>(8)</sup> The International Islamic Fiqh Academy has issued a resolution in support of this rule.<sup>(9)</sup>
- The ultimate purchaser (the owner of the land) is not entitled to acquire ownership of incomplete building structures or utilities that are already in place without giving consideration to the builder if the builder is unable to continue to discharge his obligation. The basis for this is that the construction was initiated by the builder at the request of the ultimate purchaser and such a request is stronger than a mere permission to build on the latter's land.
- The basis for the permissibility of a contract of Istisna'a including a clause that the manufacturer is not liable for extra expenses that result from additional conditions inserted into the contract at a later date as a result of directives of the relevant authorities, is because this condition is agreed upon by the parties and does not affect the purpose of Istisna'a contract. The Shari'ah Supervisory Board of Kuwait Finance House has issued a Fatwa in respect to this ruling.<sup>(10)</sup>
- The basis for the permissibility of a penalty clause in an Istisna'a contract is that such a clause is in the interest of the contract and because it is laid down in respect to an obligation regarding items that must be produced and delivered in the future and not in respect to monetary debt.

### **Supervision of the Execution of an Istisna'a Contract**

The basis for the permissibility for the Institution, when acting as the ultimate purchaser, to appoint a technically experienced consulting firm and the permissibility for the Institution, when acting as the manufacturer, to appoint the ultimate purchaser as an agent is because agency is permissible and there is nothing against it in an Istisna'a contract provided it is done with the agreement of the parties.

---

(8) The Hadith has been related by Al-Bukhari in his "*Sahih*" [1: 179] and [2: 965].

(9) International Islamic Fiqh Academy Resolution No. 64 (7/2).

(10) See: Fatwa No. (251).

### **Delivery and Disposal of the Subject-Matter**

The basis for the impermissibility of selling the items to be produced prior to taking either actual or constructive possession of them is that such an action is considered as selling a non-existent item. It is also considered as selling what one does not own because it is not available for the seller at the time of conclusion of the contract.

### **Parallel Istisna'a**

The basis for the permissibility of the Institution entering into a contract with another party in order to sell, in the capacity of manufacturer, builder or supplier, items whose specification conforms to the wishes of that other party, on the basis of Parallel Istisna'a, is that in such a case there are two separate deals of Istisna'a. There is no link between the two contracts; hence, this is not an instance of two sales in one deal, which is impermissible. The separation of the two contracts also has the effect of making the transaction a type of non-Riba-based financing.

## Appendix (C)

### Definitions

#### **Istisna'a Contract**

Istisna'a is a contract of sale of specified items to be manufactured or constructed, with an obligation on the part of the manufacturer or builder (contractor) to deliver them to the customer upon completion.

#### **Parallel Istisna'a**

Another form of Istisna'a, known in modern custom as Parallel Istisna'a "*al-Istisna'a al-Muwazi*", takes effect through two separate contracts. In the first contract, the Islamic Financial Institution acts in the capacity of a manufacturer, builder or supplier and concludes a contract with the customer. In the second contract, the Institution acts in the capacity of a purchaser and concludes another contract with a manufacturer, builder or supplier in order to fulfil its contractual obligations towards the customer in the first contract. By this process, a profit is realised through the difference in price between the two contracts and, in most cases, one of the two contracts is concluded immediately, (i.e. the Istisna'a contract entered into with the manufacturer, builder or supplier), while the second contract (i.e. the contract entered into with the customer) is concluded later.

#### **Difference Between Istisna'a and Ijarah**

The contract of Istisna'a differs from the contract of Ijarah in the sense that the latter is a contract of services without any commitment to supply materials whereas the former requires that the manufacturer or builder provide both services for the transformation or construction process and ultimately to supply the materials in the form of the finished items.

#### **Difference Between Istisna'a and a Standard Construction Contract**

The contract of Istisna'a also differs from a standard construction contract in that the latter is regarded as an Ijarah contract if it is confined to providing

services only, with the materials to be provided by the customer (the person who engaged the Institution to carry out the construction work). But if a construction contract requires the builder to provide both the services and the materials needed to fulfil the contract, then it is an Istisna'a contract.

#### **Difference Between Istisna'a and Salam**

The Istisna'a contract also differs from a Salam contract in the sense that the former is a contract that involves a sale of specified items that have by nature to be manufactured or constructed. In other words, an Istisna'a contract is applicable to materials that require transformation by a manufacturing or construction process. The Salam, on the other hand, is a contract of sale of specified goods, the permissibility of which is not attached to a condition that the goods must be manufactured or constructed.

