

INCOME PURIFICATION MECHANISM FOR ISLAMIC FINANCIAL INSTITUTIONS: A PROPOSED FRAMEWORK

Mahbub Ali

Abstract

The study aims to propose a framework of income purification mechanism for Islamic financial institutions (IFI). The framework delineate the concept of illegitimate income and its sources from an Islamic perspective so that a cohesive approach in dealing with diverse non-compliance events based on established principles of Shariah is established. Although it is not expected for IFI to deliberately involve in illegitimate activities, any incident of non-compliance needs to be immediately addressed, rectified and reported. This is not only to ensure the purity of the income earned but more importantly for IFI to put in place adequate systems and controls to ensure such non-compliance with Shariah rules and principles can be averted.

Keywords: *Shariah non-compliant, non-halal income, income purification, void, contract rectification*

1. INTRODUCTION

The concern over Shariah compliant transactions is firmly entrenched in activities and operation of Islamic financial institutions (IFI). As a business entity established within the ambit of Shariah, IFI is expected to be guided by values, principles, objectives and rulings of the Shariah. However ensuring effective Shariah compliance is not a straightforward matter. As financial markets are increasingly becoming sophisticated, heightened product innovations and engineering in Islamic finance entails the genuine concern over the need to strengthen Shariah compliance throughout the product life cycle. Indeed, failure to comply with Shariah not only invokes financial risk but may eventually expose IFI to the risk of breaking the trust and confidence of investors and depositors. This inexorably leads to dire consequences, including massive withdrawal and insolvency risk. As a case in point, governance failure had cost Dubai Islamic Bank USD50 million in 1998 when a bank official did not conform to the ethical term of advancing financing. This had subsequently resulted in a run on its deposits of USD138 million, representing 7% of the bank's total deposits, in just one day (Warde, 2000).

In Malaysia, endeavor to reinforce sound Shariah regulation and supervision leads to new issuance of Bank Negara Malaysia's Shariah Governance Framework (SGF) for the Islamic financial institutions on 1st January 2011. The main objective of this guideline is to enforce and strengthen the IFI's Shariah governance structures, processes and arrangements, ensuring that all of their operations and business activities to be consistent with the requirement of Shariah. Pursuant to issuance of SGF, Islamic Financial Services Act (IFSA) which was legislated by Bank Negara Malaysia in 2013, enforces IFIs to have management of Shari'ah non-compliant risk and requires IFI to ensure that their aim, operation, and all business activities are in compliance with Shari'ah (<http://www.global-islamic-finance.com>).

The Guideline necessitates IFI to institute a clear internal control and process on how to address the issue of Shariah non-compliant in a holistic manner. In other words, Shariah compliant should not only focus on structuring and issuing Shariah pronouncement alone but covers the whole spectrum of IFIs operation, both ex-ante and ex-post aspects of Islamic financial transactions.

However, there is a kind of misperception in the market today for having the general view that should a bank fails to act in accordance with the Shariah rules, the transaction should be considered null and void from Shariah viewpoint and hence all income derived thereon is considered tainted and everything should be channeled to charity. Essentially, not all Shariah non-compliant transactions result in the tainted income to be purified by way of channeling it to charity. There are also possible instances whereby the proceeds generated need to be returned to the original owner. In other instance, only the prohibited portion is supposed to be channeled to charity while the remaining portion could be retained as income. In certain situation whereby rectification could be made to the contract or transaction, the proceeds can still be recognized as IFI's income provided all the necessary amendments have been made.

Against this backdrop, this present study focuses on the mechanism of dealing with non-halal income resulting from non-Shariah compliant transactions. Specifically, the paper sets out to provide answers to the following research objectives:

- To identify sources of non-halal income
- To discuss the approach to deal with non-halal income
- To propose the mechanism of income purification for Islamic financial institutions.

Following this brief introduction, the paper is organized according to the following structure: the next section discusses the concept of non-halal income from Shariah viewpoint.

The third section elaborates on the approaches in dealing with various sources of non-halal income. While the fourth sections provides examples of scenarios in which Islamic financial transactions could treat their tainted income, the final section concludes this study.

II. THE CONCEPT OF NON HALAL INCOME

Some contemporary scholars defined *mal haram* (illegitimate income) as wealth which Shariah has prohibited the holder to utilize it in any possible way (Yasin, 1414AH). Other scholars provided a broader scope of definition which states: Anything that Shariah has prohibited Muslim from appropriating due to a preventive factor (Al-Baz, 2004, 39). The latter is more general than the former definition as the prohibition is not confined to only utilize the items but also to possess it. Meanwhile, Al-Ghazali defined *mal haram* as any property which is acquired through illegitimate way, such as via corruption, theft, *riba*, hoarding, gambling, etc. (Al-Baz, 2004, 39).

2.1 Sources of Non-Halal Income

Essentially, income-generating or wealth-accumulation activities that involve money do not invoke the issue of *haram li dhatihi* (non halal in its essence) since money in its substance is permissible. However, a particular sum of money may be deemed impermissible if it is derived from illegitimate sources. This is known as *haram li ghayrihi* (prohibited due to external factors). The following discussion will shed further light on the possible sources of impermissible income (*mal haram*, hereafter referred to as non-halal income) due to external reasons.

In general, the non-halal income due to external factors may be originated from two possible sources (Al-Baz, 2004):

1. Income acquired without the consent (*bi ghairi ridha*) from the legal owner. Examples are income realized through theft (*sariqah*), usurpation (*ghasb*) and deception.
2. Income earned with the consent of the owner whereby the legal owner expresses his assent to give a specific asset or cash, either contractually or not. However, his action is not approved by Shari'ah. In this regard, Ibn Taimiyyah further divided this category into two possible scenarios; (i) non-*halal* income possessed through nominate contracts; and (ii) non-*halal* income earned without having any specific contractual forms, such as income via *rashwah* (bribery), *maysir* (gambling), *hadiya umra* (gift to employees while executing their duties), etc. (Ibn Taimiyyah, 2005). While income earned without specific underlying contract is clear and easily understandable, the following discussion will delineate non-*halal* income sources through specific nominate contracts.

2.1.1 Non-Halal Income from Invalid Contracts

In Islamic transaction, validity of contract is important in determining whether a transaction can be considered permissible or impermissible. A valid contract from an Islamic viewpoint is when all the essential pillars and conditions of the contract are fulfilled. This categorically determines the status of income derived from any transaction conducted.

According to the majority of jurists, there are only two possible rulings on the status of a contract: valid (*shahih*) and invalid (*ghayr sahih*), and this latter category has other names (*ba'il* and *fasid*) which can be used interchangeably for it (Zuhaily, 2004). *Shahih* is a contract in which all the essential elements —such as the contracting parties, subject matter, and offer and acceptance—and all the underlying conditions are fulfilled (al-Minyawi, 2010).

From a Shariah point of view, a valid contract establishes all the legal implications that the Shariah has assigned to a contract of that type (al-Namlah, 1999, 1:412). For example, the buyer attains the exclusive right to possess and utilize the asset while the seller becomes entitled to the consideration. All income generated from this class of contract is deemed legal (Ayyub, 2007).

On the other hand, a contract that is invalid is one that violates the pillars and Shariah conditions of the contract (Zuhaily, 2004). The following are examples of factors that render a contract invalid: the asset transacted is an impure or prohibited commodity such as blood, pork, wine, a carcass; the asset is not fully possessed by the seller or is undeliverable; there is excessive uncertainty in the delivery date or price; or the contract is performed by parties without legal eligibility to execute contracts. From the Shariah point of view, an invalid contract does not produce the legal effects of that contract. There is no exchange of financial rights and responsibilities due to it; the buyer does not have any right to dispose of the asset, while the seller cannot possess the income realized. Such a contract must be properly re-executed, starting from scratch.

The majority of jurists do not distinguish between *batil* (void) and *fasid* (voidable) in financial transactions, both terms are the opposite of *sahih*, having a single legal implication (al-Ramli, 1994) and are often used interchangeably. On the other hand, the Hanafi School took a different position from the majority of classical jurists. They classified contracts into three categories: *sahih* (valid), *fasid* (irregular) and *batil* (void), and considered *batil* and *fasid* to be different in substance and ruling. *Fasid* is an intermediary class of contract between *sahih* and *batil* (al-Bukhari, 1997).

According to the Hanafi School, *batil* is a contract that is invalid due to a defect in any of the essential elements (pillars) of the contract (al-Kasani, 1986, 5:305). The following are examples of such defects: if the contract involves impure or prohibited items as the subject matter; the subject matter has no value from the Shariah perspective; the asset is not fully owned by the seller; the acceptance is not in conformity with the offer; the contracting parties have not reached the age of maturity; the contract contains fraud, deceit, etc. The Hanafi conception of a *batil* contract has the same implications as the majority's category, *ghayr sahih* (invalid). A *batil* contract does not give rise to any legal consequences. The contract is treated as if it does not exist. Therefore, the buyer in a sale contract is not entitled to the asset while the seller has no right to the consideration. All income generated from a void contract is ruled as non-*halal*; hence, it cannot be possessed or utilized (al-Baz, 2004).

Meanwhile, a *fasid* (voidable) contract is a unique class of contract recognized in the Hanafi School's categorization scheme. Unlike a *batil* contract, the essential elements of a *fasid* are present, but the contract is tainted by a defect in an accessory attribute (*waaf*) (Mahmud, 2000, 8:139). Hanafi jurists identified various factors leading to a *fasid* contract, as highlighted below:

1. Ignorance (*jahalah*); i.e., insufficient information. The *jahalah* may exist with regard to four matters:
 - a. the asset; e.g., the seller says, "I hereby sell you some of my cloth," and the parties disperse without the seller specifying which cloth is being sold.

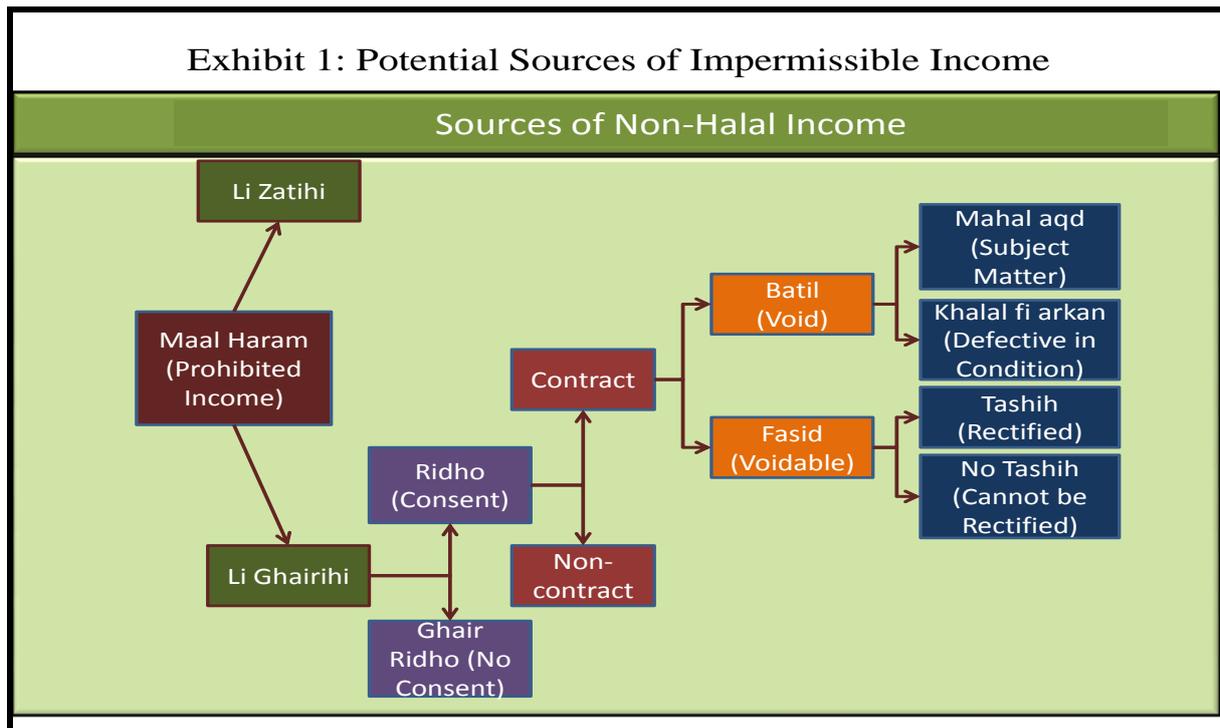
- b. the price; e.g., the seller says to the buyer, “I hereby sell this asset to you for RM 100 spot payment or RM 200 deferred payment” and the parties disperse without the buyer accepting one of the prices in particular (al-Imrani, 2006, 80).
 - c. the time of delivery.
 - d. the guarantee, surety or the pledge; e.g., a seller stipulates a guarantee or pledge without specifying what it is (Zuhaily, 2004, 5:3444-3446).
2. The existence of an invalid condition. The Hanafi School defined an invalid condition (*shart mufsid*) as a condition that is neither consistent with the nature and implication of the contract, nor endorsed by textual authority, nor admitted by customary practice. In fact, the condition offers a benefit to only one of the contracting parties (or a third party) at the expense of the other contracting party (Zuhaily, 2004, 5: 3471). One example is tying a loan agreement to a sale contract; e.g., Ali agrees to give a loan to Zayd on the condition that Zayd sells his asset to Ali. In this case, Zayd may consider discounting the price in favour of Ali due to the loan facility, resulting in a loan that extracts profit (Arbouna, 2007, 346).
 3. The existence of an element of *riba*. The majority of jurists consider the existence of *riba* to invalidate the contract (make it *batil*). However, the Hanafi School holds that *riba* does not make a contract void (*batil*); rather, it makes it irregular (*fasid*) and, hence, rectifiable (Wizarat al-Awqaf wa al-Shu’un al-Islamiyyah, 1404-1427AH, 9:101).

Unlike a *batil* contract, the income from a *fasid* contract is not irretrievably illegal; it is irregular but rectifiable. Once the intolerable elements are eliminated, the contract becomes *shahih*; thus, the income becomes legal (*halal*).

Indeed, the Hanafi approach to invalid contracts in financial transactions is not limited to them. It is also supported by some Maliki and Shafii jurists. Al-Qarafi, of the Maliki School, acknowledged that the Hanafi approach is sound (al-Qarafi, 1994, 2:83). Some Shafii scholars also differentiate between *fasid* and *batil* in certain contracts such as *wakalah*, *iarah*, and *ijarah*. Some even follow the Hanafi view regarding all types of contracts (al-Ramli, 1994, 25). Contemporary *fiqh* scholars have generally adopted the Hanafi view. Therefore, this paper has employed the Hanafi categorization of invalid contracts to develop a cohesive approach for income purification mechanism for Islamic financial institutions. The authors view the Hanafi's differentiation between *batil* and *fasid* to be more practical and relevant to the current context and the needs of market players. There are a number of reasons for that judgment:

First, practically speaking, not every contractual defect is serious enough to warrant re-execution. Some defects are minor and can easily be rectified by removing the objectionable elements. Second, in the current context, re-execution of contracts creates practical complexity as institutions tend to use boilerplate contracts to undertake the same basic type of transaction with thousand of clients, and some contracts involve cross-border transactions. Adopting the majority view will undoubtedly impose hardship and difficulty on the market. Third the Hanafi's categorization provides more options to the market players to apply the Islamic law of contract in modern financial operations.

Exhibit 1 depicts the summary of the discussion so far pertaining to the sources of impermissible income. It is pertinent to be clear about the sources of impermissible income before developing a holistic income-purification framework for Islamic financial institutions. The following subsection shall delineate the approaches and mechanisms for dealing with various sources of impermissible income as discussed above.



3. DEALING WITH NON-HALAL INCOME

In Islam, a Muslim is not supposed to enter into any transaction that is in violation of Shari'ah rulings and principles. However, in the event that he does transgress the boundary of Shari'ah principles, the Shari'ah requires the Muslim to repent and rectify the wrongdoings immediately. Therefore, it is imperative that any income derived from impermissible sources undergo an immediate process of rectification or purification.

However, the rectification and purification process may vary, depending upon sources and scenarios. Some non-*halal* income may have to be purified by channeling all of the tainted money to charity while in some cases it may be required to return the wealth to the original owner. In certain scenarios, rectification can be made without resorting to channeling all the income to charity or the original owner. The following discussion examines the treatment of non-*halal* income from various sources and scenarios identified in the preceding section.

3.1 Non-Halal Income Due to Its Essence (Haram li Dhatihi)

As described in the foregoing discussion, *haram li dhatihi* is what is prohibited due to the intrinsic nature of the item, such as pork, wine and other impure items (Ibn Rushd 2004, 3:52; Ibn Qudamah, 1968, 9:162). In this case, the Shari'ah does not recognize the items as assets having value that can be owned and treated as legal property by the holder. Hence, the holder should immediately rectify the wrongdoing by destroying the items (*itlaf*); they should neither be returned to the original owner nor channeled to charity. It is narrated by Anas that Abu Talhah asked the Prophet (peace be upon him) about orphans who had inherited wine. Allah's Messenger (peace be upon him) told him: "Pour it out." Abu Talhah asked if he could make vinegar of it. He replied, "No." (Abu Dawud, n.d, 3:326)."

Nevertheless, if the original owner is a non-Muslim, the recipient may return these items to him, as these are recognized as property in the hand of a non-Muslim, according to

the Maliki and Hanafi viewpoint. However, generating income or accumulating wealth through ownership or transacting items of this category of prohibition is completely prohibited from the Shariah viewpoint.

3.2 Non-Halal Income from Elements Prohibited Due to External Reasons

Within this category, there are two possible scenarios: the prohibited income is derived either with or without the original owner's consent. The treatment of income for each of these two scenarios shall be discussed in brief.

3.2.1 Non-Halal Income Acquired without the Owner's Consent

This type of prohibited income is realized without prior consent from the legal owner, such as income derived from robbery, theft, etc. In this case, the income must be purified by returning it to the owner. The obligation to return the income back to the original owner is justified by a *hadith* in which Rasulullah (peace be upon him) said: "Whoever oppresses his brother with regard to his honor or any other matter should seek his forgiveness today, before [repayment] is no longer in dinars or dirhams" (Bukhari, 1422H, 3:129).

3.2.2 Non-Halal Income Acquired with the Owner's Consent

As indicated in the previous section, the non-*halal* income acquired with the consent of the owner may be realized through either a nominate contract or a non-specific form of contract. The following discussion delineates the treatment of each scenario.

3.2.2.1 Consent via a Nominate Contract

The Hanafi's categorization of invalid contracts as *batil* or *fasid* is employed to deal with this type of income. Each type of invalid contract has a different treatment.

In a case of *batil* contract, Shariah does not consider the contract to be existent. Therefore, the transaction does not have any legal effects or implications. Hence, any income derived from this type of contract is unlawful and must be purified. A void sale contract, for example, does not cause any transfer of ownership. The seller should therefore refund the price while the buyer has to return the "purchased asset".

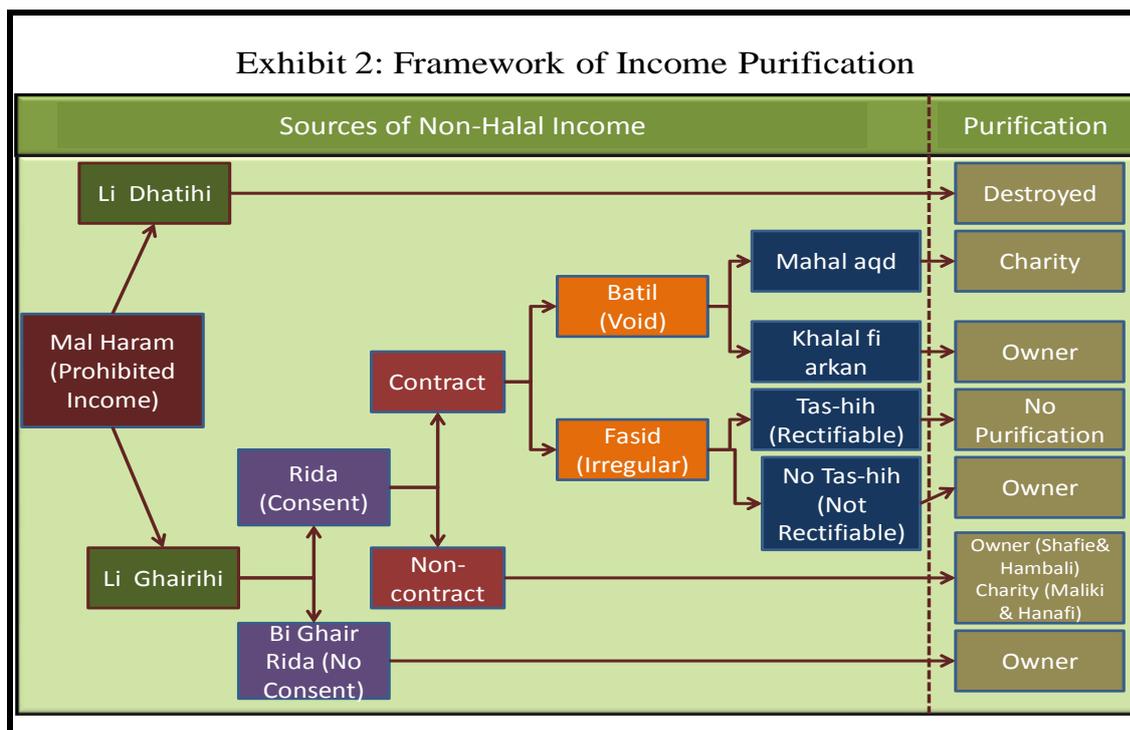
However, in case the transacted asset is an item clearly prohibited by the Shariah, such as pork, wine or other impure items, the counter-value of such asset must be channeled to public benefit (Ibn Taymiyyah, 2005, 29:291) and is not to be returned to the original owner. This is in consideration of the Shariah principle that it is unlawful to assist others to commit sins.

Unlike a *batil* contract, a *fasid* contract, as promulgated in the Hanafi and contemporary *fiqh* approach, does not necessarily require re-execution of the contract. In most cases, the rectification process can be done in one of two ways. The first way is to eliminate objectionable elements that render the contract *fasid*. If such elements are eliminated, the contract becomes valid. This is based on the Hanafi legal maxim: "*When the impediment disappears while the reason for the ruling is present, the [original] ruling returns*" (Wizarat al-Awqaf wa al-Shu'un al-Islamiyyah, 1404-1427AH, 12:60). However, if the objectionable elements persist, the contract becomes void, and all income generated and assets received must be returned to their original owner.

3.2.2.2 Consent without a Nominate Contract

There are instances in which illegal income is derived with the consent of the owner from a transaction without using a specific nominate contract; for example, the income generated from gambling (*maysir*), bribery (*rishwah*), gifts to officeholders, etc. (Ibn Taymiyyah, 2005, 28:593-594).

Jurists have different opinions with regard to the treatment of such income. Some scholars held that the income derived by illegal means with the consent of the owner must be returned to the original owner. This was the view of the Hanbali and the Shafii Schools in their authentic opinion, based on *qiyas* (analogy) with an invalid contract (Ibn Taymiyyah, 1995). Under this view, one who receives a non-*halal* gift (*rishwah*) must return it to the donor (al-Mawardi, 1990). Other scholars are of the view that the income should neither be returned to the original owner nor be possessed (al-Balkhi, 1310AH). It cannot be returned to the owner to avoid any form of assistance in committing sins. Likewise, the asset cannot be possessed by the recipient because a prohibited action cannot legally justify transfer of ownership (al-Baz, 2004, 351). Therefore, the income should be channeled to the Bayt al-Mal (the Public Treasury). Exhibit 2 is a diagram that summarizes the proposed framework for Islamic financial institutions to treat their non-*halal* income based on the various scenarios mentioned in the discussion above.



4. FRAMEWORK OF INCOME PURIFICATION FOR ISLAMIC FINANCIAL INSTITUTIONS

The study on the principle of income purification together with the concept of non-halal income has been a subject of wide discussion in the field of Islamic jurisprudence. As discussed in the previous sections, different sources of illegitimate wealth necessitate different treatments and purification processes. For the purpose of this study, we simplify the discussion by providing a summary of its application to Islamic financial institutions in Table

1. Examples of their application to various Islamic finance operational issues are also provided in the corresponding column to further illuminate our understanding of the concept and the various approaches to dealing with illegitimate income.

Table 1: Application of Income Purification Mechanism in Islamic Financial Institutions

Sources	Description	Treatment
<i>Haram li Dzatihi</i>	1. In offering a trade facility based on <i>Murabahah</i> to the Purchase Orderer (<i>murabahah lil amir bi shira'</i>), IFI was found to be importing mixture of goods (<i>halal</i> and <i>haram</i>). A portion of it is actually alcoholic beverages which was only discovered after an audit was performed at the port by the Shariah Auditor. Under the facility agreement, bank is supposed to enter into a sale contract with a customer who has undertaken to purchase once the goods possessed and owned by the IFI.	1.The IFI needs to exclude the haram portion of the imported goods which is the beverages. 2. The IFI can only proceeds with the sale of the remaining halal portion of the imported goods. 3. The beverages need to be disposed by the bank at its own cost.
<i>Haram li Ghairihi</i>		
A. Non- <i>halal</i> income derived from a void (<i>batil</i>) transaction due to defective in <i>mahal al-aqd</i>	1.The IFI was found to advance working capital financing to a wine manufacturing company or even to finance the purchase of bottles for the wine.	1.The IFI must channel all profits derived from the financing to charity. The principal amount can be retained. 2.Re-execution of contract is not allowed because subject matter is <i>haram</i> .
	2. In managing a portfolio, it is found that one of the securities which was previously classified by the Securities Commission as Shariah-compliant stock has changed its status into non-Shariah compliant.	1. The IFI must immediately dispose the non-Shariah compliant stock. 2. Any capital gain derived from the divestment process can be retained if the disposal took place on the announcement date made by the Securities Commission. 3. If the disposal took place long after the announcement made, then

		only principal amount can be retained while the capital gain need to be channelled to charity from the date of announcement until the date of actual divestment.
B. Non- <i>halal</i> income derived from Void (<i>batil</i>) transaction due to absence in one of the pillars in the contract	1. In extending a credit line or cash financing to a company which previously enter into Letter of Credit (LC) <i>murabahah</i> agreement with the IFI, it is found that the second leg sales contract signed with the company does not involve any asset, but mere signing a document.	1. Re-execution of contract can be done provided that asset is still available. 2. If the asset is no longer available (eg. has been consumed), or the transaction was long completed, the IFI must return all profits earlier recognized from the financing to client. If client could no longer be traced than it should be channelled to Baitul MĒl. The principal amount can be retained.
	2. In reviewing a statement of debit card transaction made by client, the IFI found that the Islamic debit card was used by client to pay for gambling activities in a casino. The structure of the Islamic debit card is based on <i>ujrah</i> , whereby the IFI earns fees out of utilization of the debit card	1. The contract of <i>wakalah</i> is void due to nature of subject matter is illegitimate activity. 2. The percentage of fees initially earned associated to the gambling transaction only, need to be channelled to charity.
	3. In <i>bay' bithaman ajil</i> (BBA) for cash line facility to corporation as practised by many Islamic banks in Malaysia, Asset Sales Agreement (ASA) is required to be executed first prior to executing Asset Purchase Agreement (APA). However, it was found that APA was executed prior to ASA, which effectively means APA was executed without an asset as underlying since client had not owned the asset prior to selling it back to bank. Therefore whatever amount of financing	1. The contract of APA is void. 2. The profit derived from the transaction is deemed to be <i>riba</i> and hence returned to client. 3. If client could not be traced, then the profit should be channelled to the Baitul Maal. 4. The principal portion of the financing could be retained by the bank.

	disbursed by bank is now deemed as a loan rather than originated from sale contract. Hence, any amount repaid by client in excess of principal is deemed as <i>riba</i> .	
C. Non- <i>halal</i> income derived from voidable (<i>fasid</i>) transaction due to the presence of alien condition but rectifiable.	1. In reviewing a contract of sales, it was found that a condition is imposed to the buyer for not having the right to get delivery of the asset purchased.	1. The clause in which the condition is stated need to be removed and notification is required to be sent to customer for the rectification made.
	2. In a <i>takaful</i> product, it was found that a company introduced a structure which invoked <i>riba</i> issue. For example, the contribution paid is treated like a normal premium in an exchange contract such that it is not regarded as <i>hibah</i> contributed to help each other. Rather premium paid for a policy granted. (no segregation of fund between participants' risk fund (<i>tabarru'</i>) and shareholder's fund). In addition, contracted monetary benefits other than the regular mishap and calamity were merely taken from participant's risk fund which consequently changes the whole structure from <i>tabarru'</i> concept to exchange (<i>muawadat contract</i>) that invokes <i>riba</i> since the exchange of money with money (amount contributed and amount of benefits) are not of the same value.	1. The contribution should be segregated into participant's fund and participant's risk fund. 2. Whatever surplus earned need to be returned to participants' fund.
	3. In reviewing a contract of commodity <i>murabahah</i> , it was found that only price is quoted without any disclosure made to its cost price. This contradicts to the nature of <i>murabahah</i> which is based on trust sale principle whereby the cost and mark-up profit must be clearly disclosed.	1. This can be rectified by changing the <i>murabahah</i> contract into <i>musawamah</i> contract which does not require the IFI as a seller to disclose the cost price.

D. Non- <i>halal</i> income derived from voidable (fasid) transaction due to the presence of alien condition but non-rectifiable.	1. In reviewing an inter-bank deposit-placement scheme based on <i>wakalah bil istithmar</i> contract, it was found that a clause required deficit bank (as agent or wakeel) to guarantee certain percentage of return to the Islamic bank as principal (surplus bank). The contract has matured and payment of both principal and profit already made and received by the IFI	1. The contract of <i>wakalah</i> is voidable due to the presence of unwarranted condition. 2. The contract is deemed as loan. 3. Principal amount can be retained. 4. Profit amount which was previously recognized need to be clawed back and returned to the counterparty.
	2. In reviewing London Metal of Exchange (LME) procedures and policies, it was found that physical delivery of commodities is not allowed. This actually affects the status of <i>murabahah</i> sales contract signed with the broker which has a specific clause that disallows taking delivery.	1. The contract of sales is voidable due to the presence of unwarranted condition. 2. The contract is deemed as loan. 3. Principal amount can be retained. 4. Profit amount which was previously recognized need to be clawed back and returned to the counterparty.
E. Non- <i>halal</i> income derived from a transaction albeit through consent of owner but without specific Shariah permissible nominate contract.	1. In an attempt to be selected as panel lawyers for an Islamic bank, it was found by Shariah auditor that some law firms practice giving gift in the form of entertainment packages to the regional managers of the Islamic Bank. This inevitably impairs bank's integrity in the selection process of panel lawyers.	1. Based on Shafie and Hambali's Schools: - The whole quantum of fees charged need to be returned to the client. 2. Based on Maliki and Hanafi's Schools: - The whole quantum of fees charged need to be channelled to charity to avoid invoking 'ianah 'alal ma'siah (assisting in doing evil).
F. Non- <i>halal</i> income derived from transaction which is done without the	1. In the event of audit, IFI was found to charge an amount of fees for early settlement which was higher than what was indicated in the sales agreement. This transaction is akin to theft, which is taking people's money without his	1. The IFI needs to return the amount of fees earlier earned to customer. 2. The IFI is also required to send letter to customer notifying the mistake and

consent of owner	consent or aware.	seeking apology.
	2. In the event of audit, IFI was found to impose compensation (<i>ta'widh</i>) charges to delinquent client that did not actually reflect the actual cost incurred by the institution. Moreover the charges is also higher than the maximum allowable <i>ta'widh</i> charge stipulated by Bank Negara Malaysia which is currently stands at 1% out of the outstanding balance without compounding.	1. The IFI needs to return the excess amount earlier charged to customer 2. The IFI is also required to send letter to customer notifying the mistake and seeking apology.

5. CONCLUSION

This paper has presented a framework of the income purification mechanism for Islamic financial institutions. It started by delineating the concept of illegitimate income from the Shariah viewpoint. This includes identifying the various possible sources of illegitimate income derived from invalid and defective transactions from an Islamic commercial law perspective. Incidences of Shariah noncompliance should be promptly, effectively and efficiently dealt with in the manner appropriate to each type of noncompliance. The Islamic principles of income purification elucidated in this paper shed light on how an IFI can immediately act to rectify and remedy the situation.

Overall the framework presented here may benefit the practitioners of Islamic financial institutions, and even Muslim entrepreneurs in general, who need specific guidance to improve their exercise of Shariah-compliant practice and governance. The discussion on the diverse approaches to income purification not only provides adequate guidance to IFIs, who must decide which courses to take and how much to commit to them, but more importantly, assists them in constructing a robust Shariah-risk-management framework to prevent noncompliant transactions from actually happening. It is crucial that potential Shariah noncompliance exposure be understood and efficiently managed to ensure that IFIs continue providing Islamic financial services to their clients in a safe and sound manner.

Such a framework can, therefore, be instrumental in enhancing stakeholders' trust and confidence in the operations of IFIs. It is now commonly acknowledged that the consequences of a weak Shariah governance and compliance process are not only financial but also legal and reputational and can impact the economy as a whole. Hence, sound Shariah governance and compliance practices have become essential for the efficient, viable and sustainable growth of Islamic financial institutions. The fact that Islamic finance has become an integral part of the financial system in many countries means that the soundness of its operations is essential to maintaining the overall robustness of those economies.

References

- Al-Bahuti, M (1993), *Sharh Muntaha Al-Iradat*, Beirut: Alam Al-Kutub, 1st edition
- Al-Bayhaqi (1425AH), *Ma'rifah al-Sunan Wa al-Athar*, Beirut: Dar Qutaybah
- Al-Baz, A (2004), *Ahkam al-Mal al-Haram wa Dhawabituh al-Intifa' wa at-Tasharruf bihi fi al-Fiqh al-Islami*, Urdun: Dar Nafais
- Al-Imrani, A (2006), *Al-'Uqud Al-Maaliyah Al-Murakkabah, Dirasah Fiqhiyyah Ta'shiliyyah wa Tathbiqiyyah*, Riyadh: Daar Kunuuz Isybiliya li Nashr wa al-Tauzi'
- Al-Jaziri, A. (2003), *Al-Fiqh al-Ala Madzahib al-Arba'ah*, Beirut: Dar Kutub Ilmiyah
- Al-Kasani (1986), *Bada'i al-Shana'i fi Tartib al-Sharai'*, Beirut: Dar al-Kutub al-'Ilmiyah
- Al-Mawardi (1990), *al-Ahkam al-Sultaniyyah*, Cairo: Dar al-Hadith
- Al-Minyawi (2010), *Al-Mu'tashar min Sharh Mukhtashar al-Ushul min 'Ilm al-Ushul*, Egypt: Al-Maktabah Shamilah
- Al-Namlah (1999), *Al-Muhadzab fi 'Ilmi Ushul al-Fiqh al-Muqaran*, Riyadh : Maktabah Rusyd
- Al-Qarafi (1994), *Al-Dhakhirah*, Beirut: Dar Al-Gharb Al-Islami, 1st edition
- Al-Qarafi (1994), *Al-Furuq: Anwar al-Buruq fi Anwar al-Furuq*, Beirut: 'Alamu al-Kitab
- Al-Ramli, S. (1994), *Ghayatu al-Bayan*, Beirut: Dar al-Ma'rifat
- Al-Rumi (2004), *Anis al-Fuqaha' fi Ta'rifat al-Alfadz al-Mutadawilah Baina al-Fuqaha'*, Beirut: Dar Kutub al-Ilmiyah
- Al-Sarakhsi, M. (1993), *Al-Mabsut*, Beirut: Dar Al-Ma'rifah
- Al-Shatibi, I (1997), *Al-Muwafaqat*, Egypt : Al-Maktabah Al-Tijariyyah Al-Kubra
- Al-Shafie, M (1990), *Al-Umm*, Beirut: Dar Al-Ma'rifah
- Al-Thabari (2000), *Jami' al-Bayan fi Ta'wil al-Qur'an*, Beirut: Mussasah Risalah
- Al-Tirmidzi (1975), *Sunan Al-Tirmidzi*, Egypt: Musthafa Al-Babi Al-Halabi
- Al-Zayla'i (1313AH), *Tabyin al-Haqaiq Sharh Kanz al-Daqaiq wa Hashiyah al-Shalbi*, Cairo: Al-Mathba'ah al-Kubra al-Amiriyah
- Arbouna, M.B. (2007), The combination of contracts in Shariah: A Possible mechanism for Product Development in Islamic Banking and Finance, *Thunderbird International Business Review*, Vol. 49 (3) 341-369, May-June 2007
- Ayyub, M. (2007), *Understanding Islamic Finance*, England: John Wiley & Sons
- Bukhari (1422AH), *Sahih al-Bukhari*, Dar Tawq al-Najah
- Hawawini, N (ed) (n.d), *Majallat Al-Ahkam Al-Adliyyah*, Karachi: Karkhana Tijarat Kutub,
- Ibn Manzur (1414AH), *Lisan Al-Arab*, Beirut: Dar Sadir, 3rd edition
- Ibn Nujaim (1999), *Al-Ashbah wa an-Nadzair*, Beirut: Dar Kutub 'Ilmiyah
- Ibn Abidan (1992), *Rad Al-Mukhtar Ala Al-Dur Al-Mukhtar*, Beirut: Dar Al-Fikr, 2nd edition
- Ibn Qudamah (1968), *Al-Mughni*, Cairo: Maktabat Al-Qahirah
- Ibn Rushd, M (1988), *Al-Bayan Wa Al-Tahsil*, Beirut: Dar Al-Gharb Al-Islami, 2nd edition
- Ibn Rushd, M. (2004), *Bidayat Al-Mujtahid Wa Nihayat Al-Muqtasid*, Cairo: Dar Al-Hadith
- Ibn Taymiyyah (1418AH), *Al-Siyasah al-Shar'iyyah*, KSA: Wizarah al-Shu'un al-Islamiyyah
- Ibn Taymiyyah (1987), *Al-Fatawa Al-Kubra*, Beirut: Dar Al-Kutub Al-Ilmiyyah, 1st edition,
- Ibnu Qudamah (2002), *Raudhat al-Nadzir wa Jannatu al-Munadzir*, Beirut: Muassasah al-Rayyan
- Ibnu Taimiyyah (2005), *Majmu' Fatawa*, Egypt; Dar al-Wafa'
- Mahmud, A. (2000), *Al-Binayah Sharh al-Hidayah*, Beirut: Dar Kutub Ilmiyah
- Rayner. SE (1991), *The Theory of Contract in Islamic Law*
- Warde, I (2000), *Islamic Finance in the Global Economy*, UK:Edinburgh University Press.
- Wizaratu al-Awqaf wa Al-Syu'un al-Islamiyah (1404-1427AH), *Al-Mausu'ah al-Fiqhiyyah al-Kuwaitiyah*, Kuwait: Dar al-Salasil

Yasin, M (1414AH) , Zakat al-Mal al-Muharram. Paper presented in *Nadwah Rabi'ah Liqadhaya al-Zakah al-Mu'ashirah*, 17-18 Syawal 1414H in Bahrain
Zuhaily, W. (2004) , *Al-Fiqh al-Islami wa Adillatuhu*, Damascus: Dar al-Fikr