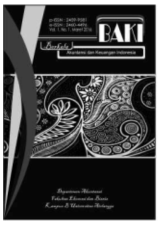

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THE IMPORTANCE OF COMPLIANCE WITH ACCOUNTING ETHICS STANDARDS ISSUED BY AAOIFI IN ACTIVATING THE GOVERNANCE OF ISLAMIC BANKS: AN ANALYTICAL STUDY

PENTINGNYA KEPATUHAN STANDAR ETIKA AKUNTANSI YANG DITERBITKAN OLEH AAOIFI DALAM MENGAKTIFKAN TATA KELOLA BANK SYARIAH: STUDI ANALITIK

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I N F O A R T I K E L

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A B S T R A C T

Purpose – The purpose of this study is to highlight the importance of adhering to the ethical standards issued by (AAOIFI) in activating the governance of Islamic banks and financial institutions.
Design/methodology/approach – The analytical and deductive method was used in the study of ethical standards and governance issued by (AAOIFI) through a review of previous literature as well as empirical and descriptive studies related to this subject to derive the importance of compliance with these standards in governance by attempting to link those ethical standards to various governance theories such as Agency Theory, Stakeholder Theory, or Corporate Social Responsibility (CSR) in Islamic finance, which diverge in their philosophy from other conventional institutions.
Findings – Ethical standards play important roles in activating Islamic governance, and they are two interconnected and interdependent components in Islamic financial institutions as they constitute one of the foundations of Islamic law from which they derive the reason for their existence and public trust in them.
Originality/value – This study provides a review of previous studies pertaining to empirical evidence related to ethics and governance in Islamic financial institutions, as well as what came from AAOIFI standards regarding the accounting ethics standards and governance in those organizations, in order to provide an opportunity for more thorough and empirical studies on this subject

Kata Kunci:

A B S T R A K

Bank Islam, Pemerintahan, Standar Etika Akuntansi.

Tujuan – Tujuan dari penelitian ini adalah untuk menyoroti pentingnya mematuhi standar etika yang dikeluarkan oleh (AAOIFI) dalam mengaktifkan tata kelola bank dan lembaga keuangan Islam.

Desain/metodologi/pendekatan – Metode analitik dan deduktif digunakan dalam studi standar etika dan tata kelola yang dikeluarkan oleh (AAOIFI) melalui tinjauan literatur sebelumnya serta studi empiris dan deskriptif terkait dengan subjek ini untuk mendapatkan pentingnya kepatuhan terhadap standar ini dalam tata kelola dengan mencoba menghubungkan standar etika tersebut dengan berbagai teori tata kelola seperti Teori Keagenan, Teori Pemangku Kepentingan, atau Tanggung Jawab Sosial Perusahaan (CSR) dalam keuangan Islam, yang berbeda filosofinya dari lembaga konvensional lainnya.

Temuan - Standar etika memainkan peran penting dalam mengaktifkan pemerintahan Islam, dan mereka adalah dua komponen yang saling berhubungan dan saling bergantung dalam lembaga keuangan Islam karena mereka merupakan salah satu dasar hukum Islam yang menjadi alasan keberadaan mereka dan kepercayaan publik terhadapnya.

Orisinalitas/Nilai – Studi ini memberikan review terhadap studi sebelumnya yang berkaitan dengan bukti empiris terkait etika dan tata kelola di lembaga keuangan Islam, serta apa yang berasal dari standar AAOIFI mengenai standar etika akuntansi dan tata kelola di organisasi tersebut, untuk memberikan gambaran kesempatan untuk studi yang lebih menyeluruh dan empiris tentang hal ini

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1. Introduction

Islamic banking's relevance and function have been drawing attention on a global scale over the past 20 years Although its financial strength is still in its infancy, compared to the conventional banking industry, the Islamic banking sector has surpassed US$1.5 trillion, and according to figures released by the Islamic Financial Services Board (2018), and it had expected to reach the amount of Islamic assets in the banking sector will reach US$3.2 trillion by the end of 2020 (Fida et al., 2020). The principles of social virtue, good governance, environmental preservation, and moral behavior on the part of individuals and organizations in accordance with Islamic philosophical and ontological criteria form the basis of the Islamic banking system (Asutay, 2014). Accordingly, Islamic banks are permanently obligated to maintain this distinctive personality through an absolute commitment to the provisions of Islamic *Sharia* and not conflict with its purposes. Therefore, the bodies supervising Islamic financial and banking institutions such as the Islamic Financial Services Board (IFSB) and the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) have developed a set of codes, guidelines, and procedures related to the ethics of practicing the accounting profession in these institutions with principles for the governance of Islamic banks, which play a pivotal role in increasing the trust and credibility of those dealing with these institutions, as they show the extent of Islamic banks' commitment to regulatory controls, accounting, and auditing standards, and legitimate fatwas issued by regulatory, accounting and *Sharia* bodies. In the same context, banks have many characteristics and features that affect corporate governance mechanisms such as conflict of interest between shareholders, and debt holders, banking regulation, the complexity of bank activities, and opacity are some of the issues that make banking governance different from the governance of other non-financial companies (John et al., 2016). However, businesses, entrepreneurs, and industrialists worldwide are attempting to use Islamic financing services. These professionals' perspective has changed because the Islamic code of conduct mandates fair and transparent financial transactions, not because there is a new product or sector of finance that may have the same characteristics as some other sectors (Marri et al., 2012).

On other hand, the scandals that shook the business world and led to the collapse of several major companies in the United States came in (2002) such as Enron, WorldCom, Tyco, Global Crossing, and (Arthur Anderson) which is considered one of the five largest accounting and auditing companies in the world at that time, as a result of its involvement in the collapse of (Enron) after practicing misleading reports and financial statements, where Enron and Arthur Andersen were plagued with a terrible reputation that led to their collapse which negatively affected the US financial markets, prompting the US government to introduce a law Sarbanes-Oxley Act (2002) to reduce low ethics in the accounting and auditing (Grama, 2014; Grasso et al., 2009). The Sarbanes-Oxley Act and its revisions are thought to have the potential to bring moral standards into the world of finance (Strohm, 2007). Researchers have hypothesized that lax corporate governance systems are to blame for the link between financial crises and business dysfunction (Conyon & He, 2016). Moreover, the accounting industry, like many others, created the Code of Ethics for Professional Accountants, which was ratified by the International Ethics Standards Board for Accountants and obligates member organizations of IFACs and corporations not to apply standards that are less stringent than those outlined in this document. This is because of how big and severe the issue is.

The Guiding Principles and Conduct of Business for Institutions Offering Islamic Financial Services and the Ethics Code for Islamic Financial Institutions (IFIs) Employees have both been published by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI). The IFSB explicitly states that the goal of its guiding principles is to strengthen the pertinent moral, social, and religious dimensions in business conduct in addition to providing a framework that fosters a climate of confidence and a supportive environment that upholds transparency and fair dealing comparable to the conventional frameworks. But it's not generally known how much the rules of the codes of ethics are followed and communicated to the staff of IFIs (Musa, 2015). Thus, it is clear that the issue of compliance with ethical standards in international financial institutions, in general, constitutes the cornerstone of their ability to continue and build confidence, at the same time, in Islamic financial institutions it is considered a more important issue and needs more research and investigation, as they claim that they are originally institutions based on the ethical aspect of their transactions accordance with Islamic philosophical and ontological criteria, however, although there are rare cases of financial and ethical scandals in these institutions, there are still chances for failure in the event of a contradiction between theory and practice. Accordingly, this study came to highlight the essential importance of permanent and absolute adherence to the code of conduct and ethics in Islamic financial institutions in order to reach the normative Islamic governance, because these institutions differ in their essence, objectives of existence, and the nature of their work from traditional financial institutions, and any slight moral tremor may harm them and weaken confidence in the activities of similar ones. significantly and affect its competitive position with its traditional counterparts, and in order to recall the need not to rely on the good moral reputation of these institutions after crises because the study believes that this feature if its importance is not realized may lead these institutions to deviations associated with human nature and its ominous consequences. And to take a lesson from the previous ethical scandals that hit the global financial markets. Besides, the previous studies as a whole did not make enough effort to link ethical standards and sound governance within a false assumption that governance and ethical standards are one thing. Therefore, the aim of this research is to examine the relationship between ethical standards and Islamic governance to answer the following problem: *What is the importance of the standards of ethics of the accounting profession issued by (AAOIFI) in activating the principles of governance of Islamic banks and institutions?*

2. Literature Review

2.1 Research on ethical professional behavior and governance

Numerous relevant researchers have conducted studies on the ethical professional conduct of accountants and governance. In an experimental study conducted by Finn et al. (1988) to explore the effectiveness of corporate procedures and codes of ethics in reducing ethical problems among senior-level members of the Association of International Certified Professional Accountants (CPAs), the study concluded that certified accountants see that there are opportunities in the accounting profession to engage in unethical behavior, accounting experts, in general, do not believe that unethical behavior leads to success. Besides, according to an investigation on the ethical standards for South African professional accountants (Higgs-Kleyn & Kapelianis, 1999), these accountants agree that the Code of Professional Conduct is essential and that it is crucial that it be properly developed and put into practice. Moreover, (Jackling et al., 2007) explore the opinions of IFAC members on moral dilemmas, the reasons for moral lapses, and the profession's contribution to ethical education. The findings demonstrated that, in reality, conflict of interest affects accountants the most, and the following primary ethical concerns are brought about by the research: personal conflict of interest, inability to maintain objectivity and independence, bad leadership, a lack of moral courage and judgment, ineffective professional evaluation, and a dysfunctional corporate culture. Another study on people's sensitivity to ethical dilemmas and the impact of intercultural differences among Western European nations was conducted by Arnold et al. (2007); the study discovered that a nation's culture has an impact on how ethical behavior is perceived and how codes of conduct are implemented. A sizable portion of national accounting organizations has chosen to maintain their nation-specific standards of conduct, due to cultural differences, rather to adopt the IFAC Code as their own (Clements et al., 2009). Also, another study conducted by Liu et al. (2016) on a sample of (516) businesses registered on the Taiwan Stock Exchange to investigate how family ownership of the company affects the quality of information disclosure and the connection between governance and family ownership, According to the study's findings, there is a correlation between family-owned firms and corporate governance through the pursuit of these Families for social and emotional prestige to gain legitimacy and enhance reputation with external stakeholders.

A similar study by Beltratti (2005), aimed to understand the relationship between governance and social responsibility, where the study concluded that governance and social responsibility are positively associated the company's market value and the potential for long-term resource growth for these businesses in the market mechanism.

Moreover, the study by Gowthorpe & Amat (2005) attempted to analyze two main types of manipulation from an ethical perspective, which are the total manipulation of the influence of pressure groups on companies to influence the financial lists in favor of their preparers, and the partial manipulation that expresses the processing of accounting numbers in favor of the entity in Spanish companies. Partial is an attempt by those who make financial statements to use their accounting ingenuity to create financial statements that serve their own interests rather than that of the users.

In light of previous studies, it can be said that corporate governance has a positive relationship with accounting practices in companies, and the accounting profession is greatly affected by ethical charters, in addition to that, bank governance can be mutually affected by the ethics of the accounting profession.

Furthermore, it is obvious that prior research concentrated primarily on the role of governance in restricting inventive accounting techniques, and that there is a dearth of research that examines the direct link between adherence to the ethical standards of the accounting profession and the duly and properly activation of corporate governance. Moreover, most of these studies on conventional financial institutions that differ in nature from Islamic financial institutions that carry the banner of moral commitment, and this gives great importance to further research into the impact of this commitment and the importance of keeping it in these institutions. Therefore, this study attempts to analyze this relationship to give a clear perception of the importance of ethical standards issued by (AAOIFI) in activating the governance of Islamic banks.

2.2 Ethics and the accounting profession

Ethics is a comprehensive set of principles of manners and values that represent the standard by which human actions and behaviors can be judged as right or wrong, good or bad, and thus constitute recognized rules of conduct that aim to guarantee that those they generate, whether individuals or institutions, live up to the appropriate level of standards do so on a solidly accepted foundation (Cooper & Leung, 1994) It is a component of human civilization that deals with values or the search for what is right and wrong. Since everything we do - or don't do - might at any time be the focus of an ethics investigation., It is challenging to escape ethics since humanity is bound to the morality of many laws because it is always looking for the fundamentals of those laws. Many individuals think that being moral requires being aware of any restrictions or rules that hinder us from following our personal interests and forces us to think about the wellbeing of society (Shanks et al., 2010). Generally, ethics may be defined as a set of moral standards that govern how individuals and organizations do their business (Todorović, 2018). Absent ethics, neither individuals nor corporations could operate. Because there are no conduct rules in a civil society without an ethical foundation for behavior, there would be anarchy and disorder (Stewart, 1996). Like other professionals, accountants work in a rapidly changing environment where company scandals, regulatory failures, and environmental catastrophes are common. Due to these factors, accountants must have a full understanding of the potential effects of professional and managerial choices as well as an understanding of the demands to uphold and observe ethical standards that may face by those engaged in the decision-making process (Cooper & Leung, 1994). The development of accounting up until the turn of the 20th century was the product of arduous labor on the part of accounting theorists and practitioners. Because of this, addressing the additional issues brought on by accounting necessitates adhering to moral and ethical standards (Aghdammazraeh & Karimzadeh, 2017). The techniques used to collect and analyze data, how those data are broken down analytically, how financial reports are produced, and how those reports are ultimately presented to users are all covered under the subject of accounting ethics. Each of the mentioned fields is equally rigorous, and in order to succeed in them, one must always expand their knowledge because laws are constantly changing in each of these fields (Todorović, 2018). An accountant ought to be capable of treating finances for clients in an entirely unbiased manner (Low et al., 2008). One of the defining traits of the accounting profession is the acknowledgment of the responsibility to act for the common good. Consequently, it is the duty of a professional accountant to satisfy both the requirements of clients or enterprises and those of the general public (Brennan, 2016; Mintz, 2014). When acting in the public interest, a professional accountant should uphold the ethical norms of conduct, impartiality, professional competence, due care, and transparency (West, 2017). In this sense, accounting ethics may be defined as a body of commonly recognized moral principles and ideals that serve as a set of rules for professional accountants as they work to ensure the comparability of financial reporting. Laws, that is, accounting-related professional and legal restrictions, provide minimum criteria for proper conduct. However, simply following the law is insufficient; further responsibility must be taken in this endeavor. Beyond the law, ethics includes all circumstances that fall outside the purview of legal and professional standards, as well as cases that are uncertain and so forth, thus the range of actions that are inconsistent with moral principles is constrained by ethical conduct norms (Todorović, 2018). According to the American Accounting Association's Committee on the Future Structure, Content, and Scope of Accounting Education, one of the objectives of accounting education is the acceptance of ethical principles (Bedford et al., 1986). Whereas conventional definitions of professions included mixes of autonomous individual practitioners with some sort of group affiliation, which frequently required specialized training, a license or test, and some type of independent discipline (Smelser et al., 2001). Becoming familiar with the moral tenets of utilitarianism, egoism, virtue and deontology will serve as the foundation for the accountant's capacity to act in the public's best interests (Aghdammazraeh & Karimzadeh, 2017). Objectivity, honesty, professional competence, secrecy, and professional behavior are the fundamental ethical standards of professional accountants (Todorović, 2018). They are the cornerstones or norms of independence. These guidelines have been in place for a long time, despite being updated sometimes because of shifting circumstances. This basically indicates that in order to conduct themselves in a professional manner while dealing with clients, auditors must not only be independent in both thought and appearance but also, they must abide by ethical standards (Anders, 2018). On the other side, Ethics are frequently limited to the capacity to distinguish between right and wrong, both in other professions and in accounting. Without being aware of the mainly designed professional rules, many things in the business world are acknowledged as either excellent or terrible. Accountants are under pressure in many situations to present unrealized income, capitalize expenses that must be recorded as period expenses, underestimate the outcome to minimize tax advantages, miss some postings, etc. Despite being dramatic requests, none of them pose an ethical dilemma. Here, everything is made apparent, such choices are wrong and immoral (Todorović, 2018).

2.3 The need for ethical standards in the accounting profession

Professional accountants are held to even higher standards by the public, and when these standards aren't met, it creates a performance gap that might be costly for the sector because it would breach the already-existing social contract (Armstrong, 1993). Users must have confidence in the quality of the specialized services provided by professionals; as a result, they have formed codes of ethics, sometimes known as codes of professional behavior. Beyond what is mandated by laws and regulations, these ethical norms urge its believers to keep a degree of self-discipline. (Wilson et al., 2016). As a result, it appears that preserving a high standard of ethics is crucial for the reputation and continued existence of the accounting profession (Nathan, 2015). Due to the subjectivity of accounting, unconscious prejudices rather than willful corruption are the causes of accounting fraud. This amply illustrates the difficulties the professional accountant faces in carrying out his or her duties while taking ethics into account (Bazerman et al., 2002). Accounting ethics aids in preventing problems caused by self-interest (Aghdammazraeh & Karimzadeh, 2017). Accountants frequently follow the ethical code's legal requirements rather than their moral ones. However, in professionalism, one must respect the ethical principles of always acting morally and not merely following the law (Cameron & O'Leary, 2015). Some accountants have evaluated and questioned the professionalism of practicing accountants as a result of events involving corporate scandals, starting with the fall of Enron and continuing through the global financial crisis. (Mcmanus & Subramaniam, 2014). Enron and Arthur Andersen, two titans in the utility and accountancy sectors, respectively, preyed on the general public, elected officials, and investors to boost their own fortune via dishonest and unlawful business practices. Investigations by the Securities and Exchange Commission (SEC) found Enron had engaged in unethical activity with relation to fraudulent financial reporting. In essence, Enron's collapse was caused by the detrimental impacts of its false accounting practices (Jennings, 2014). The stock market value of the company's shares was dramatically reduced due to improper accounting, which also had a detrimental indirect impact on the company's reputation. Following the imposition of harsh fines on the company, strict legislation controlling accounting standards was passed in an effort to strengthen the transparency and reliability of the firm's financial statements (Grasso et al., 2009). A firm can suffer from unethical behavior in addition to affecting a reputation and dependability since it increases the possibility of illegal action, which could result in decreased profit margins (Sims, 2003). Accounting ethics mandates that financial statements assist end users in making sound financial decisions. Accounting professionals are required to follow moral standards and guarantee that all end users receive correct information on time and in a transparent manner. Any deliberate attempts to produce false financial statements might significantly damage a company's reputation and lead to the following (Jaijairam, 2017): a. Due to the accountants' unethical choices, there is less supervision and oversight from supervisors, which gives auditors more leeway to act unethically and conceal evidence. By allowing for serious crimes like tax evasion and fraud, it allows for considerable data manipulations. b. The dishonest behavior of accounting experts will damage the company's reputation. The credibility and reputation of the organization among its stakeholders are impacted by this. Due to unethical actions, there is little trust in the company, which makes it difficult to conduct business. c. Financial statements have a less beneficial legal position, which has a considerable influence on the decision-making process, Contrarily, maintaining accurate financial records enhances the company's reputation with clients, creditors, and other users (Vestine et al., 2016). The main ethical criteria for professional accountants are specified in order to ensure adherence to the fundamental principles of professional ethics. These include due care, professional competence, integrity, professionalism as well as objectivity, and confidentiality. To ensure adherence to the underlying principles, professional accountants are required to identify risks of potential breaches of the aforesaid principles and to take safeguards, where appropriate. The formal guidelines do not yet fully address many significant ethical issues, and new issues continue to crop up (Carey & Doherty, 1966).

2.4 Good corporate governance

When profit maximization was the exclusive goal of a firm, Ethics-related or non-economic factors were not taken into account or valued. Nowadays, it is crucial to take into account both economic and non-economic factors when determining a corporation's performance and legitimacy as a socially responsible one (Aghdammazraeh & Karimzadeh, 2017). Corporate executives might conceal and take advantage of price-sensitive information by leveraging their insider knowledge for their own gain (Liu et al., 2016). Since management is focused on managing conflicts, the accounting sector is vulnerable to many agent conflicts that might reduce the efficacy of Corporate Governance (CG) schemes (Leventis et al., 2013). Hence that was the Sarbanes-Oxley Act (2022) which Public Corporations in the United States are required to follow, which stipulates that an audit committee shall only consist of independent directors and that independent directors must make up a majority of the board of directors. These guidelines should ensure that governance procedures may reduce agency problems and enhance company operations (Baran & Forst, 2015). Traits of good corporate governance highlighted by the United Nations Development Program (UNDP) include transparency, equity, the rule of law, accountability, participation, and strategic vision (UNDP, 2014). In the same context, the adoption of CG practices has been positively impacted by the growing exposure and openness of financial reporting operations, accounting knowledge, and competence in developing markets (Alexander et al., 2009).

2.5 Governance in Islamic financial institutions

Islamic governance is influenced by a variety of aspects, such as social responsibility, professional ethics and culture, as well as the various responsibilities placed on other responsible parties within the Islamic financial institution. These aspects also have an impact on the method used by the institution to develop, carry out, and monitor its policies, operations, work strategies, and control systems. The organization must recognize the specific Basis and Pillars of its business model for successful governance (AAOIFI, 2022):

Confidence boost: Trust is an essential element in the financial services industry, whether conventional or Islamic, as it is considered the cornerstone of the activity of Islamic financial institutions

Sound governance arrangements are necessary because the interests of individuals who effectively control the business may differ from those of the shareholders and others. This element is especially obvious in Islamic financial institutions because they collect the majority of their risk from non-shareholders. The proper practice of governance leads to enhancing public confidence, and this necessitates those in charge of governance affairs to pay sufficient attention to this, and building confidence in the Islamic financial institution is not possible without many measures, including the existence of transparent governance structures.

Shari'a compliance: Due to the social and religious considerations that Islamic financial firms must make, governance in these institutions considerably surpasses the parameters of good governance in conventional financial institutions. The capacity of Islamic financial institutions to handle their commercial activities while strictly enforcing Shari'a is really the main reason for their creation. Without it, trust in the Islamic financial institution is nonexistent.

Business model: The feature of contracts created in conformity with Islamic law distinguishes the business model of Islamic financial institutions. Additionally, it is unique from those other contracts due to the special nature of the risks involved, which the Islamic institution and its clients should be well aware of.

Stakeholders' interests: Those entrusted with governance affairs in the Islamic financial institution are responsible before all the main related parties in the Islamic financial institution, and this relationship between them includes in its components the publication of a sufficient amount of financial and non-financial information related to the institution's operations and its performance in a timely manner. The institution must also recognize the transparency needs of these parties and respond to them.

Social responsibility: Islamic financial institutions' governance structures strive to connect the interests of the necessary parties, the interests of those in charge of such structures, and the interests of society. Whereas, Sharia's guiding principles strike a balance between an individual's interests and those of the society to which he belongs. As the Islamic financial institution actually exists to aid in the deployment of funds and resources in financial formulas that are advantageous to both the investor and society as a whole. Thus, creating a platform that allows the practice of commercial activities in accordance with the bonds of Islamic law, in addition to achieving the interests of the society to which it belongs.

Business ethics and culture: Codes of ethics for working in Islamic financial institutions include a set of values derived from Sharia, and these values constitute the controls that guide the behavior of employees in an Islamic financial institution and the parties associated with it.

2.6 *Principles of corporate governance in Islamic financial institutions (AAOIFI, 2022).*

1) Effective structures for Sharia commitment: The Islamic financial institution should establish effective structures to ensure compliance with Islamic Sharia, reflecting absolute transparency with this commitment, and activating the roles assigned to each of the Board of Directors, the Sharia Supervisory Board, management, and auditors in terms of compliance with Sharia controls.

2) Fair treatment of equity holders: In addition to ensuring appropriate disclosure of the financial and banking practices used, the Islamic financial institution should give equity holders voting rights, ample opportunities for dialogue with it, and the ability to choose members of the Board of Directors and the Sharia Supervisory Board. This will allow shareholders to make informed decisions about their investments in the institution. Additionally, the requisite governance frameworks must be put in place to safeguard the interests of shareholders who bear the risks associated with the institution's operations. The board of directors should take responsibility for establishing a successful and rewarding relationship with the shareholders and be answerable to them as well. In a similar vein, holders of controlling stakes ought to defend the interests of the minority stakeholder.

3) Fair treatment of money providers and other significant stakeholders: An Islamic financial institution must ensure fair and unbiased treatment of fund providers and other significant related parties in relation to their investments and provide timely financial and non-financial information that enables sound and appropriate decision-making in transactions with the institution.

4) Appropriate and proper conditions for the board and management: The financial institution must set a set of standards that govern the appointment of members of the Board of Directors, the Sharia Supervisory Board, and management in a transparent and objective manner.

5) Effective oversight: The Board of Directors should adhere to an active role in leadership, direction, and oversight of the implementation of policies, establish a culture of Sharia compliance, set appropriate controls within the institution, achieve an appropriate balance of powers, and responsibilities, and fully assume its responsibilities towards the institution and related parties.

6) Audit and Governance Committee: The audit and governance committee of an Islamic financial institution should include terms of reference that cover financial reporting policies, internal controls, supervision, internal and external audit, and Sharia compliance.

7) Risk Management: The Board of Directors should actively engage in identifying the levels of risk that the institution may handle and make sure that the required policies and mechanisms are in place to identify, measure, and evaluate risk, provide reports on it, and restrict it.

Avoid conflicts of interest: The financial institution should put in place governance structures that ensure the avoidance of conflict between the interests of the members of the Board of Directors, the Sharia Supervisory Board, management, employees and external parties.

8) Monitor compensation policies: The Islamic financial institution should establish appropriate structures for governance in aspects related to the compensation policies of the Board of Directors, the Sharia Supervisory Board and the management, provided that these policies are characterized by independence and transparency.

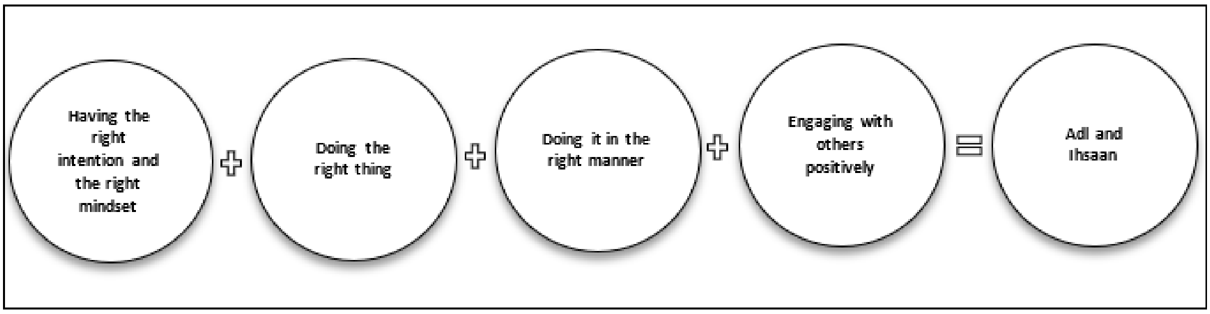
9) Public disclosure: The Islamic financial institution should have high standards for preparing the necessary reports to meet the information needs of owners, investment account holders, and other parties. The financial institution should also adopt high standards of transparency and discipline in the market in order to gain the confidence of shareholders and other parties related to its activity. Moreover, its financial reports must also be accurate, comprehensive, and timely.

10) Code of Conduct and Business Ethics: The institution should adopt policies, procedures, and practices that are compatible with Islamic Sharia to establish adherence to sound ethical rules and responsible behavior among members of the administration, members of the Sharia Supervisory Board, management, and employees.

11) Commitment to governance principles and standards: An Islamic financial institution should have an effective mechanism to ensure and monitor compliance with corporate governance standards

2.7 Islamic banking and ethics

Islamic banking is mainly based on sharia law, which derives from the Quran, Sunnah, and other secondary sources of Islamic law (Islahi & El-Gamal, 2006). Therefore, as compared to conventional banks, Islamic banks have several unique traits as Islamic banking, which follows Islamic sharia, places a greater emphasis on moral and ethical standards than the monetary value of its operations (Hamdi & Zarai, 2012). As Islam is not just a religion; it is a culture, a philosophy, and a way of life that its adherents live by (Hamid et al., 1993). They set out to enliven all they do with their values. Islamic society's distinctive accounting and commercial processes serve as an illustration of how accounting may be reconciled with moral principles (Maali et al., 2010). The institutional of Islamic finance aims to advance moral principles, such as the forbiddance of unethical behavior, the promotion of moderation, balance, and harmony in life, and aiding the disadvantaged (Rizk, 2014). Indeed, Islamic business ethics do not appear to be in urgent need of development in the same way that Western business ethics have, possibly because Muslims' personal ethics can be applied to all aspects of life and because acting ethically in business transactions does not necessitate any specialized knowledge or abilities where, in the context of Islamic philosophy, ethics predominates over economics rather than the other way around (Naqvi, 1981). According to the philosophy of Islam, Through the lenses of Adl (justice) and Ihsaan (excellence), where the former is to be understood as necessary behavior and the latter, is highly encouraged, it is possible to conceptualize ethics. Zulm (injustice) comes from a failure to achieve and sustain Adl. Because of the way the ideas of Adl and Ihsaan interact, it is usually impossible to retain Adl throughout time without also pursuing Ihsaan. This suggests that, rather than a minimalist, checklist-based approach, Islam strives for ongoing perfection in ethics. Thus, to ensure moral behavior at all times, one should put in the required time, effort, and financial resources (AAOIFI, 2022).



However, in return, there were many opinions that criticized the practices of Islamic institutions and indicated that there was a contradiction between them and the theory. According to Mansour et al. (2015), the present activities in the Islamic financial sector are incompatible with the de facto ethical standards that Islam upholds and do not contribute to building Islamic principles since Islamic financial institutions sometimes pursue a "form over content" strategy when Islamizing conventional banking, their current practices have come under fire for failing to advance these objectives. Likewise, Kuran (2010) claims that the sectoral approaches are the same makeup of Islamic banks' investment and that of their conventional counterparts, even going so far as to accuse such products of being “nothing but interest veiled in Islamic attire”. Besides, most researches on Islamic ethical behavior are normative in character, making the examination of the inconsistencies between Islamic business ethics and the activities of Islamic banks a relatively new area of research (Beekun & Badawi, 2005). Furthermore, the Shari'a's social and ethical goals and purposes have not been attained with the Islamic finance sector's explosive development (Ahmed, 2011). Therefore, according to Nienhaus (2011), Islamic banking is not the superior financial system it is touted to be by its proponents and is not superior in terms of ethics, efficiency, or stability to careful conventional banking. Moreover, although fostering a culture of morality and spirituality among Islamic banks' customers to strengthen the Islamic way of life, which, coupled with the creation of goods and services, they should represent Islamic principles in all aspects of conduct. However, Islamic banks have a tendency to overlook the ethical aspects of their business activities in favor of emphasizing the products and services supplied as being compliant with Islamic law (Lewis & Algaoud, 2001).

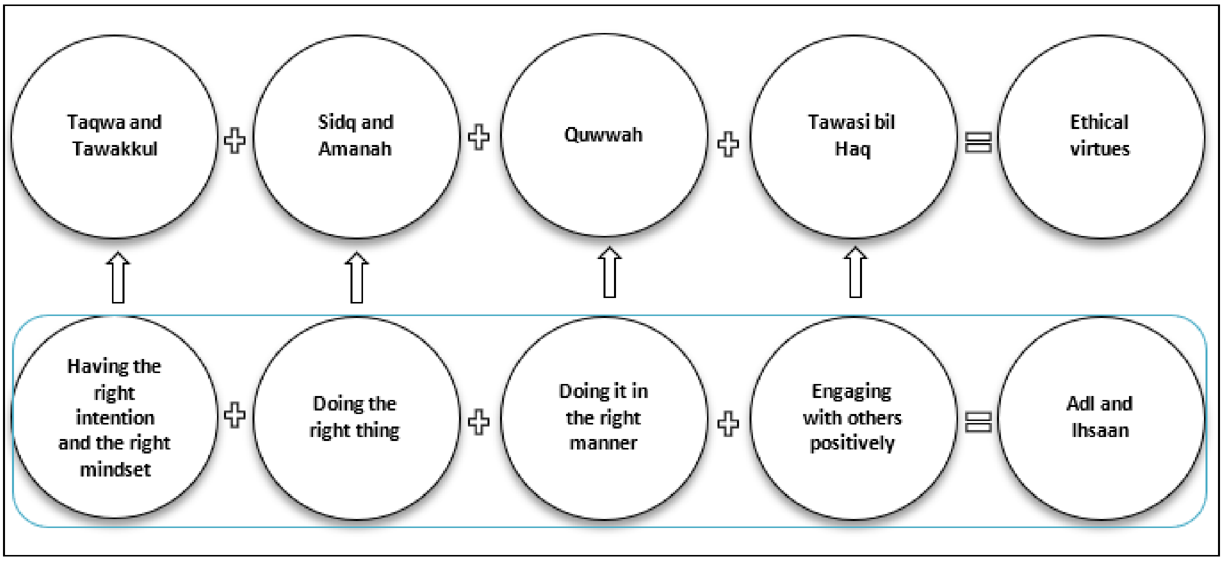
2.8 Islamic Ethical virtues

These virtues form a framework for the ethics of the accountant derived from the provisions of Islamic Sharia, so that the accountant adheres to it, motivated by his belief, in compliance with

Allah's commands, and in order to avoid His prohibitions. They are considered the moral basis on which ethics is based in Islamic Sharia.

An Islamic finance professional must maintain these ethical virtues in the context of his personal functions and responsibilities while preserving the four components of the Adl and Ihsaan equation (AAOIFI, 2022).

1) **Taqwa** (the conscience of Allah) is the awareness and recall of Allah, the Almighty, in such a way that it leads to His obedience and, in the event of disobedience, prompt repentance;
2)**Tawakkul** (dependence on Allah Almighty): Confidence Allah Almighty's will and decree and be content with the result after using all readily accessible and available resources to the best of one's ability while attempting to achieve a certain desired aim;
3) **Sidq** (integrity) - protect and advance truth while maintaining consistency and perseverance in, as well as harmony between beliefs, intentions, words, and deeds;
4) **Amanah** (trustworthiness) - uphold and carry out the obligations, privileges, and powers that come with one's position, rank, and status, including preserving the resources placed in one's charge as a matter of trust;
5) **Quwwah** (strengths) - Consistently possess the mental, physical, and intellectual strength, capacity, and competence at the level needed to carry out a duty or complete a task; and
6) **Tawasi bil Haq** (strongly encouraging truth): Encourage other people to do good and stay away from the evil in a knowing, wise, and sensible way by using reason, persuasion, authority, etc.



3. Methodology

The analytical and deductive approach was used after reviewing the charters, ethical standards, and governance of IFIs issued by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), in addition to a review of the previous literature and empirical and descriptive studies in the papers and books that dealt with business ethics charters, whether in conventional or Islamic institutions, then using the deductive approach, during the discussion of the results, to highlight the importance of what these standards can bring about in activating the governance of banks and financial institutions in their various theories whether Agency Theory, Stakeholder Theory or Corporate Social Responsibility (CSR) in Islamic financial institutions, which differ in their philosophy from other conventional institutions

4. Discussion and Results

Through examining and analyzing the results of previous studies and what was included in the code of conduct and Business Ethics and governance standards in Islamic financial institutions, it can be said that the principles of ethics of the accounting profession are of great importance in activating the governance of banks and financial institutions as they are an essential part of their principles derived from Sharia and can increase confidence those dealing with the Islamic bank, and limit creative accounting practices according to the findings of the Gowthorpe & Amat (2005) study; also enhance the value of the shares of the Islamic bank in the financial market as in the Beltratti (2005) study, and achieve a competitive advantage for it by increasing trust and transparency, as the adoption of ethical accounting standards issued by AAOIFI can help to ensure that management is acting in a manner that is consistent with Islamic principles, thus providing assurance to shareholders that their interests are being protected. This is consistent with the agency theory of good governance which suggests that the relationship between the principal (shareholders) and the agent (management) is based on trust and that the principal must have confidence in the agent's ability to act in their best interest. Many scholars hold the view that agency theory is the main contemporary interpretation and overall explanation of corporate governance, and it has emerged as the dominant factor in the theoretical knowledge of corporate governance (Bosse & Phillips, 2016). According to agency theory, the board of directors' primary responsibility is to supervise managers and make sure that their interests don't materially diverge from those of stockholders (Clarke, 2014). However, the main shortcoming of agency theory is the lack of diversity in investment organizations and interests in the literature, as well as the misunderstanding of managers' motivations. (Clarke, 2014). For instance, leadership may engage in value-decreasing activities when management interest is in a declining condition and agents might start withholding information from leaders and acting against the interests of the principals; where, the cases of Enron and WorldCom represent two prime instances of management personnel who want to advance their own interests. (Mamun et al., 2013). This makes the administration's commitment to comprehensive ethical standards imperative to avoid falling into the trap of immoral bias and the full activation of the agency theory in order to preserve the compatibility of the interests of managers and shareholders, and this is in fact one of the foundations, pillars and principles of good governance in Islamic financial institutions issued by (AAOIFI) in the fair treatment of equity holders. In addition to that, Islamic banks and institutions can prove, by adopting these standards, their commitment to all stakeholders including customers, employees, suppliers, and other members of society. This can help to build trust and confidence in the bank's operations and promote good governance practices, and this also corresponds to the stakeholder theory of good governance. Stakeholder theory points out that the way an organization makes decisions is comprehensive of both internal and external associations that could lead to the company's accomplishment of its corporate objectives (Hayibor & Collins, 2016). According to Sama-Lang & Zesung (2016) the stakeholder theory of corporate governance and ethical positivism were combined to investigate the function of ethics in the Organization for Harmonization of Business Laws, where the definition of the term "corporate social responsibility" has been expanded by the authors in order to encompass a wide range of stakeholders. In contrast, according to Schneider & Scherer (2015), corporate governance in multinational companies is not adequately representative of all parties concerned. As a result, multinational corporations have expanded their study to include the theory of stakeholders in their corporate governance practices. This is, in fact, what (AAOIFI) has adopted in its ethical standards and special standards for good governance in one of its basic principles of fair treatment of money providers and other significant stakeholders where an Islamic financial institution must ensure fair and unbiased treatment of fund providers and other significant related parties in relation to their investments and provide timely financial and non-financial information that enables sound and appropriate decision-making in transactions with the institution. Stakeholder theory of corporate governance served as the theoretical basis Mason & Simmons (2014) used to resolve the concerns of both scholars and practitioners regarding CSR to balance shareholder and stakeholder concerns. CSR needs to employ a formulaic approach, and CG procedures should support CSR. Likewise, Islamic banks can demonstrate their commitment to CSR principles and show that they are taking steps to ensure responsible corporate behavior. This can help to improve public perception of the bank, thus promoting good governance practices whereas due to the concepts of profit and revenue maximization being eliminated, the understanding of corporate governance has experienced significant changes. A shift in global interest away from profit and revenue maximization for shareholders' goals and toward the fulfillment of corporate societal responsibilities has coincided (Du Plessis et al., 2018). In the context of working toward shared objectives, there is a connection between CSR and corporate governance. (Arosa et al., 2013). Whatever, CSR has become increasingly common as a result of rising customer interest in businesses that practice it and governmental efforts to encourage companies to adopt more ethical practices. However, Sharia's guiding principles (which are the basis of AAOIFI's code of conduct and Business Ethics and governance standards) strike a balance between an individual's interests and those of the society to which he belongs. As, the Islamic financial institution actually exists to aid in the deployment of funds and resources in financial formulas that are advantageous to both the investor and society as a whole, where these standards affect the behavior of those in charge of accounting work in Islamic banks and push towards reminding compliance with Muslim morals that are called for by Sharia, furthermore, their commitment to the code of ethics increases the strength of the bank in facing all the challenges related to the application of Islamic bank governance and makes it accessible. Therefore, these codes can be considered as a practical application of the saying of Allah SWT in the Qur'an: "yet go on reminding [all who would listen]: for, verily, such a reminder will profit the believers" (Adh-Dhariyat 51:55)

5. Conclusions, Limitations, and Future Studies

Through the preceding, it can be said that business ethics are of great importance with regard to the governance of Islamic financial institutions, and they constitute two interrelated and interdependent components, as ethics is one of the main foundations of Islamic governance, and due to the social and religious considerations that Islamic financial firms must make, governance in these institutions considerably surpasses the parameters of good governance in conventional financial institutions as the capacity of Islamic financial institutions to handle their commercial activities while strictly enforcing Shari'a is really the main reason for their creation. Without it, trust in the Islamic financial institution is nonexistent, and the fact that ethics is one of the pillars of Islamic Shari'a and its most prominent purposes, therefore, can never be ignored. However, despite the stability and resilience demonstrated by Islamic banks during financial crises, there are permanent chances for failure when there is a defect and contradiction between practice and theory, as happened with Bank Islam Malaysia, which in 2005 incurred losses amounting to RM 457 million (Parker, 2005) as a result of its non-compliance with the standards that it must comply with in its commercial and financing operations. This highlights the importance and role of the Code of Conduct and Business Ethics issued by (AAOIFI), which is derived from the spirit of Islamic law, in the practices of accountants and the governance of Islamic financial institutions alike and increasing confidence in banks and financial institutions and limiting creative accounting practices.

The study was limited to the analytical and deductive side by reviewing the previous literature, the standards of Islamic governance, and the code of conduct issued by (AAOIFI). Accordingly, the study recommends more experimental research on this topic in order to try to find effective and practical tools that facilitate the application of Islamic business ethics charters in all Islamic financial institutions and not be satisfied with the normative aspect in research related to the subject. It also recommends allocating qualifying courses for all working accountants in order to familiarize them with the importance of business ethics in achieving the governance required of Islamic financial institutions.

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