

## **The Accounting Profession between Religious and Professional Ethical Codes**

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### **Abstract**

*Many agree on the importance of adopting ethics to improve the lives of communities and institutions. Given the increase in fraud cases globally despite the introduction of professional codes of conduct, this study explored whether there is room for an alternative approach to solving the problem of fraud. To this end, the study compares the ethical codes derived from religion and established global codes to determine which is most effective in addressing the problem of fraud in the auditing profession. Using a qualitative approach that examined published literature, the authors compared the International Accounting Standards (IAS) and US auditing standards with Islamic ethics and concluded that the former two do not mitigate fraud in auditing. Furthermore, the study found that adopting Islamic ethics could be a good governance mechanism to eliminate fraud..*

**Keywords:** *Accounting Profession, Ethical Principles (Code of Ethics), Audit Failure, Fraud.*

### **1. Introduction**

The monotheistic religions introduced and bound mankind to many moral values. The legislations of different countries also contain ethical principles and rules. Many countries are racing to formulate and develop ethical codes especially with regard to professions such as medicine, law, accounting and others. Professional academies have prepared ethical codes (code of conduct), moral principles and values (Arens, 2014: 125) incumbent upon professionals when implementing their commercial and non-commercial transactions with their customers to ensure high performance and society's acceptance. In this respect Materialism has spread globally. Arabs and Muslims have abandoned the principles of ethics derived from the *Shariah* law in favour of American and international ethical principles, particularly professional accounting standards.

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Professional accounting associations in the Arab world adopted the US code of professional conduct first and foremost followed by the adoption of international ethical rules. Does this favour the accounting profession in Arab and Muslim countries? If the US code of professional conduct was sufficient for global practice, why would the international community propose different ethical standards? Moreover, do Arabs and Muslims feel there is a need for Islamic ethics for accounting profession?

These questions frame the importance of the research by demonstrating the ability of the American standards of professional conduct to meet the objectives of accounting as a profession. The research then seeks to determine the ability of the international rules of professional conduct toward achieving the objectives of the accounting profession, followed by the ability of Islam ethics to that end. The study then compares the similarities between the Islamic code of conduct with the American and international standards. The research seeks to explore the extent the US, international, and Islamic codes of professional conduct can achieve the objectives of the accounting profession. It then endeavours to identify the similarities and differences between the US and international codes with the Islamic code as derived from the Qur'an and Sunnah.

## **2. Research Problem**

Professional accountants, especially in the United States are facing a rise in the number of issues raised against them. It has become a legal problem facing the profession because of the clear audit failures. In 2004, the value of compensation claims from auditors in the lawsuits filed against them equalled \$40 billion USD (Thunabat, 2015: 95). Many auditors have left the profession because of the inability to tolerate the threat of litigation, or the inability to pay the insurance premiums for professional security. This underscored the lack of respect and confidence in the profession leading to the question of how to solve the problem of the profession and regain trust in it again?

## **3. Literature Review**

Researchers, auditors, and professional auditing associations the world over have focused on formulating professional codes of conduct. Perhaps the priority has focused on preventing, detecting, and resolving cases of fraud. Fraud has emerged as the greatest danger to the profession that result from and/or in misstatements in financial statements (Arens et al. 2014). Previous studies have dealt with key themes such as cases of fraud in different countries and proposed solutions to the problem of ethics associated with accounting. In Britain, Carroll (1998) studied the corruption and conspiracy carried out by the Carroll Foundation Charitable Trust and the Indian company Satyam Computer Services Limited from 2003 to 2008 which provided telecommunications service to nearly one-third of the Fortune 500 companies. The company fraudulently announced that it had provided services to 6,000 customers who were billed for a billion dollars. The administration provided bank statements and receipts showing the value of these bills.

Faber (2005) examined the relationship between the quality of corporate governance and reliability of financial reporting in a sample of companies that have suffered from fraud and misrepresentation in their financial reports. Other studies proved that corporate governance mechanisms did not work in the fight against the rising cases of fraud in different countries as follows.

Gauthier & Mollenkam (2008) explained the case of fraud suffered by Societe Generale bank in France carried out by a single employee. The employee managed to defraud the bank of \$7.4 billion which is the sum of the bank's total profits in 150 years. This is supported by the survey conducted by the BBC and the Association of Certified Fraud Examiners (ACFE) which concluded that the world has become more corrupt than it was three years before (BBC Arabic.com, 2010). The same fraud problems are facing the profession in small group of people and professional accountants as in Gaza (Dergham, 2009).

Verschor (2011; 2014) confirmed the existence of moral corruption among professional auditors. Ernst & Young, one of the four largest auditing firms in the world audited the Lehman Brothers accounts between 2007-2014. Their records showed that the bank was engaged in short-term borrowing through the sale of assets, which led to the collapse of the bank. It was the task of the auditor during this period to help the bank hide those operations, and publish misleading and fraudulent financial reports. Verschor (2014) proved once again that the purpose of audit firms is to achieve more revenue, not to provide auditing services characterised by quality. They provide these companies consulting and administrative services to maximise their profits.

Price Waterhouse and Coopers (PWC) engaged in similar services from which one-third of its revenues is derived. Such services constitute a circumvention of the Sarbanes-Oxley Act. Similarly, the law failed to prevent the deteriorating situation that led to the 2008 global financial crisis. Also, pressure was put on Congress to ease the stipulations imposed on the companies to protect investors. The Sarbanes-Oxley Act sought to introduce a code of conduct for senior officers in financial management (Verschor & Curtis, 2012). These pressures have managed to establish the Jumpstart Our Law Business Start-ups (JOBS) of Congress and signed by President Obama on 5/4/2012 and include a provision to abolish article 404 in the Sarbanes-Oxley Act against companies that meet the definition of “emerging growth company”. Verschor (2012) proved this in another article that the new law negated the Sarbanes-Oxley Act. The research quotes the former chief prosecutor for the city of New York, Eliot Spitzer, as saying: “the new law should not be called (JOBS) but attract new forms of fraud in Wall Street because companies will apply laws that suit them as the expense of the shareholders’ interest. It invites to the return of old unethical behaviour as there no longer legal prohibitions due to the annulment of the Sarbanes-Oxley Act (SOX)”.

Moreover, the article contains an assessment of the results of the application of SOX. It pointed out that the performance of auditors has not improved over the past ten years since the promulgation of the law. The first annual address by the chairman of Public Companies Accounting Oversight Board (PCAOB), which is the first formal assessment of the quality of audit firms’ performance stated: “In 2011 the Board examined 2800 audit engagements and discovered and analysed hundreds of cases that represent audit failure, which is a dangerous deviation from proper audit or proper audit functioning. The case continued on the same pace during 2012, and it turned out that the same situation prevails globally”. An analysis of the performance of audit firms conducted by PCAOB inspectors shows that the proportion of audit failure at Ernst & Young reached 20% in 2010; more than double the cases that occurred in 2009. The ratio for Klynveld Peat Marwick Goerdeler (KPMG) was 22%, 39% for PWC, and 45% for Deloitte.

Among the cases of fraud and economic crimes as detailed by Verschor (2014) is the Diamond Food Company which the US Securities and Exchange Commission fined five million dollars for falsifying its financial statements for 2010 and 2011. The fine led to a drop in the price of the company’s shares, yet the penalty has appeared ineffective in preventing such acts. The value of the fines imposed in 2013 on all companies reached \$3.4 billion USD to the US due to irregularities. Verschor (2014) surveyed daily US newspapers for one month from which he found more than 200 cases of fraud which underscores the extent of violations taking place in the profession. In another study of the Director of the Certified Managerial Accountant (CMA) (Verschor, 2014), it was found that the number of economic crimes is on the rise. A report published by PWC (2014) showed that economic crimes reached 37% globally with the highest levels reported in Africa with 50%, North America with 41%, and the lowest is the Middle East with 21%. It would have been good if the author had analysed the reasons for the different levels of crime in various societies.

American researchers tried to solve the problem by proposing professional code of conduct. They regarded basic training as a requisite for ethical practice in US companies and encouraged high-quality training programmes encouraging ethics in their work environment. The result of a questionnaire distributed to 763 trainers from various administrative levels in United States and other countries (Verschor, 2014) led the researcher to conclude: “the research suggests that the code of conduct is not applied effectively in many companies.” Furthermore, Jason (2014) suggests creating an atmosphere that encourages whistle blowing in companies to help address fraud which devastates confidence in the profession, leads to a loss of shareholder and investor confidence. To this end, the Dodd-Frank Wall Street Reform and Consumer Protection were enacted which obliged companies to encourage intelligencer and training programmes for reporting misstatements. The massive size of misstatements and misrepresentations are distorting the financial statements and leading to liquidation which was committed by executives, in which it will be invisible to use intelligencer.

From a different perspective, Muslims in Pakistan tried to contribute to the debate about professional ethics for which they proposed Islamic audit as checks to confirm the effectiveness of Islamic financial institutions. This proposed framework also assesses administrative operations for investors and reports the extent of its commitment to Islamic law Sharia. This is their alternative to professional auditing ethics. Such a proposal requires the auditor to be aware of Islamic law and examine documents in reference to the Qur’an and Sunnah and supporting documents (Helal Uddin et al., 2013).

It seems that the Pakistani authors have confused between Auditor and *muhtasib* (*hisbah* enjoining good and forbidding evil) professions. The Prophet Muhammad (PBUH) practised *hisbah* throughout his life and was followed by the Caliphs after him (Ibn Taymiyyah: p. 8). *Al-muhtasib* oversees the markets and prices, weights and measures, distributions, currencies and Zakat collection, and monitors the promotion of virtue and prevention of vice ..., etc. An auditor differs. Moreover, the accounting and auditing standards which the authors consider Islamic are just Arabic translations of international standards. Accounting experts and auditing organisations for Islamic financial institutions agreed to these standards as a starting point while others have verified the legitimacy of these standards and that they are not incompatible with the Shariah (Accounting for Islamic Financial Institutions, 1997 p: 17). These standards are international accounting and auditing standards that have been translated into Arabic.

In South Asia, Rochania and Norakman(2011)found that fraud in accounting results from failures in accounting education and that it is the main reason for corruption and fraud. The reason for this is a lack of moral values in the education system. For an educational system to produce moral accountants, it must instil knowledge of moral values emphasise the Islamic values and beliefs which are the oneness of God and responsibility before God and to serve the public interest. Such is the foundation of morality. Islam differs from others in its morals and the way it instils and teaches these morals. For Muslims, there should be no difference between an accountant and others. For this reason, this study agrees with previous studies regarding the corruption of the accounting profession extending from a failed accounting education that has not produced moral accountants. This study calls for instilling the ethics of Islam in all Muslims, accountants and non-accountants, to produce ethical citizens. The first generation of Muslims were graduates of the masjid who gained positions of leadership of nations and lead armies. They were scholars of law, medicine, astronomy, and accounting. This is what distinguishes this study from its predecessors.

#### **4. Research Method**

The qualitative method is applied when the phenomenon is ambiguous and comprises numerous factors (Yin, 1981). It is a semantic method to derive solutions for the research problem. The problem of ethical issues associated with auditing is certainly ambiguous requiring extensive exploration through the use of semantics to identify the key concepts which serve to clarify the phenomenon. From here, the study analysed books, periodicals and research related to the study. The researchers examined the issue of audit failure by examining compliance with professional requirements and auditing standards (Arens et al.: 99, 2014). In examining fraud, the researchers focused on the misstatement of financial statements and misuse of assets (Arens et al.: 334, 2014). As for the principles of professional conduct, the researcher examined the moral principles or values accepted by professionals to regulate their professional lives and relationships with others (Arens et al.: 125, 2014).

#### **5. Theoretical Study**

That the risks of failure and decline due to fraud have motivated the drive to reform the auditing profession and established new auditing standards in 1933, considering the auditor is responsible for stock take. The Enron scandal led to a complete change of US auditing standards (Arthur Anderson, 2002). The Sarbanes-Oxley Act was then introduced in 2002 leading to many developments in the profession including the establishment of an oversight on the accounts of PCAOB; holding management responsible for the establishment of an internal control system that is evaluated annually etc. Numerous studies have found that there has been poor implementation of the SOX. The first and second studies conducted by the Committee of Sponsoring Organizations of the Tread way Commission (www.COSO.org) to analyse the fraud and manipulation in the financial statements of US public shareholding companies between 1987 to 1997 and 1998 to 2007. The results are presented in the table below:

**Table 1: Misstatements in the financial statements of US public shareholding companies\***

Statement	1987 -1997	1998 – 2007
Number of cases of fraud	294	347
The average value of fraud in the case	\$4.1 million	\$12.1 million
Misstatement of asset values and revenues in the case	\$16 million>	\$100 million
The most prominent methods of fraud	Misstatement of revenue in 50% of cases	Misstatement of revenue in 60% of cases
Perpetrators of fraud	Executive Director and Chief Financial Officer in 83% of cases	CEO and chief financial officer in 89% of cases

\*Arens,p.355; <http://COSO.Org>.

The second part of COSO's study came after the SOX Act and examined the impact of the issuance of corporate governance law and the formation of audit committees and the establishment of risk management and the adoption of the code of conduct and the practice of intelligencer. ACFE was monitoring 1843 fraud case in more than 100 countries. The results proved that fraud is still a major problem for companies around the world, and costs companies 5%, on average of their annual revenues to reach \$3.7 trillion USD worldwide. The professional ethical standards (the US and international) have proven ineffective in preventing and identifying fraud.

Nine percent (9%) of financial statements were fraudulent with a misstatement of at least one million dollars per case. The links between fraud and job levels were established with most cases of fraud committed by employees in accounting and finance, production, management, sales, customer service, and procurement (Verschor, 2014: p.9). Verschor (2014) explained, "That the external audit reveals only 3% of fraud incidents and 7% of cases are discovered by chance, internal audits revealed 14% of cases, and 54% of cases revealed by confidential intelligencer". This indicates that the external audit is the least effective means to detect fraud, and takes up to 18 months; that is after the annual audits are over. The US and international professional academies have focused on the rules of professional conduct (for workers in the auditing profession) with the hopes to regulate the behaviour of auditors and to remove fraudulent practices in the profession.

**Table 2: A comparison between the US and international principles of professional conduct**

Principles and rules of professional conduct in the American Standard Institute <a href="http://www.aicpa.org">www.aicpa.org</a>	Principles and rules of international professional conduct <a href="http://www.ifac.org">www.ifac.org</a>
Responsibilities	Professional Behaviour
Integrity	Integrity
Objectivity and independence	Objectivity
Due Care	Professional competence & due care.
Scope and nature of the services	There is no standard similar
N/A	Confidentiality

These standards have failed to put an end to fraudulent behaviour among auditors despite the implementation of a project to restructure and organise codes of professional conduct (AICPA, 2011.). This means that these two sets of ethical rules have failed to achieve the objectives of the accounting profession service. This opens the door to new suggestions for solutions to profession problems particularly fraud leading to the suggestion to apply religious (Islamic) ethical rules among accountants, particularly Muslims.

### **6. Principles and Rules of Ethical Conduct for the Muslim**

The Messenger of Allah (PBUH) summarised his mission by saying, "I was sent to perfect good character (morals)" (Muwatta:1349Hig). This led Ghazali to opine, "Strong faith generates a strong character, and the collapse of morality is due to the weakness or loss of faith" (Al-Ghazali,1999: 11-13). Al-Qaradawi says,"A believer's worship is a form of ethics, and his morality is a form of worship"(1981,p. 124). AbulA'la Maududisays, "morality is empty and baseless if one renounces faith in God and the Last day" (1968,p. 170).

Allah the Almighty described His messenger, “Ye have indeed in the Messenger of Allah a beautiful pattern (of conduct) for any one whose hope is in Allah and the Final Day, and who engages much in the Praise of Allah” (Quran 33: 21). This verse means that the ultimate aspiration of a believer is the pleasure of God Almighty because one’s faith in God and the Day of Judgement leads to ethical behaviour and guides to ethical conduct. From here, it is possible to categorise the principles and rules of ethical behaviour among Muslims into three levels:

Level I: Islam begins with the testimony that there is no god but Allah and that Muhammad is the Messenger of God, which distinguishes between infidelity and faith. The second article of faith is prayer. Allah Sobhanah says to The Prophet: “Recite (O Muhammad) what has been revealed to you of the Book (the Qur`an), and perform As-Salat (Iqamat-as-Salat). Verily, As-Salat (the prayer) prevents from Al-Fahsha (great sins of every kind, unlawful sexual intercourse) and Al-Munkar (i.e. disbelief, polytheism, and every kind of evil wicked deed) and the remembering (praising) of (you by) Allah (in front of the angles) is greater indeed (than your remembering) (praising) of Allah in prayer. And Allah knows what you do. (Qur`an:29:40). Third is Zakat. Allah says, “(They are) those who, if We establish them in the land, establish regular prayer and give regular charity, enjoy the right and forbid wrong: with Allah rests the end (and decision) of (all) affairs” (Quran: 22: 41). The fourth is fasting. The Prophet (PBUH), said, “Whoever does not give up false speech and evil actions, Allah is not in need of his leaving his food and drink (i.e. Allah will not accept his fasting)” (Sahih al-Bukhari, Book30, Hadith1903). Finally, Hajj. The Prophet said, “Whoever performed Hajj and did not utter a bad word or commit an immoral act will be like the day his mother born him”. (Al-Bukhari, Book25, Hadith 9).

These are pillars of Islam that contain spiritual, devotional, social, and economic dimensions. They affect Muslim conduct between him and his Lord and with people. Worship loses its meaning if it has no bearing on the behaviour of Muslims.

Level II: Faith (*Iman*) which the Almighty says is a higher degree than Islam: “The desert Arabs say, “We believe.” Say, “Ye have no faith; but ye (only) say, ‘We have submitted our wills to Allah,’ For not yet has Faith entered your hearts” (Quran: 49: 14). Allah, Sobhanah also said: “Only those are the believers who have believed in Allah and His Messenger, and afterward doubt not but strive with their lives for the Cause of Allah. Those! They are the truthful. (Qur`an:49:15). The Prophet (PBUH) also said, “Three things characterise a hypocrite even if they pray, fast, performed Hajj and calls themselves a Muslim: If he talks he lies, if he promises he breaches, and if he is entrusted he defrauds” (Narrated by Muslim). (Al-Bukhari, Book2, Hadith 26) This means that if a Muslim did not abide by the morality of Islam, he has left Islam. Thus the impact of ethics and its importance is recognised by Muslims as more important than the professional code of conduct for auditor. In Islam, ethics and faith are two sides of the same coin.

Level III: Excellence (*Ihsan*). The Prophet (PBUH) said, “*Ihsan* is to worship Allah as if you see Him, and if you do not see Him know that He sees you”. (Al-Bukhari, Book 2, Hadith 43), *Ihsan* includes the promotion of virtue and prevention of vice. Al-Qaradawi says, “The believer does not worship God to be virtuous, but becomes virtuous to worship God” (Al-Qaradawi, p. 126).

It can be concluded from the foregoing that the Islamic moral code includes, among others: honesty, belief in the Last Day, loyalty and devotion, which covers the standards of the American and international codes. Table 3 includes a comparison of the standards of Islamic behaviour and standards of professional conduct as a proposal for the treatment of moral corruption and fraud in the accounting profession in Muslim countries.

**Table 3: Comparing Islamic moral conduct with professional codes of conduct (US and international)\***

Aspect of Comparison	Islamic Ethical Behaviour	Professional Conduct
Source	Quran and Sunnah	Professional academies
Evidence	"To you, your religion for me my religion," "and this is my straight path so follow it" "I was sent to complete good morals."	Standards of Professional Conduct
The reason for its strength and compliance of professionals	That Allah is Hearing, Knowing, and that God has power over all things.	Keep up with the professional rules for the community's acceptance.
Extent of compliance	Part of the Islamic faith, pleasing Allah. Worship manifests in ethics and ethics manifest in worship.	Up right behaviour and quality audit.
Its persistence	To the Day of Resurrection	Adjusted each period
Outcomes	Conscience	A desire to get ISO
The level of ethics	The ethics of the prophets and the believers	Professional ethics
Number of standards	First I: the pillars of Islam. Level II: attitude of the believers, seventy-odd division Level III: ethics benefactors, to worship Allah as if you see Him, were not you see he sees you,	International standards 5 US standards 6
Method of teaching	You must act ethically, to win the approval of God through the application of the pillars of Islam	You must act ethically to get the ISO
Monitoring its application	Allah and His Messenger, peace be upon him and the believers	Members of the profession and society
Learning period	From birth until death	During the practice of the profession
Penalties for violators	In this world: of fraud not one of us, and is a hypocrite In the Hereafter: expelled from the basin Messenger of Allah, peace be upon him.	Physical punishment and if fraud did not discover there is any penalty
Its future	Continuity and success	Change
Those who comply	All Muslims	Professionals
The level of application and of support	Increased	Decreased

\*The table prepared by researchers.

The previous comparison clarified the differences between religious and professional ethical rules highlighting that religious rules are different from other ethics and superior. This result and conclusion satisfies the second aim of the research. The call for the application of religious ethics among Muslim auditors and introducing it to non-Muslim auditors is a religious duty and part of the Islamic faith. These ethics are part of the Islamic faith, and learning and applying begin from the moment of birth until death. They are adhered to by young and old, male and female. It is both the duty and the right of a Muslim for which they are held accountable in this world and the Hereafter. The Almighty said, "Then, shall ye be questioned that Day about the joy (ye indulged in!)" (Quran: 102: 8).

The implementation and monitoring of Islamic ethics begin with the individual and extend to the society. The Almighty says, "On no soul doth Allah Place a burden greater than it can bear. It gets every good that it earns, and it suffers every ill that it earns" (Quran: 2: 286). The absence of these ethical standards questions the faith of a Muslim and his association with Islam. The Prophet said, "The first thing to disappear from your religion will be trust, and the last will be prayer". (Musnad Imam Ahmad ; Al-Imam Al-Sakhawi, Hadith 237/1 ). Whosoever has abandoned prayer has left the religion. Muslims must agree first then others that their ethics must be managed; this hope will be addressed and attained by the adoption of religion to do that.

## 7. Results and Recommendations

The auditors' commitment to ethical and professional rules is weak, and existing codes have been unable to put an end to the excesses of auditors and fraudulent behaviour. The world has arrived at a standstill in addressing fraud in the auditing profession despite the commitment to apply the American or international rules of professional conduct. Ironically, the communities' that implement the rules of ethical conduct in professional environments appear more vulnerable to fraud and unethical behaviour than the societies that do not. Studies have found that America suffers from 41% of fraud in their firms, while the Middle East recorded 21% cases of fraud.

This result supports the third aim of the research.

The study recommends as a solution to fraud the application of Islamic ethics and calls for the adoption of these standards internationally. This result is consistent with the recommendations of Derghamin Gaza to adopt Islamic moral codes in auditing profession. It also supports Helaluddin's study in Pakistan. This result supports the realizable of the second and third aim of the research. This study encourages the adoption of Islamic ethics as legitimate controls limiting immoral practices in the audit profession. They are ideal, practical and workable standards that should be applied by Muslims and non-Muslims alike. The researcher recommends further studies to test the influence of Islamic morals on the auditing profession toward reducing agency practices in companies.

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