

المبادئ الأساسية لحوكمة الشركات
وتطبيقاتها في منظمة التعاون والتنمية
الاقتصادية وآفاقها في المنظور الإسلامي

إعداد

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بحث مقدّم إلى

« مؤتمر العمل الخيري الخليجي الثالث »

دائرة الشؤون الإسلامية والعمل الخيري بدبي

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هذلا البحث يعبر عن رأي الباحث
ولا يعبر بالضرورة عن رأي دائرة الشؤون الإسلامية والعمل الخيري بدبي

Abstract

The Fundamental Principles of Corporate Governance: Organization of Economic Co-operation and Development Annotations to Islamic Perspectives

Surge in concern call has taken its great profile regarding the Islamic principles of corporate governance. Corporate governance is not something new and alien to Islam. In fact, the primary feature of any Islamic economy is to give just, honest, fair and balanced society as envisioned to Islamic ethical values and rules. This paper attempt to analyze the possible need of corporate governance from Islamic perspective with the world notable principles reviewed by Organization of Economic Co-operation and Development (OECD).

This paper highlights that the dimension of Islamic corporate governance necessarily has a wider horizon which cannot be compartmentalize the roles and responsibility in which all actions and obligations are fall under the jurisdiction of the divine law of Islam, whereas, the OECD principles implements a firm with six different issue and obligations. Furthermore, the paper highlight some right view is fettering mechanism to controlled, direct and organized an economic activity from the Islamic point of view.

**The Fundamental Principles of Corporate Governance:
Organization of Economic Co-operation and Development
Annotations to Islamic Perspectives**

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**The Fundamental Principles of Corporate Governance:
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الملخص

يهدف هذا البحث إلى بيان المبادئ الأساسية للحاكمية المؤسسية في الإسلام مقارنةً مع منظمة التعاون والتنمية الاقتصادية في إدارة الشركات.

إن حوكمة الشركات في الإسلام ليست شيئاً جديداً وغريباً عنه. في الحقيقة، إن السمات الأساسية لأي اقتصاد إسلامي هو في تقديم مجتمع عادل ونزيه ومتوازن كما تُصوِّره القواعد والقيم الأخلاقية في الإسلام. وقد أبرز هذا البحث الأبعاد الأساسية للحاكمية المؤسسية في الإسلام والتي لها آفاق واسعة من خلال عدم تقسيمه للأدوار والمسؤولية التي ترتبط فيها كافة الأعمال والالتزامات، والتي تخضع للقانون الشرعي الإسلامي في حين نرى أن مبادئ منظمة التعاون والتنمية الاقتصادية تحدد تطبيقها على الشركات من خلال ستة أوامر والتزامات.

بالإضافة إلى ما سبق فإن هذا البحث يقدم وجهة نظر واقعية حول تقييد آلية التنظيم والسيطرة على الشركة وأنشطتها الاقتصادية من خلال وجهة النظر الإسلامية.

Key words: Accounting in Islam, Accounting Concepts and Practices in Islam, Islam, Accounting Ethics in Islamic concept, Corporate Governance, OECD, Jordan.

INTRODUCTION

Corporate governance characteristics albeit playing different roles in ensuring companies success are ultimately the only responsible role effecting the business economy. (Van Den Berghe et al., 2003), states that performance is finally the outcome of many interlinking factors where corporate governance is the only one possible element within the whole set of performance drivers. Good corporate governance has long been considered a crucial role for stakeholders in the business environment. Though the goal of corporate governance differs from one firm to another, or from one country to another, the main important concern is to impetus a good code of mechanisms to uplift and govern the organization. (Abdussalam, 2006), expressed that corporate governs concern a critical interest since the mid-1980's attracting a great deal of attention for the practitioners, communities, managers, shareholders, investors, regulatory agencies, as well as in the academic research. But with the current business pressure, corporate governance structure changes very fast. The financial innovation and globalization forcing the executives to adopt rigorous re-evaluation of corporate governance principles. (Meyex, 2004), says that a systematic governance means adjusting the signals with an organization such that staff automatically do the right things, without the need for oversight. Sound corporate governance practices have become

critical to world wide efforts to stabilize and strengthen good capital markets and protect investors, (Darman, 2005). Therefore, not only corporate governance is one of the main principle in running a firm successfully, but also it ensures security confidence by monitoring and controls the operation of the firm. In this present business environment with diverse cultural background, the principles of corporate governance cannot be applies for all proposition. Thus, a rigorous changes is needed to adopt purposefully and implement new corporate rules and regulations that are more robust in the face of rapid financial innovation. This implies that good corporate governance is not just comply with hard and fast rules but also seen as guidelines for a supervisory framework of different environmental structures. (Hakim, 2002), explains corporate as, "In the practical sense, corporate governance involves the nuts and bolts of how corporations should fulfill their responsibilities to their shareholders and other stakeholders. Corporate governance need to became principle based, rather than being based on rules and regulation (OECD, 2004).

Hence, therefore, it can conclude here that corporate governance is a set of mechanism helps in confirming, with fair and just dealing to all the stakeholders and to strengthening transparency and accounting.

The main objectives of this study are to briefly discuss the current state of corporate governance practices at the conventional economy and to establish the measurement of good corporate governance at the functional level and how far this approach can ensure the relativity with the Islamic corporate governance. This study describes a radically different approach focusing the similarities and differences of conventional corporate governance from the Islamic perspective. The researcher referred the Principles of corporate governance (OCED) – 2004, for the purpose of this study. It is done so, since these principles were so sound that it immediately adopted by many well profounded companies and organization and soon became a benchmark for identification of good elements all over the world.

Therefore, this paper is an attempt to bring a comparative position and to analyze the similarities and differentiations of the revised OECD principles and its annotations to the Islamic perspective.

The remainder of the paper presents into four divided section, the following section discusses the identification of corporate governance of the OECD principles and its annotation. Section three discuss the Islamic perspective of corporate governance and its comparison with OECD principles and the last section gives the conclusion of the study.

OECD PRINCIPLES OF CORPORATE GOVERNANCE

The OECD Principles of corporate governance originally adopted by the 30 member countries of the OECD in 1999 have since become a reference tool for policy makers, corporations, institutional and regulatory framework and others. It is considered as one of the principles of the twelve key standards for sound financial systems adopted by the Financial Stability Forum (FSF). It also provide practical guidance and suggestions for stock exchange, investors, corporations and to other profound organization of the world other than OECD member countries.

The OECD began a review of the principles in 2003 considering the recent changes and developments and after an extensive review process led to adopt a revised and reviewed OECD principles of corporate governance in April, 2004. The revision principles not only reflects the experience OECD countries but also the emerging and developing economics. The revised principles not only reflects the experience OECD countries but also the emerging and developing economics. The revised principles are non-binding in nature and it lays up to the governments and market participants to decide for their own framework. It also confirmed the adaptability of the principles as a reference in varying legal, economic and cultural contexts.

The following are the main areas of the OECD principles and its annotation:

Principle 1: Ensuring the basis for an effective corporate governance framework.

Annotation: The corporate governance framework should promote transparent and efficient markets, be consistent with the rule of law and clearly articulate the division of responsibilities among different supervisory, regulatory and enforcement authorities.

Principle 2: The right of shareholders and key ownership functions.

Annotation: The corporate governance framework should protect and facilitate the exercise of shareholders' rights.

Principle 3: The equitable treatment of shareholders.

Annotation: The corporate governance framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunities to obtain effective redress for violation of their rights.

Principle 4: The role of stakeholders in corporate governance.

Annotation: The corporate governance framework should recognize the rights of stakeholders established by law or through

mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

Principle 5: Disclosure and transparency.

Annotation: The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

Principle 6: The responsibilities of the board.

Annotation: The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and board's accountability to the company and the shareholders.

These OECD principles are so sound that even the non-members of OECD are implementing and adopting. As, (Morck, 2005), states that the soundness of these principles has been proved by its adoption all over the world

The main theme of these above principle lies to four basic principles. Firstly, the mechanism of business ethics, secondly the

mechanism of decision making, thirdly in adequate disclosure and transparency and lastly the mechanism of book keeping and final accounts. The next section will discuss the Islamic view of corporate government from the Islamic perspective.

1. Islamic Business principles

Islam is a universal religion, which exerted a profound influence on many important matters and aspects of human life and personality. It consequently expressed a tremendous appeal and solutions to all the problems of life and leads to a better peaceful, contented and happy life. In an Islamic society, the ways of life establish under different umbrellas of assumptions and Muslims believed Allah (S. W.T.), the Almighty as the ultimate owner of wealth and we the people are trustees on this earth.

Islam is basically an ethical and moral code of conduct. (Ahmed, 2000; Mirakhor, 2000; Warde, 2000), expressed that Islamic business is always characterized by ethical norms and social commitments, grounded on ethical and moral framework of the Shariah. (Asyraf, 2006), herewith underpinned nicely that these Shariah injunctions interweave Islamic financial transactions with genuine concern for ethically and socially responsible activities at the same time as prohibiting involvement in illegal activities or those which are detrimental to social and environmental well-being. Hence, Islamic

economic system offers many aspects and ideology differ from conventional economic. Islamic economic is an ethics based system based on the principles and rules contained in Al Quran and Sunnah. Operating trusteeship and business in Islam, one had to deal under certain code of conduct and rules, where people are exerted with limited freedom. Muslims are directed to conduct their business in accordance with the Shariah rules, i.e., to be fair, honest and just toward others. Accumulating wealth of oneself is allowed under the constraint restrictions of Islamic ethics.

The Islamic religion relates directly to all spheres of life, including how to conduct the trade and commerce. Shariah covers not only religious rituals, but also many aspects of day-to-day life, politics, economics, banking, business or contract law, and social issues (Wikipedia, 2005). Keeping in sequence (Lewis, 2005), rightly points out here that, "Islam always encouraged trade and commerce as long as it is conducted within the framework of Holy Quran, and the word of Allah as revealed to his prophet Muhammad (PBUH)".

Business transactions had long been practice since the early days of Islam, but with the colonization of the western countries, the social environmental discipline gets inflicted (infected) with the western ideology. Sequently, Islamic economics developed as a social disciples in response to this environment, with the aim of

establishing or restoring Islamic authority in areas where Muslims increasingly were falling under the sway of western ideas, (Ahmad, 1980; Naser, 1994; and Kuran, 1995). Business needs to arrange and organize in order to contest the outcome. (Lewis, 2005), explains that, how firms are organized, directed and controlled, in short what is now called corporate governance, is one aspect of this broader agenda. Yet, despite considerable interest in the topic of corporate governance recently by organizations such as the Islamic Development Bank (Chapra, 1992; Ahmed, 2000; and AAOIFI, 2003), little is written on corporate governance structures and there is not even as yet a unified expression in Arabic to represent the meaning of corporate governance (Sourial, 2004). Albeit this statement, corporate governance in Islamic law provides and embodies a more larger and vast guidelines with encompassing duties and practices as on how to deal with economic transactions upto the moral conduct of a Muslim without even defining the modern world corporate governance as such Islamic laws impetus corporate governance in every individual actions of Muslim upto the social environment. Hence, the following is a discussion as how the OECD principle of corporate governance can be seen in Islamic business activities by taking these following principles and how it governs the conduct of business.

(i) Business Ethics

In Islam, the absolute and eternal owner of everything on earth and on the heaven, belongs to Allah (S.W.T), the almighty, and we human beings are just vice regent of it. Muslims are entitled to conduct their business activity as guided by the Shariah code of conduct, which encourage to be just, fair and honest to all the person involved in the business. Therefore, a Muslim business person are hence taught to possess a high moral conduct, so not to betray, deceive or exploit his fellowships. Muslim should also not therefore overcome with there business activity with a consequent results in profit making only. At the same time, Muslims requires to work and produce and being not to be lazy and unproductive. Thus, (Abbas Ali, 2005), explains the “the Islamic work ethic, as work is a virtue in light of a person’s needs, and is a necessity for establishing equilibrium in one’s individual and social life (Nasr, 1984). This is mention in the Holy Quran (6.132): “To all are degrees (or ranks) according to their deeds”. This clearly show that any system without an appropriate ethical and moral climate, will not influence a proper system of governance. Therefore, like OECD, the above discussion clearly emphasized that Islamic business ethics promotes transparency, consistent and equal rule of law.

(ii) Decision – Making

The holy Quran clearly mandates the principles which governs the Muslims lives. These principles were imply and compiled to Muslim since the early days of the Islamic state. The ethical notion of corporate governance assume a more broader and holistic significance in Islam. The dimension of governance in all manifestations is essentially about decision making. Islamic ethics of decision making does not comply only in the hands of superior officials, but also extends the responsibility to fulfill with obligations beyond shareholders, clients, financiers, suppliers, customers, employees, embracing within spiritual religious bounty. An employee would be expected to contribute his or her knowledge to the formulation and implementation of the organizational vision and consultative procedures should be applied to all affected i.e., shareholders, suppliers, customers, workers and the community (Baydoun, Mamman and Mahmaud, 1999). Therefore, an employee shares the role of company decision making as much as the executive members do.

Islam mandates human beings as trustee of Allah in all situations and the ultimate trust is to keep in Allah, the ultimate owner of everything in this world. Muslims are taught to maintain and strengthen good relationship with superiors, clients and the

management conforming with the divine norms and rules, hence inspired the whole community with values of truthfulness, fairness, tolerance and justice etc. this shows the Islamic institutions imply decision-making in a different and more broader ways than conventional institutions do. This is written in many verses of the Holy Quran and Hadith;

“And consult them on affairs (of moment). Then, when thou has taken a decision, put thy trust in Allah (Al-Imran 3.159).

“Those who respond to their Lord and establish regular prayer; who conduct their affairs by mutual consultation; who spend out of what we bestow on them for sustenance” (Ash-Shura, 42.38).

Abu-Hamzah Anas bin Malik (RA) reported that the prophet believers (in Allah and in his religion) until he loves for his brother what he loves for himself (Al-Bukhari & Muslims). Islam introduced improvements in accordance with the moral principles enunciated by the Holy Quran (Stork, 1999).

These above verses clearly emphasize on consultation and whom to consult. The best benefited way to whom to consult are those good man who respond to God and fear God, and who can conduct fair mutual justice with equal importance to all. Thus, this conveys the Muslim to “live true in mutual consultation and forbearance, and rely on Allah. Islam encourages the participants to work together freely

and frankly when arriving at decisions (Shaikh, 1988). Islam also demands the whole group to participate in decision-making.

Another Islamic principles that represent a core element of corporate governance is that of an institution called Hisbah established under the Abbasides (750 A.D. Onwards) which ensures compliance with the Shariah requirements, particularly in the business affairs. Duties like correcting weight and measures, fair trading rules, checking business, frauds, auditing illegal contracts, keeping the market free, and preventing hoarding of necessities were carried out by this office as stated by (Abdul Rahman,1998).

Therefore, since the early days of Islam, corporate governance are embedded in an appropriate ethical environment fulfilling the bounty of Shariah. The mode of corporate governance are hence more vast and bigger in dealing with that of the OECD principles, where BOD and the senior manager are entitled to implement the decision making.

(iii) Disclosure and Transparency

In Islamic economy, accountability are entitled to produce a true and fair disclosure and transparency. Accountability is first of all to Allah. Therefore, it is clear enough that Allah (S.W.T.) reveal us to deal the business or accounting by ensuring fair and just financial

transactions between human beings and the ultimate accountability to Allah (S.W.T.). The fundamental concept of Islamic accountability is believed that all resources are made available to individuals in a form of trust. Hence true disclosure of financial facts, and accurate information should freely available to the users. Another important point involves in disclosure is to provide the users adequate information which needed for sound financial decisions. This will lead in paying accurate Zakah which is the third pillar of Islam. Accuracy in a sense, involves an aspect of fairness and just system. This can help in making of economic and business decisions consistent. This fundamental is a powerful ethics in Islamic accounting system and helps in promoting proper disclosure and transparency in any business dealing.

(iv) Book Keeping and Final Account

Islam encourages to deal business ensuring fair and just financial transaction between each other and the ultimate accountability to Allah. The first or prime accountability arises though the compact of Khilafa whereby a man is a trustee of Allah's resources. Meanwhile, the secondary accountability is established by a contact between an owner or investor and a manager. Al-Quran clearly shows us the moral ethics of dealing this principle, as

“O you who believe! when you deal with each other in transactions

involving future obligations in a fixed period of time, reduce them to writing and let a scribe write down faithfully as between the parties” (Al-Quran, 2.282).

“And if you are travelling and cannot find a scribe, then there be a mortgage taken..... And do not conceal any evidence for the whoever hides it, surely his heart is sinful, and Allah is all knower of what you do (Al-Quran 2.283).

“We shall set up justice scales for the day of judgment, not a soul will be dealt unjustly in the least and if there be (no more than) the weight of mustard seed, we will bring it (to account), and enough are we to take account” (Al-Quran, 21.47).

This verses clearly mandate that transactions in any business dealing should be written down by a good man who possess high moral conduct and can just fairly to each party.

Further, it also shows again that business should deal in a fair, honest and just manner. Assets should not be usurped and should earn in a lawful way where the economic benefits goes to its owners. Therefore, any financial transaction should determined to the balanced sheets and thus any unlawful possessions of assets are prohibited. Acquiring wealth in a unlawful means will only lead to widespread inequalities and social waste. Islamic law has very clear view on the basic principles as to how financial reporting and

accounting practice should be undertaken in terms of objectives based on the spirit of Islam and its teaching (Lewis, 2001).

Allah knows everything and whoever hides, has his own account on the day of judgment. This shows that justice and balance has profound implication for the conduct of Islamic business, and thus provide general approval and guidelines for lawful records of any business transaction in a very well organized system.

From these above discussion, Islamic business policies and relevant business and commercial affairs should conduct in a fair, just and honest manner. (Khaliffa, 2003), states that the distinctive characteristics of Islamic economics as it is godly, ethical, humanly and moderate and balanced. Islamic business since historical time requires an honest fulfillment. The institution of Hisba offers a framework of social ethics, relevant to monitor the corporation, with the objective to obligate the correct ethical behavior in the wider social context and empower individual Muslims to act as private prosecutors in the cause of better governance by giving them a platform for social action (Lewis: 2006). Islamic moral ethics also considers that those whoever cheats is not one of them and cheating is considered as a moral problem, which needs greater internal fortitude to overcome it, while conventional economy believes on deficiency of external law enforcement or of bad corporate governance.

Therefore, it clearly clarifies that accountability and responsibility are trusted to God, the ultimate authority. In Islam, dealing of corporate governance is not only just the designation or his position and power but also his internal moral enthusiasm to fulfill and carried out the conduct of the job within the bounty of Islamic Shariah. It can be also seen that the responsibility are not entitled to those only who encompass the business power but also to all those stakeholders who involved and related with the organization. Corporate governance in OECD entitled the power of decision making and participation of deeper internal business dealings to those limited persons holding higher designation as BOD and senior management authorities whereas, in Islam, those whoever related stakeholders of the organization are given full rights and responsibility to participate and conveys their thoughts and ideas in reforming better corporate governance. And above all Islam made accountable not only to stakeholders, but also to God, the ultimate owner and authority. This powerful moral ethics helps in promoting fair, just and honest business dealing.

**Comparison of Islamic Corporate Governance Principles
with OECD Principles**

**An attempt is made to bring a comparative position of
Islamic principles of corporate governance with the revised
principles of OECD.**

Principle Number	OECD Principles & Annotation	Islamic Principles
1	<p>Insuring the basis for an effective corporate governance framework</p> <ul style="list-style-type: none"> • Promotion of transparent and efficient markets with rule of law and division of responsibilities. 	<ul style="list-style-type: none"> • Promotion of business within ethical framework of Shariah. • Believes in profit and loss • Primacy of Justice and social welfare with social and spiritual obligations. • Prohibition of interest
2	<p>The rights of shareholders and key ownership functions.</p> <ul style="list-style-type: none"> • Basic shareholder rights. • Participation in Decision-making at the general meetings. • Structures and arrangements markets for corporate control. • Ownership rights by all shareholders including institutional shareholders. <p>Consultative process between shareholders and institutional shareholders.</p>	<ul style="list-style-type: none"> • Sole Authority is God. • Property as trust from God. • Society as stakeholders. • Accountability not only to stakeholders but also to God, the ultimate owner.

3	<p>The Equitable treatment of shareholders</p> <ul style="list-style-type: none"> • Protection to minority and foreign shareholders. 	<ul style="list-style-type: none"> • Just and fairness of value. • Equitable distribution of wealth to all stakeholders and disadvantages members in the form of Zakat and Sadqa. • Social and individual welfare with both spiritual and moral obligation. Sensation of Equality.
4	<p>The Role of Stakeholders in Corporate Governance.</p> <ul style="list-style-type: none"> • In creating wealth, jobs and sustainability of financially sound enterprises. 	<ul style="list-style-type: none"> • Islamic accountability to Falah and social welfare orientation. • Haram / Halal dichotomy in transaction. • Social & individual welfare from both spiritual and material. • Consideration to whole community.
5	<p>Disclosure and Transparency</p> <ul style="list-style-type: none"> • Matters regarding corporation. • Financial situation. • Performance, ownership and governance. 	<ul style="list-style-type: none"> • Accountability with Shariah compliance. • Socio-economic objectives related to firms' control and accountability to all its stakeholders. • Justice, equality, truthfulness transparency. • Wider accountability with written as well as oral disclosure.

6	<p>The Responsibilities of the Board</p> <ul style="list-style-type: none">• Strategic guidance.• Monitoring of management.• Accountability to company and stakeholders.	<ul style="list-style-type: none">• Accountability not only to company or board or stakeholders but to Allah the ultimate authority who leads to welfare and success.• Holistic and integrative guidance.• Negotiation and co-operation.• Consultation and consensus seeking for each decision with related stakeholders.
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Conclusion

This study has aimed to analyze the possible need of corporate governance from Islamic perspective with the world notable principles reviewed by OECD. It discusses above the current state of corporate governance practices at the conventional economy and established the measurement of good corporate governance at the functional level, comparing from Islamic perspectives. Like any other civilization and religions, Islamic culture do also embedded a good corporate governance since the early days of Islamization. Islamic society had its own different views and values comparing with the outer non-Islamic world. The strong belief of accountability in this world and the hereafter had strong implication in every Muslim lives and governs a wider scope and extended obligations of corporate governance with that compared to conventional principles. Hence success and welfare is measured with moral and ethical spiritual obligations with a strong trust in accountability with Allah, the ultimate authority.

Therefore, the recommended set of principles of OECD had long been exist since the early stage of Islamic civilization. But, with the globalization tendency and in filtering with the cultural, religious and social, business and political factors, leads to misplace the true ethos of Islamic civilization. Hence, in this present situation, the OECD principles have been successfully implemented and considered a very effective tool of corporate governance as compared to Islamic principles of corporate governance.

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