

**DA AFGHANISTAN BANK
(CENTRAL BANK OF AFGHANISTAN)**
**Guidelines on Appointment of External Shariah Auditors for
Islamic Bank/Window**

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for Islamic Bank/Window***

Accountable Executive & Custodian	Islamic Banking Division
Policy Owner	Head of Islamic Banking Division

Approved by DAB Governor:	Date	DAB Board Secretary
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ISLAMIC REPUBLIC OF AFGHANISTAN

**DA AFGHANISTAN BANK, GUIDELINES ON APPOINTMENT OF
EXTERNAL SHARIAH AUDITORS FOR ISLAMIC BANK/WINDOW**

PART A: PREAMBLE

1. Background

- a) These Guidelines on Appointment of External Shariah Auditors for Islamic Bank/Window (hereinafter referred to as "the Guideline") are issued by the Da Afghanistan Bank (hereinafter referred to as "DAB") which shall be adopted and become the guiding principles for Islamic Financial Institutions, Financial Institutions operating with an Islamic Window and Financial Institutions operating with an Islamic Unit (collectively referred to as "the Bank") in the Islamic Republic of Afghanistan (hereinafter referred to as "Afghanistan") offering Islamic financial products.
- b) The Guideline is intended to provide a guide on how to evaluate any potential external Shariah auditor for the Bank. The appointment of an external Shariah auditor who is equipped with good knowledge in Islamic finance is to ensure that the Bank may attain continuity of adherence to Shariah principles for its operations especially in relation to the financial statements prepared by a financial institution/window which conducts business in conformity with Islamic Shariah rules and principles.
- c) According to the Accounting and Auditing Organization for Islamic Financial Institutions ("AAOIFI"), Shari'a Standards on "Auditing" Standard: 1/2:

"The objective of an audit of financial statements is to enable the auditor to express an opinion as to whether the financial statements are prepared, in all material respects, in accordance with the Shariah rules and principles, the accounting standards of the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and relevant national accounting standards

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and practices in the country in which the financial institution operates".

Hence, appointment of a suitably competent Shariah auditor is crucial to achieve the above objective as Shariah audit has a distinct element that needs specialized knowledge in order to carry out the same.

- d) Besides the provisions of the appointment of an external Shariah Auditor as explained hereto, external audit for Banks may also be conducted by DAB's Supervision Unit if it desires to do so after acquiring the full ability and capacity to conduct such audit exercise. In the event the Shariah Audit of the Bank is to be conducted by DAB's Supervision Unit, the Bank need not appoint another external auditor to perform such Shariah Audit on its products and operations as the audit conducted by the DAB Supervision Team is sufficient to satisfy the regulatory requirement.
- e) Notwithstanding the above, DAB may require a Bank to conduct a Shariah Audit from an external Shariah Auditor and, after the completion of the external auditor's audit exercise; it may still require its Supervision Unit to then conduct another audit on the Bank as a second-layer basis for the purpose of verification of the external auditor's findings and report.

2. Purpose and Application

- a) These Guidelines provide the considerations and criteria for appointment of an external Shariah auditor for Islamic bank/window with the aim of ensuring that the auditor is capable of obtaining sufficient appropriate audit evidence that the Bank's financial statements have been prepared in accordance with the AAOIFI Accounting Standards and relevant national standard and practices in Afghanistan as well as relevant statutory requirements.
- b) These Guidelines shall be applicable for external Shariah auditors for all types of Islamic products comprising of debt-based and equity-based Islamic financing products.

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3. Legal Provision

- a) These Guidelines are issued pursuant to Article 2.2 of the Afghanistan Bank Law gazetted on 12/17/2003 (corresponding to 30/10/1382) in relation to the powers of DAB to regulate and supervise Banks in the Islamic Republic of Afghanistan and any amendments thereto.
- b) These Guidelines shall be read together with the following guidelines:
- i. Shariah Compliance Manual;
 - ii. Shariah Review Manual;
 - iii. Guidelines for Financial Reporting for Islamic Banking Institutions; and
 - iv. Other relevant regulations guidelines or circulars that DAB may issue from time to time.

PART B: POLICY AND PROCEDURES

4. Selection Criteria

4.1. Specific Criteria/Consideration – In Relation to Shariah Requirements

No	Criteria	Description
1	Shariah Audit License/ Registered Shariah Auditor	In addition to having a license for carrying out financial audit services, the Bank shall also consider appointing an external auditor with a Shariah audit license granted by DAB or a firm which is a registered Shariah Auditor with DAB.
2	Employees Competency	An external Shariah auditor should:- <ul style="list-style-type: none">• At all times have adequate employees with necessary

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		<p>qualification, expertise and experience for the work (the number of the minimum qualified personnel is to be prescribed by DAB);</p> <ul style="list-style-type: none"> • Provide adequate and sufficient training, whether internal or otherwise, for all employees or licensed representatives so that they acquire necessary knowledge of the work which relates to Islamic finance principles and operations.
3	Specialized Competency	<p>A Shariah auditor with the audit firm shall be competent in both the auditing knowledge and skills, as well as Shariah knowledge relevant to Islamic banks.</p> <p>Refer to Section 4.3 for Competency of Shariah Auditors.</p>
4	Appointment of Shariah Advisor	<p>It is recommended for an external audit firm to appoint a Shariah advisor to review its audit exercise in order to provide Shariah credibility and integrity in relation to its audit process.</p>
5	Conduct of audit in accordance with the Auditing Standards approved by the AAOIFI and other approved standards or forms by the regulator	<p>These standards contain basic principles and essential procedures together with related guidance in the form of explanatory and other material.</p>

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4.2. Standard Criteria

No	Criteria	Description
1	License	At all times, only licensed persons can carry out regulated activities such as auditing and expressing an opinion on the quality of compliance.
2	Track Record	A credible track record with sound testimony from previous clients is important to ensure competency in carrying out Shariah audit for a variety of Islamic financial products and services.
3	Reputation	Much of the information linked with the reputation of the Shariah auditor is subjective: competent people, quality of service, relevant expertise and good judgment. In addition to considering the general reputation of the auditor, the Bank may ask for the names of at least two (2) organizations willing to act as referees. This is important as Shariah audit is a niche and specialized skill set and proper conduct of the same is crucial to ensure stakeholders' confidence in continuous adherence to Shariah compliance.
4	Strength	Shariah auditor with reasonable financial strength will be able to attract better quality personnel especially in a niche area such as Shariah audit.
5	Fee and Transparency	Most auditors have their own pricing policy and the way this is manifested may vary. <ul style="list-style-type: none"> • Has the auditor clarified about how the charges will be calculated?

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		<ul style="list-style-type: none"> • Has the auditor clarified about all the charges that will be incurred?
6	Efficient Administration	<ul style="list-style-type: none"> • What arrangements will be in place for communications about the audit exercise; • Will the Bank be given a specific point of contact? <p>Difficulties in communication is often a cause of dissatisfaction among clients. The Bank may benefit from discussing the administration processes with the auditor upfront.</p>
7	Clear and Timely Reporting	<p>The Bank shall be clear about their requirements.</p> <ul style="list-style-type: none"> • What details are required? • How frequently are the audit reports required? <p>A sample audit report should be requested during selection process as methods and standards may vary from one auditor to another.</p> <p>In addition to written report, the Bank may wish to meet the auditor on a face to face basis at certain specified times to have the oral presentation.</p>

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4.3. Competency of Shariah Auditors

- a) The Shariah auditor shall possess adequate auditing knowledge, skills and competencies on the following:-
- i. proficiencies in applying auditing standards and procedures according to established or agreed standards;
 - ii. proficiency in accounting principles and techniques;
 - iii. understanding of management principles;
 - iv. a good understanding of the application of accounting, commercial law, taxation, finance, and information technology application system; and
 - v. Essential and adequate knowledge in Shariah principles and Shariah products and services and Shariah compliance processes.
- b) The Shariah auditor shall have the ability to construct relevant and appropriate audit tests in line with the audit objectives of any particular area of the audit. This is to correctly identify testing procedures in order to verify evidence for different auditable areas to ensure Shariah compliance.
- c) The basic qualifications of the Shariah auditor shall be as follows:-
- i. A relevant bachelor degree or professional qualification in accounting. For candidates with bachelor degree in non-accounting vocation, they shall have working experience in auditing or relevant working experience in Islamic financial institutions/Islamic Window for a minimum of 3 years;
 - ii. Adequate knowledge of Shariah. Adequate knowledge of Shariah means completion of reasonable training in Shariah knowledge on the governing Shariah principles and Shariah standards governing Islamic financial products and services. For clarity purposes, undertaking not less than 72 contact hours on basic training on Shariah principles/Shariah standards and Shariah products is the minimum requirement to make an auditor a qualified Shariah auditor.

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- iii. The basis of the training and exposure must include, but not limited to the following areas of knowledge :
- Islamic principles underlying the Islamic financial contracts such as Ijarah, Murabaha, Wadi'ah, etc (which are all prepared in the form of Shariah standards for DAB);
 - Basic operations of the products and services including the process flow of the contract, the computation of profit, profit distribution policy, penalty charge etc;
 - Shariah resolutions of the DAB SSB and the Bank's Shariah Board; and
 - Relevant and applicable pronouncements on Shariah matters issued by DAB.
- d) Pursuant to AAOIFI Standards on Auditing Standard 1/4: The auditor should comply with the "Code of Ethics for Professional Accountants" issued by the AAOIFI and the International Federation of Accountants which do not contravene Islamic rules and principles. Ethical principles governing the auditor's professional responsibilities include :-
- i. Righteousness
 - ii. Integrity
 - iii. Trustworthiness
 - iv. Fairness
 - v. Honesty
 - vi. Independence
 - vii. Objectivity
 - viii. Professional competence
 - ix. Due care
 - x. Confidentiality
 - xi. Professional behaviour
 - xii. Technical standards

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5. Custodian of the Document

The Guideline shall be under the safe custody of the Islamic Banking Division ("IBD") of DAB. Any changes to the Guideline shall be made by the IBD with prior consultation with the SSB, as reviewed by the DAB Executive Board and upon approval by DAB Supreme Council. A copy of the amended Guideline shall be made available to all stakeholders and SSB members for reference and implementation.

6. Effective Date of the Document

The Effective date of the Guideline is the _____ day of _____ 20____