

DA AFGHANISTAN BANK
(CENTRAL BANK OF AFGHANISTAN)
On-Site Examination Manual

On-Site Examination Manual

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, ON-SITE EXAMINATION MANUAL

PART A: PREAMBLE

1. Background

- 1.1 This On-Site Examination Manual (hereinafter referred to as “the Manual”) is issued by the Da Afghanistan Bank (hereinafter referred to as “DAB”) which shall be adopted and become the guiding principles for Islamic Financial Institutions (“IFI”), 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 offering Islamic financial products.
- 1.2 In principle, an on-site examination exercise shall be a procedure undertaken by DAB to review and assess on an on-site basis the compliance status of Banks in Afghanistan as to whether their operations are in line with the licensing requirements, relevant governance standards and regulations. It is also to assess and ascertain the various risk levels of the Bank.
- 1.3 The need for this Manual is primarily to provide confidence to customers and stakeholders on the Shariah compliance of the Islamic banking activities and operations of the Banks as well as to satisfy DAB, as the regulator, on the compliance status of the Banks to the relevant rules and regulations that they are subject to.
- 1.4 At the Bank’s level, the responsibility for ensuring compliance with this Manual shall be vested with the Compliance Department of the Bank. However, in the course of conducting the examination, DAB shall also be entitled to seek advice and consultation from other departments within

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the Bank or external parties such as the internal and external auditors of the Bank for the purpose of seeking information and confirmation.

2. Basis of On-Site Examination Manual from International Best Practices

2.1 The basis of this On-Site Examination Manual is established under item no. 2 of the Governance Standard for Islamic Financial Institutions (GSIFI) No. 4 of the Accounting and Auditing Organization for Islamic Financial Institutions ("AAOIFI") (hereinafter referred to as "the Standard"). The principles and procedures can be derived from the Audit & Governance Committee for IFI section since the essence of on-site examination and audit are intertwined and are aimed at satisfying the same objective. Accordingly, item 2 of the Standard reads as follows:

2. "The importance of the AGC (known internationally as the Audit Committee) for an IFI emanates from its role in:

(a) Achieving the fundamental objectives of an IFI, by enhancing greater transparency and disclosure in financial reporting; and

(b) Enhancing the public's confidence of the IFI as genuine in its application of Shari'a rules and principles.

2.2 The Islamic Financial Services Board ("IFSB") also provided prudential guidelines for supervision under its "Guidance on Key Elements in the Supervisory Review Process of Institutions offering Islamic Financial Services (excluding Islamic Insurance (Takaful) Institutions and Islamic Mutual Funds)" dated December 2007.

Accordingly, it is stated that the document is intended to foster convergence towards best practice among authorities supervising Institutions offering Islamic Financial Services ("IIFS"), enabling such

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supervisory authorities to meet their requirements when carrying out the roles expected of them in the light of IFSB standards. This convergence should lead to the establishment of a common approach to the minimum review process to be followed by authorities supervising IIFS.

3. Purpose and Application

- 3.1 This Manual shall be applicable to all Islamic banking activities and operations of the Bank. The purpose of this examination is to regularly verify that the Banks, implement and operate under all the relevant governing principles and guidelines that respectively apply to them.
- 3.2 All Banks must at all times, grant full access to any information DAB deems necessary when performing the examination, for the purposes of the examination only.
- 3.3 The principles as set out in this Manual shall constitute a general guideline for the guidance to Banks on the scope of the on-site examination. The specific application however may differ slightly though not substantially, according to the internal set-up and operation of each respective Bank.

4. Legal Provision

- 4.1 This Manual is 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.

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- 4.2 This Manual shall be read together and examined in accordance with the following manuals/guidelines:
- i. National Shariah Governance Framework;
 - ii. Shariah Compliance Manual;
 - iii. Shariah Review Manual;
 - iv. Verification Process Manual for Islamic Banking Products; and
 - v. Off-Site Examination Manual;
 - vi. Regulation on Licensing to Islamic Banks/Windows;
 - vii. Regulation on Islamic Banking Liquidity Management;
 - viii. Regulation on Asset Classification;
 - ix. Regulation on Profit Distribution;
 - x. Regulation on Large Exposures;
 - xi. Regulation on Enforcement Action;
 - xii. Guidelines on Financial Reporting for Islamic Banking Institutions;
 - xiii. Guiding Principles of Risk Management for Islamic Banks;
 - xiv. Guidelines on Recognition and Measurement of Profit Sharing Investment Account as Risk Absorbent;
 - xv. Guidelines on Product Transparency and Disclosure;
 - xvi. Guidelines on Prohibition on Specific/Restricted and Loss Bearing Fund Placement from Islamic Banks to Parent Banking Institutions; and
 - xvii. Any other regulations/guidelines/manuals that is deemed necessary and relevant by DAB from time to time.

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PART B: POLICY REQUIREMENTS

5. On-Site Examination Guide

Frequency

5.1 Within one (1) calendar year, DAB shall perform the examination at least one (1) time of each bank, at any time within that year, as deemed appropriate by DAB. However, DAB may also examine certain aspects of operations on an ongoing basis or from time to time.

Notification of Examination

5.2 It shall not be a requirement for DAB to inform any party of its examination unless deemed necessary by DAB and it decides to do so in its sole discretion.

5.3 DAB's plans or internal schedule for examinations to be carried out must not be known or given to any external party outside of the responsible parties of DAB.

Examination of Documents

5.4 In conducting the on-site examination, DAB shall be given the access of all the following documentation of the Bank including but not limited to;

5.4.1. The latest organisational structure and the respective job specifications;

5.4.2. Minutes of meetings;

5.4.3. Reports;

5.4.4. Fatwas and Circulars;

5.4.5. Operational documents;

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- 5.4.6. Financial reports/Financial statements;
 - 5.4.7. Policies and Procedures; and
 - 5.4.8. All relevant documents pertaining to product which include but not limited to marketing materials, application, sops, documentation, accounting treatment and IT system and risk management report.
- 5.5 Notwithstanding the above, DAB shall also be entitled to any other documents as deemed relevant by the representatives from DAB conducting the examination and as requested from time to time for the purpose of the examination.

Scope and Processes of the Examination

- 5.6 Any matters deemed to be non-compliant to any of DAB's guidelines, laws, regulations or rules by DAB, shall be recorded by DAB in any appropriate forms of recording.
- 5.7 The Board of Directors of any Bank found to be in non-compliance on any matter shall be responsible to take corrective action within a time frame as reasonably decided by DAB.
- 5.8 DAB shall examine the Banks for compliance with any of the guidelines, laws, regulations or rules under which it governs. Notwithstanding this, the following, but not limited to, should also be examined:

Governance and Operations:

- 5.8.1. Whether the Bank has a proper record-keeping of its licence, Articles of Association/Memorandum of Association, company registration documentation or any other documents the DAB deems necessary (wherever applicable);
- 5.8.2. Whether the Bank has internal policies for compliance with guidelines, laws, regulations and rules of DAB and whether its staff are aware of and knowledgeable about such policies;

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- 5.8.3. Whether the staff of the Bank are following internal policies and processes for compliance with guidelines, laws, regulations and rules of DAB. This may involve the checking of instances of reported non-compliance, process flows and reporting structure;
- 5.8.4. Whether customers are being made fully aware of all information, relevant terms and conditions, applicable documents and references and other such information as required via product disclosure sheet or other similar-nature documents;
- 5.8.5. Whether staff of the Bank know how and when to identify, report, manage and/or resolve a Shariah non-compliance issue;
- 5.8.6. Other areas as may be deemed appropriate by DAB, in their absolute discretion, from time to time.

Products:

- 5.8.7 Whether the Bank's customers are being made fully aware of all information, relevant terms and conditions as approved, applicable documents and references and other such information required in relation to the product subscribed;
- 5.8.8 Whether the Bank has a proper process and control mechanism for product development from origination to Shariah endorsement by its Shariah Board; and
- 5.8.9 Other areas as may be deemed appropriate by DAB from time to time.

6. Methods of On-Site Examination

- 6.1 The methods and processes that DAB may take in performing the on-site examination include, but not limited to the following:
 - 6.1.1. Interviews with staff;
 - 6.1.2. Review of reports, circulars, minutes of meetings, operating and financial reports, policies and procedures, etc;

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- 6.1.3. Consultation with advisors or external auditors;
- 6.1.4. Discussions with management;
- 6.1.5. "Mystery shopper" i.e. undercover visits to examine relevant areas from the perspective of a customer; and
- 6.1.6. Other means as may be deemed appropriate by DAB from time to time in its absolute discretion.

7. Presentation of Findings and Corrective Actions

- 7.1 After the completion of the on-site examination processes, DAB shall present the findings of its examination to the Management team of the Bank via a special meeting as to be arranged by the Management team with the presence of the Chief Executive Officer of the Bank as a mandatory requirement within seven (7) days of such notification of request by DAB.
- 7.2 In the event that DAB discovered any instances of non-compliant event by the Bank on any particular matter as described in this Manual hereto, the Board of Directors or other division nominated by them in the Bank has the responsibility of taking corrective actions within a specified time frame as decided by DAB and as duly communicated to the Bank. For the avoidance of doubt, overall responsibility for compliance issues rests with the Board of Directors of the Bank.
- 7.3 Such corrective actions are mandatory and shall be treated with utmost importance by the Bank for the purpose of improving its internal control system and business performance.
- 7.4 The Bank shall be given a grace period of six (6) months to perform the corrective actions, or a further extension period of time as duly granted by

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DAB upon specific request by the Bank underlying its reasons and justifications for such request, failing which the Bank may be subjected to punitive actions by DAB pursuant to Article 122 of the Afghanistan Bank Law.

8. Custodian of the Document

This On-Site Examination Manual shall be under the safe custody of the Islamic Banking Division of DAB. Any changes to the Manual shall be made by the Islamic Banking Division of DAB (hereinafter referred to as "the IBD"), as reviewed by the Governor of DAB and upon approval by the DAB Shariah Supervisory Board. A copy of the amended Manual shall be made available to all stakeholders for reference and implementation.

9. Effective Date of the Document

The Effective date of this Manual is the _____ day of _____ 20____