

DA AFGHANISTAN BANK
(CENTRAL BANK OF AFGHANISTAN)
Shariah Review Manual

Shariah Review Manual

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

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

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PART A: PREAMBLE

1. Background

- 1.1 This Shariah Review 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, 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 A Shariah Review process is an examination of a Bank's level of compliance, in all of its Shariah-compliant activities, with the requirements of the Shariah. This examination includes contracts, agreements, policies, products, transactions, memorandum and articles of association, financial statements and reports, circulars etc. All parties involved in conducting the Shariah Review, culminating with the Bank's Shariah Board have access to all records, transactions and information to conduct the Shariah Review.
- 1.3 The need for Shariah Review is mainly to provide confidence to the stakeholders on the Shariah compliance of the Islamic banking activities of the Bank. Shariah Review shall provide assurance on the integrity of the Bank's internal control system to ensure Shariah compliance. This Manual aims to provide guidelines on arrangements, structures and processes necessary to properly and effectively conduct Shariah Review within the Bank.

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- 1.4 Shariah Review shall constitute an integral part of the governance structure of the Bank and shall be read and interpreted in the light of the Shariah Governance Framework ("SGF") of the Bank.
- 1.5 The task of conducting the Shariah Review shall be upon the Shariah Department (for full-fledged Islamic Financial Institutions) and the Islamic Banking Department/Unit (for Islamic Window or Islamic Unit operations) of the Bank together with the Internal Audit division of the Bank if properly qualified and independent. Over the period of time, if the Bank establishes its own dedicated Shariah Review Department or has its own Shariah Review Officer within the governance structure of the Bank, then the Shariah Review Department/Officer shall bear the full responsibility of the duties as provided in this Manual hereto and if the department consists of more than one (1) person, the Head of the Shariah Review Department shall be responsible for the end-to-end Shariah Review processes.
- 1.6 For the avoidance of doubt, whenever any provision refers to "Shariah Department", reference is made to a full-fledged Islamic Financial Institution and whenever any provision refers to "Islamic Banking Department or Islamic Banking Unit", reference is made to a financial institution with an Islamic window or Islamic Unit. For the purpose of this Manual, all will hereinafter be referred to as the "the Shariah Department".
- 1.7 Any particular exemption to any of the provisions as provided herein shall only be permitted via a formal application being submitted by the Bank after prior consultation with its Shariah Board (hereinafter referred to as "the Shariah Board"), to the Shariah Supervisory Board of DAB (hereinafter referred to as "the SSB") outlining the reasons and justifications for such requests.

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- 1.8 If any new or additional guidelines on Shariah compliance are to be adopted, the Shariah Board of the Banks shall always be consulted first before the adoption of same.

2. Basis of Shariah Review from International Practices

- 2.1 Shariah Review under the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI):

Shariah Review is mentioned under the AAOIFI Governance Standard for Islamic Financial Institutions No. 3 (hereinafter referred to as "the Standard") where it describes the principles of Shariah Review (termed as Internal Shari'a Review), its objectives, processes as well as ethical considerations, performance, management and quality assurance of the review. The elements of an effective Shariah Review control system are also specified.

According to item 2 of the Standard, the objective of the Shariah Review is defined as follows:

".....to examine and evaluate the extent of compliance with Islamic Shari'a rules and principles, fatwas, guidelines, and instructions issued by the IFI's Shari'a supervisory board (SSB), hereafter referred to as Shari'a rules and principles."

- 2.2 Practice and Standard of Malaysia:

The requirement for Shariah Review is encapsulated in Malaysia's Shariah Governance Framework under Section VII, Principle 7 whereby the Shariah Review function (termed as Shariah Audit in the said framework) is defined as follows:

"the periodical assessment conducted from time to time, to provide an independent assessment and objective assurance designed to add value and improve the degree of compliance in

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relation to the Islamic Financial Institutions (hereinafter referred to as "IFIs") business operations, with the main objective of ensuring a sound and effective internal control system for Shariah compliance".

3. Purpose and Application

- 3.1 This Manual shall be applicable to the Shariah compliant business activities, operations and products of the Bank comprising of debt-based, fee-based and equity-based Islamic financing products.
- 3.2 The principles as provided in this Manual shall constitute a general guideline for the guidance to Banks and all Banks are expected to have their own internal Shariah Review Manual pursuant to their internal set-up and governance structure. Such specific principles as provided in the Banks' internal Shariah Review Manual shall be deemed acceptable so long that it does not explicitly contravene any of the provisions set out in this Manual hereto.

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.
- 4.2 This Manual shall be read together with the following manuals/guidelines:
- a) National Shariah Governance Framework; and
 - b) Shariah Compliance Manual

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PART B: POLICY AND PROCEDURES

5. Definition of Shariah Review

- 5.1 Shariah Review may be defined as 'the periodical assessment conducted from time to time, to provide an independent assessment and objective assurance designed to add value and improve the degree of compliance' in relation to the Bank's Shariah-compliant business activities, with the main objective of ensuring a sound and effective internal control system for Shariah compliance. Shariah Review as required by this manual shall be performed by the Shariah Department together with the Internal Audit Department pursuant to clause 1.5 hereto.
- 5.2 If required, the Shariah Review function may be outsourced to an external third party pursuant to the Guidelines on Outsourcing of Islamic Banking Operations as issued by DAB, but will be under the purview of the Shariah Department together with the Internal Audit Department.
- 5.3 Shariah Review is an independent assessment and objective assurance process that involves obtaining and evaluating sufficient and reliable evidence to establish whether the Bank's Shariah compliant activities and operations are in accordance with established Shariah criteria and recommending rectifications and improvements thereof.
- 5.4 Shariah Review helps the Bank to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of Shariah risk management, internal control for Shariah compliance and Shariah governance process.
- 5.5 Shariah Review involves executing of regular assessment on Shariah compliance in the Shariah compliant activities and operations of the Bank by a qualified Shariah review officer (hereinafter referred to as "Shariah

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reviewer”), with the objective of ensuring that the activities and operations carried out by the Bank do not contravene with the Shariah principles. For the avoidance of doubt, the Shariah reviewer may be the same person under the Shariah Department if the department has only 1 person at the time being.

6. Objectives of Shariah Review

6.1 The Shariah Review function shall provide an independent assessment and objective assurance of the Shariah compliance level of the Shariah compliant banking activities and operations, including the internal control for Shariah compliance.

6.2 Its primary objective is to ensure that the Management of the Bank discharges its responsibilities in relation to the implementation of the Shariah rules and principles as determined by the Bank's Shariah Board. This Manual provides guidance on the need to establish institutional arrangements and requirements to facilitate the effective implementation of Shariah Review as an integral component of the SGF of the Bank.

6.3 The Shariah Review objectives shall include but not limited to:

- a) Clearly specified internal control objectives in relation to Shariah compliance requirements;
- b) Adequacy of the internal control system in relation to Shariah compliance requirements;
- c) The effectiveness of the implementation of internal control system in relation to Shariah compliance requirements;
- d) The validity, completeness and timeliness of the documentary evidence in relation to Shariah compliance requirements;
- e) The effectiveness of implementation document control system in relation to Shariah compliance requirements;
- f) The adequacy and completeness of the standard operating procedures (SOPs) in relation to Shariah compliance requirements;

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- g) The adequacy, completeness, timeliness and reliability of the reporting system in relation to Shariah compliance requirements; and
- h) The adequacy, completeness and reliability of information technology applications and systems in relation to Shariah compliance requirements.

7. Shariah Review Reporting Channel

- 7.1 The organizational status of the Shariah Review shall be sufficient to accomplish its responsibilities and that it shall not be lower than that of the Internal Audit Department.
- 7.2 The Shariah reviewer shall have full and continuous support of the Management Board (hereinafter referred to as "the Management") and Board of Directors (hereinafter referred to as "the Board"). He shall have direct and regular communications with all level of managements including the Management, the Board, external auditors (if necessary) etc which shall enhance the organizational status of the Shariah reviewer.
- 7.3 The Shariah reviewer shall be responsible to the Management and the Management shall ensure full Shariah Review coverage, adequate consideration of the Shariah Review reports and appropriate action on the Shariah Review recommendations. The Management shall present Shariah Review findings to the Board at least on an annual basis and the Shariah reviewer shall be present during the time of the presentation at the BOD meeting.

8. Scope of Shariah Review

- 8.1 Shariah Review shall cover the review of the adequacy of the Shariah governance process of the Shariah Compliant business activities and operations of the Bank with reference to the established Shariah criteria.

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- 8.2 The scope of work encompasses the examination of the adequacy and effectiveness of the system of internal Shariah control and the quality of performance in carrying out assigned responsibilities. Shariah rules and principles shall provide direction to the scope of work and activities to be reviewed.
- 8.3 The purpose of the examination of adequacy of the internal Shariah control system is to ascertain whether the system provides reasonable assurance whether the Shariah compliant business activities of the Bank is effective and efficient in meeting the objectives of Shariah compliance. The examination of the effectiveness of the system is to ensure that the system was functioning as intended.
- 8.4 Hence effective planning, organizing and directing of the processes by the reviewer is necessary to determine whether reasonable assurance for the accomplishment of Shariah compliance objectives as well as other goals exist.
- 8.5 Shariah Review requirements shall comprise of all aspects of the Bank's Shariah compliant business activities and operations, including:
- a) the review of financial statements of the Bank's entire Shariah compliant business activities;
 - b) the review on organisational structure, people, process and information technology applications systems related to the entire Shariah compliant business activities;
 - c) the review of the Bank's Shariah compliant products and services; and
 - d) the review of adequacy of the Shariah governance process.
- 8.6 In the case of Shariah Review of the financial statements of the Bank, the Shariah reviewer shall attest that the items presented and disclosed in the

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- financial statements of the Bank to be compliant with Shariah requirements and in accordance with the guidelines approved by the Bank's Shariah Board. These may include matters such as segregation of funds in products such as deposits, investment accounts, financing, investment, recognition of income and expenses, income/profit distribution and purification of income (if any) as per the decisions made by the established Shariah criteria.
- 8.7 Shariah Review on people shall be aimed at providing assurance that the human resource policy addresses the need for competent staff with integrity to manage and execute Bank's Shariah compliant business activities and operations. The Human Resources management, with the approval from the Bank's Shariah Board is expected to develop human resource policy that caters for the specific needs of the Bank.
- 8.8 For the purpose of Shariah Review on the Bank's processes such as the offering of Islamic financial products and services, the Shariah reviewer shall ensure that the Bank satisfies the following requirements:
- a) avoid activities and operations that are prohibited by the Shariah;
 - b) fulfilment of the contract requirements and conditions of the contracts according to the Shariah principles and in accordance with the guidelines approved by the Bank's Shariah Board and SSB;
 - c) proper application of Islamic commercial contracts' concepts and principles in contracts and agreements as well as product features and mechanisms; and
 - d) the Bank's Shariah compliant activities and operations shall satisfy the Bank's policies and objectives that are consistent with the Shariah.
- 8.9 Shariah Review shall assess and reasonably assure that the Shariah governance process as required by the SGF of the Bank is adequately addressed by the Bank. The Shariah reviewer shall review the roles and functions of the Management and the Bank's Shariah Board in ensuring the Shariah compliant activities and operations are in place.

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8.10 The Shariah Review shall assess and reasonably assure that the formal reporting channel on Shariah matters is carried out effectively and in a timely manner.

8.11 The established Shariah criteria shall include:

- a) the Shariah resolutions and decisions by the Bank's Shariah Board;
- b) the approved product manuals and the standard operating procedures (SOPs) of the Shariah Department of the Bank; and
- c) in arriving at its decisions on Shariah compliance, the Bank's Shariah Board shall have regard to the relevant pronouncements on Shariah matters issued by the SSB.

8.12 In the event(s) of conflict among or between any of the above criteria, the matters shall be referred to the SSB for a final decision. This is to ensure that the Bank's Shariah compliant business activities and operations are in compliance with the highest authority in Afghanistan.

9. Competency of the Shariah Reviewer

9.1 The Shariah reviewer shall be competent in both, his technical skills and his Shariah knowledge relevant to the Shariah Compliant Banking business activities and operations of the Bank. While Shariah knowledge refers to the appreciation of substantive principles of Islamic law and the technicalities of the resolution, technical skills refer to his competency in understanding the whole process of the product offering from the submission, approval, implementation, core banking system to the recovery as well as in underpinning any Shariah gap in this whole process.

9.2 On knowledge competency, the basic qualifications of the Shariah reviewers shall be as follows:

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- a) having a relevant bachelor degree or professional qualification in Shariah or alternatively has been working in Islamic banking for more than 2 years;
- b) having adequate knowledge and understanding of the functions of a bank, and the Islamic products and services available under the contemporary Islamic Banking and Finance industry covering the whole process of a bank ; and
- c) having adequate knowledge and understanding of doing the review in order to find the Shariah gaps or breach as well as to propose recommended roadmap for a better Shariah compliance for processes and system.

9.3 Adequate knowledge and understanding on the functions of banks and the Islamic products and services as stated under Clause 9.2 (i) above means that the Shariah reviewer shall be well-versed in the following areas:

- a) Islamic principles underlying the Islamic financial contracts such as ijarah, murabahah, wadi'ah etc;
- b) basic operations of the products and services including accounting treatment, the computation of profit, profit distribution policy, penalty charge, etc;
- c) Shariah resolutions and decisions of some notable Shariah Boards and/or Shariah standards;
- d) relevant and applicable pronouncements on Shariah matters; and
- e) Relevant processes being adopted in the Bank covering the whole value chain of a product offering

9.4 The Shariah reviewer shall maintain their technical competence through continuing education in order to maintain their proficiency and further develop their ability to conduct the Shariah Review exercise in the subsequent years. The Management shall bear the responsibility of sending the Shariah reviewer to the relevant trainings at least two (2) times in a year to ensure the continuous progress of their personal development.

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- 9.5 To ensure an effective Shariah Review control system and management process is in place, the Shariah reviewer shall not undertake any operational activities of the Bank to avoid any potential of conflict of interest.

10. Performance of the Shariah Review Work

The performance of Shariah Review work comprises of the following:

10.1 Planning and Documentation:

- a) establishing Shariah Review objectives and scope of work;
- b) obtaining Shariah Board's and SSB's resolutions, guidelines, instructions, prior year Shariah Review results (if applicable) and other relevant correspondence with supervisory and regulatory agencies;
- c) determining the capacity as well as resources to perform the review;
- d) communicating with relevant parties involved with the review;
- e) performing feasibility survey and interview on activities, risks and controls to identify areas of emphasis;
- f) developing Shariah Review programmes;
- g) determining mode and timing review results to be communicated; and
- h) obtaining approval of the Shariah Review work plan from concerned authorities including the Bank's Shariah Board.

10.2 Examining and evaluating Shariah Review information:

The Shariah reviewer shall collect, analyze, interpret and document information related to Shariah Review objectives to support their Shariah Review results. Types of information are as follows:

- a) examination of documents;

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- b) observations;
- c) analytical reviews;
- d) inquiries; and
- e) discussion with Management

The quality of information should be sufficient, relevant, reliable and useful to provide sound basis for Shariah Review findings and recommendations. All prepared working papers by the reviewer should be complete, organized, reviewed by the head of department and retained for a specified period.

10.3 Reporting:

Quarterly reporting to the Management and copies to Bank's Shariah Board shall be made. Prior to issuing the report, the Shariah reviewer shall discuss conclusions and recommendations with the Shariah Department of the Bank (in the case the Shariah Department consist of more than one(1) officer) who has responsibility for ensuring Shariah compliance. The quality of report should be objective, clear, constructive and timely. The report shall include the following:

- a) purpose;
- b) scope;
- c) findings;
- d) opinion;
- e) recommendations;
- f) corrective actions;
- g) feedback from those reviewed; and
- h) any disputes relating to Shariah interpretation to be resolved with Bank's Shariah Board.

10.4 Follow up:

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The Shariah reviewer has a duty to follow up with corrective action(s) and recommendation(s) so as to ensure that the gap/breach is rectified and to prevent recurrence of future non-compliance.

11. Due Professional Care

The Shariah reviewer shall exercise due professional care in performing the Shariah Review exercise. The level of professional care exercised shall be proportionate to the complexity of the Shariah Review exercise undertaken.

12. Quality Assurance of Shariah Review

12.1 The Shariah Board and Management shall implement adequate quality control policies and procedures to ensure that the Shariah Review is conducted in accordance with AAOIFI Governance Standard for Islamic Financial institutions No. 3 or any other standards or guidelines approved by Bank's Shariah Board.

12.2 Quality control procedures may include review of all work papers to ensure that review procedures were properly understood and executed. Additional discussions may be held with the Management, if required, to ensure that all significant matters were covered during the review.

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13. Custodian of the Document

This Manual shall be under the safe custody of the Islamic Banking Division (“IBD”) of DAB. Any changes to this Manual 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 Manual shall be made available to all stakeholders and SSB members for reference and implementation.

14. Effective Date of the Document

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