

**DA AFGHANISTAN BANK
(CENTRAL BANK OF AFGHANISTAN)**
Verification Process Manual for Islamic Banking Products

***Verification Process Manual for Islamic Banking
Products (Post – Resolution Issuance by the Shariah
Board)***

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, VERIFICATION PROCESS MANUAL FOR
ISLAMIC BANKING PRODUCTS (POST RESOLUTION)**

PART A: PREAMBLE

1. Background

- 1.1. This Verification Process Manual for Islamic Banking Products (post – resolution issuance by the Shariah Board) (hereinafter referred to as “the Manual”) is issued by the Da Afghanistan Bank (hereinafter referred to as “DAB”) which shall be adopted and become part of 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 debt-based financing products initially with equity based products to follow in the future.
- 1.2. This Manual shall be used by the Bank’s Shariah Department (for full-fledged Islamic Banks) or Islamic Banking Department/Unit (for Conventional Banks operating under an Islamic Window/Unit) in conjunction with the Shariah resolution (Fatwa) issued by the Bank’s Shariah Board (hereinafter referred to as “the Shariah Board”) in relation to any Islamic Banking products being offered by the Bank.
- 1.3. The Manual will be used to ensure the correct Shariah compliant operationalization and offering of the Islamic Banking Product.
- 1.4. For the avoidance of doubt, in the event of a conflict between the provisions of this Manual and the Fatwa of an Islamic Banking product, the Fatwa of the Islamic Banking product will prevail.

2. International Best Practices

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- 2.1. The Accounting and Auditing of Islamic Financial Institutions (hereinafter referred to as "AAOIFI") have not issued a standard on the verification process for Islamic financial products.
- 2.2. The Islamic Financial Services Board (hereinafter referred to as "the IFSB") have also not issued any guidance on this issue.
- 2.3. The current international practice is to leave this issue under the purview of the respective Shariah Board of the Bank.
- 2.4. However in accordance with Clause 5 of the AAOIFI Governance Standards for Islamic Financial Institutions No.2 Shariah Review (hereinafter referred to as "the Governance Standard") the responsibility for compliance rests with the Management Board of the Bank (hereinafter referred to as "the Management").
- 2.5. Clause 5 of the Governance Standard reads as follows:

" 5 While the Shari'a Supervisory Board is responsible for forming and expressing an opinion on the extent of an Islamic Financial Institution's ("IFI's") compliance with the Shari'a, the responsibility for compliance therewith rests with the management of an IFI. (Consideration should be given to the definition of management in relevant national legislation and regulations). To enable management to carry out this responsibility effectively, the Shari'a Supervisory Board of the IFI shall assist by providing guidance, advise and training relating to compliance with the Shari'a. The Shari'a review of an IFI's does not relieve management of their responsibility to undertake all transactions in accordance with the Shari'a. It is the management's responsibility to provide to the Shari'a Supervisory Board all information relating to the IFI's compliance with Shari'a."
- 2.6. Therefore, in the Islamic Republic of Afghanistan context, the entity that shall ensure the verification process of the Islamic Banking Products is the Shariah Department/ Islamic Banking Department/Unit of the Bank (hereinafter collectively referred to as "the Shariah Department").

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3. Purpose and Application

- 3.1. The Manual aims at providing the appropriate methodology to ensure that the resolutions issued by the respective Shariah Board for Islamic banking products are fully complied with and that the various Islamic banking products approved by the Bank's Shariah Board are offered to the market in a Shariah-compliant manner and the operation of the Islamic Banking product is conducted by the Bank in a Shariah-compliant manner.
- 3.2. The Manual shall only be applicable to the Banks as defined above, the provisions of same shall not apply to full-fledged conventional banks.
- 3.3. The provisions of the Manual shall take effect after a resolution is issued by the Banks's Shariah Board in relation to any Islamic banking product. Prior to the issuance of a resolution, the product shall be governed under a separate Manual entitled "Approval Procedure Manual for Financial Products".
- 3.4. The principles as set out in this Manual shall constitute a general guidance for Banks and all Banks are expected to provide their own detailed Islamic financial product verification system. Such specific systems shall be deemed acceptable so long that it does not explicitly contravene any of the provisions as contained in this Manual.

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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. These Guidelines shall be read together with the following documents:
- 4.2.1. Guidelines on Product Transparency and Disclosure;
 - 4.2.2. The National Shariah Governance Framework;
 - 4.2.3. The Shariah Compliance Manual;
 - 4.2.4. The Shariah Review Manual;
 - 4.2.5. The On-Site assessment Manual;
 - 4.2.6. The Off-Site assessment Manual;
 - 4.2.7. The Shariah financial products approval procedure Manual;
and
 - 4.2.8. Other relevant regulations, manuals, guidelines or circulars that DAB may issue from time to time.

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PART B: POLICY AND PROCEDURES

5. Overall Policy objectives

- 5.1. The most important overall control objectives of banks are the following:
- 5.1.1. Identify the most important legal problems that may conflict with the application of resolutions issued by the Shariah Board and to find practical solutions to these issues with the assistance and approval of the Bank's Shariah Board and their legal advisors;
 - 5.1.2. Maintain the Bank's funds and funds of investment account holders according to the controls and standards prescribed by regulator and the Shariah Board;
 - 5.1.3. Commitment to fundamentals, policies, rules and regulations set by the Bank. Where the Bank finds Shariah compliance issues it must conduct analysis on their causes, and make recommendations for the treatment of same as soon as possible;
 - 5.1.4. Reassurance that the Bank's activities are conducted in accordance with the provisions and principles of Islamic law in general, as well as in accordance with the legal opinions and interpretations issued by the Sharia Supervisory Board of DAB (hereinafter referred to as "the SSB") and the Bank's own Shariah Board.
- 5.2. Overall supervision of Banks covers the following key areas :
- 5.2.1. Shariah compliance control;
 - 5.2.2. Financial control;
 - 5.2.3. Administrative control; and
 - 5.2.4. Banking supervision.
- 5.3. As clauses 5.2.2. , 5.2.3 and 5.2.4 are dealt with separately by DAB, this Manual will deal only with supervision of Shariah compliance control.

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6. Policy Requirements – Shariah Fundamental Tracking Points (SFTPs)

- 6.1. All Islamic Banking products and variations to the original products offered by the Bank to the market must have a signed resolution issued by their Shariah Board. The resolution should include the necessary product features and the Shariah basis of the product. The resolution may, however, include other aspects such as legal documentation and commercial aspects of the product.
- 6.2. The process for ensuring that Islamic banking products are approved in a Shariah-compliant manner is particularly set out in the manual entitled "Approval Procedure Manual for Islamic Financial Products."
- 6.3. The Shariah Department must keep the original resolutions in duplicate and a resolution Certificate (an abbreviated version of the original resolution where the original resolution may contain proprietary information or commercially sensitive information), in a secure location and shall cause digital copies of the same to be for back-up purposes.
- 6.4. It shall be a matter of the Bank policy whether to produce the resolution or a resolution Certificate to customers who may enquire for the same. The production of resolution to a third party must be recorded for record purposes to control the circulation of the resolution in the market.
- 6.5. The Shariah Department shall ensure that the minutes of the Shariah Board meeting (hereinafter referred to as "the Minutes") that approved the particular Islamic Banking Product are endorsed by the scholars and that an extract of the Minutes is incorporated within the original text of the resolution (wherever relevant and applicable). The Minutes are not to be released to the public.
- 6.6. The Shariah Department must further ensure that all documents approved by the Shariah Board in the resolution (and approved amendments

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- thereto) for the relevant Islamic Banking product are used by the front office in the sequence prescribed in the resolution.
- 6.7. The Shariah Department must monitor the Islamic product's implementation to ensure compliance with Shariah principles with special focus on areas of potential Shariah non-compliance conducts risks and to propose the relevant proactive actions to avoid this potential non-compliance. This may relate to the section of the most likely areas of breach of Shariah compliance in respective product guideline.
 - 6.8. The Shariah Department shall ensure that all translations of the resolution and the associated documents post approval, if relevant and applicable, are carried out by a duly accredited translator. The translation shall also be equally vetted and endorsed by the Shariah Board.
 - 6.9. The Bank shall ensure that, post-product approval, the product is brought to market in a manner that is consistent with the underlying resolution and all approved marketing materials, legal documentation and accounting treatment approved by the Bank's Shariah Board.

7. Methods of Control

- 7.1. Intended methods of control to be engaged by the observer (in this case the "Shariah Officer" for both full-fledged and Islamic Window/Unit operations) are as follows:
 - 7.1.1. **Personal control method:** This refers to the action of the Shariah Officer himself to undertake the field visits to the Bank and its affiliates, subsidiaries and related offices/branches. The Shariah Officer will interview all types of Bank's personnel covering front office, middle and back office staff as well as the branch manager and his personnel. This method of control is very important and effective because there could be many breaches that could have occurred in the detailed practices which are not visible from documents and paper work-related activities;

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- 7.1.2. **Sudden control method:** Under this method, the Shariah Officer may, periodically, set an uninformed visit to some departments or branches or activities of the Bank. The primary objective is to observe the quality of adherence to the Shariah principles and processes in day-to-day works and activities;
- 7.1.3. **Review method:** The examination of the documents, accounts and records and files in order to check that the financial transactions have been recorded in the books and the accounting information contained therein reflects the activities carried out by the Bank during the period.

8. Works of the Shariah Officer

- 8.1. The Shariah Department shall be responsible for establishing a culture within the organisation that emphasises and demonstrates to all levels of personnel the importance of internal controls. All personnel at Shariah Department need to understand their role in the Shariah internal controls process and be fully engaged in the process.
- 8.2. The Shariah Department shall appoint a Head Shariah Officer (only in situation where the Department consists of more than one (1) person) who will be in charge of verifying that the Bank's Islamic Operations are processed according to procedures using the methods of control outlined above. His primary duty will be to minimise operational non-Shariah compliance risks arising from the marketing, originating and processing of Shariah compliant products and to ensure Shariah compliance in an end to end basis for all operations in the Bank. The Head Shariah Officer shall report to the Board of Directors on an annual basis. The Head Shariah Officer shall have the following responsibilities:
- 8.3. **First control level:** it includes all the controls carried-out permanently by the Bank itself and by the hierarchy or performed automatically when integrated into the Information Technology (IT) processes.

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- 8.3.1. Developing and implementing Shariah Compliance Manual or Shariah Review Manual (as the case may be) and Control strategies and Procedures approved by the Shariah Board;
 - 8.3.2. Developing the operational applicable internal Shariah audit and control objectives and scope of work;
 - 8.3.3. Determine the resources required to identify, monitor and control Shariah non-compliance risk in the Bank's operations.
- 8.4. **Second control level:** this ex-post control is carried out continuously and systematically by the Head Shariah Officer or his nominee. It aims to check the regularity of control operations of the first control level. It is performed through Shariah Fundamental Tracking Points (hereinafter referred to as "SFTP"), which are mandatory controls covering major Shariah rules.
- 8.4.1. Define with the Shariah Board and Business Line Managers SFTP of the Islamic Banking operations (depending on the implemented products). Business Line and support departments Managers (where relevant) are responsible of the operational implementation of the SFTP;
 - 8.4.2. Performing regular surveys and interview with the bank's departments including the front, middle and back office, on activities to identify areas of non-compliance. The Shariah Officer shall, in consultation with the Shariah Board, determine what level of regularity shall be observed in engaging Bank staff in surveys and interviews;
 - 8.4.3. Co-ordinating with the permanent control Controllers for the establishment of applicable controls to ensure Shariah – compliance is observed for both existing products and any amendments made thereto and new products being brought to market;
 - 8.4.4. Launching of Permanent Control reporting campaign and the consolidation of the control results;

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- 8.4.5. Regularly reporting to the Board of Directors with copies of the quarterly reports distributed to the Shariah Board. Quality of report should be objective, clear, constructive and timely. Reports shall include the Purpose, Scope, Findings, Opinion, recommendations, and corrective actions;
- 8.4.6. Identify legal issues that may arise for example:
- 8.4.6.1. Make sure there is evidence of transactions, for example, in relation to products involving the Commodity Murabaha which is the responsibility of bank employees, the front office to ensure the customer signs the relevant documents and the back office to ensure that the trade occurs and the money realised from the trade are passed to the customer / bank (as the case may be) in a proper manner;
 - 8.4.6.2. Refer the issues arising in the operations that are not literally covered by a resolution to the Bank's Shariah Board to issue a resolution or enhance the resolution (as the case may be);
 - 8.4.6.3. To make suggestions and recommendations to the Shariah Board to ensure compliance with resolutions is as operationally smooth as it can be;

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9. Operational Procedures To Verify Compliance Of The Financial Products Of The Bank With Resolutions Issued

- 9.1. These procedures are as follows :
- 9.1.1. The field study and collect data and information on the nature of the Islamic Banking Products offered by the Bank;
 - 9.1.2. Evaluate the understanding and commitment of staff controls to the Islamic Banking Product;
 - 9.1.3. Develop a plan and program audit and forensic audit selection methods and in light of the goals of the Shariah Department and the Shariah Board;
 - 9.1.4. Identification of the evidence necessary to audit all Islamic banking products of the Bank;
 - 9.1.5. The implementation of a verification process for Shariah-compliance according to plan, program and methodology approved by the Shariah Board. For the avoidance of doubt, Shariah verification process is only concerned with the Shariah aspects of Islamic Banking Products. Know Your Customer ("KYC") and other regulatory compliance issues are **not** within the purview of a Shariah verification process;
 - 9.1.6. To obtain clarifications on some of the issues that appear when a Shariah verification process takes place;
 - 9.1.7. The preparation of periodic reports containing notes and foundations settled and recommendations to be utilized in the future; and
 - 9.1.8. Follow the Shariah periodic reports to check that steps were taken by the Bank to implement recommendations contained therein;

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9.2. The sample report template in **Clause 10** hereto shall be approved by the Shariah Board for each product offered by the Bank. The level of sampling required for a valid verification process to be compiled will be deliberated by the Shariah Board of the Bank and their determination on this issue minuted and approved at the next Shariah Board meeting.

10. Sample Report Template

<p>Bank Islamic Sharia Supervisory Management</p>	<p>Verification (post resolution) program Current accounts And issuing cheques</p>			
<p>- Branch name :</p> <p>- name of the department :</p> <p>- name of the section :</p> <p>- Audit type :</p> <p>- Sample size :</p>	<p>- the name of the branch manager :</p> <p>- the name of the Director of Administration :</p> <p>- Head of Department Name :</p> <p>- the date of the beginning of the audit :</p> <p>- the date of the end of the audit :</p>			
M	Operational procedures	Evidentiary requirements	Verification style	Notes
1	Original signed resolution together with minutes of Shariah Board Meeting approving same.	Sight documents	Review /Audit	
2	Up to date transaction documents with minutes of Shariah Board minutes approving latest version of same.	Sight documents	Review /Audit	
3	Audit of the contract between the client and the Bank to open a current	Image	Review /Audit	

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<p>4</p> <p>5</p> <p>6</p> <p>7</p> <p>8</p> <p>9</p>	<p>account.</p> <p>Audit fees and fees and commissions charged to the client in the light of the regulations of the Central Bank (DAB) and internal regulations of the Bank.</p> <p>Check the actual fees and expenses deducted from the customer's account against the schedule of charges of the product approved by the Shariah Board.</p> <p>Audit confirmations sent to the customer and examine the differences, if any.</p> <p>Discuss Shariah observations with the employee and ways to address them.</p> <p>Preparation of reports and send them to the competent authorities.</p> <p>Follow-up reports to check on the proper path to take.</p>	<p>Regulations issued by DAB</p> <p>Sight statements</p> <p>Image authentication Sent Image reply</p> <p>Minutes discussion</p> <p>Reports</p> <p>Reports</p>	<p>Review /Audit</p> <p>Review / Audit</p> <p>Field visit</p> <p>Delivery</p> <p>Follow-up</p>	
<p>Shariah Officer</p>	<p>Shariah Officer</p>			

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11. Custodian of the Manual

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.

12. Effective Date of the Manual

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