

# SIGAR

**Special Inspector General for  
Afghanistan Reconstruction**

**SIGAR 14-16 Audit Report**

## AFGHANISTAN'S BANKING SECTOR: THE CENTRAL BANK'S CAPACITY TO REGULATE COMMERCIAL BANKS REMAINS WEAK



JANUARY  
2014

# SIGAR

## Special Inspector General for Afghanistan Reconstruction

### WHAT SIGAR REVIEWED

The near collapse of Kabul Bank in September 2010 raised major concerns among U.S. and other international donor agencies regarding the capacity of Afghanistan's central bank, Da Afghanistan Bank (DAB), to regulate Afghanistan's commercial banks through its Financial Supervision Department. This department is responsible for ensuring the health of the banking sector by controlling the issuance of licenses and regulating Afghanistan's commercial banks and other financial institutions. It conducts off-site monitoring of financial activities and on-site examinations that scrutinize policies, procedures, and compliance with Afghan laws and regulations.

SIGAR previously reviewed U.S. efforts to improve the Afghan government's capacity to regulate the financial sector and to strengthen controls and tracking of U.S. funds flowing through the Afghan economy (SIGAR Audit 11-13).

We conducted this audit to determine the extent to which various U.S. government agencies, as well as key international donors, have taken steps to strengthen the regulatory capacity of DAB following the near collapse of Kabul Bank.

SIGAR conducted this work in Kabul, Afghanistan and Washington, D.C. from June 2013 to January 2014.

---

January 2014

## Afghanistan's Banking Sector: The Central Bank's Capacity to Regulate Commercial Banks Remains Weak

---

### SIGAR 14-16 AUDIT REPORT

#### WHAT SIGAR FOUND

Afghanistan's banking sector remains fragile and in need of robust regulation by Da Afghanistan Bank (DAB). Further, forensic audits of major commercial banks in Afghanistan have identified systemic weaknesses in many areas of banking governance and operations, including personnel capacity, internal controls, accounting, credit analysis, and compliance with regulations. DAB's ongoing limitations and inability to conduct robust oversight allows such weaknesses in Afghan banks to remain unchecked, heightening the risk of another banking crisis.

The U.S. Agency for International Development (USAID), the Department of the Treasury (Treasury), the Department of State (State), and the Department of Defense have not provided technical assistance to DAB since 2011, when Afghan President Hamid Karzai banned U.S. advisors from working with the central bank. However, the DAB Financial Supervision Department's (FSD) capacity to fulfill its banking sector regulatory functions is severely limited and in need of outside technical assistance to help it meet international standards. Treasury and USAID expressed a willingness to resume technical assistance to DAB and have established conditions that the Afghan government and DAB must fulfill before the agencies will take steps to resume activities at DAB. To date, however, the Afghan government has not accepted these conditional offers of assistance.

In addition, technical support from international organizations remains quite limited. U.S. agency officials stated that, following the Kabul Bank crisis, international organizations, such as the World Bank and the International Monetary Fund, became the primary providers of capacity development programs at DAB FSD. However, World Bank officials told SIGAR they are terminating one of the bank's two programs with DAB because of unsatisfactory results caused, in part, by "a deteriorating security environment." The IMF does not currently have any advisors assisting DAB.

In conclusion, the Afghan banking sector remains unstable and at risk of experiencing another crisis similar to the near collapse of Kabul Bank.

#### WHAT SIGAR RECOMMENDS

Given the current impasse between the U.S. and Afghan governments regarding conditions that must be met before additional technical assistance is provided to DAB, SIGAR is not making any recommendations at this time. However, because of the fragile state of the banking sector and its importance to the overall stability of Afghanistan, SIGAR will continue to carefully monitor the situation.



**SIGAR**

Office of the Special Inspector General  
for Afghanistan Reconstruction

January 8, 2014

The Honorable John F. Kerry  
Secretary of State

The Honorable Charles T. Hagel  
Secretary of Defense

The Honorable Jacob J. Lew  
Secretary of the Treasury

Dr. Rajiv Shah  
Administrator, U.S. Agency for International Development

This report discusses the results of SIGAR's audit of U.S. government and international efforts to strengthen the regulatory capacity of the Afghan central bank (Da Afghanistan Bank or DAB) after the near collapse of Kabul Bank in September 2010. We found that U.S. government agencies terminated all of their programs providing assistance to DAB after the Kabul Bank crisis, and have not reengaged due, in part, to the Afghan government's reluctance to meet conditions stipulated by the U.S. government that must be fulfilled before assistance to DAB is resumed. In addition, we found that support to DAB from international institutions, such as the World Bank and International Monetary Fund, is limited.

Given the current impasse between the U.S. and Afghan governments regarding assistance to DAB, we are not making any recommendations at this time. However, because of the fragile state of the banking sector and the importance of this sector to the health and stability of Afghanistan's economy, we will continue to closely monitor this situation.

We received technical comments on a draft of this report from the Department of State, the Department of the Treasury, and the U.S. Agency for International Development, which we incorporated into this report, as appropriate. We also provided the draft report to the Department of Defense, which did not submit any comments. SIGAR conducted this work under the authority of Public Law No. 110-181, as amended, and the Inspector General Act of 1978, as amended; and in accordance with generally accepted government auditing standards.

A handwritten signature in black ink, appearing to read "John F. Sopko".

John F. Sopko  
Special Inspector General  
for Afghanistan Reconstruction

CC: The Honorable James B. Cunningham  
U.S. Ambassador to Afghanistan

## TABLE OF CONTENTS

Background.....	4
U.S. and International Support for DAB FSD Has Been Limited Following the Near Collapse of Kabul Bank .....	5
Conclusion.....	10
Agency Comments .....	11
Appendix I - SCOPE AND METHODOLOGY .....	12
Appendix II – ACKNOWLEDGMENTS.....	13

## ABBREVIATIONS

---

AML/CFT	Anti-Money Laundering/Countering the Financing of Terrorism
DAB	Da Afghanistan Bank
DOD	U.S. Department of Defense
ECF	Extended Credit Facility
EGGI	Economic Growth and Governance Initiative
FSD	Financial Supervision Department
IMF	International Monetary Fund
State	U.S. Department of State
Treasury	U.S. Department of the Treasury
USAID	U.S. Agency for International Development

In 2003, Afghanistan's central bank (Da Afghanistan Bank or DAB) resumed regulatory functions necessary to ensure the stability of the country's banking sector. Since then, Afghanistan's banking sector has grown from two state-owned commercial banks and four state-owned special purpose development banks to nine privately-owned commercial banks, three state-owned commercial banks, and four foreign commercial banks, with more than 400 total branches across Afghanistan.<sup>1</sup>

Between 2003 and 2010, DAB's Financial Supervision Department (FSD), which is responsible for ensuring the health of the banking sector by controlling the issuance of licenses for banks and other financial institutions, failed to provide the oversight needed to identify the issues that led to the near collapse of Kabul Bank, then the largest banking service provider in Afghanistan. At the time of its near collapse in September 2010, Kabul Bank had an extensive network of branches and its services included the distribution of most Afghan government salaries. In November 2012, the Independent Joint Anti-Corruption Monitoring and Evaluation Committee issued a report on the collapse of Kabul Bank.<sup>2</sup> The committee determined that the bank was used to run an investment scheme in a "regulatory vacuum," diverting savings assets to personal and business ventures. Kabul Bank's near collapse resulted in a bail-out from the Afghan government at a cost of more than \$800 million—approximately five to six percent of Afghanistan's gross domestic product—potentially depriving the Afghan people of important services and programs. Since the Kabul Bank crisis, and the massive Afghan government bail-out, international scrutiny of other commercial banks in Afghanistan has intensified and identified systemic weaknesses.

Afghanistan's fragile banking sector requires robust financial supervision. According to the International Monetary Fund (IMF), a well-regulated financial system is essential for both domestic and international economic and financial stability. Further, assisting the Afghan government to develop the financial capabilities it needs to function independently is a key reconstruction objective of the U.S. and Afghan governments, as well as the international community.

We conducted this audit to determine the extent to which U.S. agencies, including the Department of Defense (DOD), the Department of State (State), the Department of the Treasury (Treasury), and the U.S. Agency for International Development (USAID), as well as key international donors have taken steps to strengthen the oversight and regulatory capacity of DAB following the near collapse of Kabul Bank. This report will be followed by a separate audit report which evaluates the process by which U.S. agencies provide direct assistance funds to the Afghan government and the internal controls in place to safeguard those funds while deposited in Afghan banks.

To accomplish this objective, we reviewed Afghan laws and U.S. policies and plans relevant to U.S. initiatives to improve DAB's capacity to regulate Afghanistan's banking sector. Additionally, we analyzed assessments conducted by Afghan and international organizations to determine the capacity and needs of the bank. We met with officials from State, Treasury, DOD, USAID, and DAB. We also met with officials from international donor organizations such as the IMF and the World Bank, which implement capacity development programs with the Afghan government. We conducted our work in Washington, D.C. and Kabul, Afghanistan from June 2013 through January 2014, in accordance with generally accepted government auditing standards. Appendix I includes a discussion of our scope and methodology.

---

<sup>1</sup> According to the World Bank, Afghanistan Economic Update, April 2013, the total assets of the Afghan banking sector amount to about \$4.4 billion with approximately \$3.8 billion in total liabilities.

<sup>2</sup> Independent Joint Anti-Corruption Monitoring and Evaluation Committee, *Report of the Public Inquiry into the Kabul Bank Crisis*. November 15, 2012. The committee monitors and evaluates national and international efforts to fight corruption in Afghanistan. It reports to the public, Afghan parliament, Afghan president, and international community.

## BACKGROUND

---

DAB was established in 1939, but by the end of 2001, the formal Afghan financial system<sup>3</sup> was nearly nonexistent and, according to DAB, its sole function was printing Afghan currency. Since then, the Afghan government and DAB have executed numerous reforms to the Afghan banking sector to develop a modernized financial system and, in 2003, the Afghan government revised DAB's governing legislation. As a result of that legislation, the Afghan government gave DAB responsibility to maintain domestic price stability, foster a stable financial system, and promote an efficient national payment system and sustainable economic growth. To achieve these objectives, DAB formulates and executes the government's monetary policy, and licenses and regulates financial institutions operating in Afghanistan. DAB FSD is responsible for ensuring the health of the banking sector by controlling the issuance of licenses for banks and other informal financial institutions, such as hawalas and foreign exchange dealers.<sup>4</sup> The department is also responsible for regulating Afghanistan's commercial banks and other financial institutions by conducting off-site monitoring of financial activities and on-site examinations that scrutinize policies, procedures, and compliance with applicable laws and regulations.

In early September 2010, the Afghan banking sector experienced a major setback when news of widespread fraud at Kabul Bank caused the withdrawal of almost half of the bank's deposits, nearly causing the collapse of the country's largest bank and provider of government salaries. The Kabul Bank crisis highlighted the weaknesses of DAB, and particularly the FSD, in fulfilling its core functions. Following the Kabul Bank crisis, a number of stakeholders, both Afghan and international, reviewed FSD's capacity to fulfill its regulatory and oversight functions, and identified several areas that needed improvement.<sup>5</sup> The following are some of FSD's oversight and regulatory lapses that these stakeholders identified as contributing factors in the near collapse of Kabul Bank:

- FSD did not conduct rigorous background checks on bank shareholders.
- After issuing a license to, and the opening of, Kabul Bank, FSD did not confirm that the operations of the bank were consistent with the submitted licensure application.
- FSD did not conduct any on-site examinations of Kabul Bank for the first 2.5 years of the bank's operations.
- FSD did not have an information technology specialist available to provide expertise at on-site examinations, preventing it from verifying key information and accounting records provided by Kabul Bank.
- FSD did not ensure Kabul Bank branches obtained legally-required permits.
- FSD failed to impose and collect a fine when Kabul Bank failed to maintain minimum required reserves.

---

<sup>3</sup> According to the IMF and the World Bank, after years of conflict, confidence in the banking system in Afghanistan was absent in 2001, and most organizations operating in Afghanistan used the informal financial sector to conduct banking business. *The IMF and the World Bank, Informal Funds Transfer Systems: An Analysis of the Informal Hawala System*, March 23, 2003.

<sup>4</sup> Hawala dealers are individuals engaged in an informal money transfer system common in the Middle East and South Asia. Under Afghan law, all operating hawalas are required to be licensed and report their transactions periodically to DAB. Money service providers are individuals or entities that engage in funds transfers, and they may also provide safekeeping and check cashing services.

<sup>5</sup> The reviews include USAID Office of Inspector General, *Review of USAID/Afghanistan's Bank Supervision Activities and the Kabul Bank Crisis*, March 16, 2011; The World Bank, *Afghanistan Economic Update* October, 2010; IMF Country Report, *First Review Under the Extended Credit Facility Arrangement*, August, 2012; Independent Joint Anti-Corruption Monitoring and Evaluation Committee, *Report of the Public Inquiry into the Kabul Bank Crisis*, November 15, 2012. In addition, other reports such as Kroll's Forensic Audit of Kabul Bank, and Afghan government's Memorandum of Economic and Financial Policies, discuss the lapses in DAB FSD's oversight capacity.

- Kabul Bank produced internal policy documents in accordance with DAB's Regulation on Corporate Governance; however, when FSD found that the bank did not comply with its own policies, FSD did not hold Kabul Bank accountable for the violations.

To address some of the weaknesses identified in the aftermath of the Kabul Bank crisis, these stakeholders made a number of recommendations to the Afghan government and DAB to help prevent future financial crises. The IMF, in renewing its Extended Credit Facility (ECF)<sup>6</sup> program, proposed several terms intended to reform Afghanistan's financial system and regulatory regime. By agreeing to meet these terms, the Afghan government would qualify for assistance financing under the IMF's ECF program. The Afghan government initially did not agree with key elements of the proposed program, resulting in a delayed renewal of the ECF, which in turn negatively affected funding levels from other international donors, including the U.S. government.<sup>7</sup> Ultimately, the Afghan government agreed to the key IMF demands, and the IMF approved a renewed ECF program. Under the renewed program, the Afghan government committed to achieving reforms throughout the government, including at DAB FSD, by agreeing to meet IMF's proposed benchmarks for the ECF program.<sup>8</sup>

DAB's Action Plan for Strengthening Financial Supervision emphasizes the importance of the banking sector—and the key role that financial supervision plays in the banking sector—to Afghanistan's economic health and private sector development. For example, it states that “for the financial sector to work effectively and efficiently, the proper legal and regulatory framework and business enabling environment must be in place.”<sup>9</sup> Similarly, the U.S. Mission to Afghanistan Post Performance Management Plan enumerates eight specific assistance objectives for the period 2011-2015, which cover the U.S. government assistance portfolio in Afghanistan.<sup>10</sup> One of these objectives is to assist Afghanistan in attaining “a developed business climate that enables private investment, job creation, and financial independence.” To achieve this objective, the plan stresses the need for financial sector reform and support for DAB to establish international standards-based supervision of commercial banks.

## U.S. AND INTERNATIONAL SUPPORT FOR DAB FSD HAS BEEN LIMITED FOLLOWING THE NEAR COLLAPSE OF KABUL BANK

---

U.S. government officials, international donor organizations, and the Afghan government have all stated that the Afghan banking sector remains “fragile,” and the U.S. government has emphasized that strengthening DAB's financial supervisory function is a key reconstruction priority. For example, the U.S. Mission to Afghanistan Post Performance Management Plan (2011-2015) stresses the importance of U.S. government

---

<sup>6</sup> The ECF is a 3-year program that provides financial assistance to Afghanistan, as well as other countries, and is the primary IMF tool for providing medium-term assistance to low-income countries. ECF financial support is generally provided through loans at zero percent interest rates.

<sup>7</sup> The existence of an ECF agreement is important to the international community because it demonstrates the Afghan government's political will to enact necessary reforms. Adherence to the IMF benchmarks and fulfilling macroeconomic requirements also has a direct effect on levels of foreign aid from the international community to the Afghanistan Reconstruction Trust Fund. For example, the donor community withheld 85 percent of the total \$933 million in donations to the fund in solar year 1390 (March 2011- March 2012) until after the IMF approved a new ECF agreement for Afghanistan in November 2011.

<sup>8</sup> These benchmarks include the creation of strategies to build capacity throughout the Afghan government in responding promptly to economic crimes; the submission to Parliament of a new banking law; information-sharing agreements between FSD, the Financial Transactions and Reports Analysis Center of Afghanistan, and government law enforcement agencies; and reforms to FSD.

<sup>9</sup> Da Afghanistan Bank, Action Plan for Strengthening Financial Supervision

<sup>10</sup> The U.S. Mission to Afghanistan Post Performance Management Plan is an interagency document. The Departments of Defense, Agriculture, Justice, Homeland Security, Treasury, USAID, and the Federal Aviation Administration jointly developed and implemented the plan, which includes objectives for 2011-2015 identified by the Presidents of the United States and Afghanistan, the U.S. Secretary of State, and the U.S. Ambassador to Afghanistan.

engagement with DAB and states that “further assistance in financial sector and central bank operations will include working with the DAB to conduct monetary policy, strengthen prudential supervision, and encourage expansion of financial sector branch networks outside Kabul.” Similarly, at the Tokyo Conference in July 2012, the Afghan government and the international community expressed the need to improve the integrity of public financial management and the commercial banking sector by strengthening banking supervision and reforms at DAB.

According to USAID, Treasury, and State officials, the Afghan banking sector remains weak and in need of vigorous regulation. Following the Kabul Bank crisis, all of the major banks in Afghanistan were subjected to several audits. Those audits—conducted as part of a World Bank program—indicated widespread and systemic weaknesses in the banks’ financial conditions and operational capabilities.<sup>11</sup> Among the weaknesses were underdeveloped or nonexistent policies and procedures, a lack of appropriate accounting expertise, and a failure to follow international accounting principles. Other deficiencies included weak governance and organizational structures, regulatory violations, and a need for capacity-building and training.

Although a key reconstruction priority, U.S. government agencies have not taken direct steps in recent years to assist DAB in achieving the stated U.S. goal of strengthening DAB’s regulatory capacity. Specifically, following the near collapse of Kabul Bank, U.S. government agencies—including USAID, Treasury, State, and DOD—terminated any ongoing support to DAB FSD. They have not since provided any bilateral assistance—technical or otherwise—to DAB FSD.<sup>12</sup> Following the collapse of Kabul Bank, President Karzai decided that U.S. government advisors were no longer welcome at DAB. Additionally, DAB FSD officials stated that the Afghan government’s criticism of U.S. technical assistance to DAB FSD in the aftermath of the Kabul Bank crisis also contributed to the disengagement of U.S. agencies from the bank. According to DAB FSD officials, although the DAB governor agrees that FSD would benefit from additional technical assistance, he has not formally requested such assistance from U.S. government agencies. USAID, Treasury, and State officials stated that although they are willing to provide the needed technical assistance to DAB FSD, there remains a lack of political will on the part of the Afghan government that would reassure U.S. agencies that their technical assistance is appropriately used.

Below is a detailed explanation of former U.S. government agency technical assistance to DAB, reasons for disengagement or not providing assistance, and the conditions under which each agency would consider providing assistance in the future.

## USAID

USAID began providing technical assistance to DAB FSD in September 2003 through a contract with BearingPoint.<sup>13</sup> This assistance continued under Deloitte through the establishment of USAID’s Economic Growth and Governance Initiative (EGGI) in August 2009. As part of the \$92 million USAID contract, Deloitte provided trainers and technical experts to help build DAB FSD’s capacity to regulate the banking sector by strengthening supervision efforts and developing human capacity for bank examiners at DAB FSD.<sup>14</sup>

---

<sup>11</sup> The audits were a part of the World Bank’s Financial Sector Rapid Response Project. Two firms, Mazars, a France-based audit firm, and Talal Abu-Ghazaleh Organization, a Jordan-based audit firm, each conducted audits of five commercial banks.

<sup>12</sup> Neither State nor DOD provided any technical assistance to DAB FSD. DOD’s Task Force for Business and Stability Operations provided assistance to Afghan banks to increase their ability to accept electronic funds transfers and develop a retail payments infrastructure that will allow banks to establish an Automatic Teller Machine/Point of Sale network.

<sup>13</sup> USAID originally awarded the contract (EEM-I-00-07-00005-00) to BearingPoint, which sold its public services businesses (including the EGGI contract) to Deloitte in May 2009. Because the same advisors who worked for BearingPoint continued to perform services under Deloitte, we refer to Deloitte as the contractor for the purposes of this report.

<sup>14</sup> Deloitte’s responsibilities under the EGGI contract included (1) developing DAB’s capacity to regulate the financial sector, (2) Working with DAB to support the conduct of monetary policy, (3) encouraging the expansion of financial sector branch networks, (4) building the capacity of Afghan commercial banks, (5) providing support to the Ministry of Finance to improve economic forecasting, (6) assisting various Afghan ministries to strengthen private sector development, and (7) working with local governments to implement economic policy reforms.



A USAID Office of Inspector General report found that USAID's oversight of the EGGI program was weak, and Deloitte's advisors at DAB FSD "did not follow up aggressively on indications of fraud at Kabul Bank." Consequently, "Deloitte and the mission lost opportunities to contain the problems at Kabul Bank."<sup>15</sup> USAID officially terminated the DAB FSD capacity-building component of the EGGI contract in June 2011, following the September 2010 Kabul Bank crisis and President Karzai's subsequent directive in March 2011 that U.S. advisors were no longer welcome at DAB.<sup>16</sup> According to USAID, it terminated the DAB FSD component of the EGGI contract with Deloitte due to "the changed conditions on the ground" and to ensure that its "technical assistance is as effective as possible." Since then, USAID has not provided technical assistance to DAB FSD, in part due to direction from Embassy officials that future efforts to strengthen DAB's supervisory capacity would be led by the World Bank and the IMF. USAID officials told us that the agency is willing to resume activities to strengthen DAB's supervisory and regulatory capacity, provided that DAB meets certain conditions. According to USAID officials, the agency would consider reengaging with DAB if the central bank commits to achieving designated milestones and issuing a formal assistance request to the agency. One major milestone USAID officials indicated they might require DAB to meet prior to reengaging is the reform of Afghanistan's banking and anti-money laundering/countering the financing of terrorism (AML/CFT) laws. USAID officials stated that the current laws create systemic weaknesses in the banking sector, and USAID is reluctant to train DAB officials while issues remain that adversely affect the foundation of the sector.<sup>17</sup> Similarly, the Independent Joint Anti-Corruption Monitoring and Evaluation Committee report on the Kabul Bank crisis states that "new banking laws are needed to address weaknesses in corporate governance, capital, large exposures, related parties, consolidated supervision, early intervention, enforcement, bank resolution, and Islamic banking."

## Treasury

Treasury began supporting DAB in March 2006 through the provision of a resident advisor to the Financial Transactions and Reports Analysis Center of Afghanistan—the Afghan financial intelligence unit. Additionally, in February 2010, Treasury assigned a resident advisor to begin providing support to the newly-created AML/CFT Section of the FSD. The resident advisor supported the AML/CFT section by assisting the section to (1) develop thorough AML/CFT on- and off-site examination procedures for banks, (2) devise a standard rating system for AML/CFT compliance ratings, (3) prepare draft examination procedures for money services providers, and (4) conduct targeted reviews of several money service providers that were identified as having been involved with suspicious transactions. The resident advisor also provided training and mentoring to FSD personnel in the conduct of bank examinations.<sup>18</sup>

Treasury officials described the working conditions for its technical advisors at DAB FSD as "difficult," even before the Kabul Bank crisis, and stated that conditions worsened following the bank's near collapse. Treasury's technical assistance ended in March 2011 when the Afghan president banned U.S. government advisors from working at DAB. According to Treasury officials, other reasons for its disengagement with DAB FSD include (1) incorrect statements from the Afghan government that U.S. government advisors were

---

<sup>15</sup> USAID Office of Inspector General, *Review of USAID/Afghanistan's Bank Supervision Activities and the Kabul Bank Crisis*, Report Number F-306-11-003-S, March 16, 2011.

<sup>16</sup> Since terminating support for DAB FSD, USAID's primary method of supporting the Afghan banking sector is through its \$74 million, 5-year, Financial Access for Investing in the Development of Afghanistan program. USAID began the program in May 2011 to help improve the commercial banking sector by focusing on commercial bank activities, rather than the supervisory and regulatory efforts that EGGI supported. Program activities include (1) providing banks with technical assistance in the fundamentals of banking, (2) assisting women entrepreneurs through targeted business development and training, and (3) facilitating private sector loans. In addition, USAID's efforts through the program include providing support to the Afghanistan Banks Association, the Afghanistan Institute for Banking and Finance, and the Afghanistan Microfinance Association.

<sup>17</sup> As of September 2013, new AML/CFT and banking laws were drafted but not passed by Parliament.

<sup>18</sup> Treasury's Office of Technical Assistance conducted two capacity building projects at DAB—the Support for Financial Transactions and Reports Analysis Center of Afghanistan project between March 2006 and mid-December 2010 and the Support for AML/CFT Section of Financial Supervision Department between February 2010 and March 2011.

responsible for the Kabul Bank crisis and (2) Treasury's "lack of conviction that technical assistance would support a DAB/financial sector strengthening plan in which Treasury had confidence."

In December 2011, the DAB Governor inquired about the possibility of Treasury resuming its support of the AML/CFT aspects of financial supervision. Treasury established six conditions for the resumption of Treasury assistance to DAB:

1. Afghanistan's IMF program must be on track.
2. Former Kabul Bank shareholders cannot be involved in the banking sector, either directly or indirectly.
3. A clear communication from President Karzai that Treasury advisors would be welcomed.
4. Cessation of public statements by the Afghan government that the U.S. government is responsible for the Kabul Bank crisis.
5. Conviction that Treasury engagement would support a DAB/financial sector strengthening plan in which Treasury had confidence.
6. A clear understanding, in writing, of the role of Treasury technical advisors, the objectives of their support, progress benchmarks, their obligations of confidentiality, and how the work of advisors would relate to that of other assistance providers.

After being notified of the Treasury conditions, the DAB Governor did not pursue the matter. Officials from DAB FSD confirmed that they have not requested assistance from the department since Treasury established the conditions. As a result of the Afghan government's reluctance to meet the conditions, Treasury has not provided technical assistance to DAB since March 2011. However, according to Treasury officials, they engage with DAB through informal, periodic meetings to encourage DAB to meet the IMF benchmarks for the ECF program. DAB officials stated that, while DAB has achieved many IMF benchmarks, it needs technical assistance to meet all of them, as called for under Treasury's first criterion.

## State

State has not provided any technical assistance to DAB FSD. According to State officials, the Embassy Economic Section does not have the capacity or expertise to implement a technical assistance program or provide technical advisors to DAB.<sup>19</sup> The Economic Section, together with the Treasury Attaché, interacts with the Afghan government on bilateral and international economic policy issues, including matters related to banking sector laws and regulations. According to State officials, the Embassy regularly holds policy conversations with DAB and other stakeholders in the banking sector, but it does not conduct formal assessments of DAB or Afghan banks. The Embassy relies instead on products and reports from international organizations, such as the IMF.

## DOD

DOD has not provided any technical assistance to DAB FSD. From 2010-2011, DOD's Task Force for Business and Stability Operations (TFBSO) had some initiatives to improve the ability of Afghan banks to accept electronic funds transfers and develop a retail payments system.<sup>20</sup> Projects carried out by the Task Force in Afghanistan are limited by law to those "determined by the Secretary of Defense, with the concurrence of the Secretary of State, as strengthening stability or providing strategic support to the counterinsurgency campaign in Afghanistan."<sup>21</sup> According to Task Force officials, since fiscal year 2011, State concurred with all Task Force

---

<sup>19</sup> The Embassy's Economic Section is a component of the State Department's presence in Afghanistan. The section is responsible for managing, monitoring, and reporting on the full range of economic issues between the U.S. and Afghan governments.

<sup>20</sup> The Task Force created the project in response to DAB's request for assistance in enhancing consumer electronic and mobile payment capability and to support its own goal to improve the business environment for private foreign investment.

<sup>21</sup> Ike Skelton National Defense Authorization Act for Fiscal Year 2011, Pub. L. No. 111-383, § 1535, 124 Stat. 4137, 4426-28, as amended.

initiatives in Afghanistan with the exception of its banking sector projects, “pending further coordination with State, Treasury, and the Embassy.” TFBSO officials told us that as a result, the Task Force had to terminate its support to the Afghan banking sector and has not been able to reengage. When we asked State officials why they did not concur with TFBSO’s banking sector projects, they indicated that their predecessors, who were no longer posted at the embassy, had made the decision following President Karzai’s ban on technical advisors at DAB. They did not provide any additional explanation for the non-concurrence. TFBSO officials stated that they have not proposed another banking sector project.

## IMF and World Bank Provide Limited Assistance

Officials from Treasury, State, and USAID all stated that, following the Kabul Bank crisis, international organizations, such as the IMF and the World Bank, became the primary providers of technical assistance at DAB FSD. However, the IMF does not currently have any advisors assisting DAB and World Bank officials told us that they are terminating one of their two programs with DAB due to unsatisfactory results.

### IMF

According to the IMF, a resilient, well-regulated, and well-supervised financial system is essential for both domestic and international economic and financial stability, and problems in financial systems can trigger capital flight, exchange rate pressures, and create large fiscal costs to rescue troubled financial institutions. To prevent the kind of costs to the Afghan government that resulted from the Kabul Bank crisis, one of the IMF’s objectives in Afghanistan for the 2011-2014 period is to safeguard the financial sector, in part, by strengthening Afghanistan’s banking laws and DAB’s supervisory and regulatory capacity and internal regulations. To achieve those objectives, the IMF began providing two resident advisors to DAB FSD in early 2011.<sup>22</sup> One advisor assisted in developing DAB FSD’s ability to perform on-site and off-site examination, while the second advisor helped the department draft laws and train new employees recruited in the wake of the Kabul Bank crisis. One advisor’s contract expired in July 2013, while the second advisor left Afghanistan in early 2013 due to health issues. According to DAB FSD officials, it is possible he will not be deemed fit to return, in which case the IMF will continue to have no resident advisors at FSD.

The IMF advisors played an important role training and mentoring DAB FSD employees for on-site and off-site examinations. For example, USAID’s EGGI final report states that DAB FSD bank examiners lack the experience necessary to effectively fulfill their responsibilities. According to the report, “on average, FSD examiners had 24 months of total work experience, which is considerably short of the minimum five-year experience held by mature practitioners in other parts of the world.”<sup>23</sup> In addition, DAB FSD officials stated that recruitment of FSD examiners continues to be a challenge because, after the Kabul Bank crisis, staff bank examiners were convicted and imprisoned for their failure to prevent the crisis. Consequently, DAB does not have sufficient numbers or adequately experienced examiners.

According to DAB FSD officials, to meet one of the IMF benchmarks, FSD produced a 5-year strategy that addresses DAB FSD’s weaknesses with assistance from donors. To accomplish this, DAB is currently negotiating terms of reference with the IMF in order to receive additional technical assistance. DAB FSD officials stated that they prefer two technical advisors, one for the on-site and one for the off-site financial supervision units. However, according to these officials, the IMF has so far been willing to provide only one. At the time of this report, however, IMF did not have any advisors assisting DAB.

### World Bank

The World Bank has implemented two projects at DAB since 2009, but does not currently provide any technical assistance to DAB FSD. Its first program, the \$8 million Afghanistan Financial Sector Strengthening Project,

---

<sup>22</sup> The U.K. Department for International Development provided the funding for the two advisors.

<sup>23</sup> Economic Growth and Governance Initiative, Final Report, October 2013.

provided technical assistance to DAB for the improvement of its banking supervision and regulatory functions and to “establish key building blocks for further financial sector reform.” Although the project helped create the Afghanistan Institute of Banking and Finance<sup>24</sup> and helped launch DAB’s Collateral Registry,<sup>25</sup> the World Bank ultimately deemed the project’s progress to be “moderately unsatisfactory” and is ending the program. According to World Bank officials, the project did not have satisfactory results due in part to the “deteriorating security situation.”

The World Bank’s other program at DAB was its Financial Sector Rapid Response Project. The World Bank launched this \$19 million program in August 2011 to assist DAB in developing action plans to improve banking supervision and implement a modern national payment system. The program, expected to run through 2016, included audits of 10 Afghan commercial banks and further support for the development of the Afghanistan Institute of Banking and Finance.<sup>26</sup> Those audits concluded that the banks are generally weak in their financial conditions and operational capabilities, although not as problematic as Kabul Bank was prior to its near collapse.

World Bank officials told us they recognize the critical importance of improving DAB FSD’s capacity, but stated that there is a high risk of engagement with FSD after the Kabul Bank crisis. World Bank officials also stated that after the expulsion of U.S. advisors from DAB, the World Bank struggled to fill DAB’s assistance needs that were previously met by USAID and Treasury, and ultimately attempted to achieve too much with too few resources. The officials noted that World Bank programs providing assistance to DAB FSD were originally designed only to fill in the gaps left by the more comprehensive projects implemented by other international donors and U.S. agencies, which had comparatively large roles at DAB FSD when the World Bank’s programs began. When the U.S. government withdrew its advisors from DAB and terminated its programs, it created large gaps in capacity development needs throughout DAB.

## CONCLUSION

---

The banking sector is essential to the long-term economic growth and financial development of Afghanistan, and a strong regulatory regime is a key component of that goal. The 2010 Kabul Bank crisis resulted in widespread loss of confidence in the banking sector and the loss of more than \$800 million to the Afghan government and its people. Further, the events at Kabul Bank highlighted the limited capacity of DAB’s FSD to regulate the banking sector, enforce its bank supervision function, and its needs for capacity development and technical assistance to meet international standards. Unfortunately, since early 2011, the U.S. and Afghan governments have been at an impasse regarding U.S. assistance to DAB. U.S. government agencies have offered to provide assistance, based on certain conditions, but the Afghan government has not accepted. In the absence of active U.S. participation, and only limited World Bank and IMF involvement, the Afghan banking sector remains weak and at risk of further instability, threatening the government’s path toward achieving sustainable economic and financial growth. Given the current impasse between the U.S. and Afghan governments regarding a resumption of technical assistance to DAB, we are not making any recommendations at this time. However, we will continue to carefully monitor this situation.

---

<sup>24</sup> The Afghanistan Institute of Banking and Finance is a nonprofit organization established to address a shortage of skills and domestic training programs in the Afghan financial sector by developing a body of qualified bankers and financial professionals in Afghanistan, and by developing an independent financial services training institute.

<sup>25</sup> The Collateral Registry is an online database administered by DAB. It provides a central registry of movable properties in Afghanistan used as collateral, enabling creditors to check whether proposed collateral has already been offered to other creditors.

<sup>26</sup> On November 26, 2013, the World Bank’s Board of Executive Directors approved \$6.7 million for the additional financing and restructuring of its Financial Sector Rapid Response Project.

## AGENCY COMMENTS

---

USAID, State, and Treasury provided technical comments, which we incorporated as appropriate. We also provided a draft of the audit report to the Department of Defense; however, the Department did not provide comments.

## Appendix I - SCOPE AND METHODOLOGY

---

This report provides the results of SIGAR's audit of U.S. assistance provided to develop the regulatory and supervisory capacity of Afghanistan's central bank (Da Afghanistan Bank or DAB). The initial scope of the audit included two objectives, 1) to evaluate the steps taken by various U.S. agencies to strengthen the oversight and regulatory capacity of DAB after the near collapse of Kabul Bank, and 2) to evaluate the process by which U.S. agencies provide direct assistance funds to the Afghan government and the internal controls in place to safeguard those funds while deposited in Afghan banks. During the course of the audit, we decided to address the two objectives in separate audit reports. The objective of this audit was to determine the extent to which various U.S. agencies, as well as key international institutions, have taken steps to strengthen the oversight and regulatory capacity of DAB after the near collapse of Kabul Bank in September 2010. DAB has several departments which are tasked to perform a number of objectives that include maintaining domestic price stability; promoting an efficient national payment system; executing monetary policy; executing foreign exchange policy; managing foreign exchange reserves; printing and issuing Afghan currency; and licensing, regulating, and supervising the Afghan commercial banking system. For the purposes of this audit, we limited the scope of our objective to a review of (1) the capacity of DAB's Financial Supervision Department (FSD), which is responsible for ensuring the health of the financial sector by controlling the licensing of banks and other financial institutions, and (2) the support provided to DAB FSD by U.S. government agencies and international institutions following the near collapse of Kabul Bank.

To evaluate U.S. efforts to improve DAB's capacity to regulate its banking sector, we reviewed U.S. and Afghan strategies, plans, and other program documentation relevant to banking sector development programs that U.S. agencies have implemented in Afghanistan. Additionally, we prepared and sent a questionnaire to each agency regarding their efforts to assist DAB. After reviewing the agency responses to this questionnaire, and following our initial meetings with relevant officials, we determined that U.S. agencies do not currently have any active programs in support of DAB's capacity to regulate and supervise the Afghan banking sector.

Given the internationally-recognized vital role of a stable banking system in national economies, as well as the importance of a strong Afghan central bank to the U.S. mission in Afghanistan and the Afghanistan National Development Strategy, we sought to determine the reasons behind the lack of U.S. support for DAB's supervisory and regulatory efforts. To do so, we conducted interviews in Washington D.C., and Kabul Afghanistan, with officials from State, USAID, DOD, and Treasury regarding U.S. actions related to the Afghan banking sector. In addition, we reviewed relevant program documentation from all agencies.

To determine what international or multilateral efforts may be either in place or planned to support capacity-building efforts at DAB FSD, we met with Kabul-based officials from the World Bank, the International Monetary Fund, and the Asian Development Bank. We also reviewed relevant program documentation related to their respective assistance programs at DAB FSD. To determine the assistance needs of DAB FSD and the circumstances surrounding its current and former relationships with U.S., international, and multilateral efforts to support it, we examined documentation related to the aftermath of the Kabul Bank crisis as well as assessments of the current state of the Afghan banking sector. These documents included official reviews of the lessons learned from the crisis, audits of Afghan commercial banks, and evaluations of DAB's effectiveness in supervising and regulating the sector. In addition, we conducted a site visit to DAB in order to interview relevant officials regarding the assistance needs of DAB FSD and its relationship with U.S. agencies.

We conducted our audit work in Kabul, Afghanistan, and Washington, D.C., from June 2013 to January 2014, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. This audit was performed by SIGAR under the authority of Public Law No. 110-181, as amended, and the Inspector General Act of 1978, as amended.

## Appendix II – ACKNOWLEDGMENTS

---

Matthew Dove, Senior Audit Manager

Zubair Hakim, Analyst-in-Charge

Ryan Heger, Program Analyst

Daniel Tessler, Program Analyst

This audit report was conducted under  
project code SIGAR-082A.



## SIGAR's Mission

The mission of the Special Inspector General for Afghanistan Reconstruction (SIGAR) is to enhance oversight of programs for the reconstruction of Afghanistan by conducting independent and objective audits, inspections, and investigations on the use of taxpayer dollars and related funds. SIGAR works to provide accurate and balanced information, evaluations, analysis, and recommendations to help the U.S. Congress, U.S. agencies, and other decision-makers to make informed oversight, policy, and funding decisions to:

- improve effectiveness of the overall reconstruction strategy and its component programs;
- improve management and accountability over funds administered by U.S. and Afghan agencies and their contractors;
- improve contracting and contract management processes;
- prevent fraud, waste, and abuse; and
- advance U.S. interests in reconstructing Afghanistan.

## Obtaining Copies of SIGAR Reports and Testimonies

To obtain copies of SIGAR documents at no cost, go to SIGAR's Web site ([www.sigar.mil](http://www.sigar.mil)). SIGAR posts all publically released reports, testimonies, and correspondence on its Web site.

## To Report Fraud, Waste, and Abuse in Afghanistan Reconstruction Programs

To help prevent fraud, waste, and abuse by reporting allegations of fraud, waste, abuse, mismanagement, and reprisal, contact SIGAR's hotline:

- Web: [www.sigar.mil/fraud](http://www.sigar.mil/fraud)
- Email: [sigar.pentagon.inv.mbx.hotline@mail.mil](mailto:sigar.pentagon.inv.mbx.hotline@mail.mil)
- Phone Afghanistan: +93 (0) 700-10-7300
- Phone DSN Afghanistan: 318-237-3912 ext. 7303
- Phone International: +1-866-329-8893
- Phone DSN International: 312-664-0378
- U.S. fax: +1-703-601-4065

## Public Affairs

Public Affairs Officer

- Phone: 703-545-5974
- Email: [sigar.pentagon.ccr.mbx.public-affairs@mail.mil](mailto:sigar.pentagon.ccr.mbx.public-affairs@mail.mil)
- Mail: SIGAR Public Affairs  
2530 Crystal Drive  
Arlington, VA 22202