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Audit Says Kabul Bank Began as 'Ponzi Scheme'

By MATTHEW ROSENBERG
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Kabul Bank became Afghanistan's largest financial institution by offering the promise of modern banking to people who had never had a saving or checking account. What it really dealt in was modern theft: "From its very beginning," according to a confidential forensic audit of Kabul Bank, "the bank was a well-concealed Ponzi scheme."

Afghan and American officials had for years promoted Kabul Bank as a prime example of how Western-style banking was transforming a war-ravaged economy. But the audit, prepared this year for Afghanistan's central bank by the Kroll investigative firm, gives new details of how the bank instead was institutionalizing fraud that reached into the hundreds of millions of dollars and obliterated Afghans' trust after regulators finally seized the bank in August 2010 and the theft was revealed.

Going further than previous reports, the audit asserts that Kabul Bank had little reason to exist other than to allow a narrow clique tied to President Hamid Karzai's government to siphon riches from depositors, who were the bank's only substantial source of revenue.

At one point, Kroll's investigators found 114 rubber stamps for fake companies used to give forged documents a more legitimate look. And the auditing firms used by the bank never took issue with loan books that were "almost entirely fraudulent," Kroll found, recommending that the Afghan government explore suing the last such auditor, A.F. Ferguson & Co., a private Pakistani firm with a franchise under PricewaterhouseCoopers.

When Afghan regulators, aided by American officials, first discovered the extent of the fraud at the bank in the summer of 2010, "we never imagined that the criminality was as deep as it was, that it was so widespread and that it included high-ranking officials and their relatives," said Abdul Qadeer Fitrat, at the time the governor of the Bank of Afghanistan, the country's central bank.

"At the beginning, I received information from the U.S. Embassy that maybe $150 million or $200 million is gone in bad loans to powerful people," he said. The number soon climbed close to $900 million, though "we did not know who took the loans and that they were all tied to a few individuals."

What Kroll's audit found is that on Aug. 31, 2010, the day the Bank of Afghanistan seized Kabul Bank, more than 92 percent of the lender's loan portfolio — $861 million, or roughly 5 percent of Afghanistan's annual economic output at the time — had gone to 19 related people and companies, according to the audit.

Among the largest beneficiaries were a brother of Mr. Karzai and a brother of First Vice President Muhammad Qasim Fahim who each owned stakes in the bank that had been bought with loans from the bank, according to the audit and regulatory officials. For their part, both have insisted that they never took part in any fraud at the lender.

Reached for comment, Mr. Karzai's spokesman, Aimal Faizi, stressed that the president considered the audit incomplete: Mr. Karzai still believes Kroll has to find out where all the missing money has gone, to which countries it was sent and to which accounts if the firm wants the report to be seen as credible, Mr. Faizi said.

The New York Times obtained a copy of the 277-page audit report, which Afghan and Western officials have confirmed was the one Kroll prepared.

The two men that Afghan prosecutors, Western officials and the Kroll audit accuse of profiting most from the fraud were the bank's principal owners: Sherkhan Farnood, its chairman and a former World Series of Poker Europe winner, and his former bodyguard, Khalil Fruzi, who served as the bank's chief executive.

Working with the bank's executives, they devised simple, yet effective, schemes to fool weak and reluctant regulators, and the Americans who were advising them, the audit says.

The owners kept two sets of books, and hid loans to themselves and their shareholders by taking them in the names of friends, relatives and even domestic servants, according to the audit and Afghan officials. They grouped related loans together to better keep track of who owed what. Hundreds of millions of dollars in illicit loans were routed to Dubai through a money exchange controlled by Mr. Farnood, who founded the bank.

Kabul Bank employed people to forge documents for fictitious companies, which were then audited by accounting firms that appear to have been complicit, according to Kroll. That is where the rubber stamps came in: they bore the names of those false companies, like Abdul Mahmood Trading and Ali Jan Abdul Hadi Ltd., to lend an air of respectability to fake documents.

Toward the end, Mr. Fruzi even expensed foreign shopping sprees at stores like Louis Vuitton and Versace in Dubai and New Delhi. Mr. Farnood was snapping up villas in Dubai with bank money, though he has maintained they were investments gone bad, nothing more.

Bailing out depositors cost the cash-strapped Afghan government more than $825 million, and Afghan and Western officials say that only between $200 million and $400 million, depending on how assets are valued, has so far been recovered from shareholders.

For many Afghans, the scandal surrounding Kabul Bank, a linchpin of the economic order established here by Americans and their allies, has cemented the opinion that the United States brought crony capitalism, not free markets, to Afghanistan. The audit is likely to reinforce that view while raising potentially troubling questions about who is being prosecuted here in connection with the scandal, and who is not.

The United States and its allies have pressed hard for prosecutions, threatening to cut aid if no action was taken. The completion of the forensic audit, which was financed by international donors and delivered in March, was another demand by the international community, as was a separate report, due later this week, by an Afghan government-funded but largely independent corruption watchdog commission composed of Afghan and foreign experts.

Mr. Farnood and Mr. Fruzi top the list of 22 defendants charged so far, and both are on trial in Kabul. Many others on the list are Kabul Bank executives who are accused of helping to carry out fraud, though it is unclear whether they personally profited.

Few officials have any problem with those prosecutions. But there are questions about the charges brought by Afghan prosecutors against a few officials at Afghanistan's central bank. Western officials, speaking on condition of anonymity, expressed worries that those cases appeared to be intended to end further investigation into Kabul Bank. Kroll has said it has no evidence that the Bank of Afghanistan's staff members were complicit in Kabul Bank's collapse.

In the most prominent such case, the former chairman of the Bank of Afghanistan, Abdul Qadeer Fitrat, has been indicted primarily for failing to warn the Afghan government about Kabul Bank and concealing the fraud there — an accusation that one Western official called "laughable." Several Western and Afghan officials insist that Mr. Fitrat had actively pressed inquiries of Kabul Bank, and believed he had been indicted in order to scare him off. He fled the country last year.

Even Mr. Farnood said Mr. Fitrat had done nothing wrong: "Fitrat was the one person who was not involved in any bribing," he said in a telephone interview.

The situation was particularly galling, the officials said, because apart from Mr. Farnood and Mr. Fruzi, the other "high-value beneficiaries" — each of whom still owes at least $5 million to the bank, Kroll estimates — have yet to face any legal action. That group includes Mahmood Karzai, the president's brother, and Haseen Fahim, the vice president's brother.

In an interview, Mahmood Karzai said he had repaid all the money he originally owed, an amount he put at $5.3 million. He insisted that Kroll had miscalculated and included assets he never owned, like a villa in Dubai, when it tallied his liability at $30.5 million.

He called Kroll “a piece of puke” and said it had relied too heavily on evidence provided by Mr. Farnood, who in the summer of 2010 began cooperating with American officials and, subsequently, Afghan investigators after a dispute with his fellow shareholders.

Neither Mr. Fahim nor Mr. Fruzi responded to phone messages seeking comment.

Kabul Bank did serve some legitimate functions — for instance, the United States paid the salaries of hundreds of thousands of soldiers, police and teachers through it.

But many of the bank’s practices seemed tailor-made to lure depositors by any means available. One popular gimmick detailed by the audit was known as a Bakht account, which offered those who opened them a chance to win houses, cars and jewelry at glitzy prize drawings.

The only real winners, however, were the bank’s senior managers and their friends, the audit found. The new depositors’ money was used principally “to provide free financing to the other business interests of senior management and a group of connected persons.”