



**SPECIAL STUDY REPORT
ON
EFFECTIVENESS OF BANK
GUARANTEES IN SAFEGUARDING
GOVERNMENT INTERESTS
WAPDA PROJECTS
AUDIT YEAR 2021-22**

AUDITOR GENERAL OF PAKISTAN

PREFACE

Articles 169 and 170 of the Constitution of the Islamic Republic of Pakistan 1973, read with Sections 8 and 12 of the Auditor General's (Functions, Powers, Terms and Conditions of Service) Ordinance 2001, require the Auditor General of Pakistan to conduct audit of any authority or body established by the Federation. This Special Study of Effectiveness of Bank Guarantees in Safeguarding Government Interests was carried out accordingly.

The report is based on special study of WAPDA projects in order to examine and identify the issues relating to Bank Guarantees in development projects of WAPDA as well as in O&M projects. The Directorate General of Audit Water Resources conducted this Special Study of effectiveness of Bank Guarantees in safeguarding government interests during July, 2021 to October, 2021 with a view to report significant issues pertaining to obtaining, renewal and extension of Bank Guarantees to stakeholders.

The audit observations included in this report have been finalized in the light of discussions in the Departmental Accounts Committee (DAC) meeting.

The Special Study Report is submitted to the President of Pakistan in pursuance of Article 171 of the Constitution of the Islamic Republic of Pakistan 1973, for causing it to be laid before both houses of Majlis-e-Shoora [Parliament].

Islamabad
Dated: 02 JAN 2024

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(Muhammad Ajmal Gondal)
Auditor General of Pakistan

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ABBREVIATIONS & ACRONYMS

| | |
|-------|--|
| BC | Building Circle |
| BG | Bank Guarantee |
| CCC | Central Contract Cell |
| CDR | Cash Deposit Receipt |
| CE | Chief Engineer |
| CEO | Chief Executive Officer |
| CHPS | Chashma Hydel Power Station |
| CNY | Chinese Yuan |
| DAC | Departmental Accounts Committee |
| DBDP | Diamer Basha Dam Project |
| DLP | Defect Liability Period |
| E&M | Electrical & Mechanical |
| FIDIC | Federation Internationale Des Ingenieurs-Conseils |
| FIR | First Information Report |
| FWO | Frontier Works Organization |
| GBHP | Ghazi Barotha Hydropower Project |
| GCC | General Conditions of Contract |
| GM | General Manager |
| GmbH | Gasellschaft mit beschränkter Haftung (Company with Limited Liability) |
| IB | Instructions to Bidder |
| JHPS | Jinnah Hydel Power Station |
| JV | Joint Venture |
| KTDP | Kurram Tangi Dam Project |
| LC | Letter of Credit |
| M&S | Monitoring & Surveillance |
| MDO | Mangla Dam Organization |
| MoWR | Ministry of Water Resources |
| O&M | Operation & Maintenance |

| | |
|--------|--|
| OAC | Operational Acceptance Certificate |
| OPD | Outpatient Department |
| PAO | Principal Accounting Officer |
| PC-I | Planning Commission Proforma-I |
| PD | Project Director |
| PEC | Pakistan Engineering Council |
| PKR | Pak Rupees |
| PPRA | Public Procurement Regulatory Authority |
| RE | Resident Engineer |
| SOPs | Standard Operating Procedures |
| T4HPP | Tarbela 4 th Extension Hydropower Project |
| TDP | Tarbela Dam Project |
| TMA | Tehsil Municipal Administrator |
| TPH | Tarbela Power House |
| US\$ | United States Dollar (Currency) |
| WAPDA | Water and Power Development Authority |
| w.e.f. | With Effect From |

EXECUTIVE SUMMARY

The Directorate General Audit Water Resources conducted the Special Study during July, 2021 to October, 2021 on effectiveness of Bank Guarantees (BGs) in safeguarding the government interests. The main objectives of the study were to identify the issues relating to obtaining, renewal, verification and encashment of bank guarantees in development as well as Operation & Maintenance (O&M) phase of WAPDA projects.

WAPDA is an autonomous body working under the administrative control of Ministry of Water Resources. It was established with the mandate to develop water and hydropower resources in an efficient manner to meet the requirements of the country.

Bank guarantee is sum of money obtained by the employer from contractor for successful execution of the contract agreements and to save the employer from losses.

Thirty five (35) WAPDA formations were planned to be audited during Phase-I of Audit Plan 2021-22. Field Audit Teams reported observations pertaining to BGs of WAPDA formations. These observations were issued to the management for furnishing their responses along with Secretary / Principle Accounting Officer (PAO) during January, 2022 for holding of Departmental Accounts Committee (DAC) meeting. The DAC meeting was held on October 26, 2022. The observations were finalized in the light of recommendations of DAC.

Key Audit Findings

- i. BGs were not obtained within stipulated time period and as per approved template specified in contract documents;
- ii. BGs were not encashed upon non-compliance of conditions of bidding/ contract documents;
- iii. BGs were either not renewed or did not remain valid till the expiry of defect liability period;
- iv. Due to delay in renewal of BGs, the work remained uncovered by the assurance in the form of BG for the intervening period;

- v. BGs were not got verified from the issuing banks for confirmation of their genuineness by the project management;
- vi. Action was not taken against the contractor who provided a fake BG, and
- vii. In few cases, the value of BG was not enhanced to give effect of increase in the value of contract as a result of issuance of variation orders or enhancement in exchange rate.

1. INTRODUCTION

1.1 Types of Bank Guarantee

Normally, banks offer three types of BGs. Financial Bank Guarantee relates to sale and purchase transactions of the customers wherein BGs are obtained to ensure the repayment of debts. Foreign Bank Guarantee relates to the successful execution of the offshore sales and purchase contracts. In Performance based Bank Guarantee, the beneficiary can seek reparations from the bank for non-performance of the obligation as laid out in the contract. If the counterparty fails to deliver the services as promised, the beneficiary will claim their resulting losses from the guarantor i.e. the bank.

1.2 Rules / Provisions for Obtaining Performance Bank Guarantee

According to Clause-32.1 of Standard Form of Bidding Documents (Civil Works) issued by the PEC and harmonized with PPRA Rules 2004, “the successful bidder shall furnish to the employer a Performance Security in the form and the amount stipulated in the bidding data and the Conditions of Contract within a period of 28 days after the receipt of Letter of Acceptance.”

According to Clause-10.1 of FIDIC “If the contract requires the contractor to obtain security for his proper performance of the contract, he shall obtain and provide to the employer such performance security within 15 days after the receipt of the Letter of Acceptance, in the sum stated in the Appendix to Tender. When providing such security to the employer, the contractor shall notify the engineer of so doing. Such security shall be in the form annexed to these conditions or in such other form as may be agreed between the employer and the contractor. The institution providing such security shall be subject to the approval of the employer. The cost of complying with the requirements of this clause shall be borne by the contractor, unless the contract otherwise provides.”

1.3 Legal aspects of Validity and Claims under Bank Guarantee

According to Clause-10.2 of FIDIC “the performance security shall be valid until the Contractor has executed and completed the works and remedied any defects therein in accordance with the Contract. No claim shall be made against such security after the issue of the Defects Liability Certificate in

accordance with Sub-Clause-62.1 and such security shall be returned to the Contractor within 14 days of the issue of the said Defects Liability Certificate.”

If the contractor has not provided the Performance Certificate 28 days prior to the expiry date of the performance security, the employer shall ask the Contractor to extend the validity of the performance security. The Contractor, being the Applicant of Performance Security, gets the extension of performance security from the issuing bank (the Guarantor) and submits it to the employer.

According to Clause-10.3 of FIDIC “Prior to making a claim under the performance security, the employer shall, in every case, notify the Contractor stating the nature of the default in respect of which the claim is to be made.”

According to Clause-32.2 of Standard Form of Bidding Documents (civil works) issued by the PEC and harmonized with PPRA Rules, 2004, “Failure of the successful bidder to comply with the requirements of Sub-Clause IB.32.1 or Clauses IB.33 or IB.35 shall constitute sufficient grounds for the annulment of the award and forfeiture of the bid security.

1.4 Internal Controls for Verification of Bank Guarantee

The contractor, within 28 days after receiving the letter of acceptance, shall deliver the performance security to the employer. The employer after receipt of performance security through official letter or by deputing a representative, request the issuing bank for verification/authentication of the performance security. The issuing bank, on receipt of the employer’s letter, processes the validation/authentication of performance security as per the bank’s policy. The employer receives the verification letter through courier/post from the issuing bank and/or from bank’s head office/regional office. As per DAC directives circulated vide Member Finance letter No.MF/DAC /30/2019/243-45 dated July 12, 2019, all performance guarantees of banks relating to WAPDA projects are required to be verified.

The Directorate General of Audit Water Resources conducted Special Study on Effectiveness of Bank Guarantees in Safeguarding Government Interests during execution of Annual Audit Plan 2021-22 with a view to highlight the issues relating to BGs in different WAPDA Projects.

2. STUDY DELINEATION

This Study is defined with reference to its purpose, scope and potential beneficiaries in the following paragraphs:

2.1 Purpose of Study

The special study was conducted to identify the issues relating to requisition, verification, and validity of Performance Guarantees at the time of award of contracts. Further, to identify the issues pertaining to extension of performance guarantee in cases of enhancing the period of execution of contract and claims against performance guarantees in case of default of contractor.

2.2 Scope of Study

The issues related to BGs were prevailing across almost all the projects in WAPDA, whether development projects or even in O&M offices. Hence, the study was carried out in selected formations approved in the Audit Plan 2021-22 for compliance audit encompassing the entire issue within the formations of WAPDA. Accordingly, issues highlighted from these formations were incorporated in this report. The formations whose audit observations are incorporated in this study report are as follows;

- i. Chief Engineer Tarbela Power Station, Tarbela
- ii. PD Tarbela 4th Extension HPP (1410 MW), Tarbela
- iii. GM Tarbela Dam Project
- iv. PD Kurram Tangi Dam Project, Bannu
- v. RE Civil Mangla Dam Organization, Mangla
- vi. CE/PD Building Circle, WAPDA House Lahore
- vii. GM/CEO Diamer Basha Dam Project Chillas
- viii. CE/RE Chashma Hydrel Power Station, Chashma
- ix. RE Jinnah Hydrel Power Station
- x. GM Civil Ghazi Barotha WAPDA, Hattian

2.3 Beneficiaries of Study

The Special Study would be beneficial to the management of WAPDA for making policies to plug-in the loopholes in the system and developing a

comprehensive mechanism to overcome the issues pertaining to Performance Guarantees.

3. STUDY DESIGN

The study was designed keeping in view the time allocated, availability of data and methodology adopted, as enumerated under the following heads.

3.1 Time Period

The Phase-I of Annual Audit Plan 2021-22 was implemented during July, 2021 to October, 2021 in order to examine the underlying period from July, 2020 to June, 2021. Issues identified during compliance audit, pertaining to performance guarantees, are included in the special study.

3.2 Data

Main data collected and studied during audit to derive study results is as follows;

- i. PC-I of the projects (original and revised)
- ii. Contract Agreements
- iii. Consultancy Agreements
- iv. Tender Evaluation Reports
- v. Contract Files
- vi. Interim Payment Certificates
- vii. Consultancy Invoices
- viii. Minutes of Authority meetings
- ix. Variation Orders
- x. Correspondence files
- xi. Study analysis of media reports regarding the subject issue.

3.3 Methodology

The methodology adopted during the execution of Special Study was as under;

- a. Review of Documents;
 - PPRA Rules & Guidelines

- Contract Agreements / FIDIC Manuals
 - SOP's regarding the verification of performance security
 - Verifications obtained from Bank
 - Actions taken against the contractors and officers who failed to safeguard the interest of management and Public Exchequer
- b. Site visits
- c. Discussions with management.

4. DATA ANALYSIS

Data was collected through requisition of record during execution of the compliance audit of different formations conducted during the 1st phase of Audit Year 2021-22. The data was available in respective offices of Project Directors and Chief Engineers/General Managers O&M. On the basis of analysis of data from different angles and perspectives, a number of discrepancies regarding validity period and expiry of bank guarantees etc. for various WAPDA projects were noticed and reported in the study results.

After collecting record data analysis was made as follow:

- Original BGs were checked whether these were collected for exact value as required under the contract
- Whether adjustment (increase/decrease) in the value of BG was made to take effect of change in contract price
- Whether the BGs were intact till the completion or DLP of contract/work
- Work files were checked to validate the works completed by the contractor or it requires the completion of work at risk and cost of terminated contract through encashment/forfeiture of BG

5. STUDY RESULTS

5.1 Non-renewal of Expired Bank Guarantees

General condition of FIDIC requires that the performance bank guarantees should remain valid during execution up to completion of Defect Liability Period of the contract. It is the responsibility of the management to ask the contractor for renewal of BG 14 days ahead of its expiry. Further, while renewing the BG, some period remains uncovered as the contractor renews its bank guarantee from a different date than the expiry date.

Internal Control failure regarding non-renewal of BGs in a timely manner was observed and discussed in detail in Para-5.1.1.

5.1.1 Non-renewal of expired Bank Guarantees – Rs.4,144.670 million

According to Clause-10.2 of Contracts Agreements, the performance security shall be valid until the contractor has executed, completed and remedied defects in the works in accordance with the contract. According to Clause-4.2.1 of Conditions of Contract for Plant and Design Build Second Edition 2017, the Contractor shall ensure that the Performance Security shall remain valid and enforceable until the issue of the Performance Certificate.

During audit of accounts of various projects / formations of WAPDA for the period from July, 2019 to June, 2021, it was noticed that eleven (11) Nos. Performance Bank Guarantees valuing Rs.4,144.670 million provided by contractors / suppliers were expired before completion of works / issuance of Defect Liability Certificates. The detail is as under:

(Amount Rs. in million)

| Sr. No. | Name of Project / formation | No. of Bank Guarantees | Expiry date | Amount of Bank Guarantees |
|--------------|-----------------------------|------------------------|-----------------------------------|---------------------------|
| 1 | PD, T4HPP | 02 | July 05, 2018 | 3,105.99 |
| 2 | PD, KTDP | 02 | June 30, 2020 | 926.12 |
| 3 | CE, Tarbela Power House | 02 | November 30, 2019 & July 24, 2021 | 67.97 |
| 4 | CEO/GM, DBDP | 01 | September 30, 2018 | 32.39 |
| 5 | PD Building Circle | 01 | February 28, 2020 | 7.49 |
| 6 | RE (Civil) MDO, Mangla | 01 | April 21, 2021 | 2.92 |
| 7 | CE/RE, CHPS | 02 | June 15, 2021 | 1.79 |
| Total | | 11 | | 4,144.67 |

As per contract clauses, the performance guarantees were required to be valid up to issuance of the Defect Liability Certificate (DLC) / Operational Acceptance Certificate (OAC). However, neither the DLC or OAC was issued nor the performance guarantees were renewed till June 30, 2021. Audit held that Performance Guarantees were required to be renewed by the contractor but the needful was not done.

Non-adherence to the contract clause resulted in non-renewal of BGs amounting to Rs.4,144.67 million up to the financial year 2020-21.

The matter was taken up with the management during May to October 2021 and reported to MoWR in January, 2022. The management replied that in two cases, the contractor provided renewed BGs, in three cases the payment of IPC/retention money was withheld, in one case the whole amount of advance had been recovered whereas in other case as per recommendation of inquiry report, the contractor was invited for resolution of outstanding issues but contractor did not respond.

The DAC in its meeting held on October 26, 2022 directed the management to submit revised reply in four cases, produce record for extended BG in case of Tarbela Power House, conduct the fact finding inquiry in case of RE Civil Mangla and conclude the contract in light of conditions of contract in case of Diamer Basha Dam Project.

Audit recommends the management to justify the non-renewal of performance guarantees by the contractor until the issuance of the operational acceptance certificate/defect liability certificate, providing reasons for any refusal. Furthermore, the cost of BGs for the uncovered period from the contractor may also be recovered and ensure the compliance of DAC's decisions.

(Original Para No.9, 10, 11, 12, 14, 15 & 16)

5.2 Receipt of Bank Guarantees of lesser value than required under the Contract

Standard form of bidding documents and FIDICs General Condition of Contract requires the contractor to submit the performance bank guarantee in the form specified in contract within the stipulated period of time. As the

performance bank guarantees are obtained to secure the employer's interest, value of bank guarantees are needed to be adjusted to give effect of change in contract prices as a result of variation orders or exchange rate fluctuation.

In Tarbela 4th Extension Hydropower Project, Audit observed that as a result of amendments, the value of contract was increased from original contract price. Hence, value of BGs was required to be adjusted; however, the same was not done. Similarly, in Tarbela Power Station, the management had accepted BG of lesser value and in different currencies than required under the contract agreement. This state of weak internal controls is discussed in detail in Para-5.2.1 and 5.2.2.

5.2.1 Non-enhancement in value of performance guarantees upon corresponding increase in cost of contract (T4HPP) – Rs.1,243.76 million

According to Clause-4.2 of GCC, “without limitations to the provisions of the rest of this sub clause, whenever, the Engineer determines an addition or a reduction to the Contract Price as a result of a change in cost and/or legislation or as a result of a Variation, amounting to more than 25% of the portion of the Contract price payable in a specific currency, the Contractor shall at the Engineer's request promptly increase or may decrease, as the case may be, the value of the Performance Security in that currency by an equal percentage”.

During audit of accounts of the Project Director Tarbela 4th Extension Hydropower Project, Tarbela for the period from July, 2020 to June, 2021, it was noticed that civil work of the project was awarded to M/s Sinohydro Group Ltd China at contract cost of Rs.15,756.44 million and US\$ 104.62 million, respectively. The contractor provided performance bank guarantees against the original contract cost in the above mentioned currencies which were valid up to June 30, 2022. However, during execution, cost of the project was increased by Rs.3,961.73 million and US\$ 53.94 million, respectively. As per above mentioned clause of the Contract Agreement, the Contractor was required to increase value of its performance bank guarantees by Rs.396.17 million and US\$ 5.39 million (Equivalent to Rs.1,243.76 million), respectively. However, neither the Project Management nor Project Consultants asked the contractor to revise BGs according to the revised contract cost.

Non-adherence to the contract provisions resulted in non-increasing of value of the performance guarantees Rs.1,243.76 million.

The matter was taken up with the management in August, 2021 and reported to MoWR in January, 2022. The management replied that more than 99% work was completed and guarantees were validated up to December 31, 2022.

The management's reply was not tenable as the audit observation was about non-enhancement in amount of bank guarantees obtained.

The DAC in its meeting held on October 26, 2022 directed the management to submit revised reply.

Further progress was not intimated till finalization of the report.

Audit recommends the management to implement DAC's decision.

(Original Para No.22)

5.2.2 Acceptance of Bank Guarantees of lesser value from contractor (TPH) – Rs.35.45 million

According to Sub-Clause-10.1 of Particular Conditions of Contract Agreement, the Performance Security shall be of an amount equal to 10% of the Contract Price in currency / currencies of the Contract at the option of the bidder in the form of bank guarantee from any scheduled bank in Pakistan or from a bank located outside Pakistan duly counter-guaranteed by a scheduled bank in Pakistan.

During audit of accounts of the Chief Engineer Tarbela Power House, Swabi for the period from July, 2020 to June, 2021, it was noticed that a work was awarded to M/s Transmark International Lahore under Contract No.C-712 amounting to US\$ 4.44 million, Euro 2.47 million and Rs.224.21 million, respectively. As per above mentioned clause, the contractor was required to submit performance bank guarantee of Rs.145.92 million (10%). However, the contractor provided three performance bank guarantees valuing Rs.110.47 million resulting in provision of Performance Bank Guarantee of lesser amount to the tune of Rs.35.45 million as tabulated below:

(Amount Rs. in million)

| Particular | US\$ Portion Equivalent to PKR | Euro Portion Equivalent to PKR | Total Contract Cost in PKR | Value of Required 10% Performance Guarantee | Value of Performance Guarantee obtained | Value of Performance Guarantee less obtained |
|--------------------------------------|--------------------------------|--------------------------------|----------------------------|---|---|--|
| Total Cost as per Original Agreement | 744.65 | 490.34 | 1,459.20 | 145.92 | 110.47 | 35.45 |

Audit held that obtaining Performance Bank Guarantees of lesser value was in violation of the contract provisions and an undue benefit to the contractor.

Non-adherence to Contract Provisions and FIDIC Conditions resulted into non-obtaining performance bank guarantees of the required value for Rs.35.45 million.

The matter was taken up with the management in September, 2021 and reported to MoWR in January, 2022. The management replied that total amount of acquired performance guarantees against the four LCs & performance guarantees against the local supplies was 10% of total contract value.

The DAC in its meeting held on October 26, 2022 directed the management to submit revised reply regarding the contractual status of sub-contractors and BGs provided by sub-contractors in order to access the “limit of liability” of sub-contractors alongwith validity of bank guarantees.

Further progress was not intimated till finalization of the report.

Audit recommends the management to obtain BGs as per contract besides implementing DAC’s decision.

(Original Para No.23)

5.3 Acceptance of Invalid / Fake Bank Guarantee

Performance Bank Guarantees are to be of the required value and in the form specified under the contract agreement. It is the responsibility of the management to ensure the genuineness of the bank guarantee by verifying the same from the issuing bank and as required under the contract agreement. If the bank guarantees are not in line with the covenants of the contract, appropriate action is required to be taken against the bidder / contractor. The Member Finance vide letter No. MF/DAC/30/2019/243-45 dated July 12, 2019 directed all the WAPDA formations to get the performance bank guarantees verified from

the issuing banks to ensure their genuineness. WAPDA Procurement & Contract Manual requires the management to blacklist the bidder who submits fabricated / false or forged documents besides debarring him from participating in further procurements.

In the office of Project Director Kurram Tangi Dam Project, audit observed that the BGs was not according to form specified in the contract agreement, however, despite taking appropriate action the contract was awarded, as elaborated in Para-5.3.1. Further, in RE Jinnah, it was noticed that BG was required to be verified from the issuing bank for its genuineness but needful was not done. This aspect of weak internal control is discussed in detail in Para-5.3.2. In CE (Civil) Ghazi Barotha Hydropower Project, a bidder had submitted fake BG which was identified during bidding process, the management had not taken any legal action against the contractor, this state of slackness on part of the management is explained in Para-5.3.3.

5.3.1 Irregular award of contract due to furnishing of invalid Bank Guarantee by the contractor (KTDP) – Rs.59.05 million

According to contact agreement, “within seven (7) days from the date of furnishing of acceptable Performance Security under the Conditions of contract, the employer will send the successful bidder the Form of Contract Agreement provided in the Bidding Documents, incorporating all agreements between the parties. The successful bidder shall furnish to the employer a Performance Security in the form and the amount stipulated in the Condition of Contract within a period of fourteen (14) days after the receipt of Letter of Acceptance. Failure of the successful bidder to comply with the requirements of Sub-Clauses IB.20.2 & 20.3 or 21.1 of Clause-IB.22 shall constitute sufficient grounds for the annulment of the award and forfeiture of the Bid Security”.

During audit of accounts of the Project Director Kurram Tangi Dam Project Bannu for the period from July 2020 to June 2021, it was noticed that contract for construction of staff hostel was awarded to M/s Al-Nafeh Enterprises at a cost of Rs.59.05 million. The contractor was required to furnish the Performance Bank Guarantee amounting to Rs.5.91 million as per form given in the bidding documents but the same was not provided according to the prescribed form in the bidding documents i.e contractor mentioned Clause-49 instead of

Clause-09 and added words “This bond is subject to Arbitration” which were not included in prescribed form. Audit held that due to furnishing of unacceptable Performance Bank Guarantee by the contractor, the actions of annulment of the award of contract and forfeiture of the Bid Security submitted by the contractor were required to be taken by the management. However, the same were not taken. Hence, non-annulment of award of contract and non-forfeiture of bid security needed justification and investigation at appropriate level.

Non-adherence to the contract agreement/bidding documents resulted in non-annulment of award of contract of Rs.59.05 million and non-forfeiture of the Bid Security up to the financial year 2020-21.

The matter was taken up with the management in August, 2021 and reported to MoWR in January, 2022. The management replied that the contractor submitted revised performance security bond with the validity period up to January 28, 2023. However, a fact-finding enquiry committee had been constituted by Member (Water) WAPDA on October 04, 2022 to look into the matter of extension of BGs.

The DAC in its meeting held on October 26, 2022 directed the management to complete fact-finding enquiry within 15 days and verify the extension of the BGs.

Further progress was not intimated till finalization of the report.

Audit recommends the management to ensure compliance of DAC’s decision.

(Original Para No.26)

5.3.2 Non-verification of Bank Guarantee (JHPS) – Rs.31.27 million

According to G.M Finance (Water) letter No.FD(W)/5(2)/Misc:/1680 dated February 17, 2011, submitting of a fake BG by some unscrupulous quarters has been seriously viewed by high-ups. Accordingly, in a bid to surely retard recurrence of such an action future, Member (Finance) has desired to take appropriate precautionary measures. All concerned are therefore advised to get all BGs of any type verified invariably by the issuing bank under intimation to respective bank head office.

During audit of accounts of the Resident Engineer Jinnah Hydel Power

Station WAPDA Kalabagh, for the period from July, 2020 to June, 2021, it was noticed that a performance bank guarantee valuing Euro 166,242.20 equivalent to Rs.31.27 million was provided by the contractor M/s Renken & Co. GmbH Herrlichkeit C/o M/s Shehzad International for the supply of Speed Increaser Gear Unit which was not verified from the issuing bank.

Non-adherence to the instructions of the Authority resulted into non-verification of BG from the issuing bank up to financial year 2020-21.

The matter was taken up with the management in September, 2021 and reported to MoWR in January, 2022. The management replied that an amount of Euro 1.636 million was paid to contractor on account of supply of material and dismantling of damaged speed increaser and installation services. However, contractor's payment Euro 0.168 million was outstanding whereas 10% performance security amounting to Euro 0.166 million was also retained and was valid up to December 31, 2022 which would be en-cashed in case of contractor's default.

The management's reply was not tenable as the BG was not verified from bank concerned as required under the rules.

The DAC in its meeting held on October 26, 2022 directed the management to ensure BG remain valid till the final testing and commissioning of equipment and en-cash the BG in case of non-compliance. DAC further directed the management to submit record to Audit for verification by next week.

Further progress was not intimated till finalization of the report.

Audit recommends the management either to provide proof of verification of extended BG or en-cash the BG.

(Original Para No.3)

5.3.3 Non-blacklisting of bidder on submission of fake Bank Guarantee (GBHP) – Rs.0.30 million

According to Section-4.8.1 of WAPDA Procurement and Contract Manual regarding reasons for blacklisting, Blacklisting is a serious matter and has many consequences. The Contractors / Suppliers shall be blacklisted and debarred from participating in procurement proceedings, who either consistently

fail to provide satisfactory performances or are found to be indulging in corrupt or fraudulent practices. Or the bidder has submitted false / fabricated / forged documents for consideration of tender.

During audit of accounts of the Chief Engineer/P.D Ghazi Barotha Hydropower Project Hattian for the period from July, 2020 to June, 2021, it was noticed that a tender was floated for executing work for providing and fixing chain link fence on bridges at power channel. M/s Sher Ali participated through Ikram Ullah S/o Muhammad Bashir and offered bid of Rs.8.04 million with 2% Bid Security in shape of BG Bearing No.LG/FWB/MAIN/ CD/48/2021 dated January 07, 2021 amounting to Rs.0.30 million. The said BG was issued by First Women Bank Limited Peshawar. Upon verification of BG form the Regional Head office of bank, the same bank guarantee turned out to be fake. As per provisions of contract manual the management was required to initiate proceedings for blacklisting of the said contractor but needful was not done.

Non-adherence to the provisions of contract manual resulted in non-blacklisting of bidder on submission of fake BG amounting to Rs.0.30 million during financial year 2020-21.

The matter was taken up with the management in September, 2021 and reported to MoWR in January, 2022. The management replied that the contractor had been blacklisted / debarred from participation in bidding/tender process for future projects of WAPDA for a period of 05 years on account of submission of fake BG.

The DAC in its meeting held on October 26, 2022 directed the management to provide status of F.I.R along with legal action taken against the bidder / contractor.

Further progress was not intimated till finalization of the report.

Audit recommends the management to take stern action against the bidder / contractor besides implementing DAC's decision.

(Original Para No.28)

5.4 Non-encashment of Bank Guarantees

WAPDA Procurement and Contract Manual requires the project management to clearly define in contract agreement about kind of defaults that

would lead to the encashment of the performance security. The project management had the right to encash the performance security in case of default on part of the contractor by serving notice to the contractor about the default.

Audit observed that contractors had defaulted in different contracts at Tarbela Dam Project, Tarbela 4th Extension Hydropower Project and Mangla Dam Project, the management was required to forfeit the BGs before their expiry by serving notice to the contractors but needful was not done. This aspect of weak internal controls is highlighted in detail in Para-5.4.1, 5.4.2 and 5.4.3.

5.4.1 Non-forfeiture of Bank Guarantees valuing Rs.1.21 million and non-execution of work at risk & cost of defaulting contractors (TDP) – Rs.4.89 million

According to Clause-12.2 of Contract Agreement, if the Contractor abandons the work or fails to comply with a valid instruction of the engineer/employer, the employer may give notice referring to this Sub-Clause and stating the default. The Contractor then shall demobilize from the site leaving behind any Contractor’s Equipment which the employer instructs, to be used for the completion of the works at the risk and cost of the Contractor.

During audit of accounts of the General Manager Tarbela Dam Project, Tarbela for the period from July, 2020 to June, 2021, it was observed that two works worth Rs.12.068 million were awarded to two different contractors as detailed below;

(Amount Rs. in million)

| Sr. No. | Name of Contractor | Description of work | Date of award | Date of completion | Contract Cost | Work executed | Remaining work |
|--------------|-----------------------|---|---------------|--------------------|---------------|---------------|----------------|
| 1 | Zia-ul-Haq | Water proofing of 62 No Residential Buildings at main Mehran, Directorate and Snonober Colony Civil-I TDP | 4.1.2012 | 04.06.2012 | 4.938 | 3.050 | 1.888 |
| 2 | M/s Bilal Enterprises | Construction of Causeway No.7 on Ghazi Faqirabad Road | 19.5.2014 | 20.8.2014 | 7.130 | 4.129 | 3.001 |
| Total | | | | | 12.068 | | 4.889 |

However, the contractors could not complete the works as per contract agreement. Both contracts were terminated on December 19, 2018. Audit held

that the employer was required to forfeit performance securities amounting to Rs.1.21 million and complete the remaining works valuing Rs.4.89 million at the risk & cost of the defaulting contractors. However, neither performance securities of contractors were forfeited nor the remaining work was executed at the risk & cost of the defaulting contractors.

Non-adherence to Contract clauses and WAPDA Rules resulted in non-forfeiture of performance securities and non-execution of the incomplete works at the risk and cost of the defaulting contractors.

The matter was taken up with the management in September, 2021 and reported to MoWR in January, 2022. The management replied that remaining/pending work of Causeway No. 07 Ghazi Faqirabad Road was carried out by local administration (TMA) and no payment was made to TMA. As soon as the work of waterproofing of remaining sixteen houses got completed, Audit would be informed accordingly.

The DAC in its meeting held on October 26, 2022 directed the management to complete the works at the risk & cost of the contractors and get the record verified from Audit by December 31, 2022.

Further progress was not intimated till finalization of the report.

Audit recommends the management to ensure completion of works at the risk & cost of the contractors besides implementing DAC's decision.

(Original Para No.18)

5.4.2 Release of Bank Guarantee and issuance of Defects Liability Certificate without rectifying defects (T4HPP) – Rs.4.76 million

According to Clause-2.39 of the World Bank Guidelines, Contracts for works and single responsibility contracts shall require security in an amount sufficient to protect the borrower in case of breach of contract by the contractor. This security shall be provided in an appropriate form and amount, as specified by the employer in the bidding document. A portion of this facility shall extend sufficiently beyond the date of completion of the works or facilities to cover the defects liability or maintenance period up to the final acceptance by the borrower.

During audit of accounts of the Project Director Tarbela 4th Extension Hydropower Project, Tarbela for the period from July, 2020 to June, 2021, it was

noticed that a contract for “Construction of Roads, Water Supply, Overhead Water Tank, Sewerage (complete) and Green Area Development” was awarded to M/s Sahibzada Liaqat Ali Shah & Co. on February 19, 2018 at a bid cost of Rs.41.58 million with completion up to November 09, 2018 (263 days) and 180 days of defects liability period. Later on, the contract cost was increased to Rs.47.62 million through variation orders and completion date was extended three times up to July 20, 2020. The contractor provided performance bank guarantee for Rs.4.16 million initially valid for January 24, 2019 which was finally extended up to December 31, 2020. Completion certificate was issued on November 30, 2020 w.e.f. July 20, 2020. The performance bank guarantee was released to the contractor on December 03, 2020 without issuance of defects liability certificate. Defects liability certificate had not been issued till August 09, 2021 due to non-remedying the defects/short comings included in the punch list. It is pertinent to mention that taking-over certificate of the project had not been issued till date of Audit. As per the above mentioned procurement guidelines, the contractor was required to provide performance guarantee, valuing Rs.4.76 million with validity beyond the date of completion of the works or facilities to cover the defects liability or maintenance period up to final acceptance by the borrower. Audit was of the opinion that performance guarantee of less value and less validity period and releasing the same before issuance of defects liability certificate was violation of the procurement guidelines of the World Bank which put the work at risk.

Non-adherence to procurement guidelines of the World Bank resulted in obtaining performance bank guarantee from contractor of lesser value and without coverage of the defects liability period.

The matter was taken up with the management in August, 2021 and reported to MoWR in January, 2022. The management replied that GCC could not be amended by any executing agency and there was no provision in the GCC for any increase in value of performance guarantee irrespective of increase in contract price. Performance security was released within 28 days after issuance of completion certificate as per contract provision.

The DAC in its meeting held on October 26, 2022 directed the management to submit detailed revised reply with proper justification and documentary evidence to Audit.

Further progress was not intimated till finalization of the report.

Audit recommends the management to justify non-obtaining of performance bank guarantee for enhanced amount of contract besides fixing responsibility for release of performance bank guarantee without issuance of Defect Liability Certificate.

(Original Para No.27)

5.4.3 Non-encashment of Bank Guarantee on default of contractor (MDO) – Rs.0.93 million

According to Para-5.2.2(b) of WAPDA Procurement and Contract Manual 2014, “the contract should define clearly the kind of defaults that would lead to the encashment of the performance security”.

During audit of accounts of the Resident Engineer (Civil) Mangla Dam Organization, Mangla for the period from July, 2020 to June, 2021, it was noticed that a contract for Rehabilitation of Water Supply / Sewerage System at Mangla Colony was awarded to M/s Malik Muhammad Akbar Khan, Islamabad at a contract price of Rs.9.34 million on January 01, 2020. As per contract, the work was to be completed up to May 31, 2020 which was extended up to August 11, 2020 by the management. However, the contractor failed to complete the work up to the extended period; therefore, performance guarantee of the contractor amounting to Rs.0.93 million was required to be forfeited upon its expiry i.e. December 19, 2020 but the same was not done. The BG expired and could not be encashed in time due to negligence of the management for which no responsibility was fixed.

Non-adherence to WAPDA Procurement Manual and Contract Clauses resulted in expiry of the BG amounting to Rs.0.93 million and non-encashment thereof during the financial year 2020-21.

The matter was taken up with the management in August, 2021 and reported to MoWR in January, 2022. The management replied that contractor submitted performance security amounting to Rs.0.934 million in shape of Call Deposit Receipt (CDR) in lieu of extended BG which was encashed in favour of R.E (Civil) MDO Mangla. However, liquidated damages @ 10% of contract price would be deducted from the contractor’s final bill.

The management's reply was not tenable as no liquidated damages were imposed on the contractor till date of audit.

The DAC in its meeting held on October 26, 2022 directed the management to provide record i.e. work completion certificate, evidence of encashment of CDRs, copy of final bill of the contractor and liquidated damages deduction certificate and get it verified from Audit within 15 days.

Further progress was not intimated till finalization of the report.

Audit recommends the management to ensure compliance to DAC's decision

(Original Para No.19)

5.4.4 Non-forfeiture of Bank Guarantee on supply of sub-standard equipment (TPH) resulting in loss of – Rs.0.32 million

According to Para-5.2.2 (b) of WAPDA Procurement and Contract Manual, the performance Securities are required as a condition of Contract validity. The guarantee ensures that the Contractor shall fulfill his obligations under the contract. The Contract shall define clearly the kind of defaults that would lead to the encashment of the performance security.

During audit of accounts of the Chief Engineer Tarbela Power House, Swabi for the period from July 2020 to June 2021, it was noticed that Purchase Order was issued to M/s AZ International on July 11, 2017 for supply of 6 complete sets (32 segments) of Carbon Seal Rings (Right and Left) along-with 6 sets of Garter Spring (2 springs each) at a bid cost of Rs.3.24 million. The supplier supplied the equipment. The seals were installed on Units 6, 7 and 9, but performance of the newly installed seals was found un-satisfactory. All of the seals were found damaged within 3 to 4 weeks from the date of their installation, resulting in severe water leakage. The supplier was asked time and again to replace the damaged seals; however, the same were not replaced till September 20, 2021. This showed that most of the seals were found damaged after installation up to June 08, 2018. Performance Guarantee of the supplier was valid up to June 12, 2018. Since, neither the supplier agreed to renew the Performance Guarantee nor replaced the damaged / substandard seals, the employer was required to forfeit the Performance Guarantee before its expiry. However, the formation authorities failed either to get the damaged/substandard equipment

replaced or get the Performance Guarantee of the supplier forfeited which showed negligence and lack of interest in safeguarding the Authority's interest and un-due favor to the supplier and loss to national exchequer.

Non-adherence to clauses of WAPDA Procurement and Contract Manual and negligence resulted in non-forfeiture of Performance Guarantee of the supplier who failed to make supply as per agreed terms and conditions.

The matter was taken up with the management in September, 2021 and reported to MoWR in January, 2022. The management replied that reminders were issued to supplier for extension of BG. The firm was blacklisted by the PPRA for a period of 03 years w.e.f. January 10, 2022 to January 09, 2025 due to failure in fulfilling contractual obligations.

The DAC in its meeting held on October 26, 2022 pended the para till the decision of court and directed the management to pursue the court case vigorously. Furthermore, submit revised reply regarding supply of substandard equipment.

Audit recommends the management to investigate the matter of non-renewal of BG at appropriate level for fixing responsibility.

(Original Para No.20)

6. Recommendations

In view of above study results, following measures are recommended for the management of WAPDA to improve project management practices:

- i. Standard Operating Procedures (SOPs) regarding strengthening of internal controls for requisition, verification, and validity of Performance Guarantees to be developed and incorporated into the Instructions to Bidder;
- ii. BG be obtained from the contractor within stipulated time frame required, otherwise, the bid securities be forfeited
- iii. BG be verified from the issuing bank well in time for authentication of their genuineness
- iv. Strict legal action to be taken against the supplier / contractor who provided fake BG
- v. The contractor may be asked well in time to renew the BGs with short expiry period as required under provisions of the standard contracts
- vi. In cases, where uncovered period is observed regarding renewal of BGs, cost of BG for uncovered period must be recovered from the contractor, and
- vii. The contractor may be directed to enhance the value of BG at the time of enhancement in the value of contract whether due to issuance of variation order(s) or exchange rate fluctuations.

7. Conclusion

The special study report was conducted in line with TORs approved by the Special Sector Audit Wing with special focus on risk areas connected with contractual provisions regarding Bank Guarantees. The key audit findings have highlighted risk areas such as non-provision of the bank guarantees by the contractor according to contractual provisions, non-initiation of verification process regarding originality of the provided bank guarantee by the project offices, non-forfeiture of bank guarantee of non-responsive contractors, non-blacklisting of the contractor who provided the fake bank guarantees and non-initiation of legal actions against the contractor for provision of fake bank guarantees.