

**OPERATIONS MANUAL  
BANK POLICIES (BP)**

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*These policies were prepared for use by ADB staff and are not necessarily a complete treatment of the subject.*

**SUPPLEMENTARY FINANCING**

**A. Introduction**

1. ADB may provide supplementary financing at the borrower's request to cover a financing gap that may emerge because of changes in the original cost estimates, financing arrangements, or an operation's scope and/or design.

**B. The Policy**

2. The policy deals with supplementary financing of ADB's public and private sector investment operations (investment projects, sector development projects, and investment components of sector development programs) provided in the form of supplementary financial assistance (a loan, Asian Development Fund [ADF] grant, equity investment<sup>1</sup> or guarantee, as applicable) during implementation. Technical assistance (TA) loans to prepare a subsequent phase of a long-term investment program or project may be proposed as supplementary financing.

**C. Scope of the Policy**

3. ADB may provide supplementary financing beyond the amount specified in the original financial assistance agreement for investment operations:

- (i) to ensure successful completion of ADB-financed projects in the event of a financing gap or a cost overrun<sup>2</sup>;
- (ii) to finance modified or incremental activities or components to address additional financing needs necessitated by operation restructuring or scaling up when the original financing amount is not sufficient to cover these activities or components.

4. Supplementary financing may be provided either in the form of new supplementary financial assistance or, in the case of a public sector project, by reallocating unutilized loan proceeds from ongoing loans to the same borrower.<sup>3</sup>

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<sup>1</sup> In the context of the policy on supplementary financing, a supplementary equity investment can be provided in connection with project financing.

<sup>2</sup> The term "cost overrun", as used in this OM section, refers to the excess of the project expenditures incurred or expected to be incurred by the borrower over and above the project cost estimate as originally approved by the Board.

<sup>3</sup> See OM Section H6 (Use of Surplus Loan Proceeds).

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### 1. Eligibility for Supplementary Financing

5. ADB may consider supplementary financing for a public sector operation if it is satisfied that such financing is warranted by the economic situation of a developing member country (DMC), particularly the nature and extent of its external and fiscal deficits.

6. ADB may provide supplementary financing to cover a financing gap or a cost overrun on an ADB-financed project<sup>4</sup> provided that:

- (i) the project continues to be a priority in the government's development strategy (or, if it is a private sector project, it is consistent with the current country partnership strategy); and
- (ii) supplementary financing will help achieve the original project objectives and benefits.

7. ADB may provide supplementary financing for modified activities or components proposed as part of operation restructuring (e.g., of a project or an investment component of a sector development program) to address unanticipated circumstances and needs that emerge during implementation. The activities or components need to be consistent with the operation's development objectives, original or revised as part of operation restructuring to align with the current country partnership strategy, and to enable to achieve these objectives.

8. ADB may provide supplementary financing for incremental activities or components of an operation (e.g., a project or an investment component of a sector development program) that is performing well. To be eligible for such financing, the operation and proposed activities or components should satisfy the following conditions.

- (i) The proposed activities and components should be consistent with the current country partnership strategy and the original (or revised as part of operation restructuring) development objectives of the operation and should increase its impact, outcomes, and development effectiveness.
- (ii) The operation should have satisfactory implementation progress, including substantial compliance with finance agreement covenants, and should appear likely to attain the development objectives.

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<sup>4</sup> This includes cost overruns caused by changes to price and/or quantity of inputs and changes in financing arrangements.

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9. For public sector operations, no more than two provisions of supplementary financial assistance to finance modified or incremental activities or components may be provided to the original operation. The aggregate amount of these two provisions should not exceed the amount of the original financing approved by ADB. For private sector operations, supplementary financing assistance should not lead to prescribed investment and exposure limits being exceeded.<sup>5</sup>

10. Policy lending (program lending and policy components of sector development programs) is not eligible for supplementary financing.

### **2. Applicability of Standard Cost-Sharing Limits in Public Sector Operations**

11. Cost-sharing limits apply to the aggregate ADB portfolio in the DMC over the country strategy and program period.<sup>6</sup> The actual share of supplementary financial assistance financed by ADB may vary.

### **3. Financing Interest and Other Charges during Construction**

12. Supplementary financial assistance may include interest and other charges on the financial assistance during construction,<sup>7</sup> where applicable, if such financing is considered appropriate by ADB.

### **4. Sources and Terms of Supplementary Financial Assistance**

13. Supplementary financial assistance may have financial terms and conditions that are determined independently from the financial terms and conditions of the original financing.<sup>8</sup>

14. The sources and terms of supplementary financial assistance are determined as follows:

- (i) Whether supplementary financial assistance is provided from ADB's ordinary capital resources (OCR) or from its Special Funds resources depends upon the eligibility status of the DMC concerned in accordance with the arrangements for lending from the Asian Development Fund prevailing when the supplementary financial assistance is processed.<sup>9</sup> In the case of supplementary financing from ADF grant resources, eligibility is also guided by the ADF grant framework.

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<sup>5</sup> See OM Section D10 (Private Sector Operations).

<sup>6</sup> See ADB. 2005. *Cost-sharing and Eligibility of Expenditures for Asian Development Bank Financing: A New Approach*. Manila (Doc. R193-05, 4 August).

<sup>7</sup> See OM Section H1 (Financing of Interest and Other Charges During Construction).

<sup>8</sup> It is also possible to synchronize the repayments of the supplementary loan with those of the original loan. See paragraph 33 and footnote 21 of ADB. 2005. *A Review of the Policy on Supplementary Financing: Addressing Challenges and Broader Needs* (Doc. R303-05, 7 November).

<sup>9</sup> See OM Section A1 (Classification and Graduation of Developing Member Countries), OM Section A3 (Performance-Based Allocation of ADF Resources), and OM Section D9 (Guarantee Operations).

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- (ii) The interest and commitment charge on a supplementary loan, if financed from OCR, are the same as those for a new OCR loan<sup>10</sup> at the time of approval of the supplementary loan. If it is financed from the ADF, the supplementary loan will carry the standard interest charge.<sup>11</sup>
- (iii) The pricing (e.g., a guarantee fee, an interest rate) of guarantees and nonsovereign<sup>12</sup> supplementary loans are determined in accordance with established rules and procedures, as applicable.<sup>13</sup>

15. The proposed modified or incremental activities or components are expected to be completed within a reasonable time after the current closing date for the original program or project, which generally should not exceed 3 years for a public sector operation.

### 5. Priority for Supplementary Financing

16. In financing cost overruns, ADB gives priority to projects that are in an advanced stage of implementation and can be completed within a relatively short time. Priority may also be given to works to address damage caused by natural disasters, such as floods, earthquakes, or landslides.<sup>14</sup>

### 6. Supplementary Financing in Cofinanced Projects

17. In the case of a cofinanced project, ADB may make efforts to mobilize appropriate supplementary cofinancing. Cofinancing of supplementary financing is not pursued where (i) the project has been delayed because of poor coordination of the existing cofinanciers; (ii) the supplementary financing is urgently required, and arranging cofinancing will take additional time; or (iii) cofinancing arrangements may unduly burden the borrower.

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<sup>10</sup> See OM Section D1 (Lending and Relending Policies [OCR]).

<sup>11</sup> See OM Section D2 (Lending and Relending Policies [ADF]).

<sup>12</sup> Without government guarantee.

<sup>13</sup> See OM Section D9 (Guarantee Operations) and Section D10 (Private Sector Operations).

<sup>14</sup> Preparation and processing of supplementary financing in connection with emergency assistance loans will follow procedures defined in the disaster and emergency assistance policy (ADB. 2004. *Disaster and Emergency Assistance Policy*. Manila) and OM Section D7 (Disaster and Emergency Assistance).

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- Basis:** This OM section is based on:
- ADB. 2008. *Refining the Performance-Based Allocation of Asian Development Fund Resources* (Doc. R243-08). 21 October. Manila.
  - ADB. 2007. *Revising the Framework for Asia Development Fund Grants* (Doc. R143-07). 5 September. Manila.
  - ADB. 2005. *A Review of the Policy on Supplementary Financing: Addressing Challenges and Broader Needs* (Doc. R303-05). 7 November. Manila.
  - ADB. 2005. *Cost-sharing and Eligibility of Expenditures for Asian Development Bank Financing: A New Approach* (Doc. R193-05). 4 August. Manila.
  - ADB. 2004. *Review of the Asian Development Bank's Policy on the Performance-Based Allocation of Asian Development Fund Resources* (Doc. R249-04). 19 November. Manila.
  - ADB. 1988. *Review of Policy on Supplementary Financing of Cost Overruns of Bank-Financed Projects* (Doc. R17-88). 28 January. Manila.
  - ADB. 1983. *Review of Policy on Supplementary Financing of Cost Overrun on Projects* (Doc. R115-83, Revision 1, Final). 29 November. Manila.
- This OM section is to be read with OM Section H5/OP.
- Compliance:** This OM section is subject to compliance review.
- For inquiries:** Questions may be directed to the Director of Operations Planning and Coordination Division, Strategy and Policy Department.

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*These procedures were prepared for use by ADB staff and are not necessarily a complete treatment of the subject.*

**SUPPLEMENTARY FINANCING**

**A. Introduction**

1. The procedures described in this section apply to processing and approval of supplementary financial assistance.

**B. Application of the Policy**

**1. Flexibility in Application**

2. The search for alternative financing sources to cover a financing gap or cost overruns, including those related to cofinancing, should not result in further implementation delays or widen the financing gap. Depending on project circumstances, Management<sup>1</sup> may decide, in consultation with the borrower, either to search for additional cofinancing or to use ADB resources.

3. Consideration is given to financing of interest and other charges on the loan during construction in cases where a financing gap is caused by factors largely beyond the control of the borrower.

**2. Concept Clearance**

4. All new proposals for supplementary financing will follow established business processes, including those for concept clearance and project classification/ categorization.

**3. Identification of a Need for Supplementary Financing**

5. The need for supplementary financing of modified or incremental activities or components is normally identified during operation supervision, in particular during review missions that examine a project's overall progress. A midterm review mission may provide a good opportunity to examine whether there is such a need. However, supplementary financing, including financing to close a financing gap, may be considered at any point during project implementation.

6. Supplementary financial assistance is processed by an operational project team, which generally consists of staff from the same division of a regional department or from the private sector operations department, and may include resident mission staff and consultants. The relevant director general is responsible for forming the project team and allocating its budget.

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<sup>1</sup> For cofinanced projects, the relevant operational departments give recommendations to Management in consultation with the Office of Cofinancing Operations.

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### **4. Due Diligence**

7. For supplementary financing of purely price or financing arrangement changes the following appraisal procedures apply:

- (i) If an increase in original cost estimates was caused by currency realignment, price increases, or inflation, or by underestimation of input prices, appraisal is limited to reconfirming the project's economic viability and financial sustainability.
- (ii) If changes in financing commitments within the original financing plan were caused by difficulties in timely provision or availability of cofinancing resources, appraisal is limited to reconfirming the project's financial sustainability.

8. The proposed physical changes within the original scope and/or design, or modified or incremental activities or components, and their impact are appraised to ensure that:

- (i) the proposed supplementary financial assistance is technically feasible and institutionally sound;
- (ii) the operation remains economically viable and financially sustainable;
- (iii) relevant safeguard issues that may emerge from undertaking the proposed physical changes within the original scope and/or design, or modified or incremental activities or components, are addressed in line with the applicable safeguard policies; and
- (iv) new or revised policies approved by the Board since the appraisal of the original operation have been taken into consideration.

9. The due diligence process for supplementary financing purposes is summarized in Appendix 1.

### **5. Negotiations and Approval**

10. Negotiations of the finance documents (loan agreement, grant agreement, financing agreement, project agreement, guarantee agreement, and other documents, as applicable) may be held through a formal meeting with the borrower or through electronic communication (e.g., videoconferencing, transmitting signed and scanned documents via e-mail or facsimile machine).

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11. Supplementary financial assistance may be submitted to the Board for approval under the summary procedure.<sup>2</sup>

**6. Retroactive Financing**

12. For project expenditures incurred or expected to be incurred by the borrower under a contract in excess of the amount of unutilized original financial assistance proceeds, prior to the provision of supplementary financing, retroactive financing may be included in the supplementary financing. Retroactive financing is normally limited to contracts that (i) are ongoing and awarded under the original ADB financial assistance; and (ii) comply with time and amount limits specified in OM Section H4 on *Retroactive Financing*; provided procurement is in accordance with ADB's *Guidelines for Procurement*. The report and recommendation of the president (RRP) clearly indicates the project components and financing ceilings being recommended for retroactive financing.

**7. Report and Recommendation of the President**

13. For supplementary financing of purely price or financing arrangement changes, a concise RRP is prepared, together with amendments to the finance documents. The RRP:

- (i) briefly describes the status of project implementation, the reasons for the financing gap, why supplementary financing is needed, including information on the strengths, weaknesses, and any major problems, if applicable, of the project;
- (ii) confirms that the criteria for supplementary financing by ADB have been met;
- (iii) provides details of any changes in the cost estimates and financing plan, including a clear indication of cost increases by composition and amount, benefits, and risks;
- (iv) confirms the economic viability and financial sustainability of the project;
- (v) specifies the financial terms for the supplementary financial assistance; and
- (vi) incorporates a revised design and monitoring framework as required.

14. For supplementary financing of physical changes within the original project scope and/or design, or modified or incremental activities or components, a concise RRP is prepared, together with amendments to the finance documents or new finance documents, as appropriate. The RRP:

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<sup>2</sup> See ADB. 2005. *Revision of the Summary Procedure*. Manila (Doc. R249-05, 26 September).

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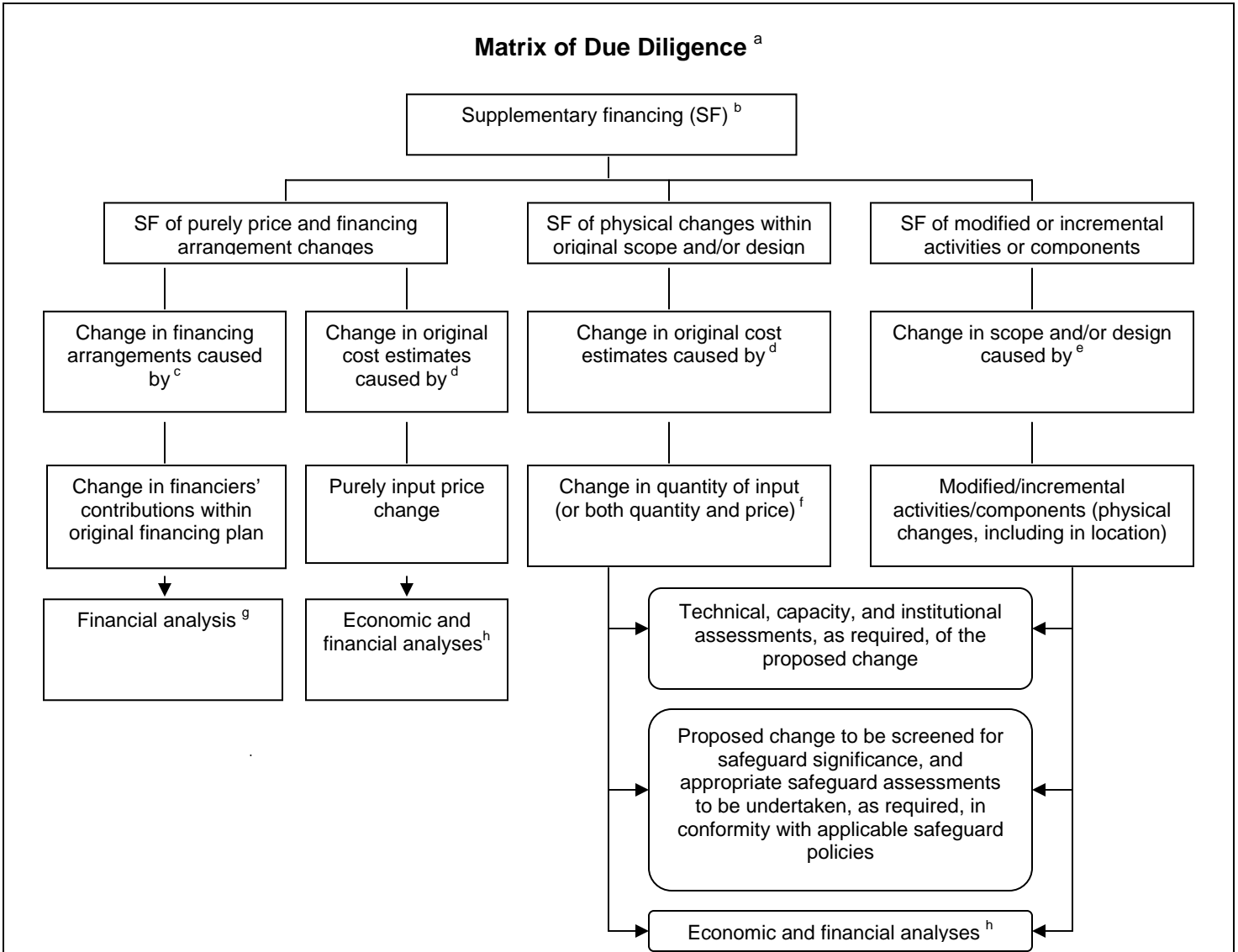
- (i) briefly describes the status of implementation, the reasons for and details of any proposed physical changes within the original project scope and/or design, or changes relating to modified or incremental activities or components, the rationale for supplementary financing, including information on the strengths, weaknesses, and any major problems, if applicable, of the operation;
  - (ii) confirms that the criteria for supplementary financing by ADB have been met;
  - (iii) provides details of any changes in the cost estimates and financing plan, including a clear indication of cost increases by composition and amount, benefits, and risks;
  - (iv) confirms the technical feasibility of the proposed activities and the operation's economic viability and financial sustainability, and, if relevant, describes how safeguard issues are to be addressed;
  - (v) specifies the financial terms for the supplementary financial assistance and a new closing date for the original operation; and
  - (vi) incorporates a revised design and monitoring framework.
15. Indicative RRP models are provided in Appendix 2.

**Basis:** This OM section is based on OM Section H5/BP and the documents cited therein.

**Compliance:** This OM section is subject to compliance review.

**For inquiries:** Questions may be directed to the Director of Operations Planning and Coordination Division, Strategy and Policy Department.

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<sup>a</sup> The matrix of due diligence applies to supplementary financing of public and private sector investment operations that is provided in the form of additional financial assistance (the loan, ADF grant, equity investment or guarantee, as applicable). For public sector operations, it also applies to supplementary financing through reallocation of unutilized loan proceeds from ongoing loans to the same borrower.

<sup>b</sup> All new proposals for supplementary financing will follow established business processes, including concept clearance and project classification/categorization.

<sup>c</sup> A change in the financing arrangements can be caused by changes in the financing contributions from the original financing parties (e.g., government or sponsors) within the original financing plan. To cover a reduced contribution from a financing party creating a shortfall on financing available to complete the project, supplementary financing will be required to meet this financing gap.

<sup>d</sup> A change in the original cost estimates, as envisaged at project appraisal, can be a function of price changes (e.g., fluctuations in the value of currencies, price increases, or inflation, or price underestimation) and/or underestimation of quantities of inputs required to achieve specified outputs. The effect of these changes would be a shortfall in the financing available to complete the project. Supplementary financing will be required to meet this financing gap.

<sup>e</sup> A change in an operation's (project or investment component of SDP) scope and/or design can be caused by modified or incremental activities/components that represent physical changes, including a change in location. These changes in the original project scope and/or design, which result in an increase in overall project cost estimates, will require supplementary financing to fill this financing gap.

<sup>f</sup> Where a change in quantity of input (or both quantity and price), as opposed to a purely input price change, is involved, due diligence may be conducted as for physical changes/modifications within originally envisaged activities/components, as required.

<sup>g</sup> When supplementary financing is to be provided to fill a financing gap that emerged due to a reduced contribution from the original financing party within the original financing plan, an economic analysis is not required, as the original cost estimates do not change. However, a financial analysis needs to be conducted to reconfirm the operation's financial sustainability as terms and conditions of supplementary financing may differ from those of the original financier.

<sup>h</sup> This involves reconfirmation of the project's economic viability and financial sustainability.

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**SECTION A: INDICATIVE MODEL OF THE SIMPLIFIED  
REPORT AND RECOMMENDATION OF THE PRESIDENT (RRP) FOR  
SUPPLEMENTARY FINANCING OF PURELY PRICE OR FINANCING  
ARRANGEMENT CHANGES**

**SUPPLEMENTARY FINANCIAL ASSISTANCE AND PROJECT SUMMARY**

(Includes reference to the original RRP and brief information on the following: borrower; classification [generally the same as for the original project]; rationale for the supplementary financial assistance; revised cost estimates; revised financing plan; supplementary financial assistance amount and terms; period of utilization; and implementation arrangements if different from those envisaged under the original financial assistance.)

- I. THE PROPOSAL  
(As in standard RRP)
- II. THE APPROVED PROJECT  
(Reference is provided to the original RRP; a concise description is limited to the sections noted below.)
  - A. Project Rationale
  - B. Objectives and Scope
  - C. Cost Estimates and Financing Plan
  - D. Status of and Progress in Project Implementation  
(This subsection should include essential information on the strengths and weaknesses of the project, including information on any major problem, if applicable.)
- III. THE PROPOSED SUPPLEMENTARY FINANCIAL ASSISTANCE  
(The sections below should provide sufficient information and analysis to enable the Board to consider approval of the supplementary financial assistance.)
  - A. The Cost Overrun  
(Describes and gives reasons for a financing gap or a cost overrun.)
  - B. Impact on the Project  
(Includes:
    - (i) an assessment of the impact of the financing gap or cost overruns on the achievability of the original project objectives;

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- (ii) a brief description of any changes in the sector and the executing agency or project company that have a bearing on the project, with suggested amendments to the design and monitoring framework, if required.)

C. Rationale

(Provides justification for supplementary financing, including:

- (i) confirmation that the policy criteria for ADB's supplementary financing have been met; and
- (ii) confirmation of the project's economic viability and financial sustainability.)

D. Revised Cost Estimates

(Provides details of any changes in cost estimates, including a clear indication of cost increases by composition and amount to ensure more transparency about cost overruns.)

E. Revised Financing Plan

(Provides details of any changes in the financing plan and information on the proposed supplementary financial assistance amount and terms.)

F. Remedial Steps

(Describes measures to prevent further cost overruns, including remedial steps to address other problems, such as delayed implementation and failure to meet objectives.)

G. Implementation Arrangements

(Describes changes in implementation arrangements, if any.)

IV. PROJECT BENEFITS, IMPACTS, AND RISKS

(Describes changes to the original project's benefits, impacts, and risks, if any.)

V. ASSURANCES

(As in standard RRP)

VI. RECOMMENDATION

(As in standard RRP)

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**SECTION B: INDICATIVE MODEL OF THE SIMPLIFIED  
REPORT AND RECOMMENDATION OF THE PRESIDENT (RRP) FOR  
SUPPLEMENTARY FINANCING OF PHYSICAL CHANGES WITHIN ORIGINAL  
SCOPE AND/OR DESIGN, OR MODIFIED AND INCREMENTAL  
ACTIVITIES OR COMPONENTS**

**SUPPLEMENTARY FINANCIAL ASSISTANCE AND PROJECT SUMMARY**

(Includes reference to the original RRP and brief information on the following: borrower; classification [generally the same as for the original project]; description of proposed physical changes within the original scope and/or design, or modified and incremental activities or components; rationale; impact and outcome of proposed activities; revised cost estimates; revised financing plan; supplementary financial assistance amount and terms; period of utilization; new estimated project completion date; implementation arrangements if different from those envisaged under the original financial assistance; beneficiaries; and risks and assumptions.)

- I. THE PROPOSAL  
(As in standard RRP)
- II. THE APPROVED PROJECT  
(Reference is provided to the original RRP; a concise description is limited to the sections noted below.)
  - A. Project Rationale
  - B. Objectives and Scope
  - C. Cost Estimates and Financing Plan
  - D. Status of and Progress in Project Implementation  
(The subsection should provide information on implementation progress, including on compliance with original financial assistance covenants, and an assessment of the likelihood of the development objectives being attained. The subsection should include essential information on the strengths and weaknesses of the project, including information on any major problem, if applicable.)
- III. THE PROPOSED SUPPLEMENTARY FINANCIAL ASSISTANCE  
(The sections below should provide sufficient information and analysis to enable the Board to consider approval of the supplementary financial assistance.)

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- A. Proposed Changes  
(Describes and gives reasons for any proposed physical changes within the original scope and/or design, or modified and incremental activities or components.)
  
- B. Impact on the Project  
(Includes:
  - (i) an assessment of the impact of the physical changes within the original scope and/or design, or changes in scope or design relating to modified or incremental activities or components, on the achievability or extension of the original (or revised as part of operation restructuring to align with the current country partnership strategy) project objectives;
  - (ii) a brief description of any changes in the sector and the executing agency or project company that have a bearing on the project; and
  - (iii) suggested amendments to the design and monitoring framework.)
  
- C. Rationale  
(Provides justification for supplementary financing, including:
  - (i) confirmation that the policy criteria and eligibility requirements for supplementary financing have been met; and
  - (ii) confirmation that supplementary financial assistance is technically feasible, institutionally sound, economically viable and financially sustainable.)
  
- D. Safeguards  
(Addresses any safeguard issues, e.g., environmental or resettlement issues, as applicable, that may emerge if the proposed physical changes within the original scope and/or design, or modified and incremental activities or components, are undertaken. New or revised policies approved by the Board since the appraisal of the original project should be taken into consideration. Any safeguard assessment that may be undertaken in connection with supplementary financial assistance should cover, as required, the proposed physical changes within the original scope and/or design, or modified or incremental activities or components, and their impact.)
  
- E. Revised Cost Estimates  
(Provides details of any changes in cost estimates, including a clear indication of cost increases by composition and amount.)
  
- F. Revised Financing Plan  
(Provides details of any changes in the financing plan and information on the proposed supplementary financial assistance amount and terms.)

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- G. Implementation Arrangements  
(Describes proposed changes in implementation arrangements, if any, and specifies changes in the implementation schedule and new estimated project completion date as applicable.)

- IV. PROJECT BENEFITS, IMPACTS, AND RISKS  
(This should generally be as in standard RRP, modified, as appropriate. Risk assessment should be linked to a revised design and monitoring framework.)

- V. ASSURANCES  
(As in standard RRP)

- VI. RECOMMENDATION  
(As in standard RRP)

APPENDIXES

SUPPLEMENTARY APPENDIXES (available on request)