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Report of the Working Group of the Management Coordination Committee on UNOPS*

1. This paper has been prepared for the purpose of showing the present status of UNOPS and its plans and projections for the immediate future, as approved by the Management Coordination Committee (MCC). It also proposes certain measures to be taken for restoring the United Nations Office for Project Services (UNOPS) to financial health and in particular towards building its operational reserve to a level necessary for regular and orderly conduct of UNOPS activities. In doing so, the paper provides proposals for cost reduction and containment and addresses the need for enhancing business acquisition from United Nations entities. The paper is based on the work of a working group established by the MCC with the participation of representatives of all members of the MCC.

Background

2. As stated in his annual report (DP/2002/19), the Executive Director informed the MCC in January 2002 that, because of an excess of administrative budget expenditure over income incurred in 2001, the operational reserve would be drawn down to \$5 million by the end of 2001. Furthermore, as a result of downward revisions to estimates of income in 2002, a further significant draw down of the operational reserve in 2002 was possible – unless corresponding reductions in the administrative budget were achieved. This was in contrast to the projections in the UNOPS revised budget estimates for the biennium 2000-2001, budget estimates for the biennium 2002-2003, and report on the level of the operational reserve (DP/2001/28) presented to the Executive Board at its second regular session in September 2001. Those projections estimated that a replenishment of the operational reserve, to the extent of \$1.5 million in each of the years 2001 and 2002, would take place during those years.

* The collection and analysis of current data required to present the Executive Board with the most up-to-date information has delayed submission of the present document.

3. The MCC was concerned by what it considered to be the perilously low level to which the operational reserve had fallen and its implications for the future of UNOPS. As an immediate response, it decided that a strict balance between income and expenditures must be maintained by UNOPS during 2002 and the administrative budget reduced accordingly. Based on preliminary estimates of income for 2002 provided by UNOPS, the MCC further decided that administrative budget expenditures should be limited to \$43 million during 2002.

4. In establishing the financial frame work for 2002 and the immediate future years, it may be useful to review the financial results of UNOPS since 1995, the first full year of its establishment as an independent, self-financing entity. As shown in Table 1, during the early years, the operational reserve was progressively increased to a peak level of \$29.5 million by the end of 1998. However, the Reserve has since been eroded every year, reaching a level of \$5 million by the end of 2001, both as a result of operating deficits and a series of direct charges (labelled “non-recurrent expenditures” in Table 1). It may also be noted that while total income has declined somewhat from \$50.1 million in 1998 to \$47.2 million in 2001, administrative expenditures have increased significantly from \$42 million in 1998 to \$52.8 million in 2001. It is therefore urgent that further erosion of the reserve is halted and its replenishment commence immediately.

Initial budget submission by UNOPS

5. At a meeting of the MCC on 16 April 2002, in response to the decision of the MCC mentioned above, the Executive Director proposed a budget for 2002 amounting to \$47 million. His position was that this level was the minimum needed at that time to assure full protection of project delivery capacity of the organization. He stated, however, that his intention was to monitor the budget closely to ensure a balance between income and expenditures by the end of 2002.

6. As stated by the Executive Director in paragraph 33 of his annual report (DP/2002/19), this budget level combined with his income estimates for the year, would result in an operating deficit for the year of \$2.9 million. This deficit, added to the costs of the necessary staff reductions, which are also a charge to the Operational Reserve (estimated at that time to be \$2.8 million), would then reduce the Reserve to nearly zero by the end of 2002.

7. The MCC considered this an unacceptable option, given the operational and other consequences of such a development. It therefore requested its Working group to review in detail all budgetary, staffing, business and other aspects of the situation and develop viable options for the MCC to consider.

Implications of the UNOPS budget proposal on the operational reserve

8. As the first step in determining whether, and to what extent, the UNOPS initial budget request of \$47 million should be reduced (possibly to the MCC ceiling of \$43 million), it was considered essential to make a projection of the operational reserve for 2002 to 2005. This projection would be based on the continuation of the current financial parameters. Accordingly, Table 2 has been prepared to show projections of various financial elements, including income, expenditures and the status of the operational reserve for this period.

9. Estimates of project income are based on the continuation of project delivery of approximately \$500 million for all years from 2002 to 2005 (with small increases in 2004

and 2005) and a small increase in the rate of support costs charged. The latter rate has fallen recently, presumably because of a change in the composition of the project portfolio and other factors, as reflected in the estimates made by UNOPS itself. Total income for 2002 has been estimated at \$44.3 million, taking into account all possible sources, including for instance rental income through subletting a part of the UNOPS premises to other United Nations organizations. All of these elements, however, are subject to uncertainty and the realization of various commitments. Taking into account the low level of the operational reserve and the fact that past estimates of income have turned out to be unrealistic, therefore, it was considered prudent to use conservative estimates of income, as shown in Table 2.

10. The projections in Table 2 alarmingly show that the operational reserve would be negative for the entire period, ending with a deficit of \$2.4 million at the end of 2005. UNOPS would clearly be rendered non-viable as a current concern under these conditions, unless a base of administrative budget at a lower and more sustainable level were established. The erosion of the operational reserve to only \$5 million at the start of 2002 imposes a major constraint – not only should income and expenditures be balanced every year but income should also exceed expenditure so that a contribution is made to the restoration of the reserve. The Working Group considered that the reserve should be built back to at least a minimum level of about \$10 million by the end of 2005 to enable UNOPS to avoid serious liquidity problems (even though this level would still fall short of the estimated level of \$21.5 million required by Executive Board formula).

Review of the initial budget submission and recommendation for the revised budgetary level

11. Based on the above, it was decided that a detailed review of the budgetary and staffing-level issues involved be conducted in order to identify the base administrative budget level for 2002. Doing so would achieve several objectives. First, as stated above, it is necessary to replenish the operational reserve to a minimum level of \$10 million by the end of 2005 to allow UNOPS carry out its operations without liquidity and other financial problems. Second, it is important to ensure that any necessary reductions do not damage the delivery and business acquisition capacities of UNOPS. Third, any further reductions should result in immediate savings beginning in 2002, recognizing that staff termination costs would reduce proposed savings.

12. The Working Group accordingly carried out a division-by-division and line-by-line review of the UNOPS initial budget proposal for 2002 of \$47 million. Table 3 provides a summary of the analysis of income and cost by UNOPS organizational divisions. Several points may be noted.

13. A comparison of the budget proposal for 2002 with the actual expenditures in 2001 shows that reductions, understandably, fall mostly in central allocations and in support divisions (such as in the Divisions for External Communications and Relations, Business and Partnership Services, and the Washington and Tokyo liaison offices), which do not contribute directly to project delivery. Of the reductions of \$5.7 million proposed, therefore, those in support divisions would amount to \$2.5 million, in central allocations to \$2.3 million and in operational divisions to only \$0.9 million.

14. A comparison of the staff count shows that no significant reductions are planned in several operational divisions. In fact, for some divisions, budgetary allocations have actually increased (or have not been materially decreased) from the levels at the end of 2001, while projected income and/or delivery have not been proportionately affected.

15. Although non-staff costs constitute only 24 per cent of total budget, planned reductions in non-staff costs would constitute 54 per cent of total reductions. These disproportionate reductions in non-staff costs, however, are not considered to be sustainable in future years.

16. Based on the above analysis, the Working Group recommended to the MCC that a revised budgetary level for 2002 of \$44 million be established. This level would represent \$3 million less than that proposed by the Executive Director but \$1 million more than the limit initially established by the MCC. In the view of the Working Group, these further savings could be achieved primarily through reductions in non-staff costs and in temporary assistance and appointments of limited duration (ALD) services.

17. Table 4 presents financial projections for 2002-2005, based on administrative budget allocations of \$44 million for 2002 (and other assumptions specified). The projections show that, under these conditions, the operational reserve could be restored to \$13.1 million at the end of 2005, which, while still falling short of the required level, could put UNOPS back on a trajectory towards financial viability.

18. The MCC, in a meeting on 30 May 2002, approved these recommendations and decided that a revised budget for 2002 of \$44 million should be prepared and submitted to the Executive Board for approval. The MCC further decided that the modest staff reductions that may become necessary as a result of this decision should be achieved through non-renewal of short-term contracts.

19. UNOPS management has prepared a detailed budget for 2002 based on this decision of the MCC. Initial indications are that further savings of \$3.1 million, as requested by the MCC, will be achieved through staff cost reductions amounting to \$1.6 million and non-staff cost reductions of \$1.5 million.

20. While challenges do remain in effecting these changes, it is considered that careful and judicious management of the budgetary adjustments mentioned above could put UNOPS on the path back to financial solvency and growth. The MCC and UNOPS management have agreed on the necessity of establishing transparent and fair mechanisms for achieving staff reductions in accordance with United Nations Staff rules and regulations. The MCC will continue to monitor the situation closely during the coming months to ensure that its decisions are implemented expeditiously and that measures necessary to help UNOPS to meet its targets for 2002 are undertaken without delay.

Enhancing business acquisition

21. It is recognized that, in promoting the financial recovery of UNOPS, business acquisition aspects and cost reductions and productivity enhancements should receive equal attention. In this connection, the decision of the Secretary-General to encourage United Nations entities to utilize the services of UNOPS on a competitive and cost-effective basis is important. As shown in the annual report of the Executive Director (DP/2002/19), UNDP continues to be the major client of UNOPS, even though its share of the total UNOPS portfolio has been declining in recent years and that of other United Nations organizations increasing progressively. The Administrator of UNDP has instructed his senior managers to continue and enhance further the use of UNOPS where it is cost-effective to do so. The MCC has asked its Working Group, as part of its work, to review any difficulties – procedural, bureaucratic or otherwise – to the work of UNOPS within the United Nations system and to make recommendations to the MCC for their resolution. Later in 2002, the

MCC may initiate an independent study of the business model of UNOPS, its cost effectiveness and the scope for further expansion of business opportunities for UNOPS within the United Nations system.

Table 1:**UNOPS financial results 1995 – 2001** (millions of US dollars)

UNOPS financial parameters									Status of operational reserve			
Year	Delivery	Avg. income rate (project portfolio)	Portfolio income	Services income	Other income	Total income	Admin exp (1)	Surplus/ deficit	Non-recurrent exp.	1 Jan. opening balance	31 Dec. closing balance	Required (2)
1995	382.9	6.9%	26.6	3.1	0.7	30.4	27.7	2.7		10.3	13.0	6.8
1996	430.8	7.3%	31.6	3.2	3.4	38.2	33.6	4.6		13.0	17.6	6.8
1997	463.1	7.6%	35.0	3.7	1.8	40.5	36.7	3.8		17.6	21.4	18.6
1998	537.8	8.1%	43.5	4.1	2.5	50.1	42.0	8.1	1.5	21.4	29.5	20.0
1999	559.9	7.7%	43.0	5.8	3.1	51.9	47.4	4.5	16.7	29.5	17.4	23.2
2000	471.1	7.8%	36.8	6.5	5.2	48.5	52.3	-3.8	3.0	17.4	10.6	25.0
2001	504.7	7.5%	37.9	7.0	2.3	47.2	52.8	-5.6		10.6	5.0	23.1

1995 – 1998: Services income prior to changing fees and travel income
1995: UNOPS payments to UNDP country offices were treated as a reduction of portfolio income not as an administrative expenditure

(1) Recurrent administrative expenditures only
(2) Calculated in line with relevant Executive Board decisions

Table 2:**Projection of UNOPS operational reserve with current financial framework***(thousands of US dollars)*

	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>Total</u>	<i>Notes</i>
Total project delivery	500,000	500,000	510,000	520,000	2,030,000	(1)
Project income rate	7.10%	7.20%	7.30%	7.30%		(2)
Total project income	35,500	36,000	37,230	37,960	146,690	
Income from services	7,632	7,300	7,400	7,400	29,732	(3)
Other income	690	500	500	500	2,190	
Income from subleases	<u>500</u>	<u>1,000</u>	<u>1,000</u>	<u>1,000</u>	<u>3,500</u>	(4)
Total income	44,322	44,800	46,130	46,860	182,112	
Administrative expenditures	47,072	45,251	47,034	47,975	187,332	(5)
Operational surplus/(deficit)	(2,750)	(451)	(904)	(1,115)	(5,220)	
Operational reserve calculation						
Opening balance	5,000	50	(401)	(1,305)	5,000	
Operational surplus/(deficit)	(2,750)	(451)	(904)	(1,115)	(5,220)	
Separation costs	<u>(2,200)</u>	<u>- -</u>	<u>- -</u>	<u>- -</u>	<u>(2,200)</u>	(6)
Closing balance of operational reserve	50	(401)	(1,305)	(2,420)	(2,420)	(7)

(1) Project delivery assumed to continue at same level as in 2002, with small adjustments for inflation

(2) Assumes fees will be renegotiated such that small increases in income rate are possible in 2003-2005

(3) Assumes no growth in IFAD loan portfolio

(4) Sublease income calculated based on 80% occupancy rate of available space

(5) All projections provided by UNOPS Finance: 2003 assumes cuts applied to whole year rather than half-year only (as in 2002); 2004-2005 assumes modest inflationary increases

(6) UNOPS estimates

(7) Excludes savings from cancellation of prior year's obligations

Table 3:**Analysis of Income and expenditures of UNOPS divisions***(thousands of US dollars)*

Division	Major Location	Project delivery		Project income		Total income		Staff count		Administrative expenditures		
		2001 actual	2002 projected	2001 actual	2002 projected	2001 actual	2002 projected	2001 actual	2002 ⁽¹⁾ projected	2001 actual	2002 proposed	Difference
Operational												
Asia	Kuala Lumpur	77,800	59,000	5,900	4,500	7,800	6,800	46	44	4,652	4,530	122
Africa I	New York	49,600	40,000	4,000	3,200	4,000	3,200	27	23	2,625	2,010	616
Africa II	Abidjan	16,300	18,000	1,800	1,400	2,600	2,400	28	27	1,498	1,613	(114)
Latin America and the Caribbean	New York	18,000	17,000	1,100	1,100	1,100	1,100	10	11	1,300	889	411
West Asia, Europe, and Arab States	New York	56,100	57,000	5,000	4,400	5,000	4,400	31	23	3,657	2,875	782
Environmental Programmes	New York	98,000	90,000	7,300	6,800	7,300	6,800	43	38	3,300	3,924	(624)
Special programmes	New York	48,400	66,000	2,900	4,100	2,900	4,100	16	20	1,104	1,287	(183)
IFAD	Rome	-	4,000	-	-	3,600	3,800	25	25	2,738	2,756	(18)
Rehabilitation and social sustain.	Geneva	68,400	75,000	6,200	6,000	6,600	6,600	60	61	⁽²⁾ 4,527	4,307	221
Procurement services	Copenhagen	<u>76,200</u>	<u>74,000</u>	<u>3,700</u>	<u>3,700</u>	<u>3,700</u>	<u>3,700</u>	<u>26</u>	<u>33</u>	<u>2,283</u>	<u>2,601</u>	<u>(318)</u>
Subtotal		508,800	500,000	37,900	35,200	44,600	42,900	312	305	27,686	26,790	896
Support												
Directorate	New York							9	6	1,459	1,207	253
Legal	New York							16	10	1,620	1,239	381
Finance and administration	New York							40	30	3,188	3,070	118
Human resources	New York							23	29	2,381	2,254	127
Training and TOKTEN	New York							7	1	511	404	107
External (including partnerships)	New York							14	6	2,011	1,239	772
Information technology	New York							20	17	3,664	2,977	687
Tokyo Liaison	Tokyo							<u>2</u>	<u>1</u>	<u>360</u>	<u>272</u>	<u>88</u>
Subtotal								131	100	15,194	12,662	2,532
Central												
										9,896	7,617	2,279 ⁽³⁾
Total savings												5,707 ⁽⁴⁾
Total administrative expenditures										52,776	47,069	

(1) In line with \$47 million budget

(2) Includes reduction of staff posts in Vienna

(3) Includes reductions in 2002 budget from 2001 expenditures of approximately \$100,000 in sub-contracts, \$150,000 in rent, \$500,000 in mainframe hardware, \$200,000 in miscellaneous services, \$150,000 in office supplies, \$438,000 in common service costs, and \$500,000 in UNDP and UN support services

(4) Includes savings in staff costs of \$2 million, and in non-staff costs of \$3.7 million

Table 4:**Projection of UNOPS operational reserve: scenario to restore UNOPS to financial health***(thousands of US dollars)*

	2002	2003	2004	2005	Total	<i>Notes</i>
Total project delivery	500,000	500,000	510,000	520,000	2,030,000	(1)
Project income rate	7.10%	7.20%	7.30%	7.30%		(2)
Total project income	35,500	36,000	37,230	37,960	146,690	
Income from services	7,632	7,300	7,400	7,400	29,732	(3)
Other income	690	500	500	500	2,190	
Income from subleases	<u>500</u>	<u>1,000</u>	<u>1,000</u>	<u>1,000</u>	<u>3,500</u>	(4)
Total income	44,322	44,800	46,130	46,860	182,112	
Administrative expenditures	44,000	41,000	42,600	44,200	171,800	(5)
Operational surplus/(deficit)	322	3,800	3,530	2,660	10,312	
Operating reserve calculation						
Opening balance	5,000	3,122	6,922	10,452	5,000	
Operational surplus/(deficit)	322	3,800	3,530	2,660	10,312	
Separation costs	<u>(2,200)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(2,200)</u>	
Closing reserve	3,122	6,922	10,452	13,112	13,112	(6)

(1) Project delivery assumed to continue at same level as in 2002, with small adjustments for inflation

(2) Assumes fees will be renegotiated such that small increases in income rate are possible in 2003-2005

(3) Assumes no growth in IFAD loan portfolio

(4) Sublease income calculated based on 80% occupancy rate of available space

(5) 2002 based on WG suggestions for restoring UNOPS to financial health, 2003 staff cuts applied for full year, no increases in non-staff costs; 2004 and 2005 based on annual increases of 3% in staff costs and 5% in non-staff costs
For inflationary adjustments

(6) Excludes savings from cancellations of prior year's obligations
