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## **UNOPS net assets**

### **Structure and allocation**

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## **I. Purpose of this paper**

1. This paper is presented pursuant to Executive Board decision 2019/20: “The Executive Board requests UNOPS to present its provisions and plans to address contingencies to the UNDP/UNFPA/UNOPS Executive Board for review during the annual session 2020, and to annually update the UNDP/UNFPA/UNOPS Executive Board on their plans on how to utilize the surplus in its operational reserves, in line with the financial regulations and rules of UNOPS”.

## **II. Elements of a decision**

2. The Executive Board may wish to: (a) take note of the conference room paper on UNOPS net assets (DP/OPS/2020/CRP.1); (b) request that UNOPS conduct a detailed study of its operational reserves and the formula for calculating the mandatory minimum reserve level; and (c) request that UNOPS, pursuant to review by the Advisory Committee for Administrative and Budgetary Questions, submit the outcome for consideration by the Executive Board at its annual session 2023.

## **III. Background**

3. The UNOPS business model is that of a demand-driven and self-financed United Nations organization. Rather than receiving assessed, core or non-core contributions, it provides services in exchange for a fee.

4. According to UNOPS financial regulation 9.01, as a self-financing entity UNOPS operates on the basis of full cost recovery and sets its management fees accordingly. Further, financial regulation 14.02 outlines that the budget shall cover anticipated revenue and intended costs. The Executive Director has the authority to increase or reduce the management budget allotment within the net revenue target established by the Executive Board. As a result of those financial regulations, UNOPS does not plan for an operating loss in any year and instead plans for a net revenue target of zero or higher.

5. As a project-based organization and in the absence of regular contributions, the UNOPS governance structure and management activities needed to support the achievement of its strategic goals are funded through fees recovered as revenue from project services provided to UNOPS partners.

6. UNOPS operates in some of the world’s most challenging environments, delivering complex multi-sectoral projects to respond to peace, security, development and humanitarian needs, including in fragile and conflict areas.

7. UNOPS does not have the possibility of accessing credit or adopting a programmatic approach to funds allocation between projects. UNOPS must act within the boundaries of its contractual obligations as a project service provider.

8. The strong growth in UNOPS project delivery in recent years has run parallel to growth in net assets and has led to a strong financial position. All financial liabilities are fully funded, including after-service health insurance and other post-employment benefits.

9. To safeguard its unique business model in the United Nations system, UNOPS relies on its low operational surplus margin and net finance income – the main building blocks of its net assets – to ensure its financial viability.

10. The usage of UNOPS reserves is limited to the purposes outlined for each operational reserve component in financial regulation 22.02. No other programmatic purposes, such as, for instance, the provision of grants, are allowed. All changes in reserve

levels are disclosed in the UNOPS financial statements, which are subject to annual audit by the United Nations Board of Auditors.

11. Chapter IV presents an analysis of how UNOPS manages its net assets. Section A describes how the UNOPS average fee and operational surplus margin have developed over the last four years compared to UNOPS delivery. In section B, each component of UNOPS net assets is fully disclosed, including the 2019 established growth and innovation reserve. The paper shows how available net assets are invested (section C) and contributed to (section D). Presented in section E, a recent benchmark review shows how UNOPS actual minimum operational reserve and net assets compare to peer United Nations organizations. Sections F and G focus on how net assets are linked to the operational risk exposure of UNOPS, and the current and potential consequences of the Covid-19 outbreak. Chapter V presents the conclusions.

## IV. Net assets management: current provisions

### A. Average fee, operational surplus margin and delivery 2016-2019

Figure 1.



12. **Average fee:** As a service provider, UNOPS charges a management fee in addition to direct project expenses to cover its governance and operational structure, including strategic leadership and policy-setting. The average fee, which represents UNOPS recovery for its indirect cost as a share of total project expenses, is an indicator of the lean governance structure of UNOPS. The UNOPS Executive Director noted at the annual session 2019 of the Executive Board that the average fee continued on a downward trend, from 4.9 per cent in 2017 to 4.7 per cent in 2018. That has decreased further, to 4.4 per cent. The decreasing average fee should be seen in the context of a relatively steady composition of the service line mix over the same period, reflecting that UNOPS is delivering ‘more for less’.

13. **Operational surplus margin:** The annual operational surplus – as displayed in the UNOPS financial statements – can be defined as the difference between total revenue (from project activities and miscellaneous) and total expenses for the period (including project and management expenses). In terms of margin, it measures the proportion of revenues from

operations left over after expenses. While the overall value of UNOPS total project expenses ('delivery') has increased by more than 50 per cent since 2016 – from \$1.4 billion to \$2.3 billion – the annual operational surplus has remained within an \$18 million to \$22 million band. Since 2017, the operational surplus margin has stabilized at a very low 1 per cent.

14. Combined with an increase in project delivery, the above decrease of average fee together with a razor-thin operational surplus margin indicates, in essence, that UNOPS is delivering more for less, developing economies of scale to the ultimate benefit of its partners and beneficiaries.

**B. UNOPS net assets components**

15. Net assets/equity is the standard term used in the International Public Sector Accounting Standards to refer to the residual financial position (assets less liabilities) at period end, comprising contributed capital, accumulated surpluses and deficits, and reserves. Net assets/ equity may be positive or negative.

16. Total net assets reported as at 31 December 2019 amounted to \$252 million. They are composed of the following elements (in \$ millions):

**Figure 2.**



17. **Minimum operational reserve.** Established through Executive Board decision 2013/33, its purpose is to cover for cost overruns associated with UNOPS management expenses and/or in case of cessation of all activities. It guarantees the financial viability and integrity of UNOPS as a going concern. The balance was \$21 million as of 31 December 2019. UNOPS expects to review the reserve in 2023, 10 years after the previous study.

18. **Growth and innovation reserve.** In 2019, the UNOPS Executive Director established a growth and innovation reserve based on her authority under UNOPS financial regulations and rules. The growth and innovation reserve provides debt or equity investments to, inter alia, sustainable infrastructure impact investment activities to catalyse investments in socially inclusive large-scale infrastructure projects that will contribute to the achievement of the Sustainable Development Goals. In 2020, UNOPS established a new business unit, the Sustainable Infrastructure Impact Investment Office ('S3I' for short), to manage the portfolio of investments under the growth and innovation reserve. The office is located in Helsinki and reports directly to the UNOPS Executive Director. The value of the reserve is set at 50 per cent of the excess operational reserve, to be calculated and reported to the Executive Board annually through the UNOPS financial statements. At the end of 2019, the balance stood at \$104.9 million, with a total of \$58.8 million allocated to sustainable infrastructure impact investment agreements as of April 2020.

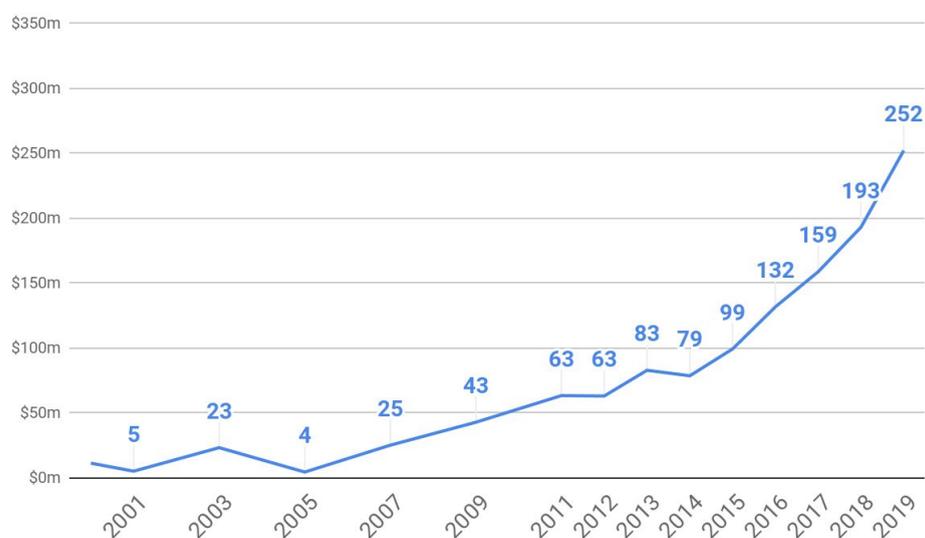
19. **Actuarial gains/losses and fair value.** The International Public Sector Accounting Standards require disclosure for transactions directly charged to net assets, such as the actuarial gains or losses in respect of post-employment benefits, as well as fair value movements in respect of investments (2019 balance: \$21.2 million).

20. **Accumulated surpluses** represent the accumulated surpluses and deficits from UNOPS operations over the years, net of those amounts transferred to other reserves. Equal to the remaining 50 per cent of excess over the minimum operational reserve (2019 balance: \$104.9 million).

21. In 2019, UNOPS provided more detail of the net assets to increase transparency. The presentation aligned UNOPS financial information better with other United Nations organizations. Among other components, the accumulated surpluses are relied upon as a contingency for unforeseeable residual risks that are not covered by project direct contributions.

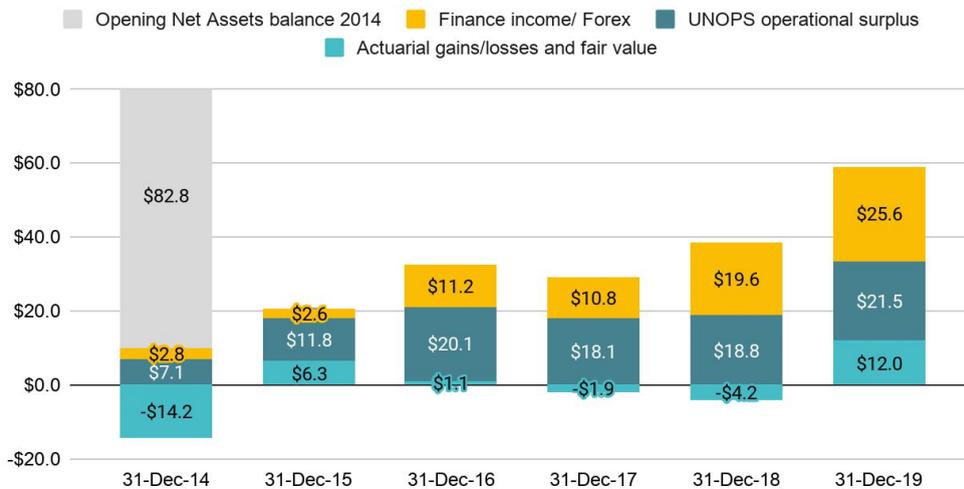
### C. Evolution of UNOPS net assets

**Figure 3. Net assets - nominal value (\$ millions)**



22. During the early 2000s, UNOPS had a number of years of operational deficits and was very close to default a number of times. Despite the increasing complexity and size of its engagement portfolio – as outlined in the above chart – for the last thirteen years (2007-2019) UNOPS has had sustained growth in net assets, also as a consequence of strengthened internal controls and a more conservative risk management approach adopted over the years.

**Figure 4. Contribution to UNOPS net assets (\$ millions): 2014-2019 trend**



23. The above chart represents how UNOPS net assets (\$252 million as of 31 December 2019, according to the UNOPS financial statements) have been built over the years, through:

- (a) **Operational surplus** (dark blue). Represented by the difference between total revenues (which includes the fees earned by UNOPS on all projects) and expenses (or delivery), the operational surplus has remained stable between \$18 million and \$22 million since 2016, generating a slim margin, around 1 per cent.
- (b) **Finance income** (yellow). The income retained by UNOPS from investments has been increasing substantially since UNOPS internalized treasury management in 2016. During 2019, the net finance income was \$25.6 million, for the first time more than 50 per cent of the total surplus for the period.
- (c) **Actuarial gains/losses and fair value** (light blue). These two elements relate to International Public Sector Accounting Standards valuation adjustments, which are posted directly against net assets. The trend shows significant changes over time and an overall marginal contribution to current levels of surplus.

24. The increase of finance income has been substantial (from \$3 million to \$26 million in 6 years), and has contributed to more than 40 per cent of the cumulative net assets since 2012. The steady operational surplus (around \$20 million since 2016) has contributed to net asset growth. In general, the strong growth in project delivery in recent years has run in parallel to growth in net assets, leading to a solid financial position.

#### D. Investments of UNOPS net assets

25. UNOPS net assets have two types of investments: available-for-sale financial assets and investments in its future revenue-generating ability (i.e., the growth and innovation reserve). Each type of investment is managed through a different process.

26. The growth and innovation reserve and related investments are governed by a specific set of instructions promulgated by the Executive Director. Sustainable infrastructure impact investments ('S3I' projects) are aligned with United Nations values and principles and the UNOPS mandate, and contribute to the achievement of the sustainable development goals. The S3I initiative was developed pursuant to the encouragement and decisions of the Executive Board (2015/12; 2016/12; 2016/19; 2017/16; 2017/26 and 2019/12). The initiative was endorsed by the Secretary-General, the Deputy Secretary-General, and the United Nations Development Coordination Office in 2019. The S3I initiative will prioritize infrastructure investments in affordable housing, renewable energy and health infrastructure

sectors. Placed in countries where UNOPS operates, S3I projects are identified based on their potential to have positive social and sustainable impact while generating financial returns.

27. As of April 2020 UNOPS had invested \$8.8 million in recapitalizing a 22-megawatt wind energy farm in Mexico; \$5.0 million into construction of 200,000 social housing units in Ghana; \$5.0 million into the construction of 100,000 social housing units in Kenya; \$2.5 million into the construction of 50,000 social housing units in India; \$2.5 million into the construction of 10,000 social housing units in the Caribbean; \$20 million into the construction of 500,000 affordable houses in Pakistan; and \$15 million into multiple renewable energy deals presently under review. The allocated growth and innovation reserve thus totals \$58.8 million, and further investments from the unallocated growth and innovation reserve are being identified by the S3I office. The allocated growth and innovation reserve is illiquid by nature, while the unallocated growth and innovation reserve is liquid and can be mobilized into approved investments without delay.

28. UNOPS net assets that are not part of the growth and innovation reserve are held with the UNOPS custodian, and the portfolios are managed by the UNOPS treasury team and external investment managers. The risk profiles of investments in the different portfolios are defined in the UNOPS Statement of Investment Principles. The Executive Director is advised by the UNOPS Investment Committee, composed of recognized investment professionals.

29. The decision to draw from the formal reserves (minimum operational reserve or growth and innovation reserve) rests solely with the Executive Director, who must report all drawdowns to the Executive Board.

30. All UNOPS investments have strict oversight requirements in place within established investing frameworks, reported annually in the UNOPS financial statements.

## **E. Benchmark review: net assets of other United Nations organizations**

31. Even though the UNOPS business model is unique in the United Nations system, UNOPS undertook a review of the net assets and reserves of several peer United Nations organizations for benchmarking purposes.

32. The organizations selected include those overseen by the joint Executive Boards. All figures compared are for the year end 31 December 2018.

33. In 2018, the UNOPS net assets to revenue ratio was 20 per cent. That ratio is substantially lower than all other organizations in the peer group, with ratios between 72 and 112 per cent.

34. Among the peer organizations, net assets ranged from \$404 million to \$7.4 billion. For the same period, the UNOPS net asset balance was \$193 million. The net assets contained several reserves and fund balances to cover specified risks and included accumulated surpluses. Net assets provide organizations with needed stability of funding for global operations.

35. The benchmark review indicates that the UNOPS net assets and net assets-to-revenue ratio are the lowest compared to the other five United Nations organizations within the peer group. Sufficient net assets are a critical risk-mitigation mechanism for United Nations organizations.

## **F. UNOPS risk exposure and contingencies**

36. UNOPS delivers projects in some of the most challenging environments, including fragile states facing high levels of uncertainty. UNOPS has developed robust risk management practices to manage increasingly complex operations in often unpredictable operational environments.

37. Most notable, in terms of risk, is our portfolio of infrastructure engagements, naturally exposed to high complexity and risks. With a total budget of \$2.7 billion, the

portfolio includes 161 ongoing engagements and is concentrated on large-scale infrastructure projects. The top 10 engagements range in size from a \$50 million project to expand access to electricity and electricity-dependent services in Yemen to a \$434 million project for building health facilities in Guatemala.

**Figure 5.**

<b>Infrastructure engagements portfolio as of 21 April 2020</b>			
<b>Budget size</b>	<b>Number of engagements</b>	<b>Total budget</b>	<b>Percentage</b>
<b>&gt; \$50 million</b>	10	\$1,319 million	48%
<b>\$30-49 million</b>	11	\$423 million	16%
<b>\$10-29 million</b>	37	\$618 million	23%
<b>&lt; \$10 million</b>	103	\$361 million	13%
<b>Total</b>	<b>161</b>	<b>\$2,721 million</b>	<b>100%</b>

38. Each project in our portfolio brings its own set of operational, reputational and/or financial risks, not all of which can be fully prevented or addressed through insurance. UNOPS carries the residual risk.

39. In March 2020, Deloitte undertook a study to assess – through a Monte Carlo simulation – the likelihood of financial default for UNOPS, given its business model and historical losses, and considering various levels of net assets as well as potential worst-case scenarios adapted to the size and complexity of its engagement portfolio.

40. Based on its history of losses and possible catastrophic events – despite the robust risk management practices in place – UNOPS carries significant risks of major cost overruns that might ultimately erase our accumulated surpluses and could put UNOPS in default.

41. Accumulated surpluses are the only contingency of UNOPS for unforeseeable residual risks that are not covered by project contribution.

42. As confirmed by the above study, it is essential that UNOPS maintain a conservative, forward-looking alignment between its accumulated surpluses and operational risk exposure.

43. Accumulated surpluses must be resilient to and minimize risks connected to the engagement portfolio, while protecting the value created for its partners and beneficiaries.

**G. Covid-19 outbreak: possible effects on UNOPS**

45. As recently reported by the Secretary-General of the Organization for Economic Cooperation and Development, the Covid-19 pandemic “brings with it the third and greatest economic, financial and social shock of the 21st Century, after 9/11 and the Global Financial Crisis of 2008”.

46. As a consequence of the pandemic, income generated from UNOPS financial investments is expected to be very low in 2020, while such income was the largest contributor to our net assets in 2019.

47. Current Covid-19 outbreak and country response restrictions have created heavy operational constraints, temporarily affecting our ability to operate in several project locations globally.

48. More generally, the considerable shift in partners' priorities is likely to pose a risk to the availability of funds for several ongoing projects.

49. Having sufficient accumulated surpluses in such a scenario is a prerequisite to allowing UNOPS to respond with agility to a possible temporary but significant funding deficit, and to having the opportunity to effectively contribute – in line with our mandate – to prevention, response, and recovery efforts during and after crises.

## **V. Conclusions**

50. The minimum operational reserve dynamic formula was established in 2013. In accordance with generally recognized best practice, UNOPS expects to review this reserve in 2023 (10 years after the previous study).

51. Our average fee continued on a downward trend in 2019. With increasing partner demand for UNOPS services, and in order to sustain its business model, UNOPS expects to continue delivering more for less and keeping its operational surplus margin slim and steady.

52. UNOPS recently created a new business unit (the S3I Office) responsible for managing the portfolio of investments under the newly established growth and innovation reserve, to which 50 per cent of the excess operational reserve in its net assets has been allocated. UNOPS will continue to report to the Executive Board on the status of current and future investments funded through this reserve.

53. Based on a benchmark review, input from an external study, and internal UNOPS analysis, the present level of net assets – while significantly higher than in 2014 – is not fully adequate to address the residual risks that UNOPS faces in the context of its portfolio of engagements.

54. Within its net assets, current accumulated surpluses are considered the main contingency support instrument to cover unforeseeable residual risks within UNOPS liabilities. While protecting the value created for partners and beneficiaries, accumulated surpluses must be resilient to, and minimize risks connected to, the UNOPS engagement portfolio.

55. With growing demand for UNOPS services, increasing complexity and tight margins, UNOPS expects to maintain a conservative approach to its net assets and strictly monitor the adherence of the current model to changing risk dynamics and the composition of our engagement portfolio.

56. Annual updates on UNOPS net assets management and plans will be provided to the Executive Board through the annual report of the Executive Director.

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