31 August 2005

Original: English

Second regular session 2005
6 to 9 September 2005, New York
Item 5 of the provisional agenda
United Nations Office for Project Services

The UNOPS action plan: supplement

I. Background

1. In its decision 2005/6 of 28 January 2005, the Executive Board requested the United Nations Office for Project Services (UNOPS) to prepare for the September 2005 session of the Executive Board a comprehensive plan of action on further measures to be implemented in 2006 to enhance the efficiency of business operations, ensure cost reductions, continue the change management process, and achieve sustainable financial viability.

2. The UNOPS action plan (DP/2005/39) presents two scenarios for achieving sustainable financial viability. Both scenarios entail a significant reduction of the UNOPS fixed-cost base and the introduction of a new service pricing mechanism, based on a transparent cost-measurement methodology.

3. The document reiterates the role and added value of UNOPS as articulated in resolution 48/501 of the General Assembly of 19 September 1994, and reiterated in February 2002 in the Note of the Secretary-General (DP/2002/CRP.5) to the Executive Board of UNDP/UNFPA.

4. This conference room paper provides updated financial projections for 2005 and for the period 2006-2008, taking into account both revised revenue projections for the current year and the impact of reimbursements required against fees for service earned in 2003 under the Oil-for-Food Programme (OFFP) and Security Council resolution 1483.

II. 2005 Performance to date

A. Operating revenues and expenditures

5. In January 2005, the Executive Board approved a 2005 budget projecting year-end revenue at $53.77 million and expenditures at $50.86 million, with year-end net

income projected at $2.91 million. The UNOPS 2005 year-end fund balance was projected to stand at $14.46 million.

6. The financial position of UNOPS at 5 July 2005, (see annex 1, 2005 financial projections) as established by the UNOPS Plan and Budget Advisory Committee, shows net income to that date of $2.37 million, based on revenues of $27.43 million and expenditures of $25.06 million. Portfolio acquisitions for delivery in 2005 have increased since January 2005. Combining revenues derived from project delivery with revenues from services, rental and interest income, and through careful management of expenditures for the remainder of the year, UNOPS anticipates being in a position to earn net income of $4.42 million during the second half of the year. This amount, together with the $2.37 million earned in the first six months of the year, yields a projected annual net income of $6.79 million for 2005. Barring unforeseen circumstances, this would result in a healthy end-2005 fund balance of $21.25 million.

B. Business acquisition

7. An encouraging indicator of demand for UNOPS services relates to its level of business acquisition. In 2004, UNOPS achieved $728 million in new business acquisition – its highest level since 1998. As of early August 2005, UNOPS business acquisition during the current year stood at $705 million (see annex 2). This represents business already entered formally into the Atlas system, and does not take into account other promising ‘pipeline’ business presently under negotiation, which is expected to be acquired this year. UNOPS management is confident that in total, new 2005 business acquisitions will comfortably exceed the levels attained in 2004.

III. Reimbursements for the Oil-for-Food Programme and their impact

8. On 18 August 2005, UNOPS received instructions to release funds earned in excess of direct and indirect costs for services rendered to OFFP under resolution 1483 during the period May-November 2003. These services covered the amendment and prioritization of oil sector contracts for delivery to Iraq, for which a flat fee for service of 1 per cent had been agreed upon.

9. In 2003, UNOPS booked a total revenue for services rendered of $15,595,181 under this flat fee for services arrangement (DP/2004/6). This represented UNOPS amendment of a total of 1201 contracts, the cumulative face value of which was $1,559,518,067, with an average amended cost per contract of $3,405.

10. The requested post-facto calculation of direct and indirect costs was established at $4,088,843, now requiring UNOPS to reimburse $ 11,506,738.

11. In addition, as the World Food Programme (WFP) subcontracted to UNOPS the amendment of a further 262 contracts, it is anticipated that UNOPS will also need to reimburse WFP for services performed on behalf of WFP in an estimated amount of $ 2.5 million.

12. For the purposes of this paper, calculation of the amount required for reimbursement comprises both the $11,506,738 already specified, and a further

estimated $2.5 million, yet to be confirmed, that may have to be reimbursed to WFP. Thus the projected total for reimbursement stands at an estimated $14.01 million.

13. The UNOPS action plan and the financial projections contained therein did not take this new development into account. Annexes 3 and 4 illustrate the anticipated impact of revised net income projections for 2005, and of the OFFP reimbursements on financial projections for options 1 and 2 for the period to 2008 as presented in the action plan. It is noteworthy that the financial projections for options 1 and 2 presented in that paper factored in the adverse impact of further organizational transformation on revenues the might derive from some reduction in overall portfolio volume; reduced confidence on the part of some clients; and an adverse impact on the morale of some staff. Projected separation costs are factored in to both options. The principal impact of the OFFP reimbursements is, therefore, a reduction in the level of the operating reserve/annual fund balance for the next several years.

14. Under the revised financial projections, the end-2006 fund balance for option 1 dips to $6.35 million, before climbing at a healthy rate in 2007 and 2008. By the end of 2008, it is projected that the end-year fund balance will be close to the mandated operating reserve level and that UNOPS will be well on the road to sustained financial viability. However, 2006 will represent the year of highest risk.

15. For option 2, the end-year fund balance declines to a low of $5.41 million in 2007, and climbs slightly to $7.37 million in 2008, illustrating that this option represents a high-risk direction in which UNOPS' financial viability remains precarious into the medium term.

16. Faced with these projections, UNOPS senior management considers that option 1 represents the optimum route to financial viability. Its focus on rapid downsizing and on realignment of operations and structure with market demand – predominantly, but not exclusively, addressing post-conflict environments and natural disaster recovery – offers the most appropriate option for managing the risks to be faced during the transformation process and the uncertainties inherent in the market where demand for UNOPS services has grown most rapidly in recent years.

17. UNOPS will reimburse the full amount of $11.51 million assessed under OFFP and will factor in the likelihood of reimbursing some $2.5 million to WFP. The total amount of $14.01 million will immediately be recorded as a liability against the 2005 operational reserve, leaving an adjusted end-2005 fund balance of $7.24 million. However, UNOPS anticipates agreement that the actual process of reimbursement can be phased over a four-year period, thus easing cash flow management. For the remaining months of 2005, UNOPS will monitor delivery and expenditures closely to ensure that the organization remains on track, to promptly address any problems that may arise, and to forestall any further erosion of the fund balance.

18. UNOPS remains fully committed to its self-financing principle and to the operating mandate entrusted to it by the Executive Board. The main impact of the OFFP reimbursements will be to reduce the level of operating reserve/annual fund balance for 2005 and subsequent years. The new financial picture does not change the fundamental actions that the organization must take, but compounds the urgency with which UNOPS must respond to market trends and client demands and must progress towards financial viability through radical action on three fronts, namely:

(a) Streamlining its business portfolio;
(b) Aligning its structure; and
(c) Cutting its fixed cost base.

IV. The way forward

19. Some of the managerial measures required for each option proposed in the action plan are presented in table 1, under paragraph 9, of that document. As UNOPS continues its transformation, with the target of achieving sustained financial viability, it will not evolve by using the same thinking that contributed to a half decade of crisis. Improvements at the margin can raise performance levels, but cannot clarify direction or establish priorities. UNOPS must seize the opportunities present in the midst of its current problems, so that it can regroup to focus on markets where there is a clear demand, where full cost recovery can be achieved, and for which UNOPS has built, or can rapidly build, the skills and talents to respond to client needs.

20. Since late 2003, UNOPS has implemented a series of measures designed to restore client confidence, respond to changing market requirements and address internal business-process deficiencies. In a highly competitive environment, increased demand for its services and record portfolio growth for two years in a row indicate that UNOPS enjoys the confidence of a growing and diversified client base, as the service provider of choice and on the basis of its record of performance. These developments have enabled UNOPS to make steady improvements in the level of its reserves, which have exceeded projections, despite necessary spending on change initiatives, systems and business processes. UNOPS has invested in strengthening its management team, decentralizing operations, improving systems and putting in place the building blocks of sound financial management and control. There have been investments in staff training in the Atlas system and imprest management, leading to measurable gains in productivity.

21. At a time when United Nations reform is imminent and necessary, the above actions represent those of an entity determined to reform, build and excel – not an entity merely struggling to survive. Discounting the OFFP reimbursements, good progress is being made in 2005 in revenue generation. Financial recovery is a realistic possibility for UNOPS.

22. Following the decision of the Executive Board, UNOPS will promptly prepare its implementation timetable for streamlining the business portfolio, aligning the corporate structure and significantly reducing fixed costs. The tasks to be accomplished are time-sensitive and have to be performed over and above the daily managerial requirements with which the UNOPS senior management team has been entrusted.

23. UNOPS requests a decision by the Executive Board which will allow the entity to move ahead expeditiously with the measures required "to enhance the efficiency of business operations, ensure cost reductions, continue a change management process, and achieve sustainable financial viability".

Annex 1

2005 financial projections

$ Mln	EB approved 2005 budget (1)	2005 actuals Jan to July) (4) (15	2005 projected (6 July to 31 Dec)	2005 projected
SECTION 1: DELIVERY				
Delivery amount	641.40	326.80	356.30 (5)	683.10
SECTION 2: REVENUES AND EXPENDITURES				
Total revenue (net of unliquidated obligations)	***53.77***	**27.43**	**31.42**	**58.85**
Revenue from implementation of project portfolio and services	51.96	26.26	30.58	56.84
Of which IFAD, PAPP, GFATM	*8.44*	*4.73*	*4.73*	9.46
Other revenue (interest, rent)	1.81	1.17	0.84	2.01
Total revenue after direct costs	***53.77***	**27.43**	**31.42**	**58.85**
Administrative expenditures (KY001-KY004)				
Salary and benefits	*28.00*	11.64		
General and administrative	*10.05*	9.17		
After-service health insurance accrual				
Subtotal	*38.05*	20.81		
Reimbursement expenditures				
Atlas payment to UNDP	*3.50*	0.50		
Reimbursement costs	*3.91*	2.74		
Subtotal	*7.41*	3.24		
Allowance for doubtful accounts	*0.70*	0.60		
Chrysler Building rent expense				
Change management programmes (separation cost)		0.41		
Audit observations-related initiatives	*4.70*			
Host Government's contribution account				
Investments for IT systems transition				
Total administrative expenditures	***50.86***	**25.06**	**27.00**	**52.06**
Income/ (Loss) from ongoing operations	***2.91***	**2.37**	**4.42**	**6.79**
SECTION 3: FUND BALANCE ROLL-FORWARD				
Beginning fund balance	*14.46* (2)			14.46
Income/ (Loss) from ongoing operations (and separations)	*2.91*			6.79
Ending fund balance (before Iraq income reimbursement)	***17.37***			**21.25**
Prior year adj.: reimbursement of 2003 Iraq programme income (3)				(11.51)
Prior year adj.: reimbursement of WFP 2003 Iraq programme income (3)				(2.50)
Ending fund balance (after Iraq income reimbursement)	***17.37***			**7.24**
Reserve should be (% on delivery + total admin. exp.): *4%*	*27.69*			*29.41*

Notes: (1) January 2005 Executive Board approval

(2) Actual number from consolidated financial statement for 2004.

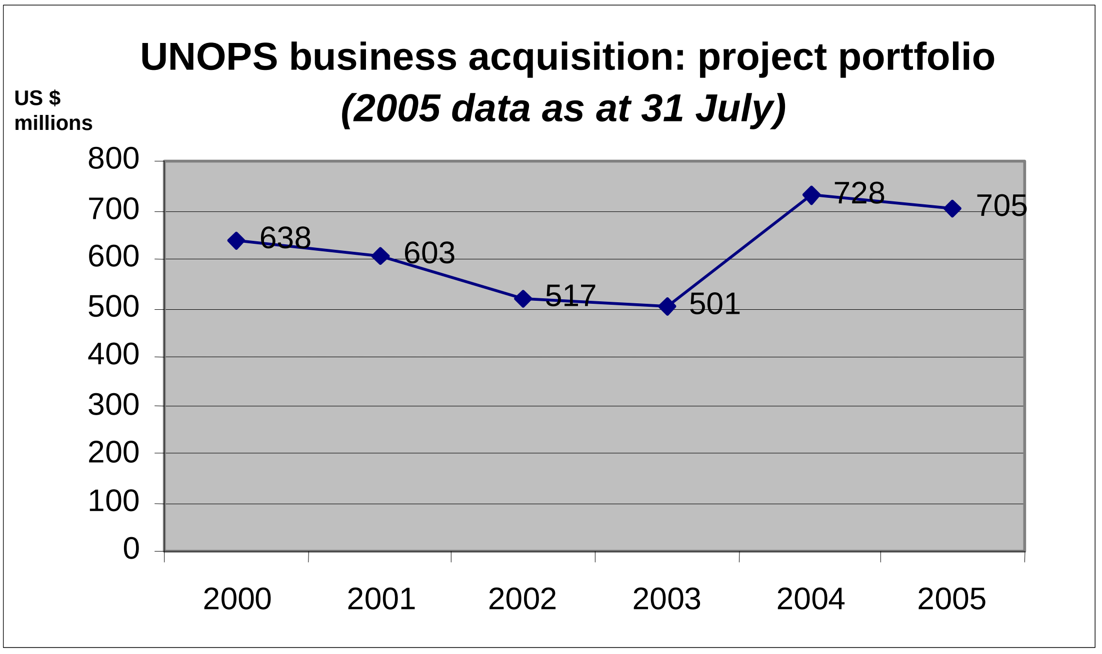
(3) As permitted under United Nations system accounting standards (UNSAS para 17(i)) the reimbursement of income is treated as a prior year adjustment; alternatively it could be recognized as an exceptional item in the 2004-2005 biennium.

(4) 2005 YTD shows actual revenues for fee based projects and estimated revenues for fixed fee projects and service projects to 5 July. Delivery and revenue from the Afghan Programme Implementation Facility are up till May.

(5) Projected delivery is based on assumed delivery of 90% of unexpended project budgets in Atlas at an average margin of 7%

Annex 2

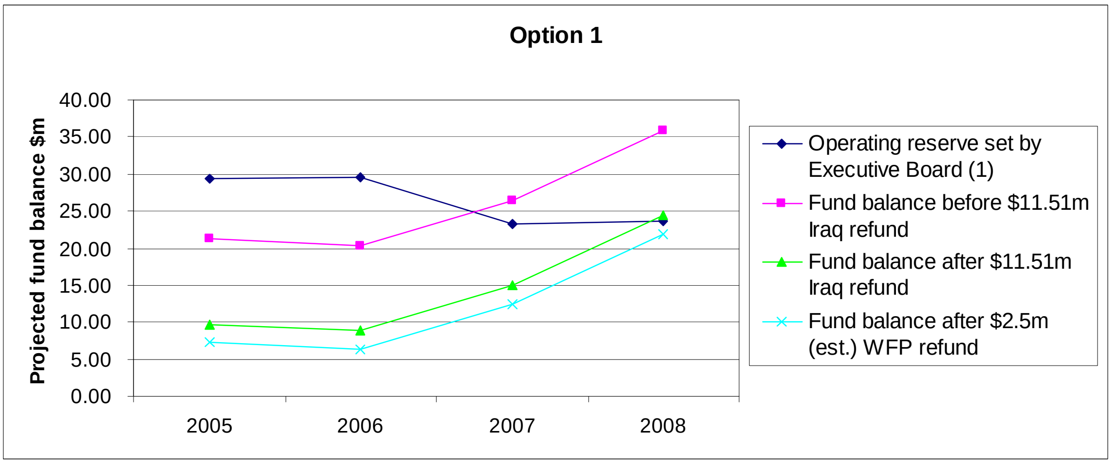
Business acquisition



Annex 3

Option 1

	2005	2006	2007	2008
Operating reserve set by Executive Board (1)	29.41	29.60	23.23	23.72
Fund balance before $11.51m Iraq refund	21.25	20.36	26.39	35.95
Fund balance after $11.51m Iraq refund	9.74	8.85	14.88	24.44
Fund balance after $2.5m (est.) WFP refund	7.24	6.35	12.38	21.94



Annex 4

Option 2

	2005	2006	2007	2008
Operating reserve set by Executive Board (1)	29.41	25.94	25.66	25.84
Fund balance before $11.51m Iraq refund	21.25	20.82	19.42	21.38
Fund balance after $11.51m Iraq refund	9.74	9.31	7.91	9.87
Fund balance after $2.5m (est.) WFP refund	7.24	6.81	5.41	7.37