Annex II

Management fee setting algorithm for the 2024-2025 biennium

1. UNOPS management fees are established based on the revenue need for the next biennium. As per table 3 of the UNOPS budget estimates document 2024-2025, UNOPS plans for a total revenue on budget basis of $325.0m. As UNOPS while drafting these estimates does not yet have a decision how the operational excess reserve process for balances accumulated beyond 2021 will be managed, the prudent assumption is to estimate that the full $325m have to be recovered in the biennium 2024-2025. Thus UNOPS revenue need as basis for the cost recovery calculation for 2024-2025 is $325m.

2. UNOPS is estimating a total amount of project expenses of $5,889m during the biennium 2024-2025. Considering the revenue need of $325m UNOPS will need an overall average recovery rate of 5.5%. This is an increase from the 4% rate that is projected for the biennium 2022-2023 and is reflective of UNOPS investments into its core structures to ensure sufficient capacity in its corporate backbone, including its oversight and compliance functions.

3. UNOPS key principles when establishing the appropriate management fee for new projects are based in the concepts of economies of scale, complexity and risk. To this extend economies of scale reflect that UNOPS will have reduced indirect cost for larger engagements. For example the preparation of legal agreements and the collaboration with partners before and during the implementation of an agreement represents a lower share of a larger agreement compared to a smaller one. Both activities that are funded through UNOPS indirect cost.

4. On the other side, the higher the complexity of an agreement, the higher UNOPS indirect cost. Complexity is measured by the amount of UNOPS personnel cost as part of the overall direct cost in an agreement compared to the amount of direct non-personnel cost. This is catering for the fact that an agreement with the same overall cost that is transactional in nature, will require less support from UNOPS corporate backbone than a similar size project that is linked to services delivered by UNOPS personnel. An example would be that a transactional procurement project for $1m should receive a lower management fee compared to an advisory project of the same size.

5. As last factor, UNOPS considers the risks of a project that might need to be covered by UNOPS indirect cost. These could be potential future write-offs as a result of delivering on a particular project. As these risks are now covered by UNOPS minimum operational reserve, UNOPS has linked any recovery of management fee for risks to the level of the operational reserve. If the minimum operational reserve requirement is met, which is anticipated for the biennium 2024-2025, then UNOPS does not recover a risk increment through its management fee. Should at any point UNOPS financial statements indicate that the minimum operational reserve requirement is not met, then UNOPS would restart the charging of a risk increment.

6. Translating the above factors into UNOPS management fee setting algorithm is done in Figure 1 below. The split of recovery rates into direct personnel cost vs. direct non-personnel cost is reflective of the principle of complexity. The use of three different models is reflective of the principle of economies of scale as UNOPS, in order to provide discounts beyond the average rate of 5.5% also needs to recover a higher rate from other agreements.

Figure 1: UNOPS Management Fee Setting Algorithm 2024-2025 - Scenario 1 with 325m revenue need

2024 + 2025
Financial Basis

Revenue need: Indirect Cost (excl. write-offs)	**325m**
Revenue basis: Direct Personnel Cost (project expense)	1,178m
Revenue basis: Direct Non-personnel cost (project expense)	4,711m
Total Project Expense Expected	5,889m
Overall recovery ratio (325m/5,889m)	**5.5%**

Cost Recovery Model
Ratios for Fee Setting

	Model 1	Model 2	Model 3
Recovery rate: Direct Personnel Cost (325m/1178m)	28%	21%	14%
Recovery rate: Direct Non-personnel cost (325m/4,711m)	7%	5%	3%
Fixed amount for economies of scale:	0k	25k	250k

7. The algorithm is based on three models. Its mechanics are that each new project budget proposal is calculated using all three models and the model that offers the lowest overall management fee is the model applied to the new engagement to set the indirect cost. For the algorithm to mathematically enable economies of scale, a base amount has been included into model 2 (USD 25k) and model 3 (USD 250k).

8. The mathematical calculation of the rates of the three models is based in UNOPS revenue need. The starting point is model 1 ensuring that small projects with either only personnel or non-personnel cost carry their weight. Then Model 3 with 50% recovery against personnel and non-personnel and 1% discount to offset the 250k fixed amount. Model 2 is the middle point between Model 1 and Model 3. The base rates are established estimating how many projects/project expenses would fall under each model aiming to achieve a balance between the application of the models.

9. Depending on the decision of the Executive Board on UNOPS use of the operational reserve excess taken in the annual session, UNOPS might also suggest to the Executive Board to recommend the approval of a revenue need of $248.1m. Considering the requested approval to abolish UNOPS S3i reserve and the other changes to UNOPS net assets, including the increase in the minimum operational reserve to $160.5m, the excess operational reserves at the end of the biennium 2022-2023 would be projected to stand at $40.9m. Given UNOPS commitment to avoid overcharging its partners, this available balance reduces UNOPS needs for additional management fee to be generated in 2024-2025. Thus the proposed basis for UNOPS revenue to be collected from management fee under this scenario 2 is at $284.1m. This will support UNOPS to keep its management fees at appropriate rates and to avoid the build up of excess reserves. This would follow the same logic as outlined above, but would consider the excess reserve funds to reduce the management fees to be collected in the biennium 2024-2025. Based on such a decision the average recovery rate for UNOPS would be 4.8%. Figure 2 below contains these details.

Figure 2: UNOPS Management Fee Setting Algorithm 2024-2025 - Scenario 2 with $248.1m revenue need

2024 + 2025
Financial Basis

Revenue need: Indirect Cost (excl. write-offs)	**284m**
Revenue basis: Direct Personnel Cost (project expense)	1,178m
Revenue basis: Direct Non-personnel cost (project expense)	4,711m
Total Project Expense Expected	5,889m
Overall recovery ratio (284m/5,889m)	**4.8%**

Cost Recovery Model
Ratios for Fee Setting

	Model 1	Model 2	Model 3
Recovery rate: Direct Personnel Cost (284m/1178m)	24%	17%	11%
Recovery rate: Direct Non-personnel cost (284m/4,711m)	6%	4%	2%
Fixed amount for economies of scale:	0k	25k	250k

10. Figure 3 show three different types of project examples and the implication of the fee setting. Please note that this shows a clear reduction of management fee from the 2013 policy compared to the update implemented in 2022. It also compares the comparable fee that would be established based on the two scenarios elaborated above. Scenario 1 is as per figure 1 above and would recover USD 325m and is likely to continue a build up of reserves. Scenario 2 is as per figure 2 above and would recover USD 284m, thus aiming to ensure that current reserve balances, if released, will be factored into the fee setting.

Figure 3: Illustration providing the fee setting policy UNOPS has from 2013 and its impact on the different category of projects

Type of Project	Fee Setting Policy Year	Direct Cost (in millions)	Indirect Cost (in millions)	Recovery Rate
Large Procurement in developing country	2013	$63.50	$1.10	1.7%
	2022		$1.50	1.5%
	2024-2025 Scenario I		$2.30	3.7%
	2024-2025 Scenario II		$1.70	2.6%
Infrastructure in fragile country	2013	$1.80	$0.11	5.8%
	2022		$0.10	5.1%
	2024-2025 Scenario I		$0.16	8.5%
	2024-2025 Scenario II		$0.13	7.1%
Advisory service in middle income country	2013	$0.05	$0.11	22.5%
	2022		$0.07	13.4%
	2024-2025 Scenario I		$0.12	23.7%
	2024-2025 Scenario II		$0.10	20.1%