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United Nations Development
Programme, the United Nations
Population Fund and the
United Nations Office for
Project Services**

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United Nations Office for Project Services

**United Nations Office for Project Services
sustainable investments in infrastructure and
innovation (‘S3i’) reserve**

Summary

In its decision 2016/12 the Executive Board supported the creation of a seed capital fund aimed at utilizing a portion of UNOPS operational reserves to make targeted contributions to early-stage investment projects in UNOPS mandated areas. Starting in 2018, UNOPS utilized financial regulation 22.02 (b) as the basis for seed capital activities within the limits set out in the regulation, and in 2019, following the same regulation, it formalized the establishment of the growth and innovation reserve.

The S3i investments are subject to annual valuation to meet International Public Sector Accounting Standards requirements, which creates a fluctuation in the annually recognized value in the financial statements. Such fluctuations in the recognized value may be potentially significant from one financial year to the next. This fluctuation in the value of the S3i investments puts UNOPS at risk of non-compliance with its financial regulations and rules pertaining to the growth and innovation reserve.

To address the risk of fluctuation in S3i investments, UNOPS put forward to the Executive Board the proposal to approve the establishment of a designated reserve for the funding and valuation of S3i investments, and the level initially approved by the Executive Board.

In addition to allowing UNOPS to meet the requirements, the separation of the S3i reserve from the growth and innovation reserve would improve the transparency and oversight of the S3i programme of work by having all financial impact reflected in one designated reserve, with the accuracy and veracity of the information confirmed by an external review.

Elements of a decision

The Executive Board may wish to (a) take note of the report on the UNOPS sustainable investments in infrastructure and innovation (‘S3i’) reserve (DP/OPS/2022/2); (b) recall the UNOPS budget estimates 2022-2023 (DP/OPS/2021/6) and its annexes, which first requested the establishment of the designated Sustainable Investments in Infrastructure and Innovation (‘S3i’) Reserve, as well as the report of the Advisory Committee on Administrative and Budgetary Questions (DP/OPS/2021/7); (c) welcome the additional assessment and rationale provided by UNOPS for the proposal to create a separate Sustainable Investments in Infrastructure and Innovation (‘S3i’) Reserve in accordance with paragraph 7 of the Executive Board decision 2021/21; and (d) approve the change in UNOPS financial regulation 22.02 to include a new subparagraph (c), to read “a S3i reserve for funding and recording the valuation of investments under the Sustainable Investments in Infrastructure and Innovation initiative, at a level set initially by the Executive Board. The Executive Director may, pursuant to the initial approval, annually increase the level of funding through the excess operational reserves. The transfers will be limited to 50 per cent of the excess operational reserves”; and (e) approve the



initial level of the S3i reserve to be set at \$105 million, with the change in level to be reported to the Executive Board through the annual report of the Executive Director and the annual audited financial statements.

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I. Purpose of this report

1. In its decision 2021/21, paragraph 7, the Executive Board requested “that UNOPS present an assessment and rationale for the proposal to create a separate Sustainable Investments in Infrastructure and Innovation (S3i) reserve and to report back to the Executive Board at its first regular session 2022, further requests that UNOPS conduct a comprehensive evaluation of the S3i initiative after the end of the pilot phase in December 2023, and present the findings to the Executive Board at the annual session 2024, as recommended by the Advisory Committee on Administrative and Budgetary Questions”.
2. The present report addresses the first part of the decision on the assessment and rationale for creation of a separate Sustainable Investments in Infrastructure and Innovation (S3i) reserve.

II. Background

3. The proposal to the Executive Board to establish a designated United Nations Office for Project Services S3i reserve was first presented in annex II of the UNOPS budget estimates for the biennium 2022-2021,¹ reviewed by the Advisory Committee on Administrative and Budgetary Questions.² The request built on the previously described structure and allocation of UNOPS net assets,³ and coincided with the review of the minimum requirement for the UNOPS operational reserve, for which an updated formula was approved by the Executive Board in its decision 2021/21.
4. The new formula for the minimum requirement for the UNOPS operational reserve has an impact for the other elements of the net asset allocation. At the same time, the S3i investments are subject to specific accounting treatment that creates fluctuation in their recognized value in the financial statements. To ensure the stability and improved transparency and oversight of the S3i initiative, investments in which are funded through UNOPS net assets, the establishment of a designated reserve is requested in a wider context. Further assessment and rationale are presented below.

A. Sustainable Investments in Infrastructure and Innovation (‘S3i’)

5. In its decision 2016/12, paragraph 4, the Executive Board supported the creation of a seed capital fund aimed at utilizing a portion of UNOPS operational reserves to make targeted contributions to early-stage investment projects in UNOPS mandated areas.
6. In March 2020, Sustainable Investments in Infrastructure and Innovation (S3i) was formally established as a stand-alone business unit in the UNOPS governance structure, making UNOPS the first United Nations organization able to make direct investments from its own balance sheet. In January 2021, with support from the Government of Finland, UNOPS established its S3i Office in Helsinki, led by an Assistant Secretary-General as Chief Executive, as approved by the Board through an exchange between the UNOPS Executive Director and the Board President in October 2019. In September 2021, the Executive Board endorsed the UNOPS Strategic Plan, 2022-2025,⁴ whereby the S3i sustainable investing initiative is reaffirmed as one of three key UNOPS priorities.
7. In line with the UNOPS Strategic Plan, 2022-2025, the S3i office will seek to enhance and accelerate the effort of engaging public and private sector investors to work collectively to scale up infrastructure investments and consider co-creating innovative financing options. The

¹ DP/OPS/2021/6

² DP/OPS/2021/7

³ DP/OPS/2020/CRP.1

⁴ DP/OPS/2021/20

UNOPS S3i will continue rolling out the initiative across its three focus-areas: (a) affordable housing; (b) renewable energy; and (c) health infrastructure.

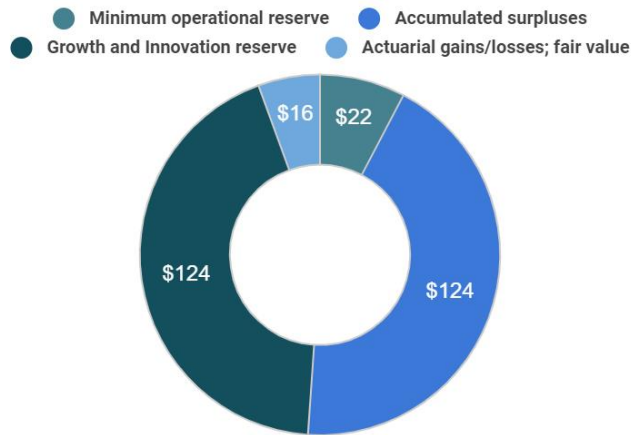
8. S3i has invested directly in several pilot infrastructure projects in Asia, Africa and Latin America in the renewable energy and affordable housing sectors from UNOPS reserves. As a minority investor in the projects, and through its operational and advisory roles, S3i provides a range of services to the projects, including environmental, social and governance impact management, negotiation with governments to obtain rights, permits and various incentives and concessions for projects, procurement and logistics. Those early direct investments pilots have helped S3i develop an institutional approach to participating in investment mechanisms such as the special purpose vehicles project, formed in partnership with the host government and the private sector.

B. UNOPS net assets

9. 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 reporting period end, comprising contributed capital, accumulated surpluses and deficits, and reserves. Net assets/equity may be positive or negative.

10. Total net assets reported by UNOPS as at 31 December 2020 amounted to \$287 million.⁵ Without applying the new calculation formula for the minimum operational reserve approved in 2021,⁶ they are composed of the elements shown in figure 1, below.

Figure 1. UNOPS net assets as at 31 December 2020 (in \$ millions)



11. According to regulation 22.02 (a) of the UNOPS Financial Regulations and Rules, the purpose of the operational reserve is to guarantee the financial viability and integrity of UNOPS as a going concern. The operational reserve shall be fully funded and held in irrevocable and promptly available liquid assets. The elements to be compensated for and covered by it shall be limited to: downward fluctuations or shortfalls in revenue; uneven cash flows; increases in actual costs above planning estimates or fluctuations in project costs; and other contingencies that result in a loss of resources for which UNOPS has made commitments.

12. Sub-paragraph (b) of the same regulation includes a growth and innovation reserve to invest in the future revenue-generating ability of UNOPS. Transfers to this reserve will be limited to 50 per cent of the excess operational reserves, over and above the level set by the Executive

⁵ A/76/5/Add.11

⁶ Decision 2021/21

Board. The specific approval of the Executive Board will be required if the amount to be transferred exceeds 50 per cent of the excess operational reserves.

13. *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.

14. Accumulated surpluses (excess operational reserves according to UNOPS Financial Regulations and Rules) represent the aggregated 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.

C. Growth and innovation reserve

15. The UNOPS Executive Director established the growth and innovation reserve in 2019 based on her authority under UNOPS financial regulation 22.2 (b).⁷ Since then, the growth and innovation reserve has provided debt or equity investments to, inter alia, sustainable investments in infrastructure and innovation activities to catalyse investments in socially inclusive large-scale infrastructure projects that will contribute to achievement of the Sustainable Development Goals. The portfolio of investments under the growth and innovation reserve is managed by the S3i business unit, established in 2020.

16. In line with the financial regulations and rules, the value of the growth and innovation reserve is set at 50 per cent of the excess operational reserve. The value is calculated and reported to the Executive Board annually in the UNOPS financial statements. At the end of 2020, the balance of the growth and innovation reserve stood at \$124 million, representing 50 per cent of the excess operational reserve (see figure 1, above).

17. Since the formal establishment of the growth and innovation reserve in 2019, UNOPS has invested \$58.8 million in seven projects under its S3i initiative (as at 31 December 2020). In October 2020, UNOPS disinvested from two projects and requested repayment of the loans, plus accumulated interest and management fees, totalling \$25.48 million. As of October 2021 UNOPS had received the value of interest and fees, with the outstanding amount reduced to \$23.8 million. UNOPS established a bad debt allowance against this outstanding amount. The provision for doubtful debts of \$22.19 million, on aggregate, against S3i initiative investments was reflected in its 2020 financial statements. Following the partial re-payment, the provision had been reduced to \$19.4 million at the time of drafting this report. UNOPS continues to work with the partner to recover the funds as promptly as possible.

18. The formula used for calculating the level of the growth and innovation reserve is based on an assumption that all funds in the reserve are readily available, and any use other than the investing of funds is reported as a draw-down from the reserve. However, the combined use to also fund S3i investments results in a fluctuation of the reserve value – a challenge from the accounting perspective, since the growth and innovation reserve provides for debt and equity investments which, in some cases, have an expected duration of 20 years and are subject to annual valuation under the International Public Sector Accounting Standards.

19. At the same time, the increase in the minimum requirement of the operational reserve approved by the Executive Board in 2021, funded through the existing net assets, reduces the level of funds available to the growth and innovation reserve.

⁷ Regulation 22.02. Within the UNOPS accounts, the following reserves may be established: (a) [...], (b) A growth and innovation reserve to invest in the future revenue generating ability of UNOPS. Transfers to this reserve will be limited to 50 per cent of the excess operational reserves, over and above the level set by the Executive Board. The specific approval of the Executive Board shall be required if the amount to be transferred exceeds 50 per cent of the excess operational reserves.

20. Therefore, the present growth and innovation reserve, which provides for the debt or equity investments under the S3i initiative, is no longer fit for purpose in reporting the S3i investments.

III. The S3i reserve

21. As a reliable partner to the private sector to mobilize funds to drive progress towards the achievement of the Sustainable Development Goals, UNOPS should establish a multi-year funding framework for S3i. It is important to avoid a stop-and-go approach resulting from the accounting practices required under the International Public Sector Accounting Standards so as not to undermine the credibility of the initiative.

22. Following Executive Board decision 2021/21, UNOPS initiated an additional external review to provide further assessment and rationale for the proposal to create a separate S3i reserve. The outcomes of that review are provided below.

A. IPSAS requirements and limitations of the present reserve rules

23. In September 2021, UNOPS contracted an external consultant to review the International Public Sector Accounting Standards requirements for an annual evaluation of the investments that fall within the category of UNOPS S3i investments. This included a desk review of UNOPS financial statements, financial regulations and rules; annex II of the UNOPS budget estimates for the biennium 2022-2023; and UNOPS S3i investment agreements and memoranda of understanding. The results of the review were presented as a report to UNOPS management.

24. The report assumes that UNOPS has adopted IPSAS 41 financial instruments, which replaces IPSAS 29 financial instruments: recognition and measurement, with effective date 1 January 2023. As early adoption is permitted, the report recommends that UNOPS consider applying IPSAS 41 in the 2021 and 2022 financial statements, allowing for more consistent financial reporting than applying IPSAS 29 in the 2021 financial statements and IPSAS 41 in the 2022 financial statements. UNOPS is considering this recommendation in light of the significant organizational efforts required for the adoption that would be applied to the full financial statement.

25. At the time of the review, which spanned September and October 2021, UNOPS had active S3i investments in affordable housing and renewable energy. The requirements for valuation of investments under IPSAS 41 were presented in the report for each investment type separately, reflecting the differences in the contractual setup.

26. For affordable housing investments, the report concluded that UNOPS was to account for its investments in affordable housing as financial assets, in accordance with IPSAS 41. The investments were evaluated to meet the criteria to be measured at amortized cost using the effective interest method.

27. IPSAS 41 requires that interest revenue is to be calculated using the effective interest method by applying the effective interest rate to the gross carrying amount of a financial asset, except for those that were credit-impaired when purchased or became so subsequently. Under IPSAS 41 a financial asset is credit-impaired when one or more events have occurred that have a detrimental impact on the expected future cash flows of the financial asset.

28. The report concluded that UNOPS was to account for its investments in renewable energy as financial assets in accordance with IPSAS 41. The report further stated that the equity shares met the criteria to be measured at fair value in the statement of financial position, with value changes recognized in surplus or deficit, except for those equity investments where UNOPS elected to present value changes in net assets/equity, and where the compulsorily convertible debentures meet the criteria to be measured at fair value through surplus or deficit. Changes of value are posted in the statement of financial performance.

29. Among the accounting requirements, the fair value measurement of the equity shares may result in significant fluctuations in the accounted value of the S3i investments containing the equity component, having a significant impact on the reported value of the investments from one financial statement to the next.

30. The growth and innovation reserve, which funds the S3i investments, is a calculation formula based on excess operational reserves, and is therefore not fit for purpose to accommodate the requirements for S3i investment accounting. The annual valuation of the investments may result in a value that exceeds the calculated value for the growth and innovation reserve, bringing UNOPS into non-compliance with its financial regulations and rules that govern the growth and innovation reserve.

B. Recommended change to the financial regulations and rules

31. The external review concluded that to avoid non-compliance with the financial regulations and rules related to the growth and innovation reserve, a designated reserve for the valuation of the S3i investments should be established.

32. The purpose of the designated reserve would be to fund all investments up to the maximum level of the reserve, and to record the valuation of the existing investments. Any losses would be debited to the S3i reserve. Similarly, any gains would be credited to the S3i reserve.

33. In line with the UNOPS budget estimates for the biennium 2022-2023 and its related annexes, as reviewed by the Advisory Committee on Administrative and Budgetary Questions, UNOPS reiterates its request that the Executive Board approve the change in UNOPS financial regulation 22.02 to include a new sub-paragraph (c), to read “a S3i reserve for funding and recording the valuation of investments under the sustainable investments in infrastructure and innovation initiative, at a level set initially by the Executive Board. The Executive Director may, pursuant to the initial approval, annually increase the level of funding through the excess operational reserves. The transfers will be limited to 50 per cent of the excess operational reserves”. The initial level of the S3i reserve is requested to be approved by the Executive Board at \$105 million, with the change in level to be reported to the Executive Board in the annual report of the Executive Director and the annual audited financial statements.

C. Governance of the S3i reserve

34. Separating the S3i investments from the growth and innovation reserve to a designated S3i reserve would improve the ability of the Executive Board to exercise oversight over the S3i-related investments.

35. The present Financial Regulations and Rules authorize an allocation of 50 per cent of the excess reserves to the growth and innovation reserve that currently provides for, inter alia, the S3i investments. This means that the funds available to S3i investments continue to grow or decline in line with the increase or reduction in excess operational reserves.

36. With the proposed addition to the Financial Regulations and Rules, the Executive Board approves the initial level of the funds allocated to the S3i reserve. Subsequent transfers to the reserve may be approved annually by the Executive Director, with transfers limited to 50 per cent of the excess operational reserves over the minimum requirement set by the Executive Board.

37. The overall level of, and internal movements in, the S3i reserve will be reported to the Executive Board annually through the annual report of the Executive Director and the audited financial statements. The reporting will include the elements required under the International Public Sector Accounting Standards, including related changes in the valuation of the investments. Similarly, both gains and losses related to the S3i investments will be reported as part of the designated S3i reserve, and not covered by any other elements of the net assets, to ensure full transparency of the S3i investments.

38. The Executive Director will continue to exercise the authority to draw from the S3i reserve, in line with the financial regulation 22 (c) ‘The decision to draw from these reserves shall rest solely with the Executive Director, who shall report all drawdowns to the Executive Board’. This means that the Executive Director will continue to authorize all the investments from the S3i reserve. If the Executive Board approves the requested addition to Financial Regulations, this sub-paragraph will be changed from (c) to (d).

D. Initial level of the S3i reserve

39. In November 2019, the UNOPS Executive Director instructed the chief financial officer of UNOPS to take formal steps to establish a growth and innovation reserve. The reserve value, in line with financial regulation 22.2 (b), was set at 50 per cent of the excess over the minimum operational reserve.

40. The level of the growth and innovation reserve in the 2019 financial statements reached \$105 million. The Executive Board is therefore requested to approve the initial level of the S3i reserve at \$105 million, in line with the original level of the growth and innovation reserve. By comparison, the growth and innovation reserve reached \$124 million at the end of 2020 (see figure 1, above).

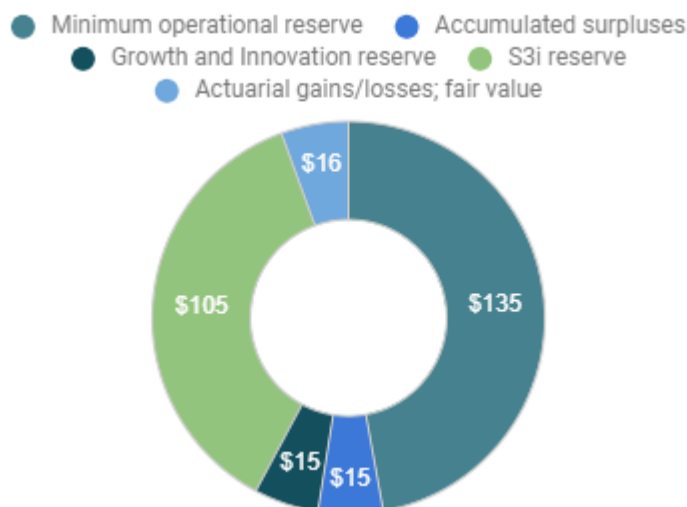
E. UNOPS net assets composition with the S3i reserve

41. To illustrate the proposed new composition of UNOPS net assets, a simulation has been made in figure 2, below, based on its net assets of \$287 million as at 31 December 2020 (see figure 1, above).

42. The new minimum requirement for the operational reserve approved by the Executive Board in 2021 results in the minimum operational reserve’s increasing from \$22 million to \$135 million when the new calculation formula is applied to 2020 net assets. While the actuarial gains/losses and fair value remain constant, at \$16 million, the remainder, instead of being divided equally between accumulated surpluses and the growth and innovation reserve, is allocated to the proposed S3i reserve, growth and innovation reserve and accumulated surpluses.

43. The S3i reserve is illustrated in figure 2 at the initially requested level of \$105 million, which, together with the increased requirement for the minimum operational reserve, reduces the level of both the growth and innovation reserve and the accumulated surpluses from \$124 million each to \$15 million each.

Figure 2. UNOPS net assets as at 31 December 2020, adjusted for the minimum operational reserve and the S3i reserve



44. The full proposed S3i reserve can be funded within the 2020 level of net assets.
45. The actual net assets are reported annually to the Executive Board in the UNOPS financial statements.

IV. Conclusion

46. Through its decision 2016/12 the Executive Board supported the creation of a seed capital fund aimed at utilizing a portion of UNOPS operational reserves to make targeted contributions to early-stage investment projects in UNOPS mandated areas. In line with that decision, starting in 2018, UNOPS utilized financial regulation 22.02 (b) as the basis for seed capital activities within the limits set out in the regulation, and in 2019 it formalized the establishment of the growth and innovation reserve following the same regulation.

47. The S3i investments are subject to annual valuation process under International Public Sector Accounting Standards requirements, which will create a fluctuation in the annually recognized value in the financial statements. Such fluctuations in the recognized value may be potentially significant from one financial year to the next. These fluctuations put UNOPS at risk of non-compliance with its Financial Regulations and Rules pertaining to the growth and innovation reserve.

48. To address the risk of any fluctuation in S3i investments, UNOPS put forward to the Executive Board the proposal to approve the establishment of a designated S3i reserve for funding and valuation of the S3i investments, and the level initially approved by the Executive Board.

49. In addition to allowing UNOPS to meet the IPSAS requirements, the separation of the S3i reserve from the growth and innovation reserve would improve the transparency and oversight of the S3i programme of work by having all financial impact reflected in one designated reserve, with the accuracy and veracity of the information confirmed by an external review.