



## **NOTE BY THE TECHNICAL SECRETARIAT**

### **REQUEST FOR THE ESTABLISHMENT OF A SPECIAL FUND FOR MAJOR CAPITAL INVESTMENTS**

1. The Technical Secretariat (hereinafter “the Secretariat”) recalls the Note by the Director-General entitled “Establishment of Special Accounts” (EC-XV/DG.22, dated 27 April 1999), wherein the Director-General indicated that “[i]n more general terms, the purpose of special accounts for equipment is to allow the OPCW to set aside over the period of the estimated lifetime of the equipment (say, 5 - 10 years) equal annual instalments so that at the end of the defined period sufficient funds are available for the purchase and replacement of major items of equipment. This approach would avoid the occurrence of “peaks and troughs” in the budget proposals which might be caused by periodic demands for major replacements with the same budget period. The Director-General anticipates recommending in the future creation of special funds for computer equipment, security items, and perhaps other kinds of equipment. The OPCW has been operational for too short a time to be able to determine these requirements at present.”
2. The Secretariat further recalls that the report of the External Auditor for the year ended 31 December 2017 (Annex 3 to EC-89/DG.3 C-23/DG.4, dated 7 August 2018) recommends a strategic approach consisting of a long-term investment programme to plan equipment purchases, which will enable better scheduling of both capital investment and procurement activity, provide for greater transparency and clearer alignment of objectives, and enable a more consistent funding strategy to avoid spikes in the annual funding required from States Parties.
3. The Secretariat notes that the financial statements of the OPCW for the year ended 31 December 2017 (Annex 1 to EC-89/DG.3 C-23/DG.4) shows that the level of fully depreciated property, plant, equipment, and intangible assets of the Organisation still in use is proportionally high. In the report of its Forty-Fourth Session (ABAF-44/1, dated 8 June 2018 and Corr.1, dated 10 July 2018), the Advisory Body on Administrative and Financial Matters (ABAF) noted that a significant portion of the Organisation’s asset categories had fully depreciated and would need to be replaced at some point.
4. The Secretariat, as part of the programme and budget consultations with States Parties this year, has indicated that, based on an initial assessment, there are projected major capital funding needs for the Organisation in 2020 and 2021 of approximately EUR 3.2 million. The Secretariat will also work to entrench major capital planning throughout all of the Organisation’s asset categories looking, at current and outer



budget years to keep States Parties informed of major capital requirements through future draft Programme and Budget consultation processes.

5. The Secretariat is of the view that the Organisation must systematically replace its assets so that they remain effective and efficient and so that the Organisation remains fit for purpose. Considering that the preparation of the draft Programme and Budget for 2020 will begin in early 2019, the Secretariat seeks the recommendation of the Conference at its Fourth Special Session to Review the Operation of the Chemical Weapons Convention (hereinafter “the Fourth Review Conference”) for the creation of a special fund for major capital investments. Such a recommendation, if approved, would allow the Secretariat to include the formulation of major capital planning directly into the 2020 draft Programme and Budget document for consideration by the ABAF and the Executive Council (hereinafter “the Council”), and possible approval by the Conference of the States Parties (hereinafter “the Conference”) in 2019.
6. In view of the above, the Secretariat proposes that the Fourth Review Conference recommend the establishment, in accordance with OPCW Financial Regulation 6.9, of a special fund for major capital investments to be used for major asset investments in property, plant, equipment, and intangible assets. The fund would be used alongside the existing Special Account for the OPCW Equipment Store used for Inspectorate equipment. The Annex to this Note provides, in a non-paper entitled “OPCW Strategic Financing: Major Capital Investment Fund (MCIF)” the detailed rationale and criteria for the proposed new fund.
7. The Secretariat also proposes that the Fourth Review Conference consider recommending that the special fund for major capital investments and the Special Account for the OPCW Equipment Store be financed in total to a target level of between EUR 750,000 to EUR 1.5 million over the period 2020 to 2021 through, inter alia, the transfer of future cash surpluses, if available, following a decision by the Conference in 2019 and subject to prior consideration of this matter by the Council.

Annex (English only):

Non-Paper – OPCW Strategic Financing: Major Capital Investment Fund (MCIF)

**Annex**

**NON-PAPER**

**OPCW STRATEGIC FINANCING:  
MAJOR CAPITAL INVESTMENT FUND (MCIF)**

**1. MCIF Proposal**

- (a) to establish a Special Fund for Major Capital Investments in accordance with Financial Regulation 6.9; and
- (b) to systematically resource both the proposed Special Fund for Major Capital Investments and the existing OPCW Special Account for Equipment Store through cash surpluses, if available, and as decided by the Conference on an annual basis, during the period 2020 to 2021 for a combined amount in the target range of EUR 750,000 to EUR 1.5 million to address capital requirements not accommodated within the General Fund budgets.

**2. ABAF, External Auditor, and Director-General Recommendations**

Recommendations for the creation of a mechanism to plan and fund major capital assets replacements have been made by the Advisory Body on Administrative and Financial matters (ABAF), the External Auditor, and in past Notes by Director-Generals.

**(a) Advisory Body on Administrative and Financial Matters (ABAF)**

In 1999, the ABAF, in the reports of its fourth session (subparagraph 6.3, ABAF-IV/3, dated 23 September 1998) and of its fifth session (subparagraph 7.2, ABAF-V/I, dated 5 March 1999), recommended that future budgets include a provision strictly limited to a reserve fund for the replacement of inspection and other equipment.

In its ABAF-44 report (ABAF-44/1, 8 June 2018 and ABAF-44/1/Corr.1, dated 10 July 2018), the ABAF indicated that the Strategic Financing Paper provided by the Secretariat was comprehensive and useful and served as an excellent source to have within one paper and among areas of importance multiple financial issues, including biennial budgeting, zero real growth budgets, sufficient working capital funds, the introduction of a major capital investment plan, and a major capital investment fund.

**(b) External Auditor recommendation**

The External Auditor's report on the 2017 OPCW and OPCW Provident Fund Financial Statements (EC-89/DG.3; C-23/DG.4, Annex 3) highlighted the importance of the development of a long-term investment programme to plan equipment purchases indicating that a planned approach will enable better scheduling of both capital investment and procurement activity. A clear

investment plan offers the opportunity for greater transparency and a clearer alignment of objectives. It will also enable a more consistent funding strategy to avoid spikes in the annual funding required for OPCW operations.

(c) **Establishment of Special Accounts: Note by the Director-General in 1999**

In a Note by the Director-General on Establishment of Special Accounts (EC-XV/DG.22, dated 27 April 1999), the Director-General indicated that “in more general terms, the purpose of special accounts for equipment is to allow the OPCW to set aside over the period of the estimated lifetime of the equipment (say, 5-10 years) equal annual instalments so that at the end of the defined period sufficient funds are available for the purchase and replacement of major items of equipment. This approach would avoid the occurrence of “peaks and troughs” in the budget proposals which might be caused by periodic demands for major replacements with the same budget period. The Director-General anticipates recommending in the future creation of special funds for computer equipment, security items, and perhaps other kinds of equipment. The OPCW has been operational for too short a time (1999) to be able to determine these requirements at present.”

**3. Proposed Introduction of Major Capital Investment Fund (MCIF)**

The concept of a Major Capital Investment Fund (MCIF) is a strategic financing initiative of the Secretariat. The concept was brought forward for initial consideration by States Parties as part of the presentations on Strategic Financing at both the Open Ended Working Group for the Future Priorities of the OPCW in October 2017 and at the Open Ended Working Group for the Fourth Review Conference in June 2018. As part of the draft 2019 Programme and Budget facilitations, the establishment of a MCIF was also introduced. During these consultations, it was decided by the Secretariat to refer the concept, in light of its strategic nature, to the Fourth Review Conference in November 2018 for further consideration and possible recommendation to the Conference for final consideration and possible approval in 2019.

The purpose of the MCIF would be for the Organisation to fund in a planned and systematic way major capital investments for Organisational assets meeting specified criteria. This is especially important for the OPCW given its ageing asset base across all asset categories and the need for ongoing replacement of its assets as well the acquisition of new assets and technologies.

Similar funds (mechanisms) are in use in the private sector and within other international Organisations, including for example the International Atomic Energy Agency (IAEA), which allows that organisation a long term sustainable method to plan and fund for major asset acquisitions.

Major one-time projects such as the ChemTech Centre construction project would *not* be financed through the MCIF scheme. However, once the ChemTech Centre is completed and operational, replacement of assets and/or emerging major capital requirements of the ChemTech Centre would then be incorporated into the planned needs to be covered through the MCIF.

The indicative requirement based on an initial major capital planning for the Organisation is envisaged as being in the order of EUR 3.2 million over the period 2020-2021. The proposal to States Parties is to begin to systematically fund in a measured manner through cash surpluses, if available, and as decided by the Conference on an annual basis during the period 2020 to 2021 a newly created Special Fund for Major Capital Investments as well as the existing OPCW Special Account for the Equipment Store. The target range amount of financing in the relevant period would be between EUR 750,000 and EUR 1.5 million in total as part of capital requirements not accommodated within the Programme and Budget. The Secretariat would also work to entrench major capital planning throughout all of the Organisation's asset categories looking at current and outer budget years and would keep States Parties informed of major capital requirements through the future draft Programme and Budget consultation processes.

As the preparation of the 2020 draft Programme and Budget will begin in early 2019, the endorsement by States Parties for the creation of a MCIF would allow the Secretariat to include the formulation of major capital planning directly into the 2020 draft Programme and Budget document.

#### **MCIF Eligibility Criteria**

The establishment of a Special Fund for Major Capital Investments would follow the following criteria for expenditure eligibility for property, plant, equipment, and intangible assets that are:

- (a) of minimum value of EUR 75,000 in total capitalised cost;
- (b) have a useful life of one year or more;
- (c) are one-off in nature and not re-occurring from one year to the next;
- (d) are for major capital investments other than those covered through the Special Account for the OPCW Equipment Store;
- (e) do not include maintenance and operating expenses; and
- (f) are related to the core activities of the Organisation;

Funding for major capital investments would follow a major capital investment plan taking into account needed assets, their useful lives, and replacement requirements as well as the emergence of new technologies and equipment. These assets purchases would be funded (all or in part) through the MCIF, if they meet the eligibility criteria.

#### **4. The OPCW Need – Looking at the current state and existing mechanisms**

The OPCW must plan for and fund large capital investment requirements across all of its asset categories. Currently the budgetary planning and funding for major capital replacement occurs partially and in limited resource against the overall major capital requirement. This need is currently partially managed through allocation in the General Fund Budget and

through the Special Account for the OPCW Equipment Store (specifically for inspection equipment) which is currently close to depletion. This approach, however, is not sufficient and does not allow for a planned and systematic manner to ensure major equipment replacement.

(a) **Special Account for the OPCW Equipment Store**

In a Note by the Director-General on Establishment of Special Accounts (EC-XV/DG.22, dated 27 April 1999), the Director General requested the creation of special accounts including a Special Account for the OPCW Equipment Store used for the procurement of new inspection equipment and including to provide a basis for evaluating new technologies and samples of new equipment, the availability of which cannot be forecast on a calendar basis; and for purchasing new (inspection) equipment approved by the Conference of the States Parties, which cannot necessarily be accomplished within the calendar year; to provide an account from which to make payments for reimbursements to States Parties for costs incurred in disposing of or decontaminating equipment on site; and testing and evaluation fees for the certification of protective and safety equipment. This Special Account for the OPCW Equipment Store had a balance of EUR 22,347 as of 30 September 2018.<sup>1</sup>

A mechanism similar to the Special Account for the OPCW Equipment Store purposed for inspection equipment does not exist for other property, plant and equipment asset categories. Now, almost 20 years after the establishment of the Special Account for the OPCW Equipment Store, the Organisation can clearly determine its major capital replacement requirements in all asset categories from health and safety, IT equipment, to software. The introduction of a major capital replacement fund will help to address the asset needs beyond inspection equipment.

(b) **OPCW Assets**

OPCW assets are classified as either “property”, “plant and equipment” or “intangible assets” and are further categorised into asset categories each of which is depreciated/amortised over the following useful lives<sup>2</sup>:

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<sup>1</sup> Report by the Director-General, OPCW Income and Expenditure for the Period 1 January to 30 September 2018 (Third Quarter of the Financial Year Ending 31 December 2018), (S/1675/2018, dated 10 October 2018)

<sup>2</sup> Reference pages 51-53 of the OPCW 2017 Financial Statements (EC-89/DG.3, C-23-DG.4), 7 August 2018

(i) **OPCW PROPERTY, PLANT AND EQUIPMENT USEFUL LIVES**

<b>Asset</b>	<b>Estimated Useful Life</b>
Inspection and verification equipment	Shorter of operational period of asset or 10 years
Security and health equipment	5 years
Office furniture and equipment	7 years
Hardware equipment	4 years
Vehicles	5 years
Leasehold improvements	Shorter of lease term or useful life

(ii) **OPCW INTANGIBLE ASSET USEFUL LIVES**

<b>Asset</b>	<b>Estimated Useful Life</b>
Acquired software	3 to 5 years
Internally developed software	3 to 10 years

(iii) **NET BOOK VALUE: REMAINING VALUE OF OPCW ASSETS (PROPERTY, PLANT AND EQUIPMENT & INTANGIBLE ASSETS)**

In the context of the OPCW, and for most international organisations, the largest expenditure category is staff cost.<sup>3</sup> For the OPCW in 2018, for example, the non-staff element of the budget amounted to approximately 34% of the budget, while the staff cost element approximately 66% of the budget. Understanding the Organisation's MTP and its longer-term vision, the staffing plan should allow the Organisation to plan and take into account forecasted needs and staffing changes including staff attrition for a two-year period and should be agreed as part of a biennial budget's staffing table, thus representing the majority of the planned budget expenditure. If significant issues or changes in assumptions were to arise, they could be revisited as part of a budget update process in the first year for the second year of the biennium. The non-staff cost elements - such as travel, consultancy/contractual services/general operating expenses, supplies and materials, and furniture - can also be planned and accommodated within a budgeting process which plans for the longer-term.

The following chart (figure 1) shows by OPCW asset category the ageing asset base of the Organisation across all asset categories. Inspection and verification equipment continues to account for the largest component (EUR 4.2 million, 83%), of the net book value of property, plant and equipment. Inspection and verification equipment is

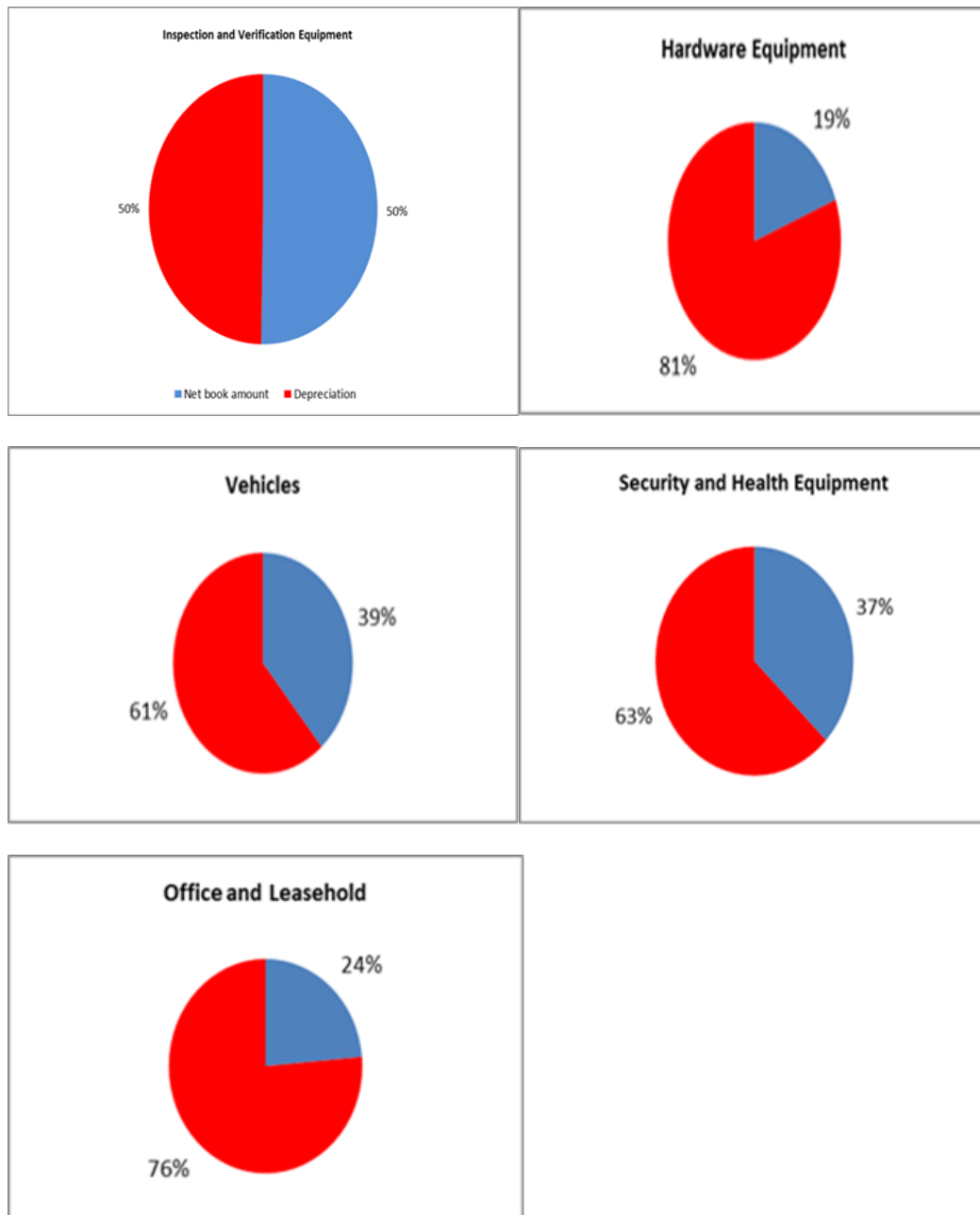
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<sup>3</sup>

C-22/DEC.5, Programme and Budget 2018, dated 30 November 2017.

on average 50% of the way through its useful life. The Organisation's other asset categories all have less remaining net book value, with all of them at least 60% of these assets fully depreciated and requiring replacement.

#### Property Plant and Equipment



## Intangible Assets

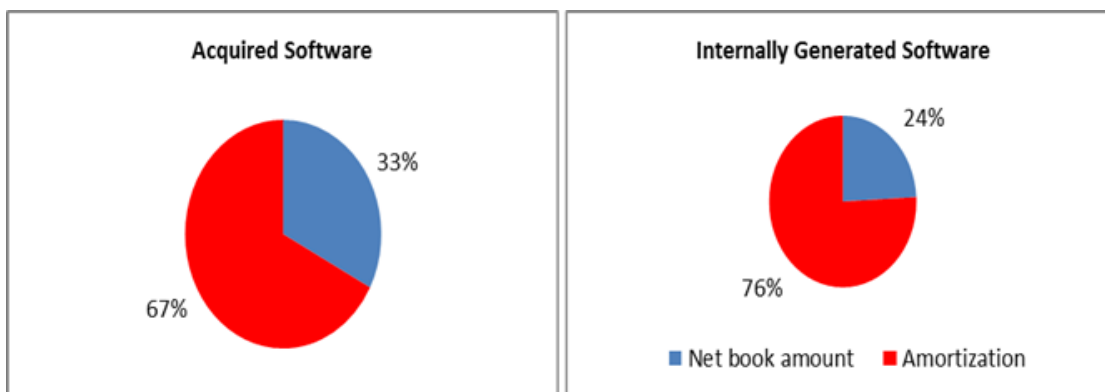


Fig 1: Major Capital Investment: OPCW Asset Base

### (iv) Indicative Types of Major Capital Investments

Major capital requirements that could be funded through the proposed MCIF and the Special Account for the OPCW Equipment Store span the asset categories of the OPCW and may include during the specified time period, items such as expansion of the Enterprise Content Management (ECM), significant scientific equipment (for example mass spectrometers), inspection equipment, building equipment, etc.

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