

Summary and Analysis of FY12 Framework

On 17 February, 2011, the Framework for the FY12 Operating Plan and Budget was posted online for community feedback. In addition, the Framework was presented to community members at a public forum in Silicon Valley, and to various community groups in person and on conference calls. Summary responses to the community feedback through the public comment forum are now posted at <http://www.icann.org/en/public-comment/#op-budget-fy2012> and below. Note that any comments regarding the additional constituency and stakeholder budget requests are not shown; these were addressed through the separate process set up with each of these groups.

The Focus Areas for the Framework Public Comment Responses were divided up into the following categories:

- Framework Format
- Staff Work
- Expense Areas
- Revenue
- New gTLD Budget
- Community Support

Framework Format:

- Though there were comments that supported the easy to manage PowerPoint style presentation, and the new idea of separating the budget's core and project activities, most respondents felt that the content was "insufficient to enable any serious analysis of the cost drivers or establish a relationship with the strategic goals and priorities....therefore quite difficult to provide meaningful or constructive feedback." It was stated that "...the level of detail in the "Core Operating Expenses... " should be detailed and compared, as in previous years. In the "Projects field, incorporating the AC/SO/SG requests for activities and services, the ALAC would prefer to see the projects expenses detailed so that the amount allocated to the community requests are clearly defined." Additional clarity was also requested around the terms "Core Operations" and "Project."
- Although the four focus areas, and details on how they should be carried out, are mentioned briefly in the Operating Plan, it is not clear to the Dansk Internet Forum (DIFO) how the budget should be connected to them. The Operating Plan specifies the cost of the main areas but fails to specify the costs on specific projects. It is important to

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DIFO that the Operating Plan (and Budget) clearly set out what expenses should be used in order to fulfill the Strategic Plan 2011-2014.

ICANN's response is that the impetus behind this year's change in format and content was in response to comments in previous years that the Framework was "nearly baked" when presented in February, and did not seem to allow for community comment and input – hence this year providing a framework in the truest sense of the word – an outline of how the budget would be approached and viewed, allowing for constructive feedback as to its development (how the budget should be utilized). The detail behind both Core Operations and Projects is now included in this year's draft FY12 Operating Plan and Budget.

To clarify Core Operations – these are the "day-to-day" activities and services provided through the work of ICANN staff as detailed in Section 1: Introduction. Projects are a temporary large endeavor undertaken to create a unique product, service or result.

ICANN will take these responses and the suggestions made by the community into account when developing next year's Framework and Operating Plan.

Staff Work:

- The community clearly supports the work of the ICANN staff, especially when it comes to Policy Development and Contractual Compliance, and makes the point that this work needs to be prioritized in FY12. "Funding should be provided in support of policy development, inclusive of support to the Policy Council and to the Working Groups as well as travel to attend relevant meetings for face-to-face time." An area that the community specifically requested ICANN to provide funding for expert studies is Whois: "ICANN's budget process should support the Whois studies funding, fully, and in a timely manner. ICANN's senior staff must recognize and maintain full support to this priority." A suitable budget for staff travel in support of constituencies/stakeholder groups is also important. The Business Constituency proposed that there should be contingency funds set aside for staff expertise to travel to regional and constituency meeting to present, as well as a separate contingency fund to be established with a reasonable amount of funding – e.g. \$150,000 – that can be drawn on for short-term urgent needs of retaining experts to support policy analysis or should an emergency Council meeting be needed.
- Several comments were made referring to Contractual Compliance and that it is important that staffing be brought up to the appropriate levels and essential automation resources be provided as compliance is a key element of the organization's reputation.

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ICANN's response is that if staff expertise, additional analysis or emergency council meetings are required, and the FY12 proposed budget does not already accommodate this request, the Policy staff can formally request additional funding to be drawn from ICANN's overall Contingency fund. In addition, the entire policy team participates at all three ICANN meetings as well other venues as needed. That support will continue in FY12, with additional resources made available as needed.

Regarding Contractual Compliance, two staff members were hired for the Contractual Compliance team subsequent to the posting of the FY12 Framework, with several more on the way.

- Finally, it was noted that “according to information provided during the San Francisco meeting about the number of staff employed by ICANN, conservative estimates would lead to personnel costs of \$180,000 per employee. ICANN would be well inspired to provide benchmarks or any relevant information to explain such high level of salary. To the international observer, this amount may indeed seem extremely high.”

ICANN response: this \$180,000 average noted above includes all personnel related expenses in addition to compensation, such as payroll taxes, health insurance, worker's compensation insurance, pension, continuing education, relocation, and recruitment expense. As a result, ICANN is providing more detail in this draft Operating Plan and Budget.

Expense Area:

- There was some confusion caused by the inclusion of “New gTLD Projects” expenses in the column titled “FY12 Framework w/out New gTLD Launch.” After further review and discussion, we believe this \$6.79 million represents ramp-up expenses that will be incurred in FY12 to build and staff New gTLD Project operations whether applications are accepted in FY12 or not. If this is the case, we recommend that ICANN clarify the table accordingly with some text or a footnote. Additionally, there was some confusion around the definitions of “New gTLD Project” and “New gTLD Application.” We recommend ICANN further clarify the definitions to explain the distinction.

ICANN response: clarification to the comments above can be found in Section 4 and Section 7 of this draft Operating Plan and Budget.

- “The two fastest-growing expenditure categories listed are Travel & Meetings (36 percent growth from FY11 budget) and Professional Services (15 percent). \$3.6 million of the \$4 million growth for Travel & Meetings is due to FY12 Projects, according to Slide 12. How is this sum allocated among the nine projects listed on Slide 14? Is the lion's share going to the “Global DNS SSR Symposium,” which is the only project listed that

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seems to consist solely of a meeting to which people might be paid to travel? For Professional Services, the \$6.8 million allocated to projects far exceeds the \$2.3 million growth called for in this category. Which of the nine projects necessitate this large allocation? “

- “The increase of Travel & Meeting expenses is striking. Plus 36 percent, \$4 million should be somehow related to a strategic project, discussed with the community. We have not been able to find, either in the documentation, or through questions raised during the San Francisco meeting, any reasonable explanation of such increase.”

ICANN response: in regard to Travel & Meeting costs, there is a 35 percent increase from FY11 to FY12 due to the following reasons: ICANN’s recent effort to support a larger number of community members’ travel; an increase in staff who travel upon community request; Board and GAC consultations; and an increase in meeting costs due to the larger scale of the international meetings. To clarify the comments above regarding Travel & Meeting costs related to Projects, the information on slide 12 was merely a view to showcase Core Operations vs. Projects, not to imply that the incremental spend in travel is wholly attributed to Projects.

- "...25 percent of expenses are professional services. It is well known that ICANN often relies on external consultants, sometimes even to perform core functions. We question whether this high level of professional services can be appropriately managed by the organization, and whether the choice of relying on professional services is consistently weighed against other options. “
- “Which Professional Services will be trimmed from the core operations functions to accommodate this huge growth in Professional Services for projects? How much of the hit will be taken, for example, by Professional Services used to support contract compliance? Or policy development?”
- “Along with the high average of wages there is also a high cost of Professional Services. These expenses rise from \$13.6 million to \$17.2 million - not including the launch of new TLDs (which will raise the amount to \$50.2 million).to DIFO it does not seem clear why ICANN needs this excessive use of professionals outside the organization, compared with the fairly high number of staff in ICANN.”

ICANN response: The FY12 draft Budget represents an increase of 15 percent from the FY11 Budget. Most of the incremental Professional Services costs are attributed to an increase in Core Operations, such as legal services, language services, data escrow, and RSTEP panel. Additionally, the FY12 draft Budget includes funding for ATRT implementation and studies related to IDN Variant Management and WHOIS.

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- “Publishing an Operating Plan and budget with a deficit put an unnecessary pressure on the launching of new TLDs, which DIFO finds unacceptable. ICANN needs to present an Operating Plan without new TLDs which at least has a break even result and not a deficit of 2.9 million dollars - even if this will mean cut in expenses (preferably on professional services) Slide 11 “FY12 Operating Expense Framework” noted a 15 percent increase in expenses which seems excessive considering there is only a 5 percent projected increase in revenue.”
- "...considering that the budget without new gTLDs already appears to be in deficit, we believe no additional requests should be granted unless an equivalent source of cost reduction is identified and approved for the FY12. Such policy is necessary if ICANN wishes to demonstrate that it manages its budget, which is the fruit of its unique position as manager of global resources, in a responsible manner.”

ICANN response: We listened to the comments of the community, identified non- critical areas where ICANN could reduce costs without compromising services, and pushed harder to reduce costs in travel and professional services in order to resolve the deficit issue.

Revenue:

- Are the new gTLD application fees considered revenue? If so, the revenue line and the new gTLD application fees line in column two should be sub-totaled.

ICANN response: Yes, the projected revenue for new gTLDs is \$92.5 million based on 500 applications at \$185,000 each. The current revenue information can be found in Section 7 of this draft FY12 Operating Plan and Budget.

- It would be helpful if ICANN provided the basis for the 2 percent growth under the registry and registrar Transactional Fees sections. What is the 2 percent based on? Also, why were registrar application fees increased by \$1000 per application?

ICANN response: The revenue projections described in the registrar and registry transactional fee section are based on fee obligations described in existing contracts with gTLD registries, holding the \$0.18 per domain name registration registrar fee constant and small growth in the projected number of domain name registrations. The \$1000 increase to the Registrar Accreditation fee represents additional costs incurred as a result of due diligence background checks in the registrar accreditation process requested in community discussions. The increase was calculated based on a cost/revenue neutral model.

- “ICANN’s budget figure for revenue this year from ccTLDs (\$1.6 million) is almost double the amount actually expected to be collected by 30 June 2011 (\$835,000). Yet the same budget figure is given for FY12. Why was ICANN’s budget so far off from reality this

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year? Is it due to one-time aberrations, or to more persistent features of the ccTLD environment? Is the FY12 budget figure grounded in reality, or is it wishful thinking about what ccTLDs should contribute?”

- “The FY11 forecast for ccTLD contributions appears to be half of the FY11 budget, while the proposed FY12 budget is similar to the FY11 budget. We find this highly surprising. Either the FY11 forecast is inaccurate or the FY12 budget should be more conservative. We tend to believe the former is the best option, but this raises questions about the way these forecasts were estimated.”

ICANN response: The FY11 forecast is based on a trended budget and represents a conservative estimate based on current fiscal year-to-date FY11 contributions. ICANN will vigorously pursue additional ccTLD contributions through the end of the fiscal year in an effort to meet the budgeted amount. ICANN recognizes the need for concerted efforts to increase ccTLD contributions and believes that these efforts will result in contributions approximating the FY12 draft Budget.

New gTLDs:

- “The new gTLD application program, assuming it launches in FY12, will bring in \$92.5 million in revenue (slide 9). However, only \$36 million of that will be spent on the launch. An additional \$6.8 million is listed as “New gTLD Project,” which we assume to be money that will be spent even if the new gTLD launch window does not open in FY12. How will these project expenses be covered if the program does not launch next year?”

ICANN response: It is correct that additional project implementation costs of \$6.8 million will be expended regardless of whether the program is approved by the Board and launched. For cash flow purposes, those costs will be funded from regular revenue and included as part of the ICANN budget. In the longer term, the development costs will be recouped at the rate of \$26,000 per application until this registrant-furnished funding is covered.

- “Assuming it does launch, expected revenue will exceed expenses by at least \$49.7 million (\$92.5 million – (\$36 million + \$6.8 million)). How is this revenue accounted for in the budget framework? We have been told that roughly one-third of the cost-recovery application fee (@\$185,000) is set aside for a contingency reserve for litigation and similar risks. That will be roughly \$31 million. This still leaves \$18.7 million to be accounted for. As with any risk contingency there is some chance that the actual expenses either will exceed the \$31 million figure or that they will be significantly less than anticipated. How are these chances reflected in the budget framework?”

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ICANN response: If the program is approved and launched, only a fraction of the evaluation effort will occur during this fiscal year. Therefore, only a fraction of the planned evaluation expenditures will be spent during this fiscal year and a majority of the expenses will be incurred in FY13. Approximately \$60,000 of each evaluation fee will be set aside for so-called “risk” costs. These costs can be better described as the expected value of low-probability, high-amount costs. For example, there is some set aside for unplanned legal expenses, for the costs associated with the possibility that there be a service outage, and so on. The costs are not merely a reserve, but a calculated expected amount of these costs. They were calculated with the help of professional insurance and risk management firms. It is thought that it will take approximately three years for expenses to be realized and determine whether the set-aside was under or over-calculated.

- “As this slide [17] notes, one feature of the new gTLD launch will be auctions to resolve string contention. How does the budget framework account for the funds ICANN would receive as a result of the auction process? How much revenue is anticipated, and how is it proposed to be spent (presumably only a small fraction will be needed to defray the expenses of running the auction)?”

ICANN response: Auctions are a contention resolution mechanism of last resort. Auctions would occur only after community priority evaluations and negotiations among parties are exhausted. No auctions are anticipated during this fiscal year. Initial evaluation might begin but would still be underway at the close of the fiscal year and so no final contention sets will be established. In any event, the new gTLD program calls for the establishment of a foundation as described in the Applicant Guidebook. The foundation would have mechanisms to ensure expenditures of auction funds are made in accordance with community consultation or representation process.

- ““New gTLD”: What assumptions are made for the number and revenue associated with any gTLDs that may be granted reduced application fees?”

ICANN response: ICANN is looking forward to the report of the Joint Application Support Working Group that will be delivered to the ALAC and GNSO. That report is expected to recommend criteria for creating reduced application fees, and possibly sources of those funds to aid applicants. It is anticipated that the GNSO and ALAC will consider and recommend all or aspects of the report to the Board.

- ““FY12 Revenue Framework”: We note that fees paid by gTLD registrants make up the overwhelming amount of ICANN’s revenue (over 94 percent). Rather than going down as a percent of total revenue, the prediction is that this is increasing. Does it make sense to subsidize almost all ICANN programs from gTLD fees while some GNSO community needs are going unmet?”

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ICANN response: The increase in percentage is primarily due to increases in the number of registries and registrants. ICANN recognizes that revenue should come from more diverse sources and is actively engaged with the ccNSO and others to develop other sources of revenue.

- “We also notice that without consideration of the New gTLD Program, the expenses for the FY2012 will exceed the revenues by \$1.287 million (1.88 percent). It is the first time that ICANN is faced with this situation. The ALAC wonders how this deficit will be compensated and hopes that this would not need to be met by the reserve or contingency funds.”

ICANN response: The Framework indicated this potential difference between revenue and expense due to the development of new expense requirements such as funding ATRT recommendation implementation. Without these new initiatives, expenses are targeted at low growth (~6 percent). As indicated in the new version of the budget, ICANN is working to reduce this difference that would be funded out of reserves if not eliminated.

- “Looking at the financial data associated with the new gTLD launch process, the ALAC is concerned that the Framework shows a massive surge in Professional Services Cost equal to nearly half the total operating expenses while only a very moderate increase in Personnel costs is shown. This leads the ALAC to be concerned that not enough investment is made in a managerial structure of increased ICANN staff count to keep track of the Professional Services contracted and keeping its costs contained. We are also concerned about the reduced levels of transparency associated with contracting out services that might be better served by staff.”

ICANN response: ICANN certainly shares this goal, that implementation of new gTLDs occurs in a well-managed, economical, competent manner. The new gTLD implementation plan, including the evaluation of applications, has been carefully designed to provide careful oversight of the process, including a quality control function. This organization has also been carefully designed so that it can grow and shrink with demand in order to preserve resources and economically provide services. Additionally, key talents and skills will not be available as permanent staff and are available only through contracting. These decisions have been based on extensive consideration and evaluation.

- "...no information is available as to how ICANN will manage the proposed 30 million dollars contingency fund for the new gTLD programme...or how and when it will be released, we call for this how ICANN will manage these funds, or how and when it will be released, we call for this money to be escrowed separately from the reserve fund, and donated to Internet-related foundations two years at the latest after the launch of new gTLDs.”

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ICANN response: Approximately \$60,000 of each evaluation fee will be set aside for so-called “risk” costs. These costs can be better described as the expected value of low-probability, high-amount costs. For example, there is some set aside for unplanned legal expenses, for the costs associated with the possibility that there be a service outage, and so on. The costs are not merely a reserve, but a calculated expected amount of these costs. They were calculated with the help of professional insurance and risk management firms. It is thought that it will take approximately three years for expenses to be realized and determine whether the set-aside was under or over-calculated.

- “Contributions to Reserve Fund”: Instead of recovering the historical new gTLD costs, we recommend that it would be better to reduce application fees, especially for needy applicants and underserved language communities.”

ICANN response: It was determined that the costs of new gTLD program development should not be borne by today’s registrants but should be borne by the applicants. This is inline with the GNSO Policy. Going forward, in the event that recovering development costs exceeds ICANN expenses or reserve fund requirements, the result will be to reduce registrant fees that are paid through gTLD registries and registrars. As discussed earlier, ICANN is looking forward to the Joint Application Support Working Group’s report that will be delivered to the ALAC and GNSO. That report is expected to recommend criteria for creating reduced application fees, and possibly sources of those funds to aid applicants. It is anticipated that the GNSO and ALAC will consider and recommend all or aspects of the report to the Board.

Community Support:

- “Travel support should continue for the meetings of the Nominating Committee representatives, and their meetings should be timed to coincide in all cases with the face-to-face ICANN meetings, so that these parties can travel to such meetings, and interact with the community, observe the interactions of Board and other organizations they are responsible to make appointments to.”
- “GNSO support should be increased, including services for SGs and constituencies.”

ICANN response: ICANN acknowledges the importance of the Nominating Committee and its interaction with the Board and community at the ICANN meetings. The Nominating Committee holds its own budget for its activities and travel, and as of FY11 has supported its committee members’ attendance at each ICANN meeting. Regarding gNSO and other constituency and stakeholder group support, ICANN has an agreed-upon set of basic services that it offers each SO, AC, and SG. Starting in FY11, additional services have been requested for inclusion in the FY12 Budget, and those that were able to be accommodated in this fiscal year are included in Section 5 of this draft Operating Plan.