

To: Chris Disspain <ceo@auda.au>

Hello Chris,

Thank you for the letter from the ccNSO dated 26 March 2010 regarding ICANN's FY10 expenses as well as the recent postings to the public comment forum on the budget FY11 budget. I apologize to you and the ccNSO members for not previously providing formal responses to the questions in the letter. The purpose of this letter is to provide written responses to the ccNSO's questions, many of which have previously been provided orally or informally. Inevitably, these answers will raise further questions. I think the best next step would be for us to have a conference call to clear up all matters including the best process of how to ask, and answer, specific questions.

Best Regards

Kevin Wilson

CFO

ICANN

A) The answers in the first section below are structured in the order of the questions outlined in the email of March 26th:

From: Chris Disspain <ceo@auda.org.au>
Date: March 26, 2010 7:08:50 PM PDT
To: Kevin Wilson <kevin.wilson@icann.org>
Cc: ccNSO Council <ccnso-council@icann.org>
Subject: Budget questions

Hi Kevin,

When you met with the ccNSO in Nairobi, a number of questions were raised (regarding budget overruns) which remain unanswered. They are set out below and I shall be grateful if you will provide the information as soon as possible or, alternatively, let me know to whom these questions should be addressed.

1. What were the significant unanticipated legal expenses? Were they exclusively in respect to the .xxx arbitration?
2. What were the new facilities and how much money was spent on them?
3. What were the senior level hires that it was necessary to execute rapidly on and what was the nature of the expenses associated with these?
4. What were/are the strategic consulting contracts what was the nature of the expenses associated with these?
5. What was the nature of the costs associated with delays in key programmes such as the new gTLD programme?

Regards,

Chris Disspain
Chair - ccNSO
ceo@auda.org.au

“1. What were the significant unanticipated legal expenses? Were they exclusively in respect to the .xxx arbitration?”

Response: ICANN has significant legal expenses each year. In FY10, the legal professional services line item had a \$2.5 million budget. ICANN always anticipated that the ICM v. ICANN Independent Review proceedings (“IRP”). would require significant legal resources, which were budgeted. Not anticipated was the time that the esteemed, three-member IRP Panel was required to invest in reviewing and analyzing i) the voluminous written material submitted (over 500+ pp submitted by ICM in the matter), and ii) the transcripts of the testimony after the five-day hearing held in September 2009.

“2. What were the new facilities and how much money was spent on them?”

Response: Two new facilities were opened in FY10. The first new facility is in Washington DC, which was a move, rather than an actual new facility. This move was required to accommodate additional staff while taking advantage of office space cost efficiencies. As described in the board resolution <http://www.icann.org/en/minutes/minutes-09dec09-en.htm>, expenses are expected to start out at less than \$400,000 per year, and not to exceed \$600,000 per year during the lease term.”. Although the size of the office has been increased to accommodate more staff, the longer term commitment for space and utilizing a space with less costly services, results in no change to overall costs for office occupancy.

The second new facility was in Palo Alto. The ICANN Board agreed to open a Palo Alto, CA office as one of the terms of entering into the relationship with ICANN’s new CEO and President at the beginning of the fiscal year. Interim full service Regus office space was obtained for staff to use in Palo Alto costing less than \$200k in FY10. In addition, as described in the Board resolution <http://www.icann.org/en/minutes/prelim-report-30sep09.htm>, a new longer term lease was executed to meet needs for current staff, including the CEO and to attract technically oriented talent for new staff. The occupancy costs, including amortized leasehold improvements, start out at less than \$400,000 per year, and not to exceed \$600,000 per year during the lease term. In FY10, leasehold improvement plans have been developed to complete the build out of the space, which are expected to cost \$500k to \$600k (net of tenant improvement allowance). No additional occupancy costs have been spent except for the Regus temporary space at this time.

“3. What were the senior level hires that it was necessary to execute rapidly on and what was the nature of the expenses associated with these?”

Response: A listing of all ICANN staff, and their roles, are posted on the website here: <http://www.icann.org/en/general/staff.html>, and most senior level hires are announced on the

ICANN website. New hires or adjusted hires that were changed from the originally proposed budget during the fiscal year included: [Rod Beckstrom](#) - President and CEO; Paul Twomey – consulting services following the end of his tenure as President and CEO; Elise Gerich – Vice President, IANA; Whit Diffie - VP Info Security & Cryptography; [Barbara Ann Clay](#) - Vice President for Communications and Marketing; [Jamie Hedlund](#) - Vice President of Government Affairs – Americas; David Olive - VP Policy Development; [Michael Salazar](#) - Program Director for the New gTLD Application Process; [Joe Abley](#) - Director, DNS Group; [Robb Antrobus](#) - Director-gTLD Application Processing; [Dane Suenaga](#) - Project Manager, New gTLD Program; Francisco Arias - Registry Technical Liaison; Dongmei Cao - Senior Software Engineer; and David Knight - Sr. DNS Engineer.

Although ICANN generally does not provide salary information for individual staff members, information for highly compensated and key employees (as defined by the IRS) is available on the IRS Form 990 which is posted here: <http://www.icann.org/en/financials/fiscal-30jun09.htm>. Officer compensation is also listed in the compensation report which was most recently posted in January 2010 here: <http://www.icann.org/en/financials/compensation-practices-31jan10-en.pdf>.

Compensation information is also available in some detail in the FY11 Operating Plan and Budget document which is posted here: <http://www.icann.org/en/financials/proposed-opplan-budget-v1-fy11-17may10-en.pdf>. In particular, please note section 5.2.1 personnel costs which starts on page 37.

“4. What were/are the strategic consulting contracts and what was the nature of the expenses associated with these?”

Response: Professional service expenses for the FY11 budget are described in section 5.2.3 starting on page 40 of the document posted here: <http://www.icann.org/en/financials/proposed-opplan-budget-v1-fy11-17may10-en.pdf>.

In FY10, large professional service expenses have included:

- *Argo Pacific Pty Ltd – Paul Twomey’s consulting services following after his term as CEO and President ended and he served as Senior President.*
- *Compass Lexecon – new gTLD support*
- *Equinix, Inc – Security resiliency support / bandwidth*
- *Hill & Knowlton, Inc -- communications support*
- *Iron Mountain Data – data escrow services*
- *Jones Day -- IRP, litigation matters, legal advice, contract and other consulting*
- *KPMG LLP – new gTLD, risk management*

- VeriLAN Event Services Inc. – technical support during meetings

“5. What was the nature of the costs associated with delays in key programmes such as the new gTLD programme?”

Response: *Efforts over that anticipated in the FY10 Adopted budget were required to prepare the additional version of the applicant guidebook, help resolve overarching issues through economic studies, and provide additional editing and translation costs.*

,Additionally, new projects associated with the management of the reviews associated with the affirmation of commitments has caused additional unanticipated costs. For example, costs for the Accountability and Transparency Review Team (ATRT) have been spent for F2F meetings and other support, and additional expenses are being proposed for the new fiscal year. The FY11 budget for the ATRT and other reviews called for by the terms of the Affirmation of Commitments are under consideration as well.

B) Additional questions and comments were recently posted on the ccNSO website <http://ccnso.icann.org/>. Additional questions and comments from the ccNSO:

1. In ICANN’s Strategic Plan matrix (Executive Summary - pg 6), the first two line items under “DNSSecurity and Stability” are “*enhance existing DNS collaborative responses to abuse threats to DNS*” and “*initiate program for annual DNS risk assessment / systemic contingency planning*”. The ccNSO would welcome more information regarding these items and what operational and budgetary detail will be attributed to them.

Response: *The Security, Stability and Resiliency (“SSR”) budget assumptions and key activities planned for FY11 are described in the budget document. See section 4.4 and appendix A.4. Additional information can be provided upon request.*

2. On page 8, ICANN notes that “*Work to develop alternative funding sources is required to avoid delaying some planned security trainings for ccTLD operators*”. What work will ICANN undertake and will the ccNSO be consulted?

Response: *This was a statement confirming that ICANN Staff may try to find partners to continue ccTLD training at the pace of the previous years. Any inputs on this issue will be gratefully accepted by the ICANN Staff and/or additional information can be provided upon request.*

3. The quantum of ICANN’s Reserve Fund is discussed on page 9. What benchmarking work, if any, was undertaken before the decision was taken to reserve one year of operating expenses? Will this Fund be capped at any point, given annual operating expenses are a moving (and typically increasing) target?

Response: The level of one year of operating expenses was determined to be the correct reserve fund level. *Research with other similar organizations was undertaken in 2007 at the time ICANN's investment policy was formalized. One year of operating expenses was thought to be a reasonable compromise given the sizes ranged from three months to three years or much more. Plans are underway to develop a more robust definition of the Reserve Fund sizing, additional consideration of the reasons for its size, and current benchmarking. The Board Finance Committee has requested staff to engage outside experts to perform this study, and will be reviewing the reserve fund level again, later this year.*

4. Pages 11 and 12 outline ICANN's planning process and a proposed change to the process for FY12. As a general observation, the ccNSO is not certain that the draft Operating Plan and Budget is the appropriate place for the discussion of procedural changes and requests that ICANN undertake a separate public consultation on the matter.

Response: *Thank you for this productive comment and dialogue on this topic. Accordingly, development of, and decisions concerning, new planning processes will rise to the Board and community level. An initial effort for fine tuning the FY11 planning process will begin in late July. Discussions on the development plans for the FY12 Operating Plan and Budget will be initiated with SO/AC leadership in September 2010. The goal is to facilitate early and significant engagement with the SO/AC leadership for the next fiscal year's plans.*

5. On page 18, the ccNSO notes that additional expenses in FY10 related to arrangements for the Nairobi meeting have been attributed to Security, Stability and Resiliency Operations and used to explain the SSR budget over-run. The ccNSO believes that these are clearly meetings-related costs and would welcome a clear explanation of why they have not been attributed in that way.

Response: *The allocation of all of ICANN's operating expenses into the 15 organization activities identified in the Functional view of ICANN's expenses is new and evolving. There are judgment calls required. Although conceptually these costs could be considered an additional SSR requirement, and not part of the core meeting logistics, we'll note your point for future reports. More importantly, this signifies an increased review of the numbers by the community. Our goal is to make sure that each report is relevant and meaningful to the community.*

6. In section 4.9 (page 22), Global engagement and international participation is listed as \$1.2m –or nearly 20% - over budget. What were the reasons for the over-run?

Response: *Most of this increase is due to the cost allocations of executive labor and travel costs. Although each executive's time is allocated across functional areas individually, in general a higher percentage of executive labor is allocated to this functional category. With the extra costs of a senior president and other executive costs, the increase is shown impacting this organizational activity.*

7. Similarly, why did Community travel support (item 4.10 - page 22) run over budget?

Response: *Some of the increase is due to unit costs exceeding what was assumed in the budget. In addition, the administrative costs to support the community travel support are greater than anticipated in the FY10 budget.*

8. Although only a relatively minor expense item, costs relating to the ombudsman's role are budgeted to increase by nearly 25%. What are the reasons for this increase? If this is a currency exchange issue, is there a plan for ICANN to hedge against future fluctuations?

Response: *Yes, this is a result of the currency exchange rates. ICANN does have an international currency risk management policy. With Board finance committee oversight, ICANN can apply currency hedging measures, and does so when the costs to administer such measures do not exceed the risks avoided. Near-term plans are to report in U.S. dollars, and hedging would not change the reported amounts.*

9. On page 25, DNS Operations are listed as more than 100% over budget, and yet there is no discussion offered. What accounts for such a large over-run?

Response: *The increase is due to the large effort to prepare for DNSSEC, KSK, and other DNS operational activities. The costs include transfers of IT and other personnel to this organizational activity, and one-time build-out costs for the two key signing facilities.*

10. On page 27, investment income of \$4.5m is forecast for FY10. Only \$1m was budgeted for FY10 and only the same amount is budgeted for FY11. This spike in investment income was not addressed in the operating and budget framework and barely mentioned in the current document and yet goes a long way to helping ICANN come in on budget for FY10. What was the reason for the significantly higher than expected investment income and why is the budget forecast for FY11 so low?

Response: *ICANN has traditionally not considered investment income, or losses, in its operational planning activities, other than savings for possible "black swan" events. Management, and the Board Finance Committee agree that the primary operational target for ICANN is to operate within the Operating Expense line item whenever possible. Even if other income sources dramatically increase, this should not change ICANN's operating plan.*

The audited financials do require consideration for investment gains (both realized and unrealized), but the fiscal year operating plan traditionally does not. The growth in financial markets explains the bulk of the growth in ICANN's Reserve Fund. The growth in FY10 has exceeded the losses experienced in FY09, and thus the Reserve Fund is now "in the black". After consultations with UBS, ICANN's investment manager, \$1 million was used for the FY11 budget investment income estimate. This is a conservative estimate that should not impact operational activities.

11. On page 35, ICANN has listed "travel and meetings" as a single operating expense. To many stakeholders, expenses related to travel and holding meetings are two very important and separate costs and the ccNSO requests that ICANN differentiate between the two and advise how much was spent on each.

Response: *Point well taken. We'll explore how to report on this distinction in the future and certainly include this in the final reporting for the year. Some of the challenge is separating travel costs related to a specific meeting versus travel costs for non-meeting activities. Many staff and others who support ICANN, perform "non meeting" activities at an ICANN meeting.*

12. On page 42, "Organization leadership support and others", with an FY11 budget of \$0.9m, includes leadership support for the CEO and Chair. Is this secretarial support or another expense?

Response: *Yes, secretarial support for the ICANN Board Chair is included as well as other consulting and training costs for the CEO and senior leadership.*

13. Page 48 notes that ICANN has signed a 10-year lease on a Palo Alto office. Why is ICANN investing in two offices in California, given the requirement for it to internationalise, under the Affirmation of Commitments?

Response: *See response above on page 2.,*

14. On June 22, 2010, President and CEO Rod Beckstrom that ICANN's Strategic Plan is in fact a "wish list," and that not all strategic priorities will be executed. This makes serious analysis of the Strategic Plan very difficult, as there is no way for stakeholders to confidently determine which elements of the wish list are expected to be undertaken and funded, and which are not going to be funded. As such, there is a need to better prioritise the strategic initiatives to ensure that they fit with resources – in terms of financial resources, staff capacity and community capacity.

Response: *Acknowledged. Efforts to identify priorities more clearly will be integrated in the FY11 plans going forward and as mentioned above will be more heavily integrated in the development of the FY12 plans. This is also an important point to consider as new approaches are considered to the overall planning cycle.*

15. Can ICANN differentiate between structural and discretionary costs (fixed vs. variable)? In other words, can ICANN specify which priorities must be funded and which are optional and hence assist with the prioritization of what can be cut or modified with the least impact?

Response: *This is a challenging request as almost all costs are variable. Only a few long-term contracts (e.g., leases) exist. Of course, personnel costs might be considered less variable than other costs. Efforts to identify priorities more clearly will be integrated in the FY11 plans and more heavily integrated in the development of the FY12 plans.*

16. We would like to make the observation that the cost cutting measures appear to be very short term.

Response: *Acknowledged. If you can provide specific examples of cost containment efforts that are not effective for ICANN's long term success, we would welcome that feedback.*