

## **ISPCP Comments on:**

### **FY14 Draft Operating Plan and Budget**

The Internet Service Provider and Connectivity Providers Constituency (ISPCP) welcome the opportunity to comment on the FY14 Draft Operating Plan and Budget.

Noting the limited time allowed to digest and understand a draft that demands careful and detailed consideration due to its complexity and importance, coupled with the change of format which means direct comparison with previous line items (and in years earlier than FY13) is sometimes difficult to track, the ISPCP have concentrated on those areas that raised initial comments from within the Constituency.

The ISPCP pose the following questions.

#### **Disconnect between Outreach and the policy-development process**

Is ICANN proposing to do outreach through the Supporting Organizations and Advisory Committees that support the policy-development process? Or is the Engage Stakeholders Globally effort (funded for \$11.7million – Page 31) independent of those bodies?

Presume for a moment that the Engage Stakeholders Globally initiatives are successful in bringing many new participants into ICANN's policymaking process. In that case where in the budget are the allocations to provide the resources that will be required to help prepare the Supporting Organizations and Advisory Committees to welcome, brief, train, develop and mentor this influx of new participants?

We note on Pages 35-36 that NONE of the CSG Fast Track budget requests (many of which address this very issue) were funded. Are constituency-support resources provided elsewhere in the budget? Can that be made clearer? We are now at the stage where almost 50% of the budget allocated to cover community support requests has been allocated during the fast track process, but none of the requests from Constituencies within the Commercial Stakeholder Group have been dealt with. This is a cause for serious concern. Is it the expectation that unpaid volunteer participants will cover this gap without any incremental resources or support? We would request that constituency leaders are involved in any discussions or decisions that concern the allocation of resources that directly impact the ability of those groups to function in a manner that underpins ICANN's multi-stakeholder model.

The ISPCP questions how the "Engage Stakeholders Globally" and "Increase/Improve Participation" initiatives (listed on Page 26) are

coordinated. Is there a plan to ensure that all these efforts are tied together in a way that they complement and reinforce each other?

## **Process**

Given that there is a short time allotted for the community to digest or converse with the administration about this budget before it is scheduled to be approved by the Board (see p. 3), how does the administration align this budget with the key requirement that this remains a bottom-up accountable process?

The ISPCP questions the large increase in recurring costs which appears to be a consequence of this proposed budget, and questions the accountability of taking that step, particularly as the community has only had limited input and even less time to digest the detail?

Have budgetary caution and safeguards (described as “Original Approach” on Page 12) been lost during the transition to the AtTask system (described as “Revised Approach”)? Does this new approach provide adequate basis for ICANN to carry out its fiduciary responsibilities? Is there any way to re-establish the review and revision steps that were lost during the rapid transition to this new budget management regime?

An initial analysis conducted by the ISPCP identified a \$4 million arithmetic error in the new gTLD refunds item detailed on Page 38 of the first draft of this plan (See Annex One). The subsequent draft (published in response to our first analysis) contains a \$5 million arithmetic error, which we were at least able to reconcile to within \$200 thousand. Errors of this nature raise some concerns over the integrity of the underpinnings for this budget and we question whether the transition to the new budget management system been too hasty. Due to time constraints we have only analyzed one part of this document in detail, but we did identify a number of errors. The number and size of errors discovered in that limited review naturally raises concerns over the level of accuracy of the budget overall.

## **New gTLD Program**

Are the assumptions about the timing and size of the revenue-generating potential of the program realistic, given the history of delays thus far?

Is the lack of sufficient contingency within the budget likely to put pressure on staff to downplay serious obstacles that may occur during this budget cycle? How would any such occurrences be dealt with?

For example – what happens if the unfavorable current-year revenue variances (on Page 13) deepen in future years due to overly optimistic domain-name demand projections? Is there a contingency plan if the current-year short fall is actually a reflection of flattening/maturing of demand for domain names, both in existing and new gTLDs? How much of the expansion of ICANN described in this budget be gracefully unwound if actual demand and revenue fall short of projection? What is the plan to protect core functions in that scenario?

What if the gTLDs continue to be substantially delayed – does an optimistic revenue forecast, which supports the proposal to dramatically expand recurring costs, create an conflict of interest for ICANN by giving the organization a stake in, and a bet on, the timing and size of the new revenue stream? Could this perceived or real conflict reduce worldwide stakeholder confidence in ICANN’s judgment in these matters?

## **Organizational transformation**

Have the sweeping initiatives outlined on Page 9 been vetted by the community and approved by the Board?

Is there a way to phase the transition to the worldwide matrix organization that is proposed? What happens if ICANN can’t sustain the predicted rate of change, it or it causes unforeseen consequences? Has consideration been given to conducting pilot tests of this idea in a limited way before completely converting to the new structure?

There seem to be a number of overlapping initiatives in the DNS Industry Engagement area (introduced on Page 9). The ISPCP feels that there is a need to ensure that issues such as redundancy, scope-creep, the possibility of over-rapid expansion and a thoughtful determination of ICANN’s role in promoting the “DNS Industry” are; well understood, vetted by the community and approved by the Board in order to justify this spend.

Accepting that one of the primary goals of this budget is to further strengthen the infrastructure, the ISPCP questions why SSR staff & infrastructure, and bottom-up policy making bodies are suffering so badly in this budget. With so many resources being channeled into the infrastructure support of internal overhead activities (such as “institutionalize management disciplines” and “mature organizational support functions”), why is “world-facing” infrastructure being starved? We question whether these choices are being made with the encouragement and support of the Board and equally

important, question whether such decisions also require additional dialogue with those stakeholders most impacted

At a more detailed level, the ISPCP asks whether the “Optimize PDP” item (Page 32) is in line with the “GNSO Project List.” Likewise on the same page the “Evolve SO/AC Structures” item contains \$200k allocated to “Organizational Reviews” – does this imply that ICANN anticipates a self-assessment by the GNSO?

### **Reduced emphasis on Security function**

Just as the Compliance function was starved for years, the ISPCP (the recipients of the first call for help when the DNS and numbering systems break) finds the treatment of the Security function in this budget troubling.

For example – \$1.2 million of Security projects and headcount are listed as cancelled in the FY13 variance analysis on Page 17. More detail is required on what specific projects come under this heading. Have these projects been carried into FY14? If so, is that delay the primary source of the \$1.6 million of additional funding listed on page 22 (so there’s really only \$.4 million in new money)?

Given the imminent arrival of new gTLDs, and the certainty that there will be “interesting” security, stability and reliability issues arising from that change, shouldn’t the Security function be a front-and-center item in this budget? Currently the Security function only appears to be briefly mentioned, in a couple of footnotes.

### **Support for the multi-stakeholder model**

What is the rationale for the proposal on Page 26 that “Operations Excellence” (which reads like a catchall for overhead functions) receives ten times the money that is going to “Multi-Stakeholder Model Evolution” (which is at the heart of what ICANN exists to do)?

How is this budget process structured to guard against bloat in recurring overhead costs and ensure focus on the “line” functions (such as the bottom up multi-stakeholder policy development process) that the organization must deliver as part of its charter in the Bylaws and the Affirmation of Commitment?

### **In conclusion**

The ISPCP have raised a number of issues and questions and would welcome feedback and further dialogue on those issues.

## ANNEX 1 – detailed analysis of projected-refunds projection

Here are annotated versions of a page from the original slide deck summarizing the FY14 budget. Note that all of this information was presented on Page 38, it has been split to allow room for the annotation. Subsequently ICANN issued a revised version of this page. Our analysis of that revised page follows.

### New gTLD Program – Financial Summary

(In thousands)

|                                 | FULL PROGRAM                     |                               |   |
|---------------------------------|----------------------------------|-------------------------------|---|
|                                 | Current Estimate<br>(April 2013) | Prior Estimate<br>(June 2012) | Variance<br>Current vs. Prior<br>Fav/ (Unfav) |
| Total Application Fees          | \$ 364,872                       | \$ 370,000                    | \$ (5,128)                                    |
| Less: Total Refunds             | (49,934)                         | (32,930)                      | (17,004)                                      |
| <b>Net Application Fees</b>     | <b>\$ 314,938</b>                | <b>\$ 337,070</b>             | <b>\$ (22,132)</b>                            |
| <b>Expenses</b>                 |                                  |                               |   |
| Evaluation Costs                | \$ 133,393                       | \$ 142,618                    | \$ 9,225                                      |
| Overheads                       | 31,386                           | 14,238                        | (17,148)                                      |
| Historical Development Costs    | 32,454                           | 32,454                        | 0   |
| <b>Total Operating Expenses</b> | <b>\$ 197,234</b>                | <b>\$ 189,310</b>             | <b>\$ (7,924)</b>                             |
| <b>Remaining Balance</b>        | <b>\$ 117,704</b>                | <b>\$ 147,760</b>             | <b>\$ (30,056)</b>                            |

|                              | Current Estimate<br>(April 2013) | Prior Estimate<br>(June 2012) | Variance<br>Current vs. Prior<br>Fav/ (Unfav) |
|------------------------------|----------------------------------|-------------------------------|---|
| Remaining Balance            | \$ 117,704                       | \$ 147,760                    | \$ (30,056)                                   |
| Risk Reserve *               | 115,800                          | 120,000                       | (4,200)                                       |
| <b>Net Remaining Balance</b> | <b>\$ 1,904</b>                  | <b>\$ 27,760</b>              | <b>\$ 25,856</b>                              |

\* Risk Reserve of \$115.8M includes \$1.0M of actual costs incurred through March 2013


Shouldn't this be **(13,000)?**

Which then ripples through the rest of this analysis

Eg: this would now be **(26,056)**

Eg: this would now be **(21,856)**

In any event, isn't this last-corner number a **NEGATIVE** variance, so shouldn't it be in brackets?

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### New gTLD Program – Financial Summary

(In thousands)

#### VARIANCE EXPLANATIONS

**The variance seems high at \$17,004.**

The sum of variances as listed in this paragraph is:

$$\$5.8 + \$3.2 + (\$24) + \$7.3 + (\$5.3) = (\$13)$$

Isn't the variance at **-\$13 million** rather than **-\$17 million** as listed?


**Projected withdrawals of 645 seem low.**

The sum of actual/projected withdrawals listed is:  $1+35+470+150=656$ . Given that pre-reveal withdrawals is a positive number, doesn't this require a number greater than 656?

I don't know what the pre-reveal refund rate is. If the pre-reveal refund rate is 90% doesn't that mean that \$5.3m of refunds from pre-reveal would work out to 32 additional withdrawals?

We calculate projected withdrawals at 656 plus either 32 = **688** total projected withdrawals.

|  |                 |
|--|-----------------|
| <b>Application Fees</b>  | <b>(5,128)</b>  |
| (i) Applications 1930 vs. 2000 budgeted (-\$12.9M).  |                 |
| (ii) ICANN Applicant Support Contributions, 1 approved application vs. 15 budgeted (-\$1.8M); offset by application fees collected (+1M).  |                 |
| (iii) Application fee of \$5K/each for applicants who applied to the program but did not complete the process (+.8M).  |                 |
| (iv) Assumed 85 applications will elect CPE at \$10K/application (+.8M).   |                 |
| (v) Investment income from funds destined for longer term needs. Funds have been distributed across several investment manager firms with funds earning an average of 45 basis points (+1.5M).   |                 |
| (vi) Revenue for RSTEP to be billed to applicants (+2.8M).   |                 |
| (vii) Applicants that paid \$185K each but withdrew from program prior to the release of the applicant list (+3.5M).   |                 |
| <b>Refunds</b>   | <b>(17,004)</b> |
| Total projected withdrawals 645 vs. 548 budgeted; Refund percentage reflect withdrawals to date and projected withdrawal schedule; Apps @ 80%, 1 actual vs. 40 budgeted (+5.8M); Apps @ 70%, 35 vs. 60 (-\$3.2M); Apps @ 35%, 470 vs. 100 budgeted (-\$24.0M); Apps @ 20%, 150 vs. 348 budgeted (+\$7.3M); Unbudgeted pre-reveal withdrawals (-\$5.3M).  |                 |
| <b>Evaluation Costs</b>  | <b>9,225</b>    |
| Objection Processes (+14.0M); Initial Evaluation (+3.3M); Quality Control (-\$1.2M); Extended Evaluation (-\$3.3M); Program Administration (-\$4.5M); All other (+.9M).  |                 |
| <b>Overhead</b>  | <b>(17,148)</b> |
| ICANN staff allocation (-\$7.5M); Other overhead (-\$5.2M); gTLD team (-\$4.5M).   |                 |
| <b>Risk</b>  | <b>(4,200)</b>  |
| In June 2012, the assumption retained to reflect risk costs was to distribute the total amount of the risk reserve across the 3 years of the evaluation period.  |                 |
| The presentation methodology was changed in the April 2013 New gTLD Program Statement of Activities versus the June 2012 version to reflect the actual risk costs and the net balance as a risk reserve. The risk reserve of \$114.7M represents the net balance for the program to date. Future costs until the end of the program cannot be estimated. |                 |

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This table is the detail of the calculations we performed in our original analysis.

| Amt. of refund | Prjctd                 | Budget | Variance | Projected | Budget   | Variance          |          |
|----------------|------------------------|--------|----------|-----------|----------|-------------------|----------|
| 90%            | 32                     | 0      | -32      | \$5,328   | \$0      | (\$5,328)         | (note 1) |
| 80%            | 1                      | 40     | 39       | \$148     | \$5,920  | \$5,772           |          |
| 70%            | 35                     | 60     | 25       | \$4,533   | \$7,770  | \$3,238           |          |
| 35%            | 470                    | 100    | -370     | \$30,433  | \$6,475  | (\$23,958)        |          |
| 20%            | 150                    | 348    | 198      | \$5,550   | \$12,876 | \$7,326           |          |
| Total          | <b>688</b><br>(note 2) | 548    | -140     | \$45,991  | \$33,041 | <b>(\$12,922)</b> | (note 3) |

Notes:

**note 1:** Forcing ICANN-provided -\$5.3million variance into this "layer" requires 32 pre-reveal withdrawals at a 90% rate

**note 2:** Forcing ICANN stated total of 645 actual and projected withdrawals is impossible without changing out-period projections. This analysis does not attempt to find that error but notes that the projection that 645 applications will be withdrawn may be optimistic.

**Note 3:** This analysis ties out the ICANN-provided dollar-detail of each layer of refunds and supports the conclusion that there is an arithmetic error in ICANN's -17million number. On a 15-May budget call, ICANN maintained that the -\$17 million total is correct and promised a revised version of the detail to support that assertion.

## Updated page from the FY14 budget slide deck

In ICANN's updated draft there is good news and bad news. The good news is that the original errors have been corrected. The bad news is that there is still a \$5million arithmetic error (detailed below) in the version of the table in the slide deck. The table provided as a reply in the Comments Forum corrected the \$5,236k error we identified in this analysis, but not in the slides that were published in the slide deck. Furthermore, the ICANN-provided detail leaves out the pre-reveal withdrawals and thus understates the number of withdrawals that are projected. In addition, there are still several numbers that we can't reconcile.

Here is our annotated version of the slide in question.

By leaving this blank, Total Units is understated by whatever number of applications were withdrawn pre-reveal.

Using 29 (@\$185k) as pre-reveal units, Estimated Total Units could be 675. Using 39 (28@\$185k plus 11@\$5k) the total would rise to 685.

Neither of these proposals can precisely reconcile the \$5,236 dollar total.

This number is omitted from the total. That error ripples through the rest of the analysis.

What is the basis of this item? It is hard to find a number that divides evenly enough into this to back into a "Units" number for the previous column. We get close by using \$180k and 29 -- \$5,220k or 28@\$185k plus 11@\$5k for a total of 39 -- \$5235k

We cannot tie these two numbers out. Our calculation makes these \$13,598 and \$25,253 respectively

| Refund Milestone | Current Estimate (Apr 2013) |                  | Prior Estimate (June 2012) |               | Variance Fav/ (Unfav) |                    |
|------------------|-----------------------------|------------------|----------------------------|---------------|-----------------------|--------------------|
|                  | Units                       | Total Amount     | Units                      | Total Amount  | Units                 | Total Amount       |
| Pre-reveal       |                             | \$ 5,236         |                            | -             | 0                     | \$ (5,236)         |
| 80%              | 1                           | \$ 148           | 40                         | 5,920         | 39                    | \$ 5,772           |
| 70%              | 105                         | \$ 13,650        | 60                         | 7,770         | (45)                  | \$ (5,880)         |
| 35%              | 390                         | \$ 25,350        | 100                        | 6,475         | (290)                 | \$ (18,875)        |
| 20%              | 150                         | \$ 5,550         | 345                        | 12,765        | 195                   | \$ 7,215           |
| <b>TOTAL</b>     | <b>646</b>                  | <b>\$ 44,698</b> | <b>545</b>                 | <b>32,930</b> | <b>(101)</b>          | <b>\$ (17,004)</b> |

(i) Unbudgeted pre-reveal withdrawals (-\$5.2M)  
(ii) Apps @ 80%, 1 actual vs. 40 budgeted (+5.8M)  
(iii) Apps @ 70%, 105 vs. 60 (-\$5.9M)  
(iv) Apps @ 35%, 390 vs. 100 budgeted (-\$18.9M)  
(v) Apps @ 20%, 150 vs. 345 budgeted (+\$7.2M)

The pre-reveal \$5,236 has been omitted from this total. Correct total should be \$49,934

This number omits pre-reveal withdrawals – we estimate that this number should either be roughly -130 (-101-29) or -140 (-101-39).

This number is internally correct, but only using the corrected total for Current Estimate (\$49,934, not \$44,698). However there appear that there are errors in the calculations of the 70% and 35% layers that would push this to -\$16,918