**Intellectual Property Constituency (IPC) Comment
on the Draft FY18 Operating Plan and Budget**

April 28, 2017

A.   Introduction

The GNSO Intellectual Property Constituency ("IPC") hereby submits its comments regarding ICANN's Draft FY18 Operating Plan and Budget ("FY18 Budget") presented to the community in March 2017. The IPC recognizes that the role of community input into the budget takes on greater importance for FYI8 as ICANN's Empowered Community may reject a budget under ICANN's new by-laws effective October 1, 2016. The IPC has engaged in budget briefings in Hyderabad and Copenhagen as well as community calls that have been hosted by ICANN's finance department. The IPC recognizes and appreciates the finance department's continued efforts to improve the presentation and understanding of ICANN's complex budget. After consideration of the FY18 Budget and the assumptions upon which it is built, the IPC is pleased to submit the following comments.

B.   A Financial Reality Check/Time for Fiscal Prudence

The costs of the IANA Transition have placed a severe financial burden on ICANN. Extraordinary fees associated with operationalizing Post Transition IANA (PTI) and reforming ICANN's overall governance and accountability mechanisms accelerated budget pressures and undermined long term planning.

At the same time, ICANN was receiving increased revenue from the New gTLD program which included application fees and auction proceeds. Revenue from new gTLDs increased ICANN's revenue significantly while IANA was draining ICANN's reserves. This created imbalance from an operational perspective as fees from the new gTLD auctions were put in a special fund that could not be allocated to operational expenses or the IANA transition. The disposition of the auction fees is still under review and the time now is for a financial reality check for ICANN. In this vein, IPC supports moderate financial growth, replenishment of the reserves at a reasonable rate and prudent planning for the future.

In the spirit of fiscal prudence and shared community responsibility for the budget, the IPC elected not to make a special budget request for FY18. The IPC recognizes the financial challenges that ICANN faces and respects that a new way of thinking will be required to achieve fiscal balance. While some special budgets requests may be necessary, we urge the ICANN organization to consider these requests very carefully and only grant them for extraordinary needs.

C.   The Reserves

The IPC appreciates the ICANN's organization's recognition of our concerns regarding the state of ICANN's reserve fund as expressed in the GNSO open meeting in Helsinki and in our comments regarding the FY17 Operating Plan and Budget. Currently, IANA Transition Project Costs are reimbursed even 6 months for the preceding 6 months.[1]

Now that the IANA Transition has occurred, it is imperative that ICANN demonstrate to the world that it is fiscally responsible and adheres to best business practices including prudent budget oversight.   This includes adhering to nonprofit industry standards regarding reserve funds. The current standard suggests that reserves should be in sufficient amounts to cover 90-110% of a single operational year. This is considered a benchmark of good nonprofit governance and the IPC is pleased to see that ICANN operations and the Board are taking the matter seriously. IPC notes that the ICANN Board identified fiscal responsibility as a top FY18 priority during an open meeting at ICANN58 and specifically identified the reserves as a top concern.

The FY18 Budget projects the Reserve Fund at $57m by June 30, 2017 and $53m by June 30, 2018. [2] This is not encouraging as there is a decrease of $4m rather than a flattening or increase. IPC is concerned that there is no a published plan for replenishment. As the IPC learned at ICANN58, there is a Board working group tasked with developing a plan. We urge the Board to make this a top priority and to publish the plan as soon as possible but no later than ICANN59. This will enable the community to have adequate time to review the plan prior to the development and approval of the FY19 budge as it is too late to have impact on the FY18 Budget.

D.   The Caretaker Budget

One of the new additions to the ICANN operating plan is "the Caretaker Budget." This is the contingency budget upon which ICANN will operate if the Empowered Community rejects an ICANN budget.[3] The basis for the budget will be the budget as the ICANN Board would have approved it, less new positions, less 10% travel/meeting and professional service fees and less the expenses that trigger the veto. These expenses would be new expenses and not ongoing/legacy expenses. The IPC questions whether the budget that would have been approved is an appropriate baseline. It may be prudent to continue with an extension of the current year's budget with all expenditures flat until a budget agreement is reached between the Board and the Empowered Community.   Even if the IPC were to support the "would be approved" budget as the baseline, we do not support cutting any travel expenses related to face-to-face meetings to

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[1] FY18 Budget Section 6.3, page 28

[2] FYI 18 Budget Section 6.3, page 28

[3] FY18 Budget, Section 3.6, page 19

resolve any budget issues. This 10% travel reduction seems like a "stick" to punish the community rather than a conservative spending measure in a time of budget crisis. IPC would only support such a travel cut if there were a carve-out for constituency travel for ICANN sponsored meetings. IPC supports continuing legacy expenses that are obligated by ICANN through contracts.

E.   Assumptions about Growth

ICANN's budget is traditionally calculated based on predicting revenue and then building the budget. The growth predictions are conservative and based on algorithms tied to gTLD performance.[4] However, as noted above, ICANN's spending outpaced its revenues due to the IANA Transition and accountability measures. This created the reserve fund crisis. Consultations with finance department staff have revealed that new gTLD revenue is expected to be flat. This is a natural consequence of a maturing program. Further, there is the assumption that the reserve funds will not be replaced at the rate that they were depleted as this could cripple ICANN's daily operations. Flat revenues from key programs and the need to replace the reserves at a prudent pace would suggest that planning for x% growth based on x% revenue may not be the correct assumption for building the budget moving forward.

The IPC supports budget assumptions that account for a greater margin between projected revenue and expenses that would allow ICANN more flexibility in meeting its governance responsibilities and adequately funding its operating reserves.

F.   Top 15 Funded Projects

The IPC has reviewed the top 15 funded projects according the FY18 budget and agrees that that they align with ICANN's strategic plan. IPC notes that Compliance project (Project No. 152052) is ranked 10th and is encouraged by ICANN's efforts to ensure accountability, reliability and predictability when it comes to contract compliance as private contracts form the foundation of ICANN's business model and the administration of the domain name system generally. The scope of the projects reads, *to capture staff efforts to address and resolve non-compliance issues by using the informal and formal contractual compliance process. This activity covers complaints submitted to ICANN and internal efforts identified through monitoring.* This is funded at $2.4m.[5] However, the total compliance budget appears to be funded at $5.5m[6] a slight

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[4] Budget assumption information discussed at ICANN58 Community Budget Meeting

[5] See FY18 Draft Budget – Top 15 Baseline Projects
https://www.icann.org/en/system/files/files/proposed-opplan-budget-top15-projects-fy18-13mar17-en.pdf

[6] See FY18 Draft Budget, 7.14 – 4.4 Promote Role Clarity and Establish Mechanisms to Increase Trust within the Ecosystem Rooted in the Public Interest, pages 50-51

increase over last year's proposed budget of $5.4m. The IPC requests clarification as to actual proposed expenditures on this mission critical function. It would appear that a disproportionate amount of funding will be spent on review rather than to employ resources for contract interpretation and enforcement.   Auditing and metrics are important but even more important is ICANN's investment in the actual interpretation of its contracts and commitment to enforcement. This is accomplished through staff engagement with entities that are deemed out of compliance with contract terms and the efforts to steer the entities back into compliance or out of the contract.   Further, the IPC continues to stress the importance of transparency in the ICANN compliance process so that we may have levels of predictability and reliability when matters are escalated.   ICANN would be well served to consider developing easily accessible resources that explain contract compliance outcomes. The IPC has noted these issues in prior comments relating to ICANN budget practices.[7]

G.   Conclusion

The IPC has been an active and engaged participant in ICANN's budget discussions. We welcome the opportunity for continued dialog and improvement of ICANN's budget processes. The cultural of continuous improvement is even more important as the Empowered Community has the right to reject a proposed ICANN budget. The gravity of the power requires an informed and engaged community at every step of budget development. While the IPC notes the continued improvement and transparency of the budget process, we have ongoing concerns about ICANN's failure to address to its dwindling operational reserves and challenge some of the assumptions used to build the FY18 Budget considering these concerns.

We look forward to hearing the ICANN organization's response to our questions and comments prior to the Board vote on the budget in June 2017.

Respectfully submitted,

Intellectual Property Constituency

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[7] https://ipc.memberclicks.net/assets/ipc-position-papers/2016/2016_04april_30%20ipc%20comment%20on%20fy%2017%20budget%20and%20five%20year%20operating%20plan.docx.pdf