Response to CWG consultation

Question from CWG Chairs (J. Robinson & L. Fuhr) to ICANN CFO re: costs of PTI

Xavier Calvez | 1 June 2015

# Introduction

This document is a response to questions asked by Jonathan Robinson and Lise Fuhr, co-chairs of the CWG – transition by email on 12 May 2015, relative to the costs impact of the scenario under which a PTI structure would manage the IANA Functions.

A call was also held on 27 May to clarify further the scope, format and content of the expected response.

The full content of the email request is reproduced below, and a summary of the call is provided thereafter.

## Question - Email

“Dear Xavier,

I am writing to you on behalf of the Cross Community Working Group (CWG) to Develop an IANA Stewardship Transition Proposal on Naming Related Functions and in my capacity as co-chair of the CWG together with Lise Fuhr.

I know that you are aware of the submission by the CWG into the comment period for the ICANN FY2016 budget. However, the CWG has specifically requested that I ask you to review our current draft proposal for cost implications and that you provide any comments and further information that you are able to.

In particular, the proposal envisages moving from the current model of functional separation of the IANA unit within ICANN to a structure and mode of operation that is both functionally and legally separate. Our legal advisers have provided an indication of the basic costs associated with this type of structure and these are attached for your reference. However, these basic legal costs will not cover all of the issues and changes in cost. Therefore, as part of understanding the implications of the proposed transition, it will be very helpful to have your considered view of the future costs and the obvious implications for the 2016 and future ICANN budgets.

Thank-you in advance for your assistance in dealing with this question.

Best wishes,

Jonathan Robinson

On behalf of the CWG”

## Supplemental information - Call

Participants: Jonathan R., Lise F., Theresa S., Grace A., Xavier C.

* Succinct written response
* Is there a material cost change due to the PTI structure?
* Provide the possible cost change that can be identified
* Define assumptions, and provide resulting opinion
* Assume that:
  + the current operations continue operating as they are, but under a PTI structure.
  + The dedicated assets supporting the operations currently are transferred to the PTI.
  + A separate legal entity is considered necessary:
    - To emphasize the current functional separation
    - To allow for a formal contractual relationship between ICANN and the PTI
    - To provide for the possible removal of the PTI from ICANN should such an eventuality need to occur
* Provide a brief description of the process/requirements to proceed with the operations transfer.

# Assumptions

The assumptions below were defined in order to provide an answer to the questions asked. The assumptions can be changed, leading to a different answer to the questions.

## Baseline Cost model – Starting point

Based on the indications provided, Staff suggests to define a baseline cost model corresponding to the fully absorbed cost estimate of the IANA Operations, as provided by Staff to the CWG DT-O. See appendix A to this memo.

This fully absorbed cost model corresponds to the most comprehensive estimate available of the IANA operations as operating by ICANN, considering that no other more comprehensive and detailed accounting is produced by ICANN on a recurring basis otherwise.

The fully absorbed cost model includes:

* Direct and dedicated costs: for the dedicated resources within ICANN which support the IANA Functions
* Direct shared costs estimate: for the resources within ICANN which support the IANA Functions, as well as other ICANN functions and activities. These resources share their time/resources to perform specific tasks required for the operation of the IANA functions.
* Support functions costs estimate: for the resources within ICANN which support all ICANN functions, including IANA, but do not perform specific and exclusive tasks required for the IANA functions.

Using this model, Staff will describe below what cost items are expected to change if the IANA Operations would remain operationally performed as they are currently, but under a separate legal entity.

It should be understood that above described costs analysis, as appearing in appendix A, was conducted for the purpose of estimating costs of a function of ICANN. It was not conducted with the purpose to calculate costs of a separate operation. Therefore, if and when a separate entity is implemented to host the IANA Functions, the above analysis would need to be performed at a different level of precision and granularity, resulting in costs differences that could be material.

## Other assumptions

1. **Capital assets (KSK signing facility, and IT equipment and software mainly)**
   1. Dedicated assets: those assets are transferred into the PTI. It is expected that the value of these assets would significant (replacement value of several millions USD). A separate exercise would be required to assess and define the value of these assets for the purpose of implementing the PTI.
   2. Shared assets (facilities and infrastructure, notably IT-related): these assets are not transferred and the cost of such assets is shared between ICANN and the PTI.
2. **Operations:**
   1. Operational activities currently supported by dedicated resources are transferred into the PTI.
   2. Operational activities currently supported by shared resources remain shared under the PTI model.
   3. The assumed implication of the above assumption is that the shared resources remain within ICANN’s legal entity, and a cost-sharing model will be put in place to address the need to share costs between ICANN and the PTI in a “management fees” or “service” agreement.
   4. Such cost sharing model is assumed to be full cost recovery based, and “arm’s length”.

1. **Carve out process**
   1. The carve out process corresponds to the process of identifying and transferring the operations into a new entity.
   2. The impacts of the carve out process are those that can be determined as a result of a simple brainstorming exercise.
   3. A complete inventory of the steps and requirements of the carve out process has not been performed.

# Discussion

Based on the assumptions above, the following changes to the fully absorbed cost model can be expected. These costs are expected to be either new or additional to the costs of services provided by ICANN’s operations.

Based on the assumptions described in the preceding section, it should be understood that the costs resulting from the analysis below correspond to the minimum possible additional costs to the fully absorbed costs, since they are only driven by the existence of a separate legal entity, while IANA Functions remain operated as they currently are. Should the IANA Functions be operationally further segregated from the rest of the ICANN operations, different and additional costs would appear (as integration and synergies would be lost).

## New governance-related costs

* These costs are assumed to be triggered by the existence of the PTI legal entity.
* Corporate secretary and Board support costs: to maintain bylaws, manage board meetings and decisions/minutes, manage board membership and elections,… - Estimated cost of 1FTE (probably 0.5FTE corporate secretary and 0.5FTE attorney) = US$150k/year.
* Financial audit: under the presumption that a financial audit in either US or international principles would be required by law or under the bylaws. Estimated cost = US$15k/year.
* Tax filing of a Form 990 (if required by the form of the legal entity): US$10k
* Legal entity related filing fees or stamps are ignored on the basis of materiality.

Total governance-related costs: US$175k/year

## Operational costs

1. Independent legal advice:
   1. Assistance of the PTI in the management of its relationship with ICANN (regarding the management fees agreement for operational support, the operation of its board,…);
   2. Assumes that on-going legal support is otherwise provided through ICANN’s legal support;
   3. Assume US$100k.
2. Additional financial/tax support:
   1. driven by (i) the existence of the legal entity and the required assistance in financial, audit and tax matters, (ii) the existence of separate budgeting and reporting requirements, (iii) the existence of the financial implications of a separate management agreement (costing, analysis, invoicing, settlement,…), including separate bank account;
   2. Additional to the financial support of on-going activities (monthly accounting and analysis);
   3. Assume 1.0FTE (combination of accounting staff and finance management level): $US112k / Assume minimum external advice (mainly for tax purposes): US20k.
3. Separate/additional insurance costs:
   1. Assuming specific insurance policies need to be put in place, in addition to the existing ICANN’s insurance.
   2. Assume a placeholder of $US100k.
4. Separate/additional communication costs:
   1. Assume to be provided by ICANN’s operations but specifically for the PTI/IANA Functions
   2. Include on-going communication specific to the PTI/IANA functions (a separate legal entity may need to communicate differently than a department of ICANN), and separate identification (“branding”),
   3. Assume $US100k

Total Operational costs: $US432k/year

## Carve out process

Overview of high level requirements to create and organize the PTI:

* Creation of the PTI legal entity (registration, bylaws, naming),
* Modification of the ICANN bylaws, as required,
* Definition of the governance structure: board, management,
* Creation of a management agreement with ICANN for operations and support services,
* Creation of an accounting structure (general ledger, sub-ledger, fixed assets register)
* Asset transfer: identification, evaluation, APA (asset purchase agreement) creation, acquisition,
* Definition of the capital requirement (likely to be included in the bylaws)
* Definition and design of the operational monitoring, reporting, communication, additional to the current IANA

The resources required to proceed with the carve out exercise will include the time of internal resources, the required external legal work (advice, writing bylaws,..), possible asset evaluation costs (to be confirmed), and the community members involvement (to be determined).

At a very high level, the cost of the carve out process could include the following:

* ICANN Staff (Legal, Management, Finance, HR, Communication,…): 5 people for 3 months / $250k (Average 200k \* 5 \* 3/12)
* Legal costs: $100k

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