



Cost Accounting Guidelines

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Summary Points

- ICANN strives to track and report financial data in a transparent and meaningful fashion. This becomes even more important with the advent of new generic top level domains (gTLDs). New gTLD policy requires that the revenue related to processing new gTLD applications match the cost of processing those applications.
- ICANN is establishing a cost accounting approach to ensure those revenues and costs are appropriately tracked and reported.
- These Cost Accounting Guidelines are intended to provide meaningful and accurate cost reports, verifiable by an independent auditor, while avoiding excessive administrative costs.
- The community is welcome to provide feedback on the principles and processes.

Cost Accounting Principles

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1. Purpose for ICANN's Cost Accounting Guidelines

ICANN is a public-benefit, nonprofit corporation dedicated to preserving the Internet's operational stability, promoting competition, achieving broad representation of global Internet communities, and developing policy appropriate to ICANN's mission through bottom-up, consensus-based processes. ICANN receives funds from generic name registrants, through generic registries and registrars, and from country code operators and Regional Internet Registries in order to fund its organizational activities.

ICANN's organizational activities are set forth in its annually updated strategic plan, and then more specifically through each fiscal year's operating plan and budget. Development of both the Strategic Plan and the Operating Plan is based on active community input and feedback. The need to account accurately for resources spent on various organizational activities has become increasingly important for many reasons, but especially:

1. As community groups increasingly seek to understand more deeply specific components of ICANN's activities, and
2. With the adoption of the policy that the new gTLD application process should be fully self-funding, that costs should not exceed fees. See: <http://gnso.icann.org/issues/new-gtlds/pdp-dec05-fr-parta-08aug07.htm> -_Toc43798015, and
3. To ensure that special expense reports such as Functional and Expense Area Group (EAG) reports are prepared consistently.

These Cost Accounting Guidelines ensure that ICANN accurately tracks and reports on revenue and costs related to its various programs. Independent auditor reporting on ICANN's cost tracking and reporting ensures accountability to the community, further builds institutional confidence in ICANN, and is consistent with ICANN's principles of accountability and transparency. These Guidelines document and clarify that the process has been appropriately developed to facilitate cost reporting for each of ICANN's organizational activities. Furthermore, the Guidelines help ensure that costs are allocated to various organizational activities based on sound, well considered, documented, easily recalculated, and verified methodologies.

The following are critical drivers in ensuring the Cost Accounting Guidelines are clear, specific, well documented, shared openly, and reported upon by an independent auditor:

1. ICANN's stewardship role in ensuring that funds are spent wisely and resources are allocated appropriately.
2. The possible large increase of sources of funds from the new gTLD program.
3. The community requirement for fairness and transparency.
4. Building institutional trust in ICANN and its financial reporting for both the current ICANN community and the community of the future.
5. ICANN's resources are by nature heavily cross-functional. Many costs are not directly attributable to a single organizational activity.

6. The Cost Accounting Guidelines are the basis for determining an excess (or shortfall) of funding for a given gTLD round.

Additionally, ICANN's Cost Accounting Guidelines are based on reasonableness and best practices. Needlessly detailed cost tracking methods and systems that create burdensome financial processes and require additional overhead, but do not significantly provide more clarity, are to be avoided. In short, striking the right balance between precision and efficiency is key to ensuring institutional confidence in ICANN and its cost reporting by activity.

Reports on costs expended by ICANN are presented to the community on a regular basis. Such reports are reviewed by an independent audit firm.

2. Key Principles for the Cost Accounting Guidelines

ICANN's Cost Accounting Guidelines help ensure that ICANN cost reports are based on defensible logic and clear reason. The detailed processes, calculations, and assumptions used to create the cost reports should be specific and clear enough to easily allow for recalculation, or auditing, of results against pre-established methodologies. ICANN's cost reporting, and the independent auditors report, are based upon the following key principles.

The cost accounting processes are:

- Fair.
- Documented and approved in advance.
- Based on community feedback and industry best practices.
- Applied consistently over time and over all organizational activities.
- Whenever possible, established and implemented before costs are incurred and allocated.
- Based on reasonable and relevant relationships between a cost and the activity to which it is being charged. Direct costs are identified and known by all parties involved. Allocation methods for indirect or overhead costs are identified. The nature and characteristics of overhead pools are identified and clearly described. The cost accounting process must be designed to ensure all allocatable costs are assigned to the correct cost pool and are not duplicated.
- Provisions for exceptions to the cost accounting process and evolution of the process are incorporated into the process itself.

Reports on costs expended by ICANN are presented to executive management and the community on a regular basis, and such reports are reviewed by an independent audit firm.

- The independent audit firm should be internationally recognized and have a solid reputation.
- The independent audit firm is to perform agreed upon procedures that help ensure confidence in the work performed to prepare the cost reports.
- At least once a year, the independent audit firm indicates, in a report accompanying the cost reports, the specific procedures performed and the results of the work performed.

Finally, principles of reasonableness and efficiency prevail. An overly burdensome cost accounting process does not instill confidence in its results.

3. Cost Allocation Processes

After discussions with the Board Finance Committee and the Board Audit Committee, the proposed cost accounting processes were developed based on the principles described in Section 2. Consultations were held with “Big Four” accounting firm consultants and other cost accounting experts that prepare and review cost accounting disclosure statements for cost-plus government contractors and other firms that must undergo careful scrutiny of cost accounting reports. The cost accounting processes proposed for ICANN are organized by allocation type as shown here.

1. **Direct costs for outside services.** The methods for determining the allocation of costs for professional and other consulting services are described.
2. **Labor allocation.** The methods by which ICANN’s labor costs are allocated by percentage of time spent for each organizational activity are described.
3. **Labor rate determination.** The method of determining hourly labor rates, including payroll costs and fringe benefits, are described. Labor rates times the labor allocations are the labor costs by organizational activities.
4. **Travel and meeting cost allocation.** The methods for determining the allocation of costs for travel and meeting costs are described.
5. **Overhead allocations.** The types of costs that are included in overhead as well as the methods for allocating these costs are described.

The proposed cost accounting processes were developed after careful evaluation of available options. For example, some cost-plus contractors require detailed time recording systems, full-time federal government auditing, and significant resources to perform cost accounting processes. On the other end of the spectrum, many organizations use management estimates and judgment to quickly develop cost reporting.

For each cost category, ICANN developed processes designed to strike the right balance between building institutional trust versus ensuring efficient and reasonable use of registrant funds. The following charts highlight some of the balancing options considered. ICANN’s proposed process is noted by an “X” on the process option continuum.

| Labor Allocation | | | | | |
|--|--|--|--|---|---|
| ← X → | | | | | |
| Executive Judgment | Request verification from Budget Owners | Confirmations from Budget Owners | Positive confirmations from Staff | Periodic blank sheets; Staff to complete | Formal time sheet system; ties to payroll |
| Labor Rates | | | | | |
| ← X → | | | | | |
| Industry Average | Company Average | Department Average | Department and position level averages | Individual rate plus standard fringe rate | Individual rate and tailored fringe rate |
| Allocation of outside vendors, panelists, consultants, and supported costs | | | | | |
| ← X → | | | | | |
| Executive Judgment on allocations | Finance work paper support for allocations | Accounting allocates during input and review | Budget owner indicates allocation when approving | Vendor indicates allocation on invoices | Vendor contracts and invoices clearly allocate |
| Allocation of travel and meeting costs | | | | | |
| ← X → | | | | | |
| Executive Judgment on allocations | Finance work paper support for allocations | Accounting allocates during input and review | Budget owner indicates allocation when approving | Meeting costs allocated by rule of thumb | Meeting costs allocated by time, agenda line items, space, or other measure |

1. Outside services cost allocation methodology

Most costs associated with an organizational activity are based on costs directly associated with that activity. For example, for the new gTLD program, evaluation panelist costs would be direct costs associated with the new gTLD program and thus would be 100% charged to that organizational activity. ICANN allocates costs for outside vendors, panelists, and other consultants directly to an organizational activity if the specific costs for a specific activity can be identified. Management is encouraged to include the name of the specific activity in vendor contracts and to encourage its vendors to identify the appropriate organizational activity on invoices submitted to ICANN. These practices facilitate the attestation work required by an independent auditor.

When the organizational activities are not included in vendor contracts or on vendor invoices, budget owners are asked to provide that information at the time they review and provide account coding for vendor invoices. Costs that benefit more than one activity are allocated to those activities based on budget owner judgment. All persons involved in the allocation

processes for vendor and consulting invoices receive adequate training in the process to ensure that costs are correctly charged, applied, and included in the reporting. In addition, ICANN executives oversee compliance with the processes required to allocate costs to appropriate organizational activities.

2. Labor allocation methodology

During the process of developing each fiscal year's Operating Plan and Budget, department managers indicate the estimated allocation percentage for each organizational activity for each staff person in their respective departments. For example, staff that are hired for, and are wholly dedicated to, one organizational activity would be allocated 100% to that activity. Executive staff who oversee multiple projects are allocated based on estimates of time and effort for each organizational activity. The overall staff allocation percentages are compiled by the Finance Department into a schedule of labor allocation. This schedule is shared with ICANN's executive team for final review. As part of the fiscal year budget adoption, the schedule of labor allocation is approved by ICANN's executive management. An example of this schedule appears below.

Each month, as part of its internal monthly close process, Finance uses a negative confirmation process to confirm the labor allocation percentages. Periodic positive confirmations can be used as well to confirm that the results and process are as valid as possible. Department managers have the opportunity to modify the schedule of labor allocation for all staff under their supervision.

| | New gTLD | IDN | IANA | SSR | Contractual Compliance | Meetings | Constituency Support | Policy Development | Broaden Participation | DNS Ops | Overhead | Total Allocation |
|----------------|----------|-------|--------|--------|------------------------|----------|----------------------|--------------------|-----------------------|---------|----------|------------------|
| Staff Person A | 20.0% | 5.0% | | | | | | 25.0% | 25.0% | | 25.0% | 100.0% |
| Staff Person B | | 10.0% | | | | | | | 90.0% | | 0.0% | 100.0% |
| Staff Person C | | | 100.0% | | | | | | | | 0.0% | 100.0% |
| Staff Person D | 20.0% | | 80.0% | | | | | | | | 0.0% | 100.0% |
| Staff Person E | | | | | | | | | | | 100.0% | 100.0% |
| Staff Person F | | | 50.0% | | | | | | | 30.0% | 20.0% | 100.0% |
| Staff Person G | 20.0% | | | 80.0% | | | | | | | 0.0% | 100.0% |
| Staff Person H | 20.0% | | | 80.0% | | | | | | | 0.0% | 100.0% |
| Staff Person I | | | | 100.0% | | | | | | | 0.0% | 100.0% |
| Staff Person J | | | | | 100.0% | | | | | | 0.0% | 100.0% |
| Staff Person K | | | | | 80.0% | | | | | | 20.0% | 100.0% |
| Staff Person L | 30.0% | | | | | | | 50.0% | | | 20.0% | 100.0% |
| Staff Person M | | | | | | 100.0% | | | | | 0.0% | 100.0% |
| Staff Person N | | | | | | | 100.0% | | | | 0.0% | 100.0% |
| Staff Person O | 100.0% | | | | | | | | | | 0.0% | 100.0% |
| Staff Person P | 100.0% | | | | | | | | | | 0.0% | 100.0% |

3. Labor rate determination methodology

Labor rates are based on the total cost of all staff payroll, including base salary, overtime, bonuses, and time off with pay for all ICANN staff for a given fiscal year. This rate is grossed up by an expected fringe benefit rate that includes the total costs of employee benefits, workers compensation, payroll taxes, and other payroll costs. The total of all of these expected payments is then divided by the number of hours in a work year (usually 2,080 for full-time staff working the entire year) times the full-time equivalent employees expected in the fiscal year. This approach results in an average fully burdened hourly rate per employee. This labor rate multiplied by the labor allocations described earlier in this section result in the total labor costs for each organizational activity.

Periodically, and no less than once each year, this labor rate methodology is reviewed in detail to confirm that the averaging methodology does not skew results that might be realized if a more detailed, although possibly more burdensome, labor calculation were used.

4. Travel and meeting cost allocation methodology

ICANN allocates travel and meeting costs directly to an organizational activity when such costs for a specific travel assignment or meeting can be assigned to the specific organizational activity. For example, a staff member's travel costs for attending a new gTLD outreach meeting would be charged 100% to the gTLD program. Such allocations are determined by budget owners when travel and meeting-related invoices are reviewed and approved for payment.

Costs of core support for ICANN's international meetings is allocated based on analysis of the percentage of the agenda that is focused on each organizational activity.

All persons involved with the allocation processes for travel and meeting costs receive adequate training in the process to ensure that costs are correctly charged, applied, and included in the reporting.

5. Overhead rate methodology

Indirect costs are costs incurred for multiple or all organizational activities and therefore cannot be readily and specifically identified with one or a few specific activities. These indirect costs are grouped into a common overhead pool and distributed to all organizational activities based on the ratio of each activity's previously allocated costs to the total of allocated costs for all activities. An example of this allocation methodology follows.

| Example: Cost Pool to allocate \$1,500,000 | | | |
|--|--------------------------|-------------|------------------------------|
| Organizational Activity | Direct Activity Expenses | % | Amount Allocated by Activity |
| A | \$ 800,000.00 | 16% | \$240,000 |
| B | \$ 500,000.00 | 10% | \$150,000 |
| C | \$ 600,000.00 | 12% | \$180,000 |
| D | \$ 1,200,000.00 | 24% | \$360,000 |
| E | \$ 900,000.00 | 18% | \$270,000 |
| F | \$ 200,000.00 | 4% | \$60,000 |
| G | \$ 300,000.00 | 6% | \$90,000 |
| H | \$ 500,000.00 | 10% | \$150,000 |
| | | | |
| Total | \$5,000,000 | 100% | \$1,500,000 |

4. Cost Accounting Reporting Guidelines

Cost reports are prepared for internal review monthly. These reports are reviewed by executive management and included in the Dashboard presentations in unaudited format.

At least annually, cost reports are prepared more formally for the community. These reports include a report from an Independent Auditor based on agreed-upon procedures. The annual cost report includes information on the costs incurred, by organizational activity, for the fiscal year as well as inception-to-date costs incurred for specific programs such as for the new gTLD program. The annual cost report includes information related to forecasted costs-to-complete the program. The report also contains information on the exceptions noted in cost accounting processes.

The proposed report from the independent audit firm is to report on the results of an agreed upon procedures engagement. The agreed-upon-procedures report does not provide an opinion or negative assurance. Instead, the practitioner's report on agreed-upon procedures would be in the form of procedures and findings, and would discuss the exact procedures performed and the results of performing such procedures.

Samples of possible cost reports are presented in the Appendix.

5. Appendix: Sample of Possible Cost Accounting Reports

Sample of Costs for ICANN’s Organizational Activities Report Format

| | <u>FY10</u> <u>Actual</u> | <u>FY11</u> <u>Forecast</u> | <u>FY12 Est</u> <u>Budget</u> |
|--|------------------------------|--------------------------------|----------------------------------|
| New gTLD Implementation and Delegation | | | |
| IDN Implementation | | | |
| IANA and Technology Operations Improvements | | | |
| Security, Stability, and Resiliency Operations (SSR) | | | |
| Contractual Compliance | | | |
| Core Meeting Logistics | | | |
| Constituency Support | | | |
| Policy Development Support | | | |
| Global Engagement and Increasing International Participation | | | |
| DNS Operations | | | |
| Other Support Functions | | | |
| | 0 | 0 | 0 |
| | | | |

Sample of New gTLD Program Cost Analysis Report Format

| | Historical Costs up to program launch | Fyxx Applicant Processing Costs | Fyxx+1 Application Processing Costs | Estimate of costs to completion | Estimated Total Costs |
|---------------------------------------|---|---------------------------------------|--|---------------------------------------|--------------------------|
| Labor Costs | | | | | 0 |
| Outside Services | | | | | 0 |
| Panelists | | | | | 0 |
| Communications | | | | | 0 |
| Other | | | | | 0 |
| Travel and Meeting | | | | | 0 |
| Admin Support | | | | | 0 |
| | | | | | 0 |
| | 0 | 0 | 0 | 0 | 0 |
| Total # of Applications | | | | | xxx |
| Estimated Total Costs per Application | | | | | xxx,xxx |

| New gTLD program Financial Status | |
|--|---|
| Application Fees collected | 0 |
| Costs spent to date | 0 |
| Estimated costs to completion | 0 |
| Estimated Excess (shortfall) for program | 0 |