

# PROJECT DEVELOPER FORUM

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**From** martin.enderlin@pd-forum.net  
**Date** 14 October 2010  
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**Subject** **Call for public inputs on the possible introduction of the concepts of materiality and level of assurance in the clean development mechanism**

Honourable Members of the CDM Executive Board,  
Dear Mr. Mahlung,

The Project Developer Forum (PD Forum) welcomes the efforts by the Board and the Secretariat to develop a standard on the use of the concept of materiality and level of assurance in the CDM, which is in line with the mandate assigned by the CMP to the Executive Board (decision 2/CMP.5, Paragraph 22). The Project Developer Forum believes that the concept of materiality is not as difficult and complex as it might seem judging from all the attention it got and from what some confusing presentations given in the past might have left. Progress on the application of materiality will greatly facilitate the validation and verification process.

The Project Developer Forum would like to express its appreciation that the CDM EB has issued a call for public inputs on the possible introduction of the concepts of materiality and level of assurance in the clean development mechanism and is pleased to submit the following comments.

The Board requests input on the following:

(a) Threshold of the application of materiality

- Given that materiality is typically set by the intended user, it should be set by the UNFCCC. The DOEs can then apply this threshold in their work, ensuring that they meet the full requirements of the CDM process (especially the VVM).
- Without taking into account voluntary offset schemes the most advanced regulations in emissions trading markets can be observed within the two flexible mechanisms of the Kyoto Protocol (CDM and JI) and the EU Emissions Trading Scheme. Recently the EU-ETS applies materiality thresholds of 5 % for the verification at installations with annual emissions smaller than and 2 % for installations with annual emissions of more than 500 kt. This summer the JI Supervisory Board released guidance on materiality requiring thresholds of 5 % for projects with emission reductions of less than 100 kt and 2 % for all other activities. The draft standard under consideration by the CDM-EB indicates 0.5 % for large scale projects of more than 500 kt emission reduction per year, 2 % for activities with less emission reductions and 5 % for small scale activities. The PD Forum would appreciate efforts in order to harmonize these diverging thresholds, while on the other hand this divergence is not considered as a point for justifying a further delay on this development.

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- Furthermore it should be noted that the national inventories are based on a lower accuracy than those obtained through monitoring of individual projects or installations. The materiality thresholds proposed would ensure that the emission reductions from CDM are considered of sufficient accuracy for retirement by installations or national authorities.
- Please note that data verification is not only performed in the context of determining the achieved emission reductions, but also during validation, e.g. when assessing financial data to prove additionality. This kind of assessment can only deliver statements up to a certain but not absolute level of assurance. E.g. cost estimations which are usually done long before starting the implementation of an activity show in many cases some undetermined entries or refer to contingencies. Thus it is deemed necessary expanding the discussion also on other aspects than the verification of emission reductions (see also issue (b) below). For keeping the process as simple as possible without losing integrity the application of the same relative thresholds on materiality is recommended for all aspects that are not directly related to the amount of emissions or emission reductions.

(b) Scope of the application of materiality

- The application of the concepts of materiality and level of assurance should not only be limited to so-called non prescriptive requirements and the avoidance of overestimations by the use of conservative estimations. The reality in auditing is not always delivering a black and white picture based on undoubted and completely verifiable evidences. DOEs should be given the possibility to clearly express and explain such circumstances unlimited to the nature of requirements (prescriptive or non-prescriptive), the nature of data (e.g. financial vs. metered data) or the scope of assessment (validation and verification). Regulating verification and validation to every step of such activities will not be possible, as the more decisive element in such assessments is the technical expertise and experience of the auditing team which can not be replaced by a voluminous guidance delivering only prescriptive requirements. DOEs need to demonstrate their understanding and proper application of the concepts of materiality and level of assurance within the accreditation process. Thus it can be assured that the decision maker will not come to other decisions as recommended by “their extended arm”. Subjective differences in opinion cannot be fully avoided, a certain grey area reserved for personal judgment then and there needs to be allowed for and acknowledged by all parties.
- The need for objective evidence for all prescriptive CDM requirements sets a mostly-insurmountable hurdle to CDM activities in developing countries, let alone least developed countries (LDC) and therefore enhances the unbalanced regional distribution, even when considering the possibilities of requesting revisions or deviations of approved methodologies. In LDCs facts can rarely be proven by documentary evidences allowing a long-term review of technical or other developments. Any risks of misguided decisions shall be mitigated by the project proponents taking an accurate and - wherever accuracy is not possible or chosen for various reasons - a conservative approach. The DOE shall use its expert judgment to assess whether the approach taken by the project proponents to apply the requirement is accurate, if not accurate, conservative or shall enter into communication with the secretariat/EB (e.g. through a request a clarification), in order to ensure that decisions reported by the DOE will not be mistrusted during further steps of the registration process.
- The intended user (UNFCCC): should also apply materiality. There should be a level at which the intended user is satisfied that the DOE has detected and managed all errors, omissions or misstatements above the threshold.

(c) How to implement in practice the concept in CDM

- Considering the fact that the CDM is a “learning by doing” process, a bottom-up approach with practices to be introduced by the validating and verifying DOEs seems to be the most consistent

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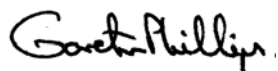
with the “learning by doing” process. It is confirmed by several remarks within the presented draft standard, too, that in principle it is already applied in many cases. What really needs to be introduced is the common understanding of the when the concept of materiality is applied and how it is applied by the DOEs and the acceptance of the CDM-EB in case the application is transparently presented. This could be delivered, as written, in a bottom-up approach, developed and presented by the DOEs in conjunction with the secretariat and consecutive revisions of the Validation & Verification Manual. Please see the list in annex 2, example 2, which shows possible aspects to be covered by first developments.

- All validation and verification reports should deliver information on all items which have been considered material including a justification for each item why they consider the underlying information in compliance with all applicable requirements. Introducing thresholds for data verification (emissions as well as for financial data) is supportive in this context, as it will enable the DOEs to define transparent cut-off points in their efforts to scrutinize the information provided by the project participants. The aim of this continuous improvement process should be a significant drop in incompleteness and review cases.
- Other aspects of existing guidance like issues on minor activity changes, consequences of minor or editorial errors identified during the completeness check, the acceptance of the sensitivity analysis as a step to deal with materiality and others could be dealt within the concepts of materiality and level of assurance. (e.g. EB54 para 69 requested the secretariat to prepare draft revisions to the guidelines to incorporate the examples of minor changes that could be dealt in the verification report, for its consideration.) Providing information by the DOE why they accept something, while proving that their recommendations are suitable and therefore should not be challenged by the EB, would form a desirable progress in the CDM.
- The concept of level of assurance as it should be applied in the CDM can only deliver a single result, namely that DOEs give statements about the compliance of activities at a reasonable level of assurance. The level of assurance is not considered as a variable which can be given as percentage, degree or whatsoever. A reasonable level of assurance places a firm requirement on DOEs to go to a detailed audit level rather than a lighter desk-based review. The VVM outlines requirements for the site visit and audit activities. Thus DOEs should issue their recommendations (on registration or issuance) at a reasonable level of assurance, demonstrating awareness of their capabilities and restrictions.

We also provided some direct comments on the phrasing of the draft standard (see annex 1) and some examples on bottom-up cases where a proper application of the concepts of materiality and level of assurance would be considered very helpful when resolving issues which are considered as dispensable obstacles (see annex 2).

We are looking forward to a promising discussion on this issue.

Kind regards,



Gareth Phillips  
Vice-chair of the PD Forum

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**Annex 1:**

**Direct Comments on the Phrasing of the Draft Standard**

- Definitions of prescriptive and non prescriptive CDM requirements, para 2 and 3  
Such definitions presume the unambiguousness of existing rules and regulations, which is not given. As stated in our letter we recommend avoiding such a rigid separation.

- note 2, para 5, "... to issue or not the CERs"  
The given strictness addressing even a single CER would close the door for transparently presented, conservative estimations (clear underestimations) even on minor aspects and thus incites DOEs to be over-conservative, which in turn increases transaction costs in terms of validation fees and delays, which suffocate especially smaller, more complex projects let alone projects in least developed countries.

- para 6, "... level of assurance .... defines degree...."  
There is no gradual decision by the DOE. Only a reasonable level of assurance can be given, as stated within our letter.

- note on page 2 "... the concept of materiality is taken into account in all CDM methodologies..."  
should be included after para 1

- there should be a new paragraph after para 6, describing the relationship between accuracy and conservativeness: "Accuracy refers to the degree of preciseness with which an information or value of a parameter can be determined. Different levels of accuracy have different implications on costs and practicality to prove a case. If for any reason, accuracy is not possible to the suggested level of detail, or a lower level of accuracy can deliver substantial cost savings, then conservativeness shall be applied in the assumptions to make up for the 'gap'. As an example, to prove biomass surplus in a region, one cannot count every single demand and every single offer. Conservative assumptions are therefore used which would be overstating the demand and understating the offer. Together with the conservative requirement to have 25% more offer than demand, the overall approach to ensure biomass surplus availability is appropriately accommodated.

- para 9 should be rewritten:  
"... shall be mitigated by the project proponents taking an accurate and - wherever accuracy is not possible/chosen for various reasons - a conservative approach. The DOE shall use its expert judgment to assess whether the approach taken by the project proponents to apply the requirement is accurate, if not accurate, conservative or shall request a clarification from the Board in case of doubt."

- Note 2 on page 3 needs to be rewritten:  
Note 2 refers to a "conservative approach" regarding "appropriate frequencies" of calibration of measurement equipment. This breaches impartiality of the DOE. The calibration requirements are set out in national legislation and/or equipment manuals. DOE's that assess "appropriate frequencies of calibration requirements" are out of scope and are also operating out of their field of expertise. It forces DOE into an advisory role, since they will have to both identify the "appropriate frequencies" and approve them. In our view application of materiality should in no way override national requirements, manufacturer requirements, and it should not force a DOE in a position in which it has to approve its own work.

- para 11 has to be rewritten:  
"... It is the responsibility of the DOE to confirm based on its local and sectoral expertise that the aggregated impact of the ignored information, taken as a whole for a CDM project, is not material." It is not appropriate to ask the DOE to provide objective evidence in many cases, as it simply does not exist. This part of the paragraph should therefore be deleted.

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**Annex 2:**

**Examples where the concept of materiality should be transparently applied and reported**

1. Minor or editorial errors identified during the completeness check with no impact on the project's qualification as a CDM project. Insufficient level of reporting is included in this category. Such issues should be dealt with by means of a simple on-the-record communication between the UNFCCC secretariat and the DOE i.e. a phone call followed up by revised documentation.

2. Minor changes/deviations from monitoring plans (compare EB54 para 69) that could be transparently presented in the verification report are as follows but not limited to:

- Calibration frequency
- Missing backup meters
- Numbers of meters and meter accuracy
- Meter location
- Shared main meter
- Diesel generator for hydros
- Model/parameters change of equipment (minor changes e.g. hydro turbine model number differences where the capacity is unchanged)

3. The following example demonstrates the urgency to apply the concept of materiality and common sense based on expertise: There is currently a review going on for a verification because the DOE did not request a design change because the stator diameter of the eventually installed generator is 5 cm shorter than foreseen in the PDD (ref. 2612, not our project): This issue is so minor, it can hardly be more minor. The DOE has transparently explained the issue in the verification report and again explained in the answer to the request for review. The review set a totally wrong signal in that DOEs are now afraid of applying any level of own judgment, which in turn stalls projects that are already at the borderline to be suffocated by transaction costs, without adding any value.

4. A parameter listed in the monitoring methodology which has no relevance in the emission reduction calculations or the environmental integrity of the project, could be assessed by the DOE in a transparent way for any inconsistency found in the monitoring of that parameter. There are concrete cases where projects apply for revision of the monitoring plan just to make sure that non-compliance with one such parameter has no affect on the emission reduction estimate and is acceptable to the EB.