

SUBMISSION FROM THE DOE/AIE COORDINATION FORUM TO THE CDM EXECUTIVE BOARD TO THE CALL FOR PUBLIC INPUTS ON THE POSSIBLE INTRODUCTION OF THE CONCEPTS OF MATERIALITY AND LEVEL OF ASSURANCE IN THE CLEAN DEVELOPMENT MECHANISM

Jonathan Avis
Chair, DOE/AIE Coordination Forum
15th October 2010

Mr Clifford Mahlung
Chair, CDM Executive Board

Dear Chair, Vice-Chair and Honourable Members of the CDM Executive Board,

The DOE/AIE coordination forum would like to thank the CDM Executive Board for the opportunity to comment publicly on the call for public inputs on the draft Standard on the use of the concept of materiality and level of assurance in the CDM.

The DOE/AIE Forum is very pleased that the Board is open to accepting the concept of materiality and warmly welcomes this draft Standard. The comments that we provide below are intended to support on-going dialogue and help the Secretariat and the Board to develop the concept and its application across the various elements of the CDM processes and decision points. The DOE/AIE Forum supports the inclusion of materiality and will be pleased to work with the Executive Board to help introduce the concept into the CDM.

It is relevant to the concept of materiality that CERs generated by the CDM are primarily designed to offset national inventories for Annex I countries with known reporting uncertainties, and are also transferred into trading schemes such as the EU Emissions Trading Scheme, which apply the concept of materiality.

Below we provide the following inputs, organised according to the specific questions raised by the Board.

- Threshold of the application of materiality
- Scope and application of materiality
- How to implement the practice in CDM

(a) Threshold of the Application of Materiality

Prescriptive requirements:

The current draft Standard does not allow for the application of materiality to prescriptive requirements. CDM is a compliance based system and eligibility of projects and conformance with procedures is essential to credibility and environmental integrity. The draft Standard has set out that 'any discrepancy in the application of a CDM requirement by the project proponents is material'. However, where there are minor problems that do not impact (eg) additionality or CER

volumes, delays to registration or issuance for otherwise good quality projects could be avoided without impacting environmental integrity, through allowing revision/deviation before the next monitoring period via a Forward Action Request. The DOEs would be able to provide the Executive Board with confirmation in its Opinion Statement that environmental integrity is not compromised and the request for registration or issuance by the DOE will still be reviewed and accepted or rejected by the Board; so this does not undermine the ability of the Board to ultimately control what it sees as material or necessary.

This is a more flexible approach than requiring deviations or revisions before every issuance. It also overcomes the potentially difficulty that there is currently no possibility to deviate from the methodology at the verification stage.

Non-prescriptive requirements:

Currently where the Board has not set a prescriptive requirement, it is already the case that the DOE must apply professional judgement and demonstrate in its report why the determination of emission reductions is appropriate and conservative (i.e. no over estimation of emission reductions). The draft Standard clarifies this and then sets thresholds at which an omission is deemed material.

It should be noted that the materiality levels suggested in the draft Standard are more stringent than those applied in other programs that are linked with CDM, such as EU ETS or JI. For example the EU-ETS applies materiality thresholds of 5 % for the verification at installations with annual emissions smaller than 500 kt and 2 % for installations with annual emissions of more than 500 kt. Earlier this year 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 large scale activities with less than 500 kt emission reductions and 5 % for small scale activities.

The expertise, knowledge and skills of the auditing team is important as guidance and procedures will not be able to foresee all situations. The level of assurance is not considered as a variable which can be given as percentage or degree, and it will not always be possible to quantify the level of assurance against these thresholds. The DOE/AIEs have experience of working in other schemes and would welcome the opportunity to discuss further how these threshold levels may be applied.

(b) Scope of the application of materiality

We believe that materiality should be applied at all stages of the CDM, including processes applied by the UNFCCC secretariat and the Executive Board. The resources of all parties involved in CDM are limited and it is not cost effective for the EB, UNFCCC Secretariat, DOEs and PPs to

be spending considerable time working on issues and delaying projects for issues that do not impact the project eligibility for registration or the number of CERs. Delays and apparent 'unreasonableness' deter participation in the CDM and may threaten its success.

Areas for consideration include:

- Methodology development and approval (it already is in the inclusion or exclusion of emissions sources based on their likely significance)
- Validation (e.g. auditing parameters set ex-ante, financial analysis - sensitivity analysis)
 - Assessment of compliance with prescriptive requirements (the materiality threshold could be set to zero % if the Board has concerns about this – see the suggestion under point (a) above.
- Verification
 - Requests for deviations and revisions
 - De minimis sources or omissions
 - Completeness and information check – issues having no or immaterial impact on emission reductions need not lead to incompleteness reviews
- Requests for review process – issues having no or immaterial impact on emission reductions need not lead to requests for review

As discussed above, applying materiality within the Secretariat's processes does not suggest that the rules are not followed, but can allow correction – for example via a Forward Action Request - rather than delay the issuance of CERs or registration of a project.

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

It is common auditing practice to apply the principle of materiality when designing the level of scrutiny of their assessment. However, this is currently not recognised by the VVM. In designing an audit plan the auditor establishes an acceptable materiality level so as to detect quantitatively material misstatements. Both the amount (quantity) and nature (quality) of misstatements need to be considered. Furthermore, materiality principles are already taken into account in methodologies since inclusion / exclusion of emission sources in methodologies is based on the principle of whether such sources are considered material.

DOEs support the definition of materiality that “*Any information is material if its omission or misstatement could influence the decision to register a project or to issuance CERs*”. We propose that EB should therefore accept that information that has an immaterial impact, or no impact, on emission reductions, is probably not relevant to that decision making. Introducing the concept of materiality in the CDM entails that one must accept the *possible occurrence* of misstatements or omissions, although the possible occurrence of misstatements or omissions is only accepted as long as these are not considered to be material and all known errors and omissions are corrected.

The DOEs propose that materiality is included in the CDM Validation and Verification Manual in order to formalise the requirements on how to apply materiality, ensure a harmonised interpretation of materiality across DOEs and reduce risk of subjectivity, and increase transparency. It must be acknowledged that application of materiality in audits relies on professional judgement and is not always fully quantifiable. The DOEs would like to emphasise that materiality is a relative concept that must be applied in the context of individual projects. Please also refer to the other suggestions made in point (a) above.

Also, categories of error or omission could be defined to determine how they must be treated and whether registration/issuance must be delayed. DOEs could be asked to confirm this categorisation and in certain circumstances to give an opinion on the impact of the issue on environmental integrity.

The Board could consider adopting the general concept of materiality, and allowing individual working groups to determine the detail in the various areas of the CDM where it may apply. Guidance/rules on materiality could be adopted in a stepped way, so that materiality guidance for non-prescriptive requirements could be adopted first, if such guidance relating to prescriptive requirements proves difficult to find agreement.

It will also be necessary to develop guidance for the UNFCCC secretariat to aid the application of materiality as a means of improving efficiency without compromising integrity.

We hope the above inputs are useful, and we look forward to providing further inputs or elaborating and clarifying these points if requested. Further workshops and/or dialogue would be welcomed.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Jonathan Avis', with a long horizontal flourish extending to the right.

Jonathan Avis
Chair, DOE/AIE Forum (CDM)

15th October 2010