PROJECT DEVELOPER FORUM

Head and Members of the JI Supervisory Committee
Mr. Benoit Leguet
Chairman
UNFCCC Secretariat
Martin-Luther-King-Strasse 8
D 53153 Bonn
Germany

Project Developer Forum Ltd.
100 New Bridge Street
UK London EC4V 6JA

Mailing address:
Schulstrasse 25
CH 3256 Dieterswil BE

t: +44 20 3286 2520
office@pd-forum.net
www.pd-forum.net

CHAIRMAN

Your contact:
Martin Enderlin
m: +41 79 459 81 18
martin.enderlin@pd-forum.net

To	ji-info@unfccc.int
From	martin.enderlin@pd-forum.net
Date	26 March 2010
Page	1/4
Subject	**Response to the call for public input on materiality and changes during project implementation**

Dear Mr. Leguet,
Honorable Members of the JISC,

Further to our submission to JISC 20 regarding materiality, we would like to formally respond to the call for public input on materiality and changes during project implementation.

Materiality

Para 19 of Annex I to the Annotated Agenda to JISC 20 raises three questions with regards to materiality, which we will address in turn below:
(a) To which processes in the JISC verification procedure should the concept of materiality apply?
(b) What level of assurance is required?
(c) What materiality level should be used?

General

We are pleased to see that the JISC recognizes that these concepts of materiality are used regularly by Accredited Independent Entities (AIEs) even though there is no official guidance within JISC documentation. We support the statement in the annex that AIEs, through their accreditation should be trusted to handle audit risks based on their professional judgment as auditors.

Materiality is an important concept of auditing. In order to express an opinion on data or information, an auditor needs to form a view on the materiality of all unidentified errors or uncertainties. A materiality threshold provides guidance to auditors on what constitutes a material discrepancy, so that they can concentrate their work on areas that are more likely to lead to materially misleading errors[1]. In the case of JI projects, these are errors that could cause the assessment to provide the wrong conclusion on whether or not to award ERUs to the project[2]. Materiality is important to both stages of JI auditing, determination and verification.

We consider that in the medium term the most appropriate document to define the JI requirements for materiality thresholds would be the DVM. However in the short term an ordinary decision by the JISC would be sufficient to give AIEs the mandate to begin using the materiality thresholds.

[1] http://www.ghgprotocol.org/standards/corporate-standard
[2] http://www.climatetrust.org/documents/OQICDMpaper_webversion.pdf

Above all, we ask the JISC to provide clarity regarding the use of the concept of materiality, and practicality in the levels of materiality and assurance.

(a) Processes to which the concept of materiality should apply

We believe the concept of materiality should be applied to determination and verification. In addition, we believe the concept is also applicable to changes during project implementation. Such changes are often outside the control of project participants, and are not foreseen or foreseeable at the time of developing the project or the submission for registration. A PDD is written during the design and feasibility stages and determination will normally occur before commissioning. Changes to meters, equipment, etc. sometimes occur as part of the construction and commissioning process and this should be recognised by any guidelines set out by the JISC. Although design changes are an inevitable part of project development, they are controllable and as such environmental integrity can still be safeguarded while adopting a more business-friendly approach, for example by means of a bottom-up positive list of design changes that can be scrutinized and "acknowledged" by the verifying AIE. We would like to emphasise a practical approach to handling changes of this nature.

(b) The level of assurance required

Whilst we recognize that it is the role of AIEs, as professional certification companies, to suggest the level assurance, we believe that reasonable assurance is in line with normal business practice. A greater level of assurance is not practical and leads to unnecessarily long determination and verification processes, and long lists of irrelevant documentation being reviewed by the AIEs, which all increase the costs and delays and therefore reduce the incentives for investment in JI projects.
The level of assurance should be related to the significance or importance of evidence to the proof of a statement, and the significance or importance of that statement. So for example, meter readings proving flow rates for the major source of GHG emissions are highly significant and should be verified with a high level of assurance – which would include inspection of calibration and maintenance documentation. Meter readings for a known minor source of emissions may be accepted at face value because even if the meter is not correctly calibrated, the impact will be negligible.

(c) The level of materiality

Whilst we recognize that it is the role of AIEs, as professional certification companies, to suggest quantitative materiality thresholds, we support the proposal made by the DOE/AIE Forum to the CDM EB for dual materiality thresholds depending on the size of the emissions reductions: 5% for projects below 100,000 tCO_2e emission reductions per year, and 1% for projects above 100,000 tCO_2e emission reductions per year. The threshold percentage is in comparison to the total amount of annual emission reductions estimated or brought about by a project activity; thus, for example, all projects reducing 40,000 tCO_2e per year would have the same absolute threshold of 2,000 tCO_2e, while a project reducing 300,000 tCO_2e per year would have an absolute threshold of 3,000 tCO_2e.

It must be understood that a materiality threshold of for example 5% does NOT mean that only 95% of the emissions are verified and 5% are "approved for free". It means that AIEs have some discretion over the level of supporting evidence that they are required to verify in relation to sources of emissions (or emission reductions) that amount to a maximum of 5%. In the event that 3 major sources account for 97% of emissions and 27 sources account for the remaining 3%, the AIE would focus their effort on the 3 major sources and probably verify the emissions from a sample of the remaining 27 sources. If they found errors in this sample, they would sample more. In the event that there are 10 sources, each accounting for 10% of emissions, then each source must be verified to a high level of assurance.

Notwithstanding the above suggestions, AIEs should always be aware of bias when applying materiality thresholds. It would normally be expected that materiality issues would act to increase and decrease emissions, to some extent cancelling out. AIEs should be sensitive to situations where materiality thresholds always act in favour of the client.

The materiality threshold also has implications for metering systems. All meters have inherent uncertainty and for important sources of emissions, more expensive meters should be used to minimize the uncertainty. However, for small sources of emissions, it is not necessary to require highly accurate meters, not because the source itself is not important, but because the difference between for example 0.5% accuracy and 2% accuracy on that source is not important. For example, in a facility with emissions of 100,000 tonnes per annum, a source accounting for 1% if emissions will emit 1000 tonnes. The difference between a meter which reads to 0.5% accuracy and 2% accuracy is on average, 15 tonnes, which is 0.015% of the total emissions. Consequently, the accuracy of meter used to monitor this source is completely immaterial.

As well as these quantitative thresholds, we also suggest that the concept of qualitative materiality be introduced to JI procedures when referring to the more descriptive elements of a PDD or monitoring plan (this therefore relates directly to the second issue of this call for public input and is also discussed below). We propose that this could be a bottom-up approach to establish a materiality threshold for recurring issues. As an example, when using a CDM methodology for JI project development, the procedures could clarify that a monitoring plan revision is not necessary for small and insignificant changes such as (i) meter location, (ii) meter calibration, (iii) and meter accuracy change, as long as the new circumstances are still in line with relevant national regulations and the CDM methodology. Any unforeseen changes not in the applied list would need to be assessed by the DOE ex-post in order to assess their significance.

Correct application of materiality will not impact upon the environmental integrity of JI projects: The correct application will reduce the likelihood of incorrect rejection of project activities (because it will help to ensure that non-material issues are not taken out of proportion and used as a reason to reject a project). At the same time, it will not increase the likelihood of incorrect registration of projects because the materiality concept is not applicable to major issues. These are assessed with or without the application of materiality.

Ultimately, the level of materiality under JI has no impact on the environmental integrity of the Kyoto Protocol, as all host parties have Quantified Emission Reduction and Limitation Commitments. However, we do agree that the level of materiality needs to be defined, and propose the levels above, to support the credibility and usability of Joint Implementation.

Project changes

Para 42 of Annex I to the Annotated Agenda to JISC 20 raises three questions with regards to changes during project implementation, which we will address in turn below:
(a) What are the specific responsibilities of the AIE with respect to verifying that the project was implemented according to plan?
(b) If the AIE finds that changes were made relative to the original project design document, what changes (and magnitude of changes) should be considered significant?
(c) If significant changes are found, how should the AIE proceed?

General

We believe that the concept of materiality is also important when dealing with the issue of changes during project implementation, as described above. In general, we would propose that the JISC follows the same procedures as already applied by the CDM Executive Board, to avoid duplications of procedure development and streamlining for market participants.

(a) AIE responsibilities

While we expect the project participants to inform the AIE of changes, it will be the responsibility of the AIE to verify whether any changes have occurred. If changes have occurred, the AIE should determine whether these changes are significant.

From experience under the CDM procedures for changes during project implementation, we can indicate that it will be important to clarify that the AIE is not requested to perform a complete new determination of the project, but that the AIE is limited to determination of the changes and the impact of these changes on the project. Under the CDM procedure, some DOEs are tending to carry out a complete new validation of the whole project, which is very time consuming and is not required according to the CDM guidelines.

(b) Significant changes

Changes are often outside the control of project participants, and are not foreseen or foreseeable at the time of developing the project or the submission for registration. Changes to meters, equipment, etc. sometimes occur as part of the construction and commissioning process and this should be recognised by any guidelines set out by the JISC. Although design changes are an inevitable part of project development, they are controllable and as such environmental integrity can still be safeguarded while adopting a more business-friendly approach, for example by means of a bottom-up positive list of design changes that can be scrutinized and "acknowledged" by the verifying AIE. We would like to emphasise a practical approach to handling changes of this nature.

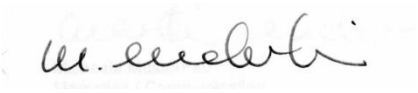
In addition, PPs could be invited to extend the range of sensitivity analysis performed in the PDD to accommodate potential changes in the project activity. These alternative scenarios could be presented in an annex to the PDD, and include an extension of the additionality analysis. In the event that such changes do materialise, and to the extent that they have already been presented in an annex, the PDD would not need to go through a re-determination.

In determining whether changes are significant, the concept of materiality should be applied. Many changes will be small changes and even large changes may not have any material impact on the additionality of the project, on the environmental integrity of the decision to register the project, nor on the reductions that can be achieved. The same thresholds as discussed above should be applied.

(c) Action upon significant changes

We believe that the CDM guidance may be used for the action upon finding significant changes.

Kind regards,



Martin Enderlin
Chair of the PD Forum