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Subject **Call for Public Inputs on Materiality**

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Honorable Members of the SBSTA,

As requested in the Further Guidance relating to the Clean Development Mechanism from CMP6 in Cancun last year<sup>1</sup>, the PD Forum would like to take this opportunity to comment on the issue of materiality.

The issue of materiality can be made as complex or simple as one wishes and we do not mean to repeat here what we have said during our earlier submissions on this subject<sup>2</sup>. Rather, we wish to highlight the following key points:

- Materiality is an auditing-guiding concept similar to, for example, the auditing principals of transparency or conservativeness. The concept of materiality's role is to align measurement and assessment costs with potential impacts of an un-detected error. Note: materiality is not intended to be a carte blanche to allow for already detected errors.
- The concept of materiality therefore is about the acknowledgment of significant versus non-significant issues and of major versus minor issues. This is a reality that DOEs carrying out validations and verifications of CDM projects are confronted with on a daily basis.
- Materiality is about the errors that are not found by an auditor (such as the DOE during validation/verification or the secretariat during the completeness check and information and reporting check). Materiality requires that the audit should be designed in such a way that any errors that are not detected by the auditor will, on aggregate, be below a certain pre-defined 'materiality threshold.' This materiality threshold could be expressed as a percentage of the CERs generated by the project or as an absolute number of CERs, but it must be defined by the CMP or the EB (as regulators of the CDM). If during a verification or validation a DOE does find any errors the response to such errors should be proportionate to the impact of the error to avoid unnecessary transaction costs, for example if an issue is so insignificant as to be *de minimis* it may not be necessary to report on it.

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<sup>1</sup>[http://unfccc.int/files/meetings/cop\\_16/conference\\_documents/application/pdf/20101204\\_cop16\\_cmp\\_guidance\\_cdm.pdf](http://unfccc.int/files/meetings/cop_16/conference_documents/application/pdf/20101204_cop16_cmp_guidance_cdm.pdf)

<sup>2</sup> See for example the PD Forum submissions to the CDM Executive Board on this subject in October 2010 (available at <http://www.pd-forum.net/files/06db835862fd06369226097983ac009f.pdf>) and May 2009 (<http://www.pd-forum.net/files/8255be617608c097fa44995f9dfe5512.pdf>) and presentations by the DOE Forum.

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- Therefore, in addition to applying the concept of materiality, a professional opinion needs to be given to determine whether an issue that is detected is major or minor (whether its impact will be significant or insignificant) and this opinion needs to be given by experts. We believe that given the level of qualification, training and practical experience that is required of DOEs to undertake validations and verifications of CDM projects, that accredited DOEs have the expertise needed to give this professional opinion..
- The distinction between minor and major issues, significant and non-significant issues is context-specific and evolving. The concept is already present in certain guidance, procedures and methodologies. For example para 77 of the VVM Version 01.2<sup>3</sup> requires that the validation report contains *“information regarding greenhouse gas emissions ... which are expected to contribute more than 1% of the overall expected average annual emission reductions, which are not addressed by the applied methodology”*. By this text, DOEs are instructed to report on omitted sources which they expect (in their professional opinion) to account for more than 1%; and by inference, they are not required to report on sources which they expect will account for less than 1%. An omitted source accounting for less than 1% of total emissions, based on the auditor’s professional opinion can be ignored *because it is too small to matter*.
- The provision of appropriately trained DOEs via the accreditation standard and an open system with checks and balances and the involvement of the wider community guarantee that environmental integrity remains preserved. In other words, there is no direct threat to the environmental integrity of the CDM because of a wider application of the concept of materiality.

In light of the comments above, we suggest the following text is presented by SBSTA as a draft decision on this matter for adoption by the Conference of the Parties at its seventh session;

*“The SBSTA requests that the EB and the Secretariat introduce the concept of materiality as much as possible in its work on guidance to DOEs on the validation and verification of CDM projects, procedures, methodology revisions and new methodologies. This includes the introduction and definition of a materiality threshold. Through this work, the EB and Secretariat should aim to ensure that transaction costs associated with validating CDM project activities and monitoring and verifying emission reductions is in proportion with the potential impacts of errors thereby reducing unnecessary workload while still preserving the environmental integrity of the CDM.*

*The SBSTA acknowledges that DOEs are best placed to interpret guidance from the CDM Executive Board on this matter and make the assessment as to whether an issue is material or not. SBSTA further acknowledges the importance of appropriately trained DOEs via the accreditation standard and an open system with checks and balances and the involvement of the wider community in guaranteeing that the environmental integrity remains preserved”.*

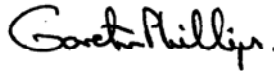
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<sup>3</sup> [http://cdm.unfccc.int/Reference/Manuals/accr\\_man01.pdf](http://cdm.unfccc.int/Reference/Manuals/accr_man01.pdf)

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Once again, we appreciate the opportunity to comment on this issue and remain available for further discussions on this and other issues essential to the efficient operation of the CDM.

Kind regards,

A handwritten signature in black ink that reads "Gareth Phillips". The signature is written in a cursive, slightly slanted style.

Gareth Phillips  
Chairman, Project Developer Forum