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Issues relating to the clean development mechanism

**Recommendation of the Executive Board of the clean
development mechanism on a procedure for addressing
significant deficiencies in validation, verification or
certification reports***

Summary

This document contains a recommendation by the Executive Board of the clean development mechanism (CDM) in response to a mandate contained in decision 8/CMP.7 to revise the draft procedure to address significant deficiencies in validation, verification and certification reports, for adoption by the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol at its eighth session. It describes a draft procedure for assessing and attributing liability for significant deficiencies in validation, verification or certification reports that are caused by the professional negligence or fraud of a designated operational entity (DOE) and provides a process for correcting those significant deficiencies. The procedure also prescribes the administrative steps to be followed by DOEs and others, including the CDM Executive Board and UNFCCC secretariat, in making or responding to a submission identifying potential significant deficiencies.

* This document was submitted after the due date in order to include information on the reporting period stipulated by the Conference of the Parties serving as the meeting of the Parties to the Kyoto Protocol at its second and third sessions.

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I. Introduction

1. The purpose of this procedure is to:
 - (a) Provide a fair and transparent process for assessing and, where applicable, attributing liability for significant deficiencies in validation, verification or certification reports that are caused by a designated operational entity's (DOE) professional negligence or fraud;
 - (b) Provide a process for correcting significant deficiencies in validation, verification or certification reports that are confirmed by the review team;
 - (c) Enhance the overall transparency and environmental integrity of the clean development mechanism (CDM).

II. Scope and applicability

A. Scope

2. This procedure prescribes the administrative steps to be followed by DOEs, other stakeholders, the CDM Executive Board (the Board), the review team, the secretariat and the independent review committee in making or responding to a submission identifying potential significant deficiencies in validation, verification or certification reports.

B. Applicability

3. This procedure shall apply only to validation, verification, or certification reports that are submitted on or after the date that this procedure enters into force.
4. Subject to paragraph 3 above, a review of potential significant deficiencies in a validation, verification, or certification report(s) shall only be initiated under this procedure if the relevant report(s) was submitted not more than three (3) years before the date of the submission identifying potential significant deficiencies in the relevant report(s).
5. This procedure does not apply to cases of excess issuance of certified emission reductions (CERs) resulting from erroneous inclusion of component project activities (CPAs) in a programme of activities (PoA). The "Clean development mechanism project cycle procedure" shall apply to such cases

C. Entry into force

6. This procedure enters into force on 1 January 2013.

III. Terms and definitions

7. A significant deficiency means, with regard to validation, verification, or certification report(s), a breach of the CDM accreditation, validation and verification rules or requirements applicable at the time of the submission of the validation, verification or certification report(s), which has resulted in:

(a) A positive validation opinion where, if the breach had not occurred, a negative validation opinion would have been given; and/or

(b) More CERs having been or intended to be issued to the registered CDM project activity or PoA than would have been or would be issued if the breach had not occurred, but excluding the number of excess CERs that fall below the materiality threshold as applied by the DOE, if any, in the relevant report(s) in accordance with the CDM rules and requirements.

8. The standard of professional care expected of a DOE when performing services for a client is the standard of skill, learning and diligence prescribed by the “CDM accreditation standard for operational entities” and the skill and care which is ordinarily exercised by professionals in good standing in the auditing profession who are experienced in validating, verifying and certifying CDM activities and practicing in the same or a similar locality under similar circumstances.

IV. Principles of liability for excess issuance of certified emission reductions

9. Where the review of potential significant deficiencies determines that there are no significant deficiencies, no liability or costs of the review undertaken in accordance with section VI. below shall be imposed on the DOE that was the subject of the review.

10. Where the significant deficiencies in any previous validation, verification or certification report(s) are a result of the professional negligence or fraud of a DOE that performed the validation, verification or certification, the DOE shall be liable for the excess issuance of CERs in accordance with section VII. below.

11. In the case of a significant deficiency arising from an incorrect parameter, determined ex ante at validation, used in the emission reduction calculations, it is the validating DOE that is liable and not the verifying DOE. However, for a significant deficiency in a monitoring plan, where a verifying DOE is also responsible for correcting an incorrect parameter, it is the verifying DOE that is liable.

V. Initiation of review

A. Identification of potential significant deficiencies

12. The following parties may make a submission identifying potential significant deficiencies in previous validation, verification or certification report(s):

(a) The Board and/or the secretariat during the assessment or review of a request for registration of a proposed CDM project activity or PoA, or a request for issuance of CERs carried out in accordance with the “Clean development mechanism project cycle procedure”;

(b) The CDM Accreditation Panel during the review of an assessment of a DOE conducted by a CDM assessment team in accordance with the “Procedure for accrediting operational entities by the Executive Board of the clean development mechanism”;

(c) Another DOE with respect to the validation or previous verification of a CDM project activity or PoA for which it is carrying out a verification and certification activity;

(d) Any designated national authority (DNA) that has authorized a project participant in a CDM project activity or PoA;

(e) The DOE that originally produced the validation, verification or certification report; or

(f) Another stakeholder.

13. A submission setting out the potential significant deficiencies identified via paragraph 12(c)–(f) above shall be submitted to the secretariat through a dedicated interface on the UNFCCC CDM website, using the form F-CDM-COMP together with sufficient supporting documentary evidence. The submission shall be treated as confidential and shall not be made public.

14. For submissions received from another stakeholder per paragraph 12(f) above, a refundable fee of USD 10,000 per submission shall be lodged with the secretariat at the time of submission. The submission shall not be processed in accordance with paragraph 16 below until payment has been received by the secretariat.

15. In the case of self-declaration by the DOE referred to in paragraph 12(e) above, the submission shall contain any relevant corrected validation, verification or certification reports and any relevant monitoring reports and attached spreadsheets that it deems necessary, as well as a quantification of any excess issuance of CERs that may have occurred as a result of the significant deficiencies in the relevant validation, verification or certification reports.

B. Preliminary investigation and recommendation on review

1. Preliminary investigation

16. Within 28 days of the receipt of identification of potential significant deficiencies, the secretariat shall prepare a summary of the facts and evidence relating to the submission (ensuring that the confidentiality of sources of information is preserved), and provide it to the DOE that prepared the validation, verification or certification reports regarding which the submission is made. The DOE shall have 28 days to provide a response to the secretariat's summary. The deadline may be extended up to 90 days from receipt of the secretariat's summary upon the request of the DOE providing reasons.

17. Within 14 days of receipt of the response from the DOE, or, if no such response is received, within 14 days of the end of the 28-day period in which the DOE may respond, the secretariat shall conduct an analysis of the submission based on the information held by the secretariat (including documentary evidence supplied by third parties) and taking into account any response provided by the DOE and shall determine one of the following courses of actions:

(a) No action is required because the information provided and the response from the DOE do not support the possible existence of potential significant deficiencies. In this case, the secretariat shall proceed in accordance with paragraph 18 below;

(b) No review is required because the DOE has admitted potential significant deficiencies. In this case, the secretariat shall proceed in accordance with paragraph 19 below; or

(c) A review is required because the information provided in the submission and the response from the DOE support the possible existence of potential significant deficiencies. In this case, the secretariat shall proceed in accordance with paragraphs 20 and 21 below.

2. No action required cases

18. Where the secretariat determines that no further action is required, the secretariat shall prepare a summary of findings of the analysis together with a recommendation of no further action. The secretariat shall submit the summary of findings and the recommendation to the Board for approval. If no member of the Board objects to the summary of findings or the recommendation within 20 days, they shall be deemed accepted by the Board.

3. DOE admission cases

19. In the cases of DOE admission referred to in paragraph 12(e) above and where the response from the DOE under paragraph 16 above admits the existence of significant deficiencies and the documents referred to in paragraph 15 above have been provided, the secretariat shall assess the information provided by the DOE and prepare a summary of findings of the assessment, together with a recommendation that corrective action be taken in accordance with section VII. below. The secretariat shall submit the summary of findings and the recommendation to the Board for approval. If no member of the Board objects to the summary of findings or the recommendation within 20 days, they shall be deemed accepted by the Board.

4. Review required cases

20. Where the secretariat determines that the existence of potential significant deficiencies warrants a review, the secretariat shall prepare a summary of findings, together with a recommendation to initiate a review, and a scope of review, which includes:

(a) The proposed membership of the review team¹ that shall undertake the review of potential significant deficiencies;

(b) The relevant validation, verification and certification reports to be examined by the review;

(c) A summary of the facts and supporting evidence (ensuring that the confidentiality of sources of information is preserved) for each potential significant deficiency in previous validation, verification or certification reports;

(d) A summary of the CDM requirements in effect at the time of each potential significant deficiency and any interpretation of them applied to the facts;

(e) If possible, an estimate of any excess issuance of CERs that may have occurred as a result of the potential significant deficiencies.

21. The secretariat shall submit the summary of findings, recommendation and scope of review to the Board for approval. If no member of the Board objects to the summary of findings, recommendation and the scope of review within 20 days, they shall be deemed accepted by the Board.

5. Board objections

22. If a member of the Board objects to the summary of findings and the recommendation, or the scope of review, received in accordance with paragraphs 18, 19 or 21 above, he/she shall notify the Chair of the Board through the secretariat, giving reasons

¹ The review team shall be drawn from experts who collectively have the necessary competences with regard to accreditation requirements, validation and verification requirements, methodological requirements, knowledge of the local context of the projects in question, legal requirements and shall be selected in accordance with a "Terms of reference for a significant deficiency review team".

in writing. The secretariat shall acknowledge receipt of the objection and make it available to the Board.

23. If a member of the Board objects to the summary of findings, the recommendation or the scope of review more than 14 days prior to the next Board meeting, the summary of findings, the recommendation or the scope of review shall be placed on the agenda of the next Board meeting; otherwise it shall be placed on the agenda of the subsequent Board meeting.

24. At the Board meeting at which the matter is placed on the agenda, the Board shall decide whether to initiate a review, and if so, shall decide the scope of review.

VI. Review of potential significant deficiencies

A. Assessment of significant deficiencies

25. Following the Board's decision to initiate a review and approval of the scope of review of significant deficiencies in previous validation, verification or certification reports, the secretariat shall do the following:

(a) Establish the review team to undertake the review of potential significant deficiencies;

(b) Notify the project participants and the DOE of the initiation of review;

(c) Make publicly available the Board's decision to initiate the review on the UNFCCC CDM website;

(d) For cases where a validation report is the subject of the scope of review, suspend the issuance of CERs for the relevant CDM project activity or PoA.

26. Within 28 days of the date of notification of the initiation of review of potential significant deficiencies, the DOE shall provide written responses to each potential significant deficiency in each relevant validation, verification or certification report as detailed in the scope of review. Such response may include:

(a) Clarification or rebuttal of the summary of the facts (including submission of any additional facts and documents) and the interpretation of the facts by the DOE that apply to the potential significant deficiency; and/or

(b) Clarification or rebuttal of the CDM requirements in effect at the time of each potential significant deficiency and the interpretation of them by the DOE applied to the facts.

27. Within the 28-day period for the DOE to provide responses to the scope of review of potential significant deficiencies, the DOE may request the review team, by email through a dedicated email address, to make a telephone call to it to provide clarifications on the issues identified if they are not sufficiently clear to it. In this case, the DOE shall provide the contact details of the person to be called with preferred time slots. The review team shall fix a call appointment within three (3) days of receipt of the request. The secretariat shall record the call.

28. Within 28 days of receipt of the response from the DOE, the review team shall prepare an assessment report on the potential significant deficiencies in the context of the scope of review, the CDM requirements applicable to the project activities that were available at the time that the validation, verification and certification reports were submitted, and taking into account the responses of the DOE.

29. If, during the assessment, the review team requires further clarification or information from a party involved in the validation or verification activity, it shall ask the party to submit a response addressing the required clarification or provide the requested information. The party shall respond within 28 days to the review team after receiving such request. If the review team receives a response from the party, it shall, notwithstanding the provision in paragraph 28 above, finalize the assessment report within 14 days of receipt of the requested clarification or information. If no such response is received, the review team shall finalize the assessment report within 14 days following the end of the 28-day period in which the party was requested to respond.

30. If, during the assessment, the review team identifies that the assessment requires input from a relevant panel or working group, it shall request the secretariat to place the matter on the agenda of the next meeting of the panel or working group. In this case, the review team shall, notwithstanding the provision in paragraph 28 above, finalize the assessment report within 14 days of receipt of the input from the panel or working group.

31. If, during the review, the review team forms the opinion that an extension of the deadline is required for the assessment, or receives a request from the DOE for an extension of the deadline for a response referred to in paragraph 26 above, it shall submit a request for a specified extension of the deadline to the Chair of the Board, explaining the reasons for the request. The Chair of the Board shall grant the extension unless he/she is of the opinion that the reasons are unjustified.

32. The assessment report shall include the findings and recommendations from the review and the reasons and rationale for the findings and recommendations, including, but not limited to:

- (a) A proposed decision to be taken by the Board;
- (b) The facts and any interpretation of the facts by the review team that formed the basis of the proposed decision, including a determination of the reasons (including whether any significant deficiency was caused by professional negligence or fraud) and responsibility for the significant deficiencies in previous validation, verification or certification report(s);
- (c) The CDM requirements applicable to the significant deficiencies in effect at the time of the submission of the request for registration or issuance of CERs and any interpretation of them applied to the facts;
- (d) A summary of any corrections required to be made by the DOE in the validation, verification or certification report(s) in question as well as any relevant monitoring report(s) and attached spreadsheets;
- (e) A quantification of any excess issuance of CERs that has occurred as a result of the significant deficiencies in the relevant validation, verification or certification reports.

B. Consideration of assessment of significant deficiencies

33. The secretariat shall forward the review team's assessment report to the DOE. The DOE shall have 14 days to submit, in writing, any objections to the findings or recommendations of the assessment report. If the DOE has raised any objections to the findings or recommendations of the assessment report it shall be given an opportunity for a hearing at a Board meeting before any decision is made by the Board. The secretariat shall forward the assessment report together with any written objections received to the Board, and shall place the matter on the agenda of the next available Board meeting.

34. If no objection to the findings or recommendations of the assessment report has been received in accordance with paragraph 33 above, the secretariat shall submit the assessment report to the Board for approval. If no member of the Board objects to the findings of the assessment report within 20 days, the assessment report shall be deemed accepted by the Board.

35. If a member of the Board wishes to object to the findings or recommendations of the assessment report, he/she shall accordingly notify the Chair of the Board through the secretariat, giving reasons in writing. The secretariat shall acknowledge receipt of the objection and make it available to the Board.

36. If a member of the Board objects to the findings or recommendations of the assessment report more than 14 days prior to the next Board meeting, the matter shall be placed on the agenda of the next Board meeting; otherwise it shall be placed on the agenda of the subsequent Board meeting.

37. At the Board meeting for which the matter is placed on the agenda, the Board shall decide whether:

(a) If presented, to accept the argument(s) of the DOE that certain or all of the significant deficiencies identified in the assessment report do not exist and that corrections to the validation, verification or certification reports are not necessary in total or in part. In this case, the Board may request the review team to re-calculate the quantity of excess CERs taking into account the Board's decision to accept the argument(s) of the DOE; or

(b) To accept the assessment report's finding that no significant deficiencies were identified and no further action is required; or

(c) To accept the assessment report's finding that confirms that significant deficiencies exist and the assessment report's recommendations, and to authorize the secretariat to implement the provisions in section VII. below; or

(d) To request the review team to clarify or expand on any aspect of the assessment report that the Board deems necessary in order for it to make a decision.

38. The review team shall complete any further work required by the Board within 14 days and submit a revised assessment report to the Board for consideration at the next available Board meeting. At that Board meeting, the Board shall make a decision in accordance with paragraphs 37(a)–(c) above.

VII. Consequences arising from finding of significant deficiencies

A. Independent review

39. A DOE may request an independent review of the Board's decision, made in accordance with paragraph 38 above, within 28 days of the publication of the Board's decision in the relevant meeting report, by following the provisions in section VIII. below. Independent review applications received after this date shall not be considered.

40. The secretariat shall not act to implement any corrective action or compensation directions against a DOE if the secretariat receives an independent review application from that DOE within the deadline set out in paragraph 39 above.

B. Corrective action and compensation

41. If the independent review application period has expired and no complete independent review application has been received, or the Board has made a second decision following an independent review, in accordance with the decision made under paragraphs 19, 34, or 37 above or paragraph 57 below, the secretariat shall do the following:

(a) Direct the DOE responsible for the occurrence of the significant deficiencies to make all necessary corrections to the validation, verification or certification report(s) as outlined in the assessment report (including where the significant deficiency is not a result of the professional negligence or fraud of the DOE);

(b) Require the DOE responsible for the occurrence of the significant deficiencies, as a result of the professional negligence or fraud of the DOE, to transfer an equivalent amount of emission reduction units (ERUs), CERs, assigned amount units (AAUs) and/or removal units (RMUs) equal to the excess CERs issued into the cancellation account in the CDM registry within 90 days or another time frame decided by the Board taking into account the circumstances of each case;

(c) If applicable, resume issuance of CERs for the project activity or PoA for which significant deficiencies were ultimately not determined or for which corrections to the validation, verification or certification report(s) have been made in accordance with subparagraph (a) above to meet CDM requirements.

C. Additional consequences

42. The Board shall decide, either at the meeting referred to in paragraph 37 above, or at the next available Board meeting after the decision is made in accordance with paragraph 34 above, whether:

(a) To suspend the accreditation of the DOE in accordance with the “Procedure for accrediting operational entities by the Executive Board of the clean development mechanism” (CDM accreditation procedure) where the significant deficiencies in the validation, verification or certification report(s) are due to fraud by the DOE; and/or

(b) No future issuances of CERs for the project activity or PoAs shall be allowed where the review and correction of the significant deficiencies in the validation have led to a positive validation opinion changing to a negative validation opinion.

43. The secretariat shall publish a summary of the Board’s final decision on the review, and any corrected validation, verification or certification reports on the UNFCCC CDM website.

D. Failure to comply with secretariat’s direction

44. If a DOE fails to respond to a scope of review within 28 days in accordance with paragraph 26 above, or fails to comply with the directions under paragraph 41(a) and (b) above, the Board shall suspend the accreditation of the DOE in accordance with the CDM accreditation procedure until such time as it complies.

E. Costs of review

45. A DOE found to be responsible for the significant deficiencies as a result of professional negligence or fraud shall bear the costs of conducting the review.

46. A fee paid in accordance with paragraph 14 shall be refunded if the Board decides to initiate a review of significant deficiencies.

VIII. Independent review of decision by the Board

A. Establishing an independent review committee

47. An independent review committee shall be established by the Board.

48. The independent review committee shall be a standing committee of three persons drawn from a pool of experts, each of whom shall have the necessary legal competencies, and collectively shall have the necessary technical and auditing competencies, in accordance with the “Terms of reference for the significant deficiency decision independent review committee”.

B. Independent review application request

49. Any review application made by a DOE shall be submitted to the secretariat through a dedicated interface on the UNFCCC CDM website. The independent review application shall include a duly completed “Independent review of significant deficiencies decision form” (F-CDM-IRSDD).

50. The secretariat shall not forward an independent review application to the independent review committee if it appears to the secretariat that the independent review application form is not complete.

51. If the independent review application form is not complete, the secretariat shall notify the DOE by email, explaining what needs to be completed. The DOE may resubmit an independent review application that is complete provided that such submission is made within the deadline set out in paragraph 39 above.

52. Within seven days of receipt of a complete independent review application, the secretariat shall forward it to each of the independent review committee members, together with the following documents, and notify the Board that such an application is being forwarded to the independent review committee:

- (a) A copy of the review team’s assessment report;
- (b) A copy of any written objections submitted by the DOE in accordance with paragraph 33 above;
- (c) A copy of the Board’s decision.

C. Process for managing independent review

1. Review by the independent review committee

53. The independent review committee shall consider the documents provided to it and decide how the independent review is to be dealt with, in accordance with the “Rules of procedure of the independent review committee”.

54. In considering how the independent review shall proceed, the independent review committee:

- (a) May request additional information or documents from any person or body that was involved in, or affected by, the original review;
- (b) Shall schedule not less than one and not more than two hearings at the United Nations campus in Bonn, Germany, and shall invite each of the following parties:
 - (i) The DOE and/or its approved representative(s);
 - (ii) The affected project participant(s);
 - (iii) The review team;
 - (iv) If required by the independent review committee, the Chair and/or Vice-Chair of the Board and/or a nominated representative(s) of the Board;
 - (v) A representative(s) of the secretariat;
- (c) Shall request the secretariat to ensure that all documents that the independent review committee consider in relation to the independent review are made available to the applicant DOE in advance of the hearing;
- (d) (Shall allow both oral and written statements from parties invited to the hearing;
- (e) May, after the hearing, make recommendations based on its assessment of the documents and the hearing; or schedule a further hearing. After the further hearing, if any, the independent review committee shall make recommendations based on its assessment of the documents and the hearings.

2. Independent review committee recommendations

55. In making its recommendations, the independent review committee shall decide whether to:
- (a) Concur with the Board's decision that is the subject of the review; or
 - (b) Recommend that the Board reconsider the decision that is being reviewed, providing reasons for such recommendation.

D. Reconsideration of the decision by the Board

56. If the independent review committee recommends that the Board reconsider the decision more than 14 days prior to the next Board meeting, the matter shall be placed on the agenda of the next Board meeting; otherwise it shall be placed on the agenda of the subsequent Board meeting.
57. At the Board meeting for which the matter is placed on the agenda, the Board shall reconsider the original decision taking into account the recommendations of the independent review committee and shall make a final decision.
58. The Board's decision taken in accordance with paragraph 57 above is final and no further review shall be allowed.
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