

Abatement Crediting and Purchasing under the Emissions Reduction Fund

Clean Energy Regulator

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Senior Executive Director
Corporate Management Branch
Australian National Audit Office
19 National Circuit
BARTON ACT 2600

Or via email:

communication@anao.gov.au.



Canberra ACT
12 September 2016

Dear Mr President
Dear Mr Speaker

The Australian National Audit Office has undertaken an independent performance audit in the Clean Energy Regulator titled *Abatement Crediting and Purchasing under the Emissions Reduction Fund*. The audit was conducted in accordance with the authority contained in the *Auditor-General Act 1997*. I present the report of this audit to the Parliament.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's website—<http://www.anao.gov.au>.

Yours sincerely



Grant Hehir
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

AUDITING FOR AUSTRALIA

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For further information contact:
Australian National Audit Office
GPO Box 707
Canberra ACT 2601

Phone: (02) 6203 7300
Fax: (02) 6203 7777
Email: ag1@anao.gov.au

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<http://www.anao.gov.au>

Audit Team

Grant Caine
Meg Byrne
Jessica Carroll
Mark Simpson

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Summary and recommendations

Background

1. The Government established the Carbon Farming Initiative in September 2011 under which entities associated with the agricultural, forestry and legacy waste (landfill) emissions sectors of the economy could register projects and earn credits for every tonne of carbon abated. In November 2014, the Government expanded the Carbon Farming Initiative to form the \$2.55 billion Emissions Reduction Fund (the fund)—allowing the registration of projects from all sectors of the economy and to purchase Australian Carbon Credit Units¹ (primarily at auction) earned by projects to meet Australia’s greenhouse gas reduction targets.² Projects already registered under the Carbon Farming Initiative transitioned automatically to the fund on its commencement on 13 December 2014.

2. The Department of the Environment and Energy (the department) is primarily responsible for the policy settings under which the initiative/fund³ operates and the development and approval of methods (which are applied by projects seeking registration under the fund).⁴ The Clean Energy Regulator (the regulator) is responsible for the administration of the fund, including:

- registering projects after undertaking assessments of project applicants and applications;
- verifying the carbon abatement claims of registered projects before issuing carbon credit units to project proponents; and
- purchasing credited and/or prospective carbon credit units from registered projects (through auctions).

3. As at 1 July 2016, the regulator has reported that it has registered over 600 projects, credited over 25 million carbon units and conducted three auctions (of which the first two were examined in this audit). The three auctions have resulted in contracts for the purchase of 143.3 million carbon credit units over the next 10-12 years from successful bidders at a cost of \$1.7 billion (representing 68 per cent of the \$2.55 billion fund).

4. The department reported in April 2016 that Australia is expected to surpass its 2020 cumulative abatement target by 78 million tonnes of carbon dioxide-equivalent, with the fund contributing an estimated 92 million tonnes.

1 One Australian Carbon Credit Unit (ACCU) equates to one tonne of carbon dioxide-equivalent (one tCO₂-e) of abatement.

2 Australia’s current greenhouse gas reduction target is five percent below 2000 emissions by 2020. Beyond 2020, Australia has committed to reduce greenhouse gas emissions by 26-28 per cent on 2005 levels by 2030.

3 For the purposes of this audit, references to fund projects cover both initiative and fund projects unless otherwise specified.

4 Initiative/fund methods (46 as at May 2016) outline project requirements and how carbon abatement is to be calculated for the various project types.

Audit approach

5. The objective of the audit was to assess the effectiveness of the Clean Energy Regulator's crediting and selection of carbon abatement to purchase under the Emissions Reduction Fund. To form a conclusion against this objective, the ANAO adopted the following high-level criteria:

- Did the regulator only register projects that met relevant legislative requirements?
- Did the regulator issue the correct quantity of carbon credit units to registered projects after verifying the claims from project proponents?
- Did the regulator design and implement the first and second auctions to purchase carbon credit units from eligible projects at least cost?
- Did the regulator appropriately manage the risks, operation and performance of the abatement crediting and purchasing components of the fund?

Conclusion

6. The Clean Energy Regulator has established sound arrangements to manage the crediting and selection of carbon abatement for purchase under the Emissions Reduction Fund. There are some aspects of the regulatory process that, nonetheless, require further attention—such as the level of documentation underpinning some areas of regulatory decision-making—to enable the regulator to better demonstrate the effectiveness of its regulatory activities.

Supporting findings

Registration of projects

7. The regulator appropriately assisted applicants to submit complete fund *Project Registration Applications*. In those cases where initial applications contained errors, ambiguities or insufficient information, the regulator effectively followed-up with applicants.

8. Applications for fund project registration and variation have been effectively assessed by the regulator, but documentation of some regulatory processes and decisions could be improved. In accordance with the design principles of the fund and the regulator's risk appetite, streamlining arrangements have been introduced that have significantly reduced third-party data checks for many fund *Project Registration Applications*. Under these arrangements, the regulator has developed and implemented sound practices and processes to assess applications for fund project registration and variation. Improved documentation of the regulator's consideration of the criteria for streamlined routine assessment and some project eligibility requirements would better position the regulator to demonstrate the basis on which registration decisions had been made.

9. The regulator has, in the main, applied sound processes to approve, declare and register fund projects in accordance with legislated timeframes. The decision minutes, while reflecting accurately the assessments undertaken, did not always contain all information relevant to the assessment process.

Assigning carbon credit units to projects

10. The regulator appropriately determined whether fund projects met their reporting obligations. Fund proponents submitted *Certificate of Entitlement Applications* (which provide the information on which the regulator undertakes its assessment), as well as supporting documentation, including *Project Offsets Reports* and independent *Audit Reports* (where required). These materials were also provided at intervals in accordance with legislated timeframes.

11. Appropriate arrangements are in place to assess the carbon abatement claims of fund projects against fund method requirements. The regulator's *Audit Report* assessments determined that, in the main, reliance could be placed on the conclusions regarding proponents' carbon abatement claims. The regulator's detailed assessments of *Certificate of Entitlement Applications/Project Offsets Reports* satisfactorily addressed most of the assessment requirements, including those outstanding from project registration (which can include regulatory approvals and eligible interest holder consents). The justification for, and documentation supporting, streamlined routine assessments (determined on a risk basis) requires improvement to enable the regulator to demonstrate the robustness of these assessments.

12. Where the delegate approved the *Certificate of Entitlement Applications*, carbon credit units assigned to projects have been accurately calculated according to fund method requirements and recorded in public registers. While sound processes have been established by the regulator to approve, issue and register the correct quantity of carbon credit units to fund projects, the material prepared for the decision-makers did not always contain all information relevant to the required decision on whether to approve or refuse a *Certificate of Entitlement Application*. In addition, the decision minutes for applications undergoing routine assessments should more clearly indicate to the decision-maker the level of assurance that these assessments provide.

Identifying carbon credit units to purchase

13. Within the context of the legislated purchasing principles of the fund, the regulator effectively designed the auction methodology, parameters and delivery arrangements for the first two carbon abatement auctions that were examined in this audit.

14. For the first two auctions, the regulator created appropriate awareness of the process and established effective arrangements to inform potential auction participants of the requirements for participation and their rights and obligations if they were successful.

15. Overall, the first and second auctions were conducted effectively and in accordance with published auction guidance. The conduct of each auction was overseen by an external probity advisor engaged by the regulator.

16. The regulator selected the least-cost abatement to purchase within the established auction parameters. The fulfilment of carbon abatement contracts will be dependent on the satisfaction of conditions precedent, the abatement credited to the projects over time and the effectiveness of the 'make good' provisions of the contracts.

Governance of crediting and purchasing activities

17. The regulator has a well-established and integrated risk management framework to guide the development and implementation of risk management plans for the fund. Under this framework, the regulator has established sound processes to identify, assess and treat risks to the effective implementation of the fund.

18. The regulator has developed appropriate guidance, including standard operating procedures, work instructions and templates, to assist staff to assess fund *Project Registration Applications, Certificate of Entitlement Applications/Project Offsets Reports* and auction applications. The development of a register of fund standard operating procedures, templates and assessment tools would better position the regulator to monitor the accuracy and currency of its guidance materials.

19. The regulator has an established performance management framework to monitor and report on fund performance, with work to strengthen the framework undertaken over recent years. To date, the regulator has been monitoring and publicly reporting on the performance of the earlier initiative and the fund against activity based performance indicators. Since 2015–16, the regulator has enhanced key performance indicators to meet performance reporting requirements under the regulator’s Emissions Reduction Fund Blueprint, its Corporate Plan, its Portfolio Budget Statements, and the Regulator Performance Framework.

Recommendation

Recommendation No.1

Paragraph 3.14

The Clean Energy Regulator should ensure that appropriate documentation is retained to demonstrate the rationale for undertaking routine or detailed assessments of abatement crediting applications and that all relevant abatement crediting assessment criteria have been addressed during streamlined assessments.

Clean Energy Regulator response: *Agreed.*

Summary of entity response

20. The Clean Energy Regulator’s summary response to the proposed report is provided below, with the full response provided at Appendix 1.

The Clean Energy Regulator welcomes the ANAO’s report. We are pleased that, after a thorough sampling and review of our files related to both the original Carbon Farming Initiative (CFI) and the Emissions Reduction Fund (ERF), the ANAO has found that the arrangements and processes implemented by the Clean Energy Regulator are sound. We note that this assessment has been conducted on the basis of processes in place for the first four years of the two schemes. Our schemes and processes continue to mature, as does our approach to the management of risk and identification of potential non-compliance.

From the beginning, the agency designed its end to end controls and standard operating procedures for the ERF to ensure both compliance with the legislative purchasing principles and to ensure an appropriate balance between scheme risk and client burden. We believe that our controls encourage high levels of participation in the scheme, while ensuring that risks are managed appropriately. The CER has the ability, both in law and in practice, to step in at any time to ensure the integrity of the ERF scheme and purchasing process. We communicate extensively to

ensure that our clients understand their obligations and have the necessary information to comply accordingly. We have specific processes and tools to ensure that any non-compliance is addressed quickly and effectively, often before it occurs or before a risk can manifest.

Of course, we are always alert to opportunities to mature our processes and respond quickly and appropriately when issues arise. We accept the single recommendation which focusses primarily on the opportunity to improve record keeping around decision making in the crediting part of the scheme. We are already working on this important measure and are confident that our changes will ensure even more robust and transparent administration of the ERF.

Our priority to date has been to manage a very large increase in applications to register projects, conducting auctions and managing the resulting contracts and delivery schedules. We now have 631 registered projects—450 of which were registered under the ERF, with the balance (181) registered during the CFI. Those projects have resulted in 309 contracts for more than 142 million tonnes of abatement at a contracted value of \$1.7 billion. The stock of projects and contracts under our management will continue to rise over time. As projects deliver, a rapidly increasing proportion of our work will be in the crediting part of the scheme. We will engage with these changes, reallocate our resources as appropriate, and regularly review our risk appetite and our processes to ensure voluntary participation is high and risk of non-compliance is low.

Audit Findings

1. Background

Introduction

1.1 Successive Australian Governments have committed to reduce Australia’s greenhouse gas emissions under the United Nations Framework Convention on Climate Change and undertaken a variety of actions to deliver on these commitments.

1.2 In 2011, the Government introduced a carbon pricing mechanism that required Australia’s biggest carbon emitters to pay a price for their emissions. To complement the carbon pricing mechanism, the Government also established the Carbon Farming Initiative in September 2011 under the *Carbon Credits (Carbon Farming Initiative) Act 2011* (the CFI Act). Under this initiative, entities associated with the agricultural, forestry and legacy waste (landfill) emissions sectors of the economy could register projects and earn credits for every tonne of carbon abated. These credits could then be sold to entities with liabilities under the carbon pricing mechanism.

1.3 The Government repealed the carbon pricing mechanism with effect from July 2014 and, by legislative amendment in November 2014, expanded the Carbon Farming Initiative to form the Emissions Reduction Fund (the fund)—allowing the registration of projects from all sectors of the economy.

1.4 Under the fund, the Government committed \$2.55 billion over 10 years to 2023–24 for the purchase of carbon Australian Carbon Credit Units (ACCUs⁵) (primarily at auction) earned by projects to be used to meet Australia’s greenhouse gas reduction targets.⁶ The Government also introduced changes to streamline the scheme and a safeguarding mechanism (to discourage large emitters from increasing their emissions above historical levels) commenced in July 2016. Projects already registered under the Carbon Farming Initiative transitioned automatically to the fund on its commencement on 13 December 2014.

1.5 The Department of the Environment and Energy (the department) is primarily responsible for the policy settings under which the initiative/fund⁷ operates and the development and approval of methods (which are applied by projects seeking registration under the fund).⁸ The Clean Energy Regulator (the regulator) is responsible for the administration of the fund, including:

- registering projects after undertaking assessments of project applicants and applications;
- verifying the carbon abatement claims of registered projects before issuing carbon credit units to project proponents; and
- purchasing credited and/or prospective carbon credit units from registered projects (through auctions).

5 One ACCU equates to one tonne of carbon dioxide-equivalent (one tCO₂-e) of abatement.

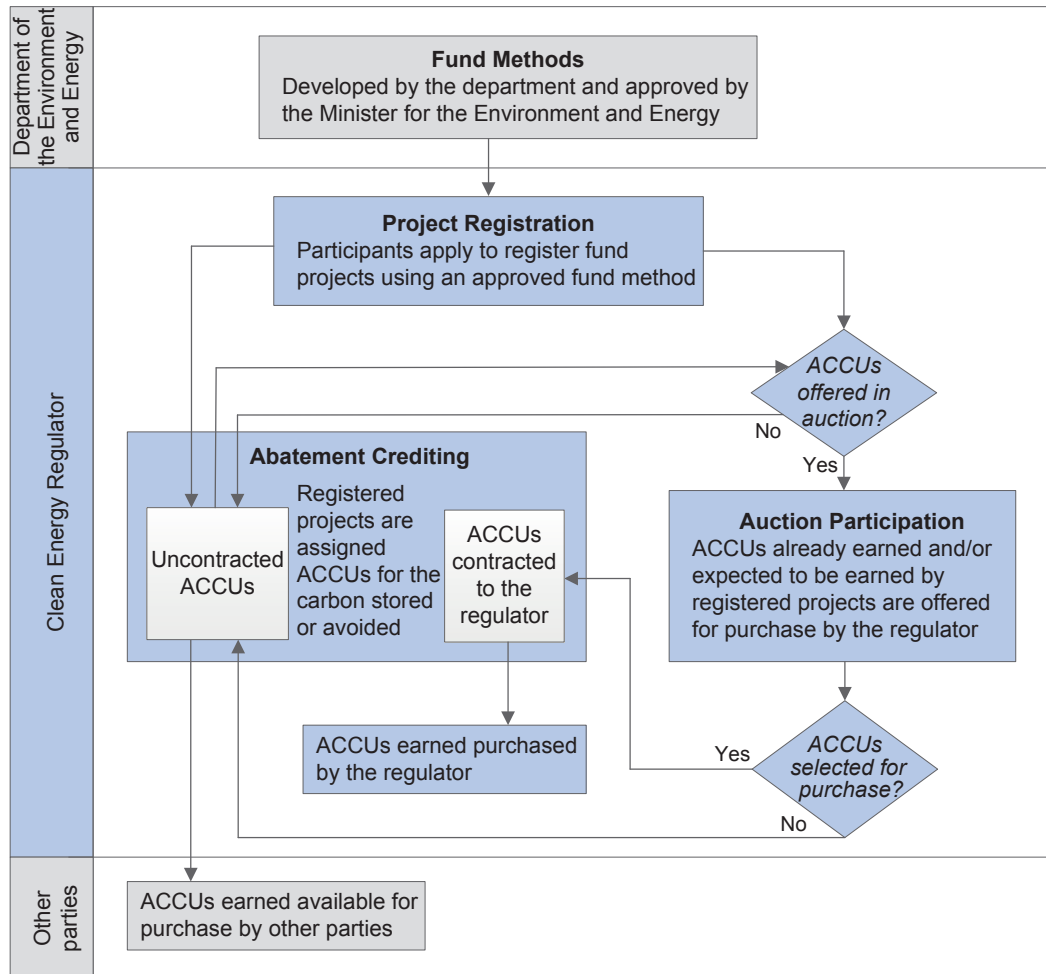
6 Australia’s current greenhouse gas reduction target is five percent below 2000 emissions by 2020. Beyond 2020, Australia has committed to reduce greenhouse gas emissions by 26–28 per cent on 2005 levels by 2030.

7 For the purposes of this audit, references to fund projects cover both initiative and fund projects unless otherwise specified.

8 Initiative/fund methods (46 as at May 2016) outline project requirements and how carbon abatement is to be calculated for the various project types.

1.6 An overview of the fund’s abatement crediting and purchasing components is provided in Figure 1.1. Under the fund, registered projects can participate in auctions in advance of, or after, earning credit units for the carbon abated. The regulator only pays proponents of registered projects selected at auction for carbon credit units that have been earned. Carbon credit units not contracted to the regulator can be sold on the secondary market to enable other entities to meet their carbon abatement obligations.

Figure 1.1: Overview of the fund’s abatement crediting and purchasing components



Source: ANAO analysis of regulator information.

Emissions Reduction Fund implementation

1.7 As at 1 July 2016, the regulator has reported that it has registered 626 active fund projects⁹, 236 of which have been credited with a total of 25.4 million carbon credit units. The

9 Excludes nine projects that were revoked at the request of the project proponents after registration.

number of projects and carbon credit units issued by methods grouped by industry or theme is outlined in Table 1.1.

Table 1.1: Active fund projects and carbon credits issued, as at 1 July 2016

Method Group	Registered Projects		Carbon Abatement		
	No. of Methods ⁽¹⁾	No. of Projects	No. of Methods ⁽¹⁾	No. of Projects	ACCUs issued (tCO ₂ -e)
Vegetation and Sequestration	12	344	12	106	11 866 309
Landfill & Alternative Waste Treatment	6	125	8	91	10 990 724
Savanna Burning	2	70	2	32	2 316 874
Agriculture	4	32	2	7	182 454
Energy Efficiency	6	38	-	-	-
Transport	2	7	-	-	-
Industrial Fugitives	1	10	-	-	-
Total	33	626	24	236	25 356 361

Note 1: After project registration, some project proponents volunteered to apply an updated method, while others have not.

Source: ANAO analysis of regulator information.

1.8 To date, the regulator has conducted three auctions (of which the first two were examined in this audit) and contracted to purchase 143.3 million carbon credit units over the next 10-12 years from successful bidders at a cost of \$1.7 billion (representing 68 per cent of the \$2.55 billion fund). Carbon credit units have been purchased at the first, second and third auctions at an average price of \$13.95 per tonne, \$12.25 per tonne, and \$10.23 per tonne respectively. The number of projects and carbon credit units contracted at auction by method group is outlined in Table 1.2.

Table 1.2: Carbon credit units contracted at the first three auctions

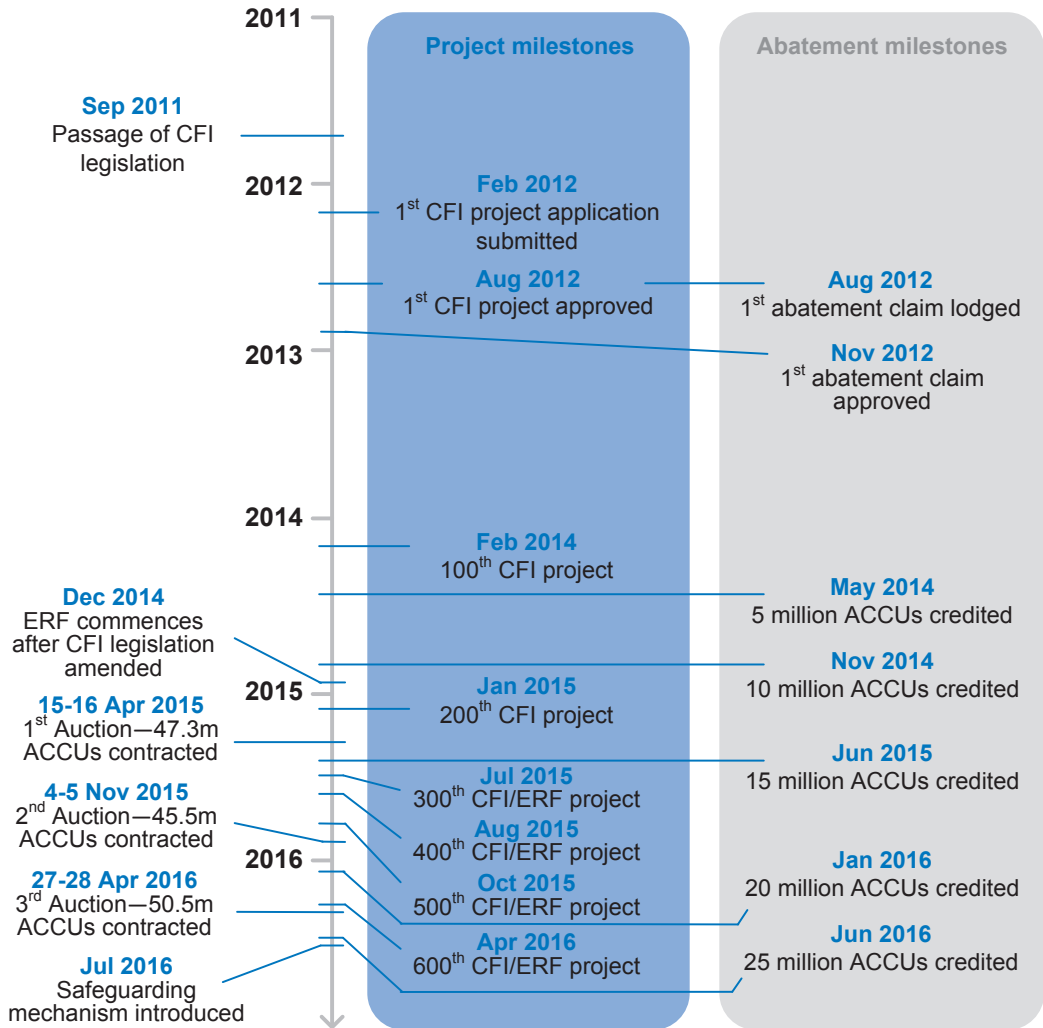
Method Group	Auction—April 2015		Auction—Nov 2015		Auction—April 2016	
	No. of Projects	ACCUs contracted (million tCO ₂ -e)	No. of Projects	ACCUs contracted (million tCO ₂ -e)	No. of Projects	ACCUs contracted (million tCO ₂ -e)
Vegetation and Sequestration	68	25.7	71	25.6	46	47.2
Landfill & Alternative Waste Treatment	64	16.6	12	3.6	10	1.6
Savanna Burning	2	0.5	33	6.6	12	0.9
Agriculture	9	4.4	6	4.1	2	0.3
Energy Efficiency	-	-	5	3.7	3	0.5
Transport	1	0.2	2	1.1	-	-
Industrial Fugitives	-	-	2	0.8	-	-
Total⁽¹⁾	144	47.3	131	45.5	73	50.5

Note 1: The total number of ACCUs contracted may not add correctly due to rounding.

Source: ANAO analysis of regulator information.

1.9 The key milestones for the initiative and fund are outlined in Figure 1.2.

Figure 1.2: Carbon Farming Initiative and Emissions Reduction Fund timeline



Source: ANAO analysis of regulator information.

1.10 In December 2015, the Government indicated in *Australia’s Second Biennial Report* under the United Nations Framework Convention on Climate Change that the fund and other policies have ‘put [Australia] on track to meet [its] 2020 emissions reduction target’.¹⁰ The Department of the Environment and Energy subsequently reported in April 2016 that Australia is now expected

10 Commonwealth of Australia, *Australia’s Second Biennial Report*, Joint Ministerial Forward, p. 1.

to surpass its 2020 cumulative abatement target by 78 million tCO₂-e, with the fund contributing an estimated 92 million tCO₂-e.¹¹

Audit approach

1.11 The objective of the audit was to assess the effectiveness of the Clean Energy Regulator's crediting and selection of carbon abatement to purchase under the Emissions Reduction Fund. To form a conclusion against this objective, the ANAO adopted the following high-level criteria:

- Did the regulator only register projects that met relevant legislative requirements?
- Did the regulator issue the correct quantity of carbon credit units to registered projects after verifying the claims from project proponents?
- Did the regulator design and implement the first and second auctions to purchase carbon credit units from eligible projects at least cost?
- Did the regulator appropriately manage the risks, operation and performance of the abatement crediting and purchasing components of the fund?

1.12 The audit examined the regulator's administration of initiative and fund projects in relation to their registration, abatement crediting and participation in the first two auctions by examining a 10 per cent sample of the respective populations (as at the closing date for registering fund projects to enable their participation in the second auction—27 October 2015). The audit did not examine the determination of fund methods by the department, the contracting of proponents successful at auction; compliance monitoring and enforcement activities; or the fund's safeguarding mechanism.

1.13 In conducting the audit, the ANAO examined regulator records relating to the administration of the fund, including standard operating procedures, assessment tools, implementation strategies and plans, and other governance documentation. The ANAO also interviewed regulator staff and sought comments on the regulator's administration of the fund from project proponents and peak industry groups.

1.14 The audit was conducted in accordance with the ANAO's Auditing Standards at a cost to the ANAO of approximately \$462 000.

11 Department of the Environment, *Tracking to 2020—April 2016 update*, pp. 1 and 3.

2. Registration of projects

Areas examined

The ANAO examined activities undertaken and processes employed by the Clean Energy Regulator (the regulator) to register projects under the Carbon Farming Initiative (the initiative) and the Emissions Reduction Fund (the fund), including the: guidance provided to prospective applicants; assessment of project applicants and applications; and approval and declaration of registered projects.

Conclusion

The regulator has established sound processes to obtain from applicants the information necessary to effectively undertake the assessments required under the *Carbon Credits (Carbon Farming Initiative) Act 2011* (the CFI Act). Those *Project Registration Applications* that were assessed as meeting requirements were approved by the delegate for registration under the fund. While the proof of identify and fit and proper person assessments have been undertaken satisfactorily, the project assessments did not always include documented consideration of all relevant criteria.

In accordance with the design principles of the fund and the regulator's risk appetite, risk-based project assessment streamlining was introduced from April 2015. The streamlined assessment process has reduced the extent of third-party data checks undertaken by the regulator during the registration process for the majority of projects. By introducing these less-intensive routine assessments, the regulator has acknowledged, and accepted, the increased risk that applications that do not meet requirements are registered (although additional assessments are undertaken before registered projects benefit from being assigned carbon credit units). There would be merit in the regulator documenting the basis on which projects were assessed as meeting the criteria for streamlined assessment and undertaking the planned review (which is now overdue) of streamlining measures to determine their effectiveness in improving efficiency and managing risk.

Areas for improvement

To strengthen project registration arrangements, the regulator should: reinforce to staff the need for project assessments and decision minutes to document the assessors' consideration of all relevant assessment criteria; and routinely reconcile the public *Fund Project Register* and the regulator's Client Records Management (CRM) System to ensure the register's currency and accuracy.

Did the regulator provide appropriate guidance on registering potential projects under the fund?

The regulator appropriately assisted applicants to submit complete fund *Project Registration Applications*. In those cases where initial applications contained errors, ambiguities or insufficient information, the regulator effectively followed-up with applicants.

2.1 The regulator has developed *Project Registration Application* and *Client Information* forms for the fund that, when completed accurately, elicits the necessary information regarding applicants' projects to be appropriately assessed for fund registration. In cases where errors or

ambiguities arise, or insufficient information has been provided, the regulator has effective processes in place to follow-up with the applicants. The prevalence of errors in application forms has reduced markedly following the replacement of hard-copy application forms with electronic smart forms from mid-2015. The use of smart forms has also reduced the time required by the regulator to assess applications.

2.2 Since 2014, the regulator has conducted annual client communication surveys to build an understanding of clients' perceptions of its overall performance, staff performance, regulatory burden and preferred channels of communication. The results from the 2015 survey of clients who identified as participating in the earlier initiative or the fund were positive, but with some areas identified for improvement such as the provision of education, training and information to assist proponents to comply with their obligations.

Did the regulator effectively assess applications for fund project registration/variation?

Applications for fund project registration and variation have been effectively assessed by the regulator, but documentation of some regulatory processes and decisions could be improved. In accordance with the design principles of the fund and the regulator's risk appetite, streamlining arrangements have been introduced that have significantly reduced third-party data checks for many fund *Project Registration Applications*. Under these arrangements, the regulator has developed and implemented sound practices and processes to assess applications for fund project registration and variation. Improved documentation of the regulator's consideration of the criteria for streamlined routine assessment and some project eligibility requirements would better position the regulator to demonstrate the basis on which registration decisions had been made.

Project Registration Application and Client Information forms

2.3 Those *Project Registration Application* forms and *Client Information* forms (when required) submitted to the regulator have, in most cases, been completed correctly by applicants. After taking into account responses to any requests for further information from the regulator, 74 of the 87 *Project Registration Applications* and variations (85.1 per cent) examined by the ANAO¹² were completed in full by applicants. While legal right and regulatory approval omissions were explicitly addressed during the application assessment process, the records retained by the regulator do not indicate whether other omissions had been addressed during the assessment process. The *Client Information* forms (which can include more than one form per project) were completed in full by applicants in relation to 23 of the 26 *Project Registration Applications*

12 The ANAO selected a sample of 87 processed applications and variations (and supporting assessment documentation) comprising 61 project registration applications and 26 subsequent variations to the registration of the selected projects. The 61 project registration applications (from a population of 608 applications processed by the regulator as at the closing date to register projects to enable their participation in the second auction—27 October 2015)—10 per cent of the population—was broadly selected in proportion with 13 key parameters, including the: date of application submission; project method; application assessor; decision delegate; and assessment result.

(88.5 per cent) examined by the ANAO where the regulator was required to establish the identity of the applicants (the remaining three applications were substantially complete).¹³

Proof of identity/fit and proper person assessment

2.4 The regulator can only register projects under the fund for applicants that can establish their identity and pass the fit and proper person test specified in the CFI Act.

Establishing proof of identity

2.5 Proof of identity testing required by the CFI Act involves the regulator's examination of the personal details/business information and certified copies of common forms of identity documentation provided by fund applicants (which for individuals can include birth certificates, passports, drivers' licenses and for body corporates includes certificates of incorporation/registration). In relation to all 26 *Project Registration Applications* examined by the ANAO where the applicants were not existing scheme participants, the regulator verified that the proof of identity information and documentation supplied by the applicants met the requirements of the CFI Act.

Fit and proper person testing

2.6 The CFI Act requires project applicants to undergo a fit and proper person assessment for their projects to be registered as eligible fund projects, unless the applicants have already been assessed as meeting the fit and proper person requirements.

2.7 Since April 2015, the regulator has adopted triaging arrangements for the fit and proper person assessments to determine whether a detailed or routine assessment would be undertaken. Fund applicants not meeting the criteria for routine assessment are to undergo a detailed assessment, including third-party data checks. Those fund applicants that meet at least one of six specific criteria¹⁴ undergo a routine fit and proper person assessment that involves an assessment of the applicants' assertions in their *Client Information* forms only. The regulator has acknowledged that, by undertaking routine assessments, it has accepted the risk (which it has assessed as low) that some participants that do not meet the fit and proper person requirements will be assessed as meeting those requirements.

2.8 Of the 28 *Project Registration Applications* examined by the ANAO that were required to undergo a fit and proper person assessment (26 detailed assessments and two routine assessments), 27 (96.4 per cent) were undertaken in accordance with standard operating procedures. The one exception was the result of an assessor error, which was rectified before any carbon credit units were issued for the project. The regulator has retained adequate documentation to support its fit and proper person assessments, except in relation to internal records searches for applicant compliance with other regulator programs/schemes. The retention of information on these searches on the assessment file would better evidence the regulator's assessment process.

13 The regulator determined from the information supplied by the applicants and an internal check of its records that the applicants' identity had previously been confirmed for the remaining 61 applications examined by the ANAO.

14 The six criteria are related to issues such as: 12-months satisfactory compliance with a regulator program/scheme or a state-based efficiency scheme; and whether the applicant: is a government entity; is a company within the top 300 on the Australian Stock Exchange; or holds an Australian Financial Services License.

2.9 The assessors did not identify any adverse fit and proper person findings for 23 of the 28 assessments (82.1 per cent) examined by the ANAO and recommended that the applicants pass the fit and proper person test. The remaining five assessments identified adverse findings, such as convictions for illegal land clearing or infringement notices for environmental damage, which had the potential to impact on the applicants' fit and proper person status. In four of these five assessments, the assessors applied the regulator's guidance material for assessing the significance of adverse findings¹⁵, assessed the adverse findings as low risk (and documented their reasons) and recommended to the delegates that the applicants pass the fit and proper person test. The assessor for the remaining assessment recommended the application's approval without documenting their consideration of the adverse finding against the regulator's guidance material. The delegates accepted the assessors' fit and proper person assessment recommendation on each occasion.

Project registration assessments

2.10 The CFI Act requires that the regulator not declare that an offsets project is an eligible project unless the regulator is satisfied that the project meets the specified criteria outlined in the Act. Additionality risk—the risk that emissions reductions credited under the fund would have occurred without scheme assistance—is among the key considerations to preserving the integrity of the fund. Under the fund, additionality risk is to be mitigated in two ways. First, approved fund methods are to be designed by the Department of the Environment and Energy (the department) to exclude most activities that are potentially commercially viable in their own right, which the Climate Change Authority considers has contributed to reasonably high additionality rates for the earlier initiative.¹⁶ Second, the regulator is to assess projects seeking registration against specified additionality criteria, such as meets newness requirement (project has not commenced implementation before fund registration) and meets regulatory requirement (project is not required to be carried out by or under a Commonwealth, state or territory law).

2.11 The regulator has developed and applies standard operating procedures for assessing *Project Registration Applications* against the registration criteria. The outcomes of the assessment are subsequently recorded in assessment tools¹⁷ (spreadsheets), with minutes prepared for the delegates justifying the assessor's recommendation. In aggregate, the 557 fund *Project Registration Applications* (541 approvals and 16 refusals) determined as at 27 October 2015 were assessed by 30 assessors, reviewed by 25 reviewers and determined by 12 delegates (three of which determined over 90 per cent of *Project Registration Applications*).¹⁸

15 Matters considered when assessing the significance of adverse findings include: the age of an offence; pattern of behaviour; degree of intent; whether those involved in the offence are no longer in executive positions; and disclosure in the fund client application.

16 Climate Change Authority, *Carbon Farming Initiative Review Report*, December 2014, p. 2. The Climate Change Authority was established to provide independent advice on Australian Government climate change mitigation initiatives.

17 Assessment tools are not used to assess variations to project registrations, with the exception of variations relating to registered project areas.

18 Excludes: 51 incomplete applications or applications withdrawn by applicants; and variations to existing project registrations.

2.12 In November 2014, the regulator implemented a streamlined approach to documenting application assessments by combining the key elements of multiple assessment spreadsheets into a single assessment tool and reducing the contents of decision minutes. This approach eliminated unnecessary repetition in assessment documentation. The regulator further streamlined the assessment of fund *Project Registration Applications* by introducing a triage approach to application assessment using risk-based criteria from April 2015. The regulator undertakes a detailed project assessment for those applicants/*Project Registration Applications* that do not meet the criteria. Those applicants/*Project Registration Applications* that meet the criteria undergo a routine assessment that significantly reduces the examination of third-party information and places greater reliance on applicants' assertions in their *Project Registration Application* forms. The majority of *Project Registration Applications* now undergo routine assessments.

2.13 The regulator's decision to streamline assessments, which has reduced the level of review undertaken at project registration, is in accordance with the Government's design principles for the fund¹⁹ and the regulator's risk appetite statement for scheme compliance and effectiveness—'in the interests of lowering transactional costs, [the regulator has an] appetite for accepting non-material and non-systemic non-compliance'. The regulator has acknowledged that, by undertaking routine assessments, it has accepted the risk (which it has assessed as low) that some applications that do not meet requirements will be assessed as meeting those requirements and be registered as eligible fund projects.²⁰

2.14 To monitor the integrity of routine assessments, the regulator proposed to review the triage procedure and criteria six months after their introduction. The regulator informed the ANAO that its review of triage procedure and criteria have been undertaken in the context of reviews of post-auction processes rather than in the form originally proposed. For example, triage criteria were changed in advance of the third auction to better direct projects with higher regulatory additionality risk to detailed assessment. In June 2016, the regulator informed the ANAO that a more detailed review of the triage model was in the early stages of planning.

2.15 The basis on which the regulator determined that applications would be subject to a routine project assessment, as opposed to a detailed project assessment, was not sufficiently documented. Of the 21 *Project Registration Applications* examined by the ANAO that underwent a routine project assessment, evidence had been retained by the regulator justifying the decision to undertake a routine assessment for three projects (14.3 per cent). Improved documentation of triage assessments would allow the regulator to better demonstrate the basis on which *Project Registration Applications* were assessed as meeting the criteria for routine assessments and that the triage process was being appropriately applied.

2.16 Notwithstanding the limited documentation of its triage assessments, the regulator has developed and implemented sound practices and processes to assess project fund applications and variations. Assessors satisfactorily completed the assessment tools for each *Project Registration Application* and variation (including in relation to 59 of the 61 completed assessment

19 Australian Government, *Emissions Reduction Fund White Paper*, April 2014, p. 8.

20 Further assessments are required before registered projects are assigned carbon credit units, which help to mitigate the consequence of registering ineligible projects under the fund.

tools (96.7 per cent) for applications examined by the ANAO).²¹ In general and in accordance with the regulators' streamlining of project assessments, the extent to which the regulator reviewed information supplied by applicants in their *Project Registration Applications* against third-party data reduced markedly after the transition from the earlier initiative to the fund. The ANAO's examination of the key assessment criteria common to all methods (including: obtaining regulatory approvals, eligible interest holder consents and legal right, and meeting the additionality criteria) indicated that third-party data checks of applicants' assertions for fund projects reduced considerably when compared to earlier initiative projects .

2.17 In relation to the aspects of additionality common to all projects assessed by the regulator, regulatory additionality is the only aspect where the regulator has placed reliance almost exclusively on applicants' assertions throughout the assessment of fund *Project Registration Applications*. Of the 60 fund project registration assessments examined by the ANAO where regulatory additionality was considered, only a small proportion relied on information other than applicants' assertions. The regulator has, however, recently reconsidered its interpretation of the regulatory additionality criterion to more closely align with the general policy intent to credit only genuine and additional abatement under the fund, which has resulted in an increase in the standard that future projects need to meet under this criterion.

2.18 In relation to the registration of projects, there is scope for the regulator to improve its assessment of:

- *Legal right*—the regulator's consideration of legal right²² was well documented in relation to the earlier initiative projects, but legal right does not form part of the documented checks undertaken by assessors at project registration for a sub-set of fund projects—sequestration projects. Decision minutes examined by the ANAO regarding the registration of sequestration projects provided to the delegate did not routinely document the regulator's formal consideration of the extent to which applicants had established legal right for their projects. The regulator informed the ANAO that legal right is a universal consideration in all project registration assessments and that it will amend its sequestration assessment tool template to explicitly address consideration of legal right.
- *List of excluded offsets projects*—since January 2015, the regulator has reduced the extent to which its assessments explicitly consider whether prospective projects are included on the list of excluded projects.²³ While the regulator routinely examined whether earlier initiative projects were excluded offsets projects (21 of 22 applicable assessments), only five of 17 detailed fund project assessments and none of the 21 routine fund project assessments explicitly considered whether the projects were

21 The two incomplete assessment tools noted key unresolved issues affecting the assessment results. The decision minutes to the delegate for both assessments explicitly documented how each issue had been satisfactorily resolved.

22 For fund projects to be able to earn carbon credit units, the project proponent(s) must have established that they have the legal right to undertake the project.

23 The CFI legislation established a list of excluded offsets projects (also known as the 'negative list') to exclude activities that pose a material adverse impact on: the availability of water; the conservation of biodiversity; employment; the local community; and/or land access for agricultural production.

included on the excluded offsets projects list.²⁴ To strengthen the registration assessment process, the regulator should document its assessment of whether projects appear on the list of excluded offsets projects.

Did the regulator appropriately approve, declare and register fund projects?

The regulator has, in the main, applied sound processes to approve, declare and register fund projects in accordance with legislated timeframes. The decision minutes, while reflecting accurately the assessments undertaken, did not always contain all information relevant to the assessment process.

Project registration decision-making

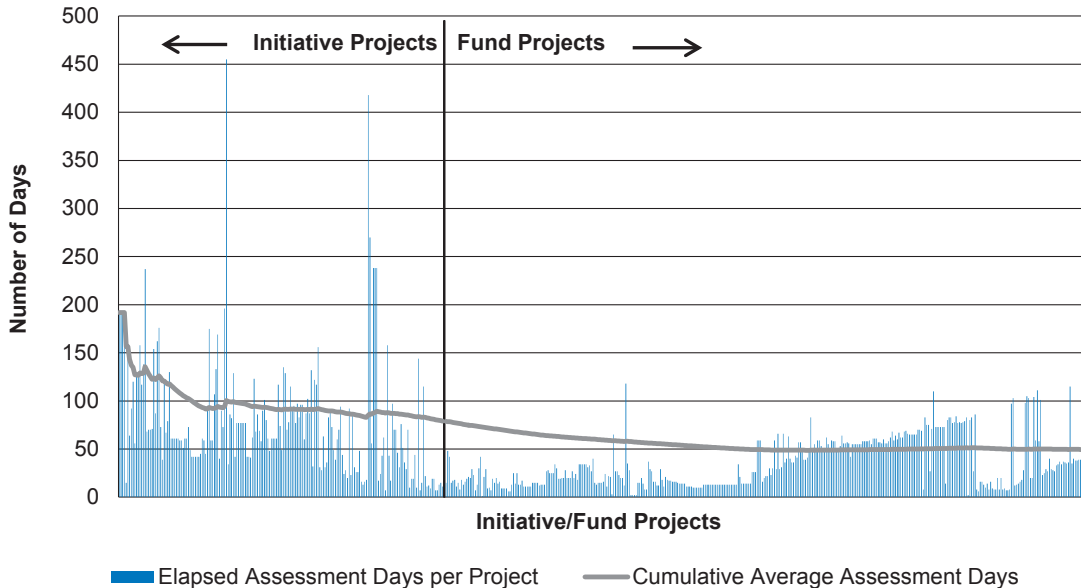
2.19 The decision minutes prepared by the assessors accurately represented the *Project Registration Application* assessments undertaken, but some minutes did not include information to demonstrate that the assessments undertaken covered all relevant considerations—particularly whether legal right had been considered and the project activities were included on the list of excluded offsets projects (as noted earlier). All 85 decision minutes examined by the ANAO accurately represented the assessments undertaken by the assessors (with the remaining two *Project Registration Applications* examined withdrawn by the applicants concerned). However, 35 of the decision minutes (41 per cent)—34 of which relate to fund project registration assessments—did not address all relevant key assessment criteria. The inclusion of the results of the regulator’s assessment against all key assessment criteria in decision minutes for future fund project assessments would provide greater assurance that registered projects have met registration requirements.

2.20 The regulator is required to take all reasonable steps to ensure that a decision is made on an application within 90 days of the application being made or after further information is received from the applicant. The regulator has reported that it has met these decision timeliness requirements on all occasions. The ANAO’s analysis indicates that, in relation to the 85 project registration/variation decisions examined, timeliness indicators had been met.

2.21 The timeliness of fund project registration (measured in terms of elapsed days) has improved appreciably over time, with the regulator’s streamlining approach to application assessment one of the primary reasons. Of all 557 project registration decisions made as at 27 October 2015, 21 decisions relating to initiative applications required in excess of 150 elapsed days to determine, while no fund application has required longer than 118 elapsed days to determine. The cumulative average elapsed days to assess *Project Registration Applications* have been reducing over time to 49.6 days as at October 2015 (including an average of 79 days for initiative project assessments and 34.6 days for fund project assessments to October 2015) as outlined in Figure 2.1.

24 All documented assessments determined that the projects did not appear on the list of excluded offsets projects.

Figure 2.1: Elapsed days to assess initiative/fund Project Registration Applications, February 2012 to October 2015



Source: ANAO analysis of regulator information.

2.22 Delegates generally evidenced their approval or refusal of project registration applications by signing the decision minutes, as required by standard operating procedures. Since mid-2015, some delegates have not signed minutes, with reliance placed on fields within the CRM System to record the approval or refusal decision (relating to 31 of the 85 minutes examined by the ANAO (36.4 per cent)). The regulator informed the ANAO in April 2016 that this practice would cease until the integrity of documentation retained in the CRM System supporting the delegates’ decisions could be confirmed.²⁵

Project registration declarations, notifications to stakeholders and entries in the Public Register

2.23 At the time the delegate approves the decision minute to register a fund project, the delegate is also to approve and issue to the project proponent a: declaration of the registered project (a copy of which is also forwarded to the relevant state/territory land registration office if the project is a sequestration offsets project); and notice outlining the project’s audit schedule when subsequently claiming carbon credit units. New projects are also required to be entered on to the regulator’s public *Fund Project Register*.²⁶

25 A similar issue occurred in relation to the delegates’ approval or refusal of *Certificate of Entitlement Applications* (discussed in Chapter 3), with the regulator also ceasing this practice until the integrity of documentation could be confirmed.

26 The regulator is required to maintain a public fund project register that summarises the details of all registered projects.

2.24 Of the 85 fund project declarations examined by the ANAO, 49 (57.6 per cent) contained accurate and complete information, with the remaining 36 declarations not containing location details that are required by the CFI legislation. All proponents had been notified of the project registration assessment decision in a timely manner and all projects were accurately recorded in the public *Fund Project Register* (which is maintained on a spreadsheet separate from the regulator's CRM System).²⁷ The regulator also correctly established audit schedules for the 37 newly registered fund projects.

27 During the audit, the regulator satisfactorily reconciled data in the public fund project register to its CRM System, making a small number of adjustments to account for omissions in the former. Periodic reconciliations between the public fund project register and the CRM System would help to ensure the currency and accuracy of the public register.

3. Assigning carbon credit units to projects

Areas examined

The ANAO examined the activities undertaken and processes employed by the Clean Energy Regulator (the regulator) to assign and register carbon credit units to projects under the Carbon Farming Initiative (the initiative) and Emissions Reduction Fund (the fund), including the assessment of *Certificate of Entitlement Applications*, *Project Offsets Reports* and independent *Audit Reports* (where required).

Conclusion

The regulator has obtained *Project Offsets Reports* and independent *Audit Reports* (where required) from project proponents in accordance with legislative requirements. These reports and the accompanying *Certificate of Entitlement Applications* were generally complete, but required information and/or documentation was not included in some cases. While the reports were appropriately assessed by the regulator, documentation supporting the less-intensive routine assessments—which will become more prevalent under the regulator’s streamlining approach—could be improved.

Those applications that have been assessed as meeting requirements were approved by the delegate, assigned the correct quantity of carbon credit units and registered appropriately in public registers.

Areas for improvement

One recommendation has been made aimed at improving the routine assessments of *Certificate of Entitlement Applications/Project Offsets Reports*.

To strengthen arrangements for the crediting of carbon abatement, the regulator should also:

- ascertain that unqualified *Audit Reports* do not contain any material findings and qualified *Audit Reports* clearly identify the material findings related to the reports’ qualification;
- review the streamlining measures to determine their effectiveness in improving efficiency and managing risk; and
- ensure that decision minutes of routine assessments clearly indicate the level of assurance that these assessments provide.

Did the regulator determine whether fund projects met their offset reporting obligations?

The regulator appropriately determined whether fund projects met their reporting obligations. Fund proponents submitted *Certificate of Entitlement Applications* (which provide the information on which the regulator undertakes its assessment), as well as supporting documentation, including *Project Offsets Reports* and independent *Audit Reports* (where required). These materials were also provided at intervals in accordance with legislated timeframes.

3.1 The first step in the issuing of credits for carbon abated by fund projects is the proponents’ submission of *Certificate of Entitlement Application* forms, accompanied by *Project Offsets Reports* outlining the project’s abatement achievements over a specified reporting period. Where required

by the regulator, these are also accompanied by independent *Audit Reports* designed to verify the claims made.

3.2 The *Carbon Credits (Carbon Farming Initiative) Act 2011* (CFI Act) provides flexibility for proponents regarding the frequency of the submission of offsets reports for their projects. Over their projects' crediting periods (generally seven or 10 years), proponents are required to submit multiple *Certificate of Entitlement Applications* and *Project Offsets Reports*. In relation to the *Certificate of Entitlement Applications/Project Offsets Reports* examined by the ANAO²⁸, all 35 were submitted at intervals in accordance with the requirements of the CFI Act, with reporting periods that commenced either at the start of the crediting period (initial offset reports) or at the conclusion of the previous offsets report (subsequent offsets reports). In those cases where errors, ambiguities or insufficient information are found, the regulator has established effective processes to follow-up proponents.

3.3 Under the initiative, all *Project Offsets Reports* were required to be accompanied by an independent *Audit Report*. This requirement was revised under the fund, with only some offsets reports provided by proponents over the crediting life of their projects (including initiative projects that transitioned to the fund) requiring an accompanying *Audit Report*.²⁹ Independent *Audit Reports* covering the *Project Offsets Reports* examined by the ANAO were submitted in support of proponents' *Certificate of Entitlement Applications* on all 28 occasions where required. *Audit Reports* were also submitted in support of two additional *Certificate of Entitlement Applications* examined by the ANAO when not required.

Did the regulator appropriately assess the carbon abatement claims of fund projects?

Appropriate arrangements are in place to assess the carbon abatement claims of fund projects against fund method requirements. The regulator's *Audit Report* assessments determined that, in the main, reliance could be placed on the conclusions regarding proponents' carbon abatement claims. The regulator's detailed assessments of *Certificate of Entitlement Applications/Project Offsets Reports* satisfactorily addressed the majority of the assessment requirements, including those outstanding from project registration (which can include regulatory approvals and eligible interest holder consents). The justification for, and documentation supporting, streamlined routine assessments (determined on a risk basis) requires improvement to enable the regulator to demonstrate the robustness of these assessments.

28 The ANAO examined key elements of the regulator's processing of applications for carbon credit units by reviewing a sample of assessed applications. The sample of 35 applications (from a population of 346 applications processed by the regulator as at the closing date to register projects to enable their participation in the second auction —27 October 2015)—10 per cent of the population—was broadly selected in proportion with 17 key parameters, including: date of application submission; project method, quantity of carbon credit units claimed; audit firm; audit findings; application assessor; decision delegate; and assessment result.

29 The determination of when *Audit Reports* are required for each project was examined in Chapter 2.

Content of Certificate of Entitlement Applications, Project Offsets Reports and Audit Reports

3.4 After taking into account responses to requests for further information from the regulator, 10 of the 34 processed applications and offsets reports (29.4 per cent) examined by the ANAO³⁰ contained all information and documentation required under the CFI Act. The remaining 24 applications and offsets reports did not include all required information or documentation, including whether the project had been implemented in accordance with the applicable method or whether sufficient details were provided regarding the calculation of the quantity of carbon abated.

3.5 The independent *Audit Reports* that are required to accompany fund *Project Offsets Reports* must: contain, among other things, a reasonable assurance opinion as to whether the project has been implemented in accordance with the project declaration, the applicable fund method and the requirements of the CFI Act in all material respects during the reporting period; and (since 2015) specify the quantity of verified abatement for the reporting period. The audits are required to be undertaken by qualified auditors registered with the regulator under the National Greenhouse and Energy Reporting Scheme (NGERS).³¹ All 30 *Audit Reports* of offsets reports examined by the ANAO were prepared by NGERS-registered auditors and contained the required reasonable assurance opinions. All *Audit Reports* since 2015 examined by the ANAO have also specified the quantity of verified abatement for the reporting period.

Assessment of Audit Reports

3.6 The audits of *Project Offsets Reports* are designed to provide assurance to the regulator regarding the extent to which projects met method eligibility requirements and carbon abatement claimed by proponents has been calculated in accordance with fund method requirements. The majority of fund project *Audit Reports* assessed by the regulator contained unqualified opinions regarding the fund projects' compliance with scheme requirements.³² Of the 290 fund *Audit Reports* assessed by the regulator as at 27 October 2015, 277 (95.5 per cent) contained an unqualified audit opinion.³³ The reasons for the qualification of some offsets reports included significant overstatement of carbon abatement in calculations and/or non-compliance with CFI Act or method requirements. In cases of significant overstatement, the regulator reduced the carbon credit units assigned to the projects concerned by the amount of the overstatement. While

30 Excludes one *Certificate of Entitlement Application* examined by the ANAO that was withdrawn by the project proponent.

31 NGERS is the national framework for reporting and disseminating information from companies that meet reportable thresholds regarding their greenhouse gas emissions, energy production, energy consumption and other information specified under the NGERS legislation. Project proponents are able to engage the qualified auditor of their choice to undertake the audit. The regulator informed the ANAO that it undertakes activities to monitor the quality of the work performed by NGERS-registered auditors that include: an annual auditor inspection program; reviews of auditors' professional development activities; and comparisons of the regulator's own audits against those of registered auditors.

32 Unqualified opinions indicate that the auditor considers that the contents of the project offsets reports are fair and reasonable in all material respects. Qualified opinions indicate that the auditor considers that the contents of the project offsets reports are fair and reasonable in all material respects, except for those aspects subject to the qualification.

33 The regulator's assessments of *Audit Reports* can involve discussions with the auditors and, on occasion, requests for the auditors to revise and resubmit *Audit Reports*.

significant findings were infrequent, auditors commonly identified immaterial findings—in 100 of the 290 *Audit Reports* (34.5 per cent)—for matters relating to the calibration of measuring instruments, measurement techniques, immaterial understatement/overstatement and record-keeping.

3.7 A key component of the regulator’s assessment of the quality of the *Audit Reports* was an assessment of whether they were: structured correctly; complied with relevant legislative requirements; and complied with the regulator’s criteria. Over 90 per cent of audits (263 of the 290 *Audit Reports*) were assessed as meeting all three characteristics. Of the remaining 27 audits (9.3 per cent), 22 did not meet one or more of the characteristics, while the regulator’s records did not clearly indicate the outcomes of its assessment for the remaining five *Audit Reports*.

3.8 The ANAO also compared audit opinions against material findings and identified four *Audit Reports* with unqualified audit opinions that identified material findings (which should, prima facie, lead to qualified audit opinions) and three *Audit Reports* with qualified audit opinions that did not identify any material findings. These anomalies were not identified and/or corrected by the regulator. The regulator should strengthen review arrangements to identify any inconsistencies in *Audit Reports* and address identified issues before accepting the reports.

Assessment of project carbon abatement claims

3.9 The CFI Act requires the regulator to issue a fund project a certificate of entitlement (that is, carbon credit units) for abatement claimed during the offsets reporting period where specified regulatory criteria have been met. These criteria include whether regulatory approvals have been obtained or whether legal right has been demonstrated.

3.10 The regulator has developed standard operating procedures for assessing the carbon abatement claims of project proponents (which are similar to those for assessing project registration applications). Assessments have involved examining proponents’ assertions in their *Certificate of Entitlement Applications/Project Offsets Reports*, consideration of the regulator’s separate assessments of independent *Audit Reports* (outlined earlier) and confirmation against third-party data. The assessment results are recorded in assessment tools (spreadsheets) and/or minutes prepared for the delegates justifying the assessor’s recommendation. The 346 *Certificate of Entitlement Applications/Project Offsets Reports* (345 approvals and one refusal) determined as at 27 October 2015 were assessed by 13 assessors, reviewed by 15 reviewers and determined by six delegates (three of which determined over 85 per cent of carbon abatement claims from proponents). *Audit Reports* accompanied 83.8 per cent of *Certificate of Entitlement Applications/Project Offsets Reports*.

3.11 In accordance with the Government’s design principles for the fund and, as was the case for the assessment of fund *Project Registration Applications*, since April 2015 the regulator has streamlined the assessment of *Certificate of Entitlement Applications/Project Offsets Reports*. Under the streamlined arrangements, the regulator introduced a triage approach that utilises risk-based criteria. A detailed assessment of proponents’ carbon abatement claims is only undertaken for those projects where the most recent audit opinion has been qualified and/or where the proponents or projects are included on the Client Alert List and/or Project Alert List

maintained by the regulator.³⁴ Routine assessments, which rely primarily on independent *Audit Reports* (and their assessment by the regulator), are to be undertaken for projects where the most recent audit opinion has been unqualified. Given the high proportion of *Audit Reports* that are unqualified, most future assessments of *Certificate of Entitlement Applications/Project Offsets Reports* are likely to be considered by the regulator as ‘routine’.

3.12 The regulator has retained insufficient evidence to underpin its decisions to undertake routine assessments and that *Certificate of Entitlement Applications/Project Offsets Reports* that were subject to routine assessments met requirements. Of the 35 *Certificate of Entitlement Applications/Project Offsets Reports* examined by the ANAO, four were subject to a routine assessment (with the remainder having been submitted prior to the introduction of the triaging approach). The regulator did not retain documentation of the triaging of applications that underpinned its decision to undertake a routine assessment of these four applications. In addition, evidence has not been retained to demonstrate that the regulator assessed whether the contents of two of the four *Certificate of Entitlement Application* forms met CFI Act requirements.³⁵

3.13 To better monitor the integrity of proponents’ carbon abatement claims in a streamlined assessment environment, the regulator should:

- improve the documentation of triage assessments of each *Certificate of Entitlement Application* against established criteria—particularly in relation to the project’s inclusion in or exclusion from the Client Alert List and/or Project Alert List;
- provide information to the delegate on the extent to which *Certificate of Entitlement Applications* meet requirements and eligibility criteria; and
- regularly review the ongoing validity of streamlining arrangements.

Recommendation No.1

3.14 The Clean Energy Regulator should ensure that appropriate documentation is retained to demonstrate the rationale for undertaking routine or detailed assessments of abatement crediting applications and that all relevant abatement crediting assessment criteria have been addressed during streamlined assessments.

Clean Energy Regulator response: *Agreed.*

3.15 In relation to the 31 detailed assessments examined by the ANAO, documentation was retained to evidence the regulator’s consideration of whether: the applicant passed the fit and proper person test; the applicant was the proponent; outstanding regulatory approvals and eligible interest holder consents had been obtained; and legal right had been fully demonstrated. There were, however, 13 detailed assessments (41.9 per cent) that contained only partial coverage of the relevant assessment areas, for example methodology questions that were not

34 An Entities of Interest List was established by the regulator in 2012 as an interim measure to assist compliance monitoring and risk management of high-risk entities across the regulator’s schemes. After the Entities of Interest List was reviewed in 2014, which identified weaknesses, the regulator developed the Client Alert List and Project Alert List. The rollout of the revised lists commenced in March 2016.

35 In contrast to the *Project Offsets Reports*, the *Certificate of Entitlement Application* forms are not subject to independent audit.

addressed (eight assessments) and insufficient consideration of the 'no-double counting test' (four assessments).³⁶

Did the regulator appropriately approve, issue and register the correct quantity of carbon credit units to fund projects?

Where the delegate approved the *Certificate of Entitlement Applications*, carbon credit units assigned to projects have been accurately calculated according to fund method requirements and recorded in public registers. While sound processes have been established by the regulator to approve, issue and register the correct quantity of carbon credit units to fund projects, the material prepared for the decision-makers did not always contain all information relevant to the required decision on whether to approve or refuse a *Certificate of Entitlement Application*. In addition, the decision minutes for applications undergoing routine assessments should more clearly indicate to the decision-maker the level of assurance that these assessments provide.

Abatement crediting decision-making

3.16 Of the 34 *Certificate of Entitlement Application* decision minutes (used by the regulator to evidence acceptance or rejection of *Certificate of Entitlement Applications*) that were examined by the ANAO (all approved)³⁷, 27 (79.4 per cent) contained all relevant information. There was information, which was relevant to the delegates' decisions, for the remaining seven applications that was not included in the decision minutes, such as whether project contraventions of the CFI legislation identified by auditors were significant to the integrity of the applications (four assessments).

3.17 While detailed application assessments provide decision makers with reasonable assurance as to whether those applications meet requirements, the regulator informed the ANAO that it considers routine application assessments provide decision makers with limited assurance—a lesser standard.³⁸ The content of decision minutes of routine assessments does not, however, clearly indicate that delegate decisions are made to the limited assurance standard. The regulator should revise its decision minute template for routine assessments to clearly indicate the level of assurance provided by the assessment activity.

3.18 In relation to the timing of decisions, delegates are required to take all reasonable steps to make a decision on an application within 90 days of the application being made or the proponent's response to a request for further information. The regulator has reported that it has met these timelines on all occasions and the ANAO's analysis confirmed that timelines had been met in relation to the 34 certificate of entitlement decisions that it examined.

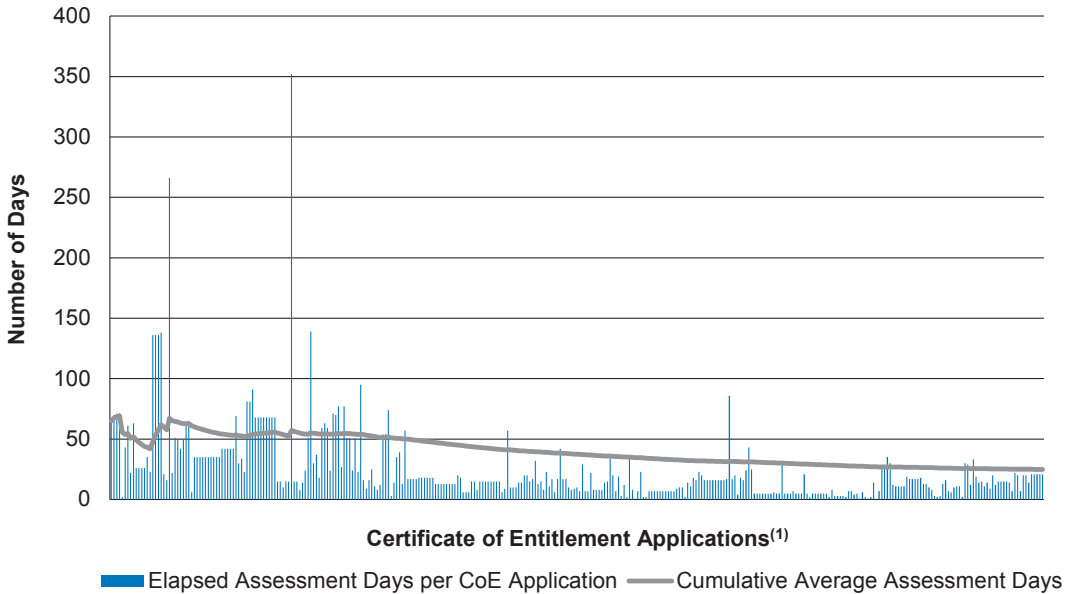
36 The 'no double counting test' is designed to ensure that the same carbon abatement is not accounted for more than once under the fund or a state/territory carbon offsets scheme. The regulator informed the ANAO that it has recently developed and implemented a process to conduct this test more rigorously.

37 Excludes one application examined by the ANAO that was withdrawn by the proponent prior to the regulator making a decision.

38 Limited assurance assessments are less onerous and/or have a narrower scope than reasonable assurance assessments, with assurance opinions qualified by the work performed.

3.19 The timeliness of *Certificate of Entitlement Application* decisions (measured in terms of elapsed days) has improved over time, as was the case for project registration. Of the 346 decisions made as at October 2015, the cumulative average elapsed days taken to assess the applications has reduced to 25 days (including an average of 13 days for those applications processed in 2015) as outlined in Figure 3.1.

Figure 3.1: Elapsed days to assess *Certificate of Entitlement Applications*, November 2012 to October 2015



Note 1: The first *Certificate of Entitlement Application* was approved in November 2012.

Source: Analysis of regulator information.

Certificate of entitlement declarations and register entries

3.20 At the time when the delegate approves the decision minute to approve a project’s abatement claim, the delegate is also to issue a certificate of entitlement to the project proponent specifying the number of carbon credit units to which the project is entitled. Based on the project information assessed, carbon credit units for the 34 approved *Certificate of Entitlement Applications/Project Offsets Reports* examined by the ANAO have been correctly calculated in accordance with fund method requirements by the regulator. In addition, carbon credit units issued to fund projects examined by the ANAO were recorded against the correct accounts in the Australian National Registry of Emissions Units.³⁹

³⁹ The Australian National Registry of Emissions Units is a system administered by the regulator that is designed to track the location and ownership of Australian carbon credit units issued under the fund, and emissions units issued under the Kyoto Protocol. The operation and management of the registry is governed by the *Australian National Registry of Emissions Units Act 2011* and related regulations.

3.21 The regulator is also required to maintain a public *Fund Project Register* that summarises the details of all registered projects, including carbon credit units issued. Carbon credit units issued under the 34 approved certificates of entitlement examined by the ANAO were accurately recorded in the register. In addition, information related to *Certificate of Entitlement Applications* recorded in the regulator's CRM System was accurate and complete for 32 of the 35 applications (91.4 per cent) examined, with the CRM System containing minor inaccuracies for the remaining three applications.

4. Identifying carbon credit units to purchase

Areas examined

The ANAO examined the activities undertaken and processes employed by the Clean Energy Regulator (the regulator) to identify carbon credit units for purchase from projects under the Emissions Reduction Fund (the fund), focusing on the design and conduct of the first two abatement auctions.

Conclusion

The regulator effectively designed and implemented the first and second fund auctions in accordance with established processes and probity guidance that, on the basis of the auction methodology applied, identified the least-cost abatement to purchase from projects over a 10-year period. The regulator created sufficient awareness of auction process requirements and appropriately supported potential proponents to participate in the auctions, including clearly outlining their rights and obligations should they be successful.

The carbon abatement contracts that have been established with successful auction participants contain schedules for the delivery of carbon credit units to the regulator over the life of the contracts. In relation to successful participants in the first auction, the regulator did not establish the capacity of their projects to generate sufficient carbon credit units to fulfil contractual requirements. The regulator strengthened arrangements to assess and treat the risk to the delivery of quantities offered at the second auction, and has indicated that arrangements will be further refined for future auctions.

Area for improvement

To strengthen the abatement purchasing arrangements, the regulator should continue to develop and periodically review abatement profiles for the most commonly used fund methods.

Did the regulator effectively design the auction methodology, parameters and delivery arrangements?

Within the context of the legislated purchasing principles of the fund, the regulator effectively designed the auction methodology, parameters and delivery arrangements for the first two carbon abatement auctions that were examined in this audit.

4.1 The CFI legislation provides for the regulator to purchase emissions reductions (carbon credit units) from proponents of eligible offsets project through a reverse auction, a tender or other purchasing process. To date, the regulator has exclusively used the reverse auction method to purchase carbon credit units.⁴⁰

Auction methodology and design

4.2 The CFI legislation establishes six principles that the regulator must consider when purchasing emissions reductions, which include purchasing carbon abatement at least cost and ensuring that administrative costs are reasonable. Within the context of these purchasing

40 A reverse auction is an auction where sellers bid for the prices at which they are willing to sell their goods.

principles, the *Emissions Reduction Fund White Paper* (released in April 2014) outlined the Government's initial expectations of the parameters for purchasing emissions reductions under the reverse auction method. Key features included:

- participants submitting single, sealed bids for their project's carbon abatement (comprising carbon credits already issued, as well as those yet to be generated at the time of the auctions);
- cost being the sole criterion for selection, with project risk and commercial readiness being assessed by the regulator in a pre-qualification phase;
- engendering competition by purchasing only 80 per cent of the emissions reductions offered for sale at an auction below a pre-set maximum price that the Government would be willing to pay (the benchmark price);
- the regulator having the option to terminate contracts if conditions precedent (relating to such issues as securing project finance and obtaining regulatory approvals) are not met in a reasonable timeframe;
- payment only after emissions reduction have occurred and carbon credit units have been issued to projects; and
- 'make-good' provisions requiring proponents to source emissions reductions from other projects should their own project earn insufficient carbon credit units to meet contract delivery requirements.

4.3 To assist with the further development of the auction methodology and parameters, the Department of the Environment and Energy (the department) engaged the Commonwealth Scientific and Industrial Research Organisation (CSIRO) to model likely bidding behaviour of fund auction participants under varying scenarios. The CSIRO's report (dated September 2014) concluded that cultivating uncertainty (including on maximum prices, the scale of future auction opportunities and even the budget available) reduces strategic bidding behaviour, keeping bidders more focused on their own costs.

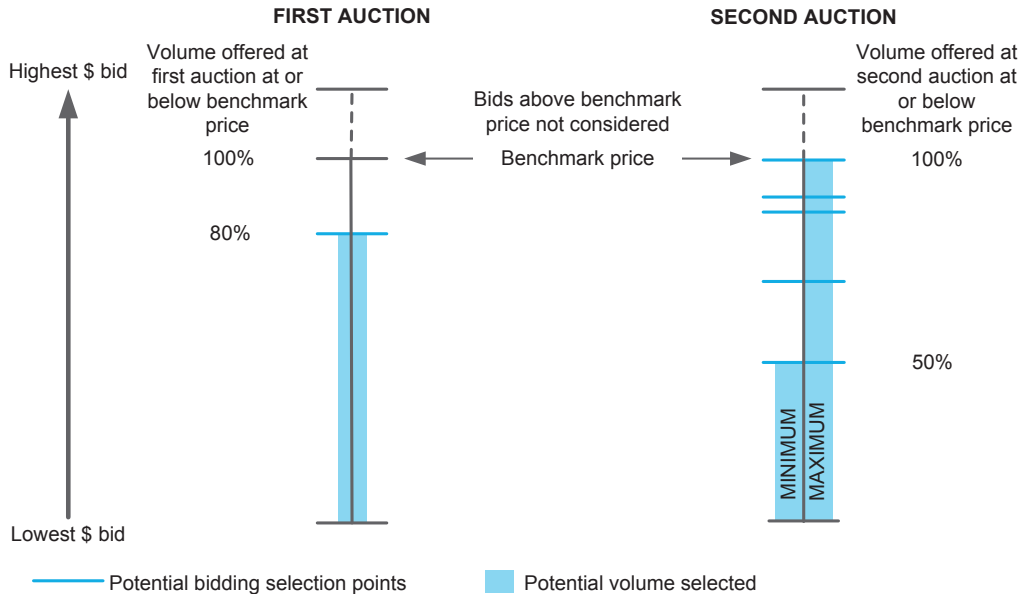
4.4 The regulator adopted the purchasing parameters contained in the fund's White Paper and incorporated the advice received from CSIRO regarding potential bidder behaviour when designing the parameters of the first two auctions. The guidelines for the first auction indicated that after auction qualification and registration (discussed later in this chapter), fund proponents would be able to lodge a single bid for each tonne of carbon abatement offered at auction for each project. The Government would purchase the lowest cost 80 per cent of total emissions reductions offered at the auction below the benchmark price.

4.5 To maintain competition among potential bidders and reduce the opportunity for strategic bidding, the regulator varied the parameters of the second auction to allow for the purchase of between 50 and 100 per cent of the lowest-cost volume offered for sale by fund participants below the benchmark price.⁴¹ The regulator pre-determined five potential decision points based on key variables (using a bid assessment tool developed for the purpose) that the regulator assessed as representing greater value for money than other potential decision points within the

41 The White Paper foreshadowed the potential to adjust auction rules in response to lessons learned about the operation and efficiency of auctions.

50–100 per cent volume purchase range. Two of the potential decision points represented the agreed boundaries of the 50–100 per cent range, with the other three placing emphasis on: the lowest average price; optimal volumes at moderate average prices; and the volume with the greatest diversity by fund method. The purchasing parameters for the first two auctions are outlined in Figure 4.1.

Figure 4.1 Purchasing parameters for the first and second auctions



Source: ANAO analysis of regulator information.

4.6 To protect the integrity of auction processes, the auction guidelines outlined: the matters that could result in potential auction participants being disqualified from participating in auctions (which included breaching the guidelines and suspected breaches of the *Carbon Credits (Carbon Farming Initiative) Act 2011*); and the responsibilities of potential auction participants not to disclose their bidding strategy or to cause the purchasing process to become unfair or disorderly.

Auction delivery platform

4.7 For the first two auctions, the regulator determined that it would be directly responsible for handling the first two of the three stages of the auction process—namely, auction qualification and registration—while auction participants were required to use AusTender to lodge their bids to complete the auction process (using unique passcodes). As AusTender could not restrict auction participants lodging multiple bids for the same project, the regulator monitored the date and time of bid lodgement to determine and accept only the first bid lodged by participants, as required by the auction rules.

Did the regulator create appropriate awareness of the auction process, participation requirements and obligations on selected proponents?

For the first two auctions, the regulator created appropriate awareness of the process and established effective arrangements to inform potential auction participants of the requirements for participation and their rights and obligations if they were successful.

Auction process awareness

4.8 In the lead-up to the first auction, the regulator developed an *Auction Communication Plan* that identified potential audiences, key messages to be conveyed, a timetable of communication activities, and factors to be considered when evaluating the success of the communication approach. Communication activities outlined in the plan and undertaken included posts/updates to the regulator's website and targeted emails to fund proponents and subscribers. An internal evaluation of the effectiveness of the regulator's external communications and engagement activities during the first auction process identified positive results.

4.9 The regulator also developed an *Auction Communication Plan* for the second auction that, while similar to the communications plan for the first auction, included expanded and refined descriptions of potential audiences, key auction messages and factors to be considered when evaluating the success of communication approaches. The communication activities undertaken during the second auction were similar to those undertaken during the first auction, with the addition of information workshops conducted by the Carbon Market Institute under contract with the department. Information workshops were held in eight mainland capital and major regional cities during June 2015 and attracted a total of 525 participants.

Auction participation requirements and obligations on selected participants

4.10 The regulator developed auction guidelines that were made available to potential auction participants on the announcement of the dates of the auctions. These guidelines were the primary mechanism used by the regulator to inform proponents of participation requirements and their rights and obligations should they be selected. The guidelines for the first and second auctions specified:

- that projects related to the bid must be registered by the regulator;
- that participants must be qualified and registered to participate, using standard application forms;
- the elements that would constitute an eligible bid from an authorised bidder; and
- that contracts covering the project(s) commence automatically on the regulator's notification of the bid's success and acceptance of the participant's offer.⁴²

4.11 The auction qualification, registration and bid forms completed sequentially by fund proponents further outlined their rights and obligations. By completing and submitting the forms to the regulator, the proponent made a commitment to sell a specified quantity of carbon credit

42 In December 2014 (and prior to the first auction), the regulator released a draft *Code of Common Terms of the Carbon Abatement Contract* and draft *Carbon Abatement Contract Guide*.

units under the terms and conditions of the *Code of Common Terms of the Carbon Abatement Contract*, supplemented by the commercial, delivery and financial terms outlined in the forms.

4.12 The notifications sent to auction participants after the completion of the qualification and registration stages also advised participants of the next steps in the auction process and the deadline for their completion. To reduce the potential AusTender access issues during the two -day auction bidding window, the auction registration notifications encouraged participants to create their AusTender usernames and passwords in advance. The regulator also produced guidance for auction participants on how to use AusTender to lodge their bids.

Did the regulator undertake the auctions effectively and in accordance with published auction guidance?

Overall, the first and second auctions were conducted effectively and in accordance with published auction guidance. The conduct of each auction was overseen by an external probity advisor engaged by the regulator.

Probity

4.13 In advance of both the first and second auctions, the regulator appointed an external probity advisor to examine whether the regulator's processes and procedures for conducting, and their application during, the auctions resulted in auctions that were fair, transparent, accountable and equitable. The services performed by the probity advisor included:

- developing, and monitoring compliance with, the auctions' *Probity Plan* and confidentiality declarations for those involved in the auction processes;
- assessing the adequacy, and sample testing the consistent application, of standard operating procedures and work instructions for auction processing;
- gaining an understanding of the bid assessment tools; and
- observing the handling and assessment of bids and the recommendation and acceptance of the proposed outcomes of the auctions.

4.14 At the conclusion of each auction, the probity advisor concluded that the regulator's auction processes and procedures were fair and transparent and that the advisor did not identify any aspects of the process that contravened the principles of probity or impacted on the equitable treatment of auction participants. The probity advisor also considered that the suggested improvements to processes, procedures and systems identified during the first auction had been implemented for the second auction. The ANAO also observed key aspects of the handling and assessment of bids for the second auction and did not observe any non-conformance with the auction's *Probity Plan*.

Regulator assessments

4.15 The ANAO examined, on a sample basis, the application of the regulator's standard operating procedures and work instructions for the auction that were also examined by the probity advisor during the first two auctions. The ANAO found that:

- auction participants satisfactorily completed and signed application forms related to the sequential stages of auction qualification, registration (including approved bidders) and bidding;
- the regulator’s delegate approved the participants’ progress through the auction process after applications had been assessed as meeting the assessment criteria; and
- notifications were sent to the participants in a timely manner after the regulator had made a decision regarding the proponents’ applications.

4.16 The documentation of the auction qualification and registration assessments adequately demonstrated the regulator’s consideration of most assessment criteria (including application completeness, validity of the project, acceptability of conditions precedent and the financial capability of the participant). The assessments for the first auction did not demonstrate that the regulator adequately established the capacity of registered projects to generate sufficient carbon credit units to fulfil quantities bid at auction. The fund’s design principles, advice to potential auction participants and the regulator’s risk management documentation indicated that the credibility of emissions reduction estimates proposed by auction participants would be reviewed during auction qualification. This review was not satisfactorily conducted for the first auction, which increased the risk that carbon credits yet to be earned by selected projects would not be sufficient to meet contract delivery schedules.⁴³

4.17 In preparation for the second auction, the regulator strengthened arrangements to assess the delivery risk of participants’ offers, including assessment of abatement estimates at auction qualification. The regulator risk-rated each registered project eligible for the auction according to three criteria—participant risk (based on participant type, extent of relationship with the regulator, and compliance history); project risk (variability/predictability with the method used) and volume risk (quantity thresholds of abatement offered for all projects proposed by the proponent). Using the risk ratings as a guide, the regulator identified 12 participants (that together accounted for approximately 60 per cent of abatement on offer) to be subject to a detailed assessment (involving scrutiny of abatement volumes offered and internal checks of intelligence relating to the participants) with the remainder undergoing routine assessment (based on applicants’ assertions).⁴⁴ The regulator considered that the limited resources and timeframe available to undertake the assessments were determining factors in the quantum of projects/participants that underwent detailed assessments.

4.18 In undertaking the detailed assessments, the regulator sought additional information from auction participants justifying their abatement claims and/or completed targeted analysis of the regulator’s information holdings during auction qualification/registration. In some cases, these assessments resulted in the auction participants proposing reductions to the abatement amounts

43 The regulator informed the ANAO that the past crediting performance of the projects contracted at the first auction provided a strong indication of their ability to fulfil contracted delivery schedules over the next 10 years. While a quarter of the total carbon credits required to fulfil first auction contracts had been earned, 30 of the 144 selected projects had not yet earned any carbon credit units at the time of their selection.

44 Projects with the greatest risk ratings were selected for detailed assessment. However, the selection methodology—that including examining all projects from some proponents—also resulted in some lower risk-rated projects undergoing detailed assessments while others with similar risk ratings underwent routine assessments.

that they would be willing to offer during the auctions, with reductions of 50 per cent or more not uncommon.⁴⁵

4.19 In addition to the detailed assessments for the second auction, any large increases in the carbon credit quantities offered by participants as they proceeded through the auction process were subjected to additional assessment.⁴⁶ These assessments resulted in the regulator's general acceptance of increases of less than a pre-set percentage from the volumes initially offered by participants, and targeted analysis and consultations for increases in offers in excess of the pre-set percentage.

Development of abatement profiles to inform assessments

4.20 To enhance its assessment of the likely carbon credit unit earning capacity of registered projects, the regulator has foreshadowed introducing additional tools in future auctions, such as abatement profiles. In December 2015, the regulator approved abatement profiles for five methods⁴⁷ that identify the likely pattern of abatement crediting over time for the methods concerned and the factors that typically influence crediting volumes across a number of variables relevant to each method. The application of robust abatement profiles will better position the regulator to undertake broad credibility checks of abatement volumes provided by proponents at various times, including:

- forward abatement estimates provided at project registration, which are used to determine the timing and frequency of future audits of *Project Offset Reports*;
- abatement claimed in *Project Offset Reports*; and
- abatement and delivery schedules offered to the regulator during auction qualification and registration.

4.21 The ANAO considers that there would be benefit in the regulator developing additional abatement profiles for the most commonly used fund methods and periodically reviewing the profiles' contents to improve their accuracy and relevance.

Did the regulator identify and select the least-cost carbon abatement to purchase?

The regulator selected the least-cost abatement to purchase within the established auction parameters. The fulfilment of carbon abatement contracts will be dependent on the satisfaction of conditions precedent, the abatement credited to the projects over time and the effectiveness of the 'make good' provisions of the contracts.

4.22 All validated bids received from pre-qualified auction participants via AusTender for the first and second auctions were entered into their respective bid assessment tools by the regulator and ranked according to price. As required by the first auction guidelines, the regulator selected

45 The regulator also informed the ANAO that, where abatement quantities offered were low or moderate, it was willing to tolerate a greater level of uncertainty in order to reduce regulatory burden and maintain efficient operating procedures.

46 Auction participants were required to state an indicative quantity of abatement that would be offered at the auction qualification stage, and the final offered quantity at the later auction registration stage.

47 As at May 2016, 46 fund methods had been approved for use, four of which were closed to new projects.

abatement comprising the lowest cost 80 per cent of the volume on offer below the pre-set benchmark price.

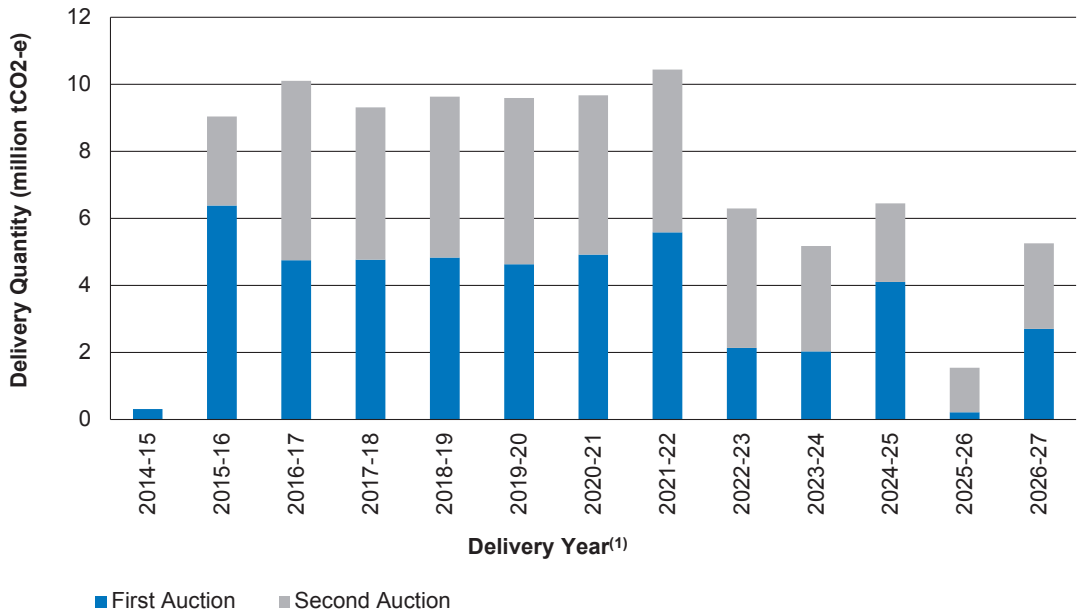
4.23 For the second auction, the regulator used the bid assessment tool to determine the five potential bidding selection points that would meet its commitment to purchase between 50 and 100 per cent of the lowest-cost volume offered for sale by fund participants below the benchmark price. The regulator chose the bidding selection point related to the highest method diversity that resulted in the purchase of 72.3 per cent of the volume offered for sale by participants below the benchmark price.

4.24 Price was the sole factor determining the ranking of each first and second auction bid. Factors such as existence/extent of conditions precedent and abatement delivery schedules—which the regulator examined during auction prequalification—were not taken into account in abatement selection decisions. The satisfaction of conditions precedent and the achievement of delivery schedules will have an impact on the extent of the fund’s contribution to Australia’s emissions reduction targets.

4.25 The establishment of enforceable purchase contracts with successful auction participants is dependent on the satisfaction of conditions precedent that were agreed between the parties during auction prequalification. The nature and type of conditions precedent vary from contract-to-contract, but include obtaining planning and environmental approvals and commencing project implementation.

4.26 The prevalence of conditions precedent in contracts with successful auction participants increased markedly from the first auction (7.5 per cent) to the second auction (65.9 per cent) because of the large proportion of projects in the first auction that had already commenced implementation under the Carbon Farming Initiative. Although the conditions precedent contained in many contracts are due to expire by June 2016, some contracts’ conditions precedent do not expire until May 2017. In the latter cases, the regulator has established separate undertakings with the proponents concerned to report periodically on progress towards the achievement of the conditions precedent. In the event that the conditions precedent cannot be satisfied, both parties are absolved of their obligations under the contract, which reduces the abatement identified to meet Australia’s emissions reductions targets.

4.27 The abatement delivery schedules in purchase contracts establish the anticipated timeframe for the regulator to receive abatement to meet Australia’s emissions reduction targets. The scheduled delivery of abatement purchased at the first and second auctions over the period from 2014–15 to 2026–27 is outlined in Figure 4.2.

Figure 4.2: Carbon abatement contracted at the first and second auctions

Note 1: Information current at the time contracts were entered into.

Source: ANAO analysis of regulator information.

4.28 The contracts state that the regulator will only pay for carbon credit units that have been credited to the proponents' Australian National Registry of Emissions Units (ANREU) accounts at the time of delivery. In the event that carbon credit units from the proponents' projects credited to their ANREU account are insufficient to meet abatement delivery schedules, the regulator:

- will accept carbon credit units sourced by proponents from other ANREU account holders;
- may agree to vary abatement delivery schedules (which may alter the abatement available to meet the established 2020 and/or 2030 emissions reduction targets), although the overall quantity and final delivery date cannot be varied; or
- will be entitled to invoke the 'make good' provisions that require contracted proponents to reimburse the regulator the contracted cost of any carbon credit unit shortfalls (plus any additional expense incurred by the regulator in sourcing carbon credit units from other ANREU account holders).

5. Governance of crediting and purchasing activities

Areas examined

The ANAO examined the activities undertaken and processes employed by the Clean Energy Regulator (the regulator) to govern the abatement crediting and purchasing components of the Emissions Reduction Fund (the fund).

Conclusion

The regulator has established effective processes to govern the abatement crediting and purchasing components of the fund. The regulator is appropriately monitoring and managing its risks to the achievement of fund objectives, has developed appropriate guidance for staff to undertake fund activities, and has progressively strengthened its performance management framework for the fund.

Area for improvement

To better manage the accuracy and currency of fund assessment guidance materials, the regulator should develop a register of relevant materials.

Did the regulator identify, assess and treat significant risks in a timely manner?

The regulator has a well-established and integrated risk management framework to guide the development and implementation of risk management plans for the fund. Under this framework, the regulator has established sound processes to identify, assess and treat risks to the effective implementation of the fund.

5.1 At the enterprise level, the regulator has a well-established Risk Management Framework encompassing:

- a risk management policy that outlines the regulator's approach to, and accountabilities and responsibilities for, managing risk;
- a risk appetite statement that outlines the level of risk consequence the regulator is willing to accept in its pursuit of its purpose and objectives (which, in the context of the fund, includes an appetite for accepting non-material and non-systemic non-compliance, in the interest of lowering transaction costs);
- a strategic risk context statement that provides a broad view of external and internal factors that could impact on the regulator's ability to achieve its objectives; and
- risk management guidelines and tools (including the risk matrix) that support day-to-day use of the framework, integration with existing processes and reflect reporting mechanisms through current committee arrangements within the regulator.

5.2 In the context of the development of the fund, key risk management documentation was incorporated into the Emissions Reduction Fund 'Blueprint' approved by the Joint Agency Executive Steering Committee (comprising senior representatives from the Department of the Environment and Energy (the department) and the regulator) in July 2014. The fund Blueprint

defined the business transformation phases necessary for the department and the regulator to implement the fund. It also identified and rated seven key risks (pre- and post-treatments) to the successful implementation of the fund—with one exception⁴⁸—and identified and assigned risk treatments to the department or the regulator. The department and regulator have been monitoring the current and target ratings of the key fund risks and implementation of risk treatments over time, including in the context of two updates to the fund Blueprint. The regulator informed the ANAO that all fund-related risks were reviewed in August 2016, including the attribution of all current and target risk ratings and the identification of additional treatments, where required.

Did the regulator develop appropriate guidance for staff?

The regulator has developed appropriate guidance, including standard operating procedures, work instructions and templates, to assist staff to assess fund *Project Registration Applications, Certificate of Entitlement Applications/Project Offsets Reports* and auction applications. The development of a register of fund standard operating procedures, templates and assessment tools would better position the regulator to monitor the accuracy and currency of its guidance materials.

5.3 To help deliver a consistent approach to the processing of fund applications, including in relation to project registrations, abatement crediting and auction participation, the regulator has progressively developed and refined standard operating procedures, work instructions and numerous assessment tools applicable to particular methods and method groups. As new methods are introduced, new assessment tools (primarily spreadsheet-based) are developed in parallel with the regulator’s assessment of the first applications applying the new methods.⁴⁹

5.4 The standard operating procedures, work instructions and assessment tools contain guidance on the assessment of applications for project registration, abatement crediting and auction participation. The comprehensiveness of guidance within abatement crediting assessment tools varies from method-to-method, including the extent to which and how applicants’ assertions are cross-checked with other internally- or externally-sourced information (for example, in relation to establishing an applicant’s identity). Greater control over assessors’ ‘tailoring’ assessment tools to applications under assessment would help to ensure that all relevant matters are addressed.⁵⁰

5.5 The regulator is yet to establish a consistent approach for authorising the use of newly developed assessment tools, nor is a central repository of assessment guidance material maintained. A centralised registry or repository of assessment guidance material would better position the regulator to more effectively manage and monitor the currency of its assessment procedures and tools.

48 The exception related to the determination of the current risk rating for one longstanding fund risk related to work, health and safety and environmental incidents.

49 Assessment tools typically break-down the numerous assessment requirements into individual components with explanatory guidance on the situations where they apply and how staff are to determine whether the applications meet each requirement.

50 Assessment criteria irrelevant to an assessment should be noted as ‘not applicable’ rather than deleted from the assessment tool.

Did the regulator implement an appropriate performance management framework to monitor and report on fund performance and its regulatory performance?

The regulator has an established performance management framework to monitor and report on fund performance, with work to strengthen the framework undertaken over recent years. To date, the regulator has been monitoring and publicly reporting on the performance of the earlier initiative and the fund against activity-based performance indicators. Since 2015–16, the regulator has enhanced key performance indicators to meet performance reporting requirements under the regulator’s Emissions Reduction Fund Blueprint, its Corporate Plan, its Portfolio Budget Statements, and the Regulator Performance Framework.

Fund performance monitoring and reporting

5.6 The Blueprint that was endorsed by the department and the regulator at the fund’s inception (and updated over time) contains four Scheme Benefits, linked to eight fund policy key performance indicator (KPI) areas and 10 operational KPIs. The department has overall responsibility for the achievement of Scheme Benefits and performance against policy KPI areas, with the regulator responsible for performance against the 10 operational KPIs. The regulator’s reporting against the operational KPIs informs the department’s reporting against its policy KPI areas and, ultimately, reporting on the extent to which Scheme Benefits have been realised.

5.7 The 10 operational KPIs are primarily activity-based measures and include the number of *Project Registration Applications* registered, the volume of carbon credit units issued, the volume of contracted abatement and level of client satisfaction with fund services provided. In February 2016, the department and the regulator approved a Benefits Realisation Plan for the fund that determined (to the extent practicable) for each operational KPI: information sources; quantitative baselines and targets; performance tolerances (green, amber and red) relative to targets; expected dates of target achievement (ranging from 2016 to 2020); and frequency of KPI measurement (annually for all measures). While the development of the plan could have been more timely, it has better positioned the regulator to report annually to the department on the achievement of the fund’s operational KPIs.

5.8 Prior to the finalisation of the Benefits Realisation Plan, the regulator had routinely monitored and reported on the performance of the earlier initiative fund, with public reporting of fund performance to date including:

- activity-based measures (similar to some of the operational KPIs) in the regulator’s 2011–12 to 2014–15 annual reports (see Table 5.1), including performance against the sole fund-related KPI that was included in the regulator’s *2014–15 Portfolio Budget Statements* (increased issuance of carbon credit units, with no set target)⁵¹;
- the release of auction results (including the number of fund projects contracted/contracts awarded, the contracted abatement volume per project/contract and average

51 KPIs contained in earlier Portfolio Budget Statements of the regulator were generic to multiple schemes administered by the regulator.

price per tonne of abatement) in accordance with timeframes published before the auctions.

Table 5.1: Fund performance as reported by the regulator, 2011–12 to 2014–15

Activity Indicators	Reported Performance by Year			
	2011–12	2012–13	2013–14	2014–15
Project registrations				
No. of <i>Project Registration Applications</i> received ⁽¹⁾	14	97	100	358
No. of <i>Project Registration Applications</i> approved ⁽¹⁾	0	68	84	139
Abatement crediting				
No. of <i>Certificate of Entitlement Applications</i> received ⁽¹⁾	-	29	85	185
No. of <i>Certificate of Entitlement Applications</i> approved ⁽¹⁾	-	22	85	184
Carbon credit units issued	-	1 750 179	4 380 473	9 318 106
Auctions				
Carbon credit units contracted to the regulator	-	-	-	47.3 million

Note 1: Differences between the number of applications received and approved in any given year are on account of applications refused, withdrawn or yet to be processed.

Source: Annual reports of the Clean Energy Regulator, 2011–12 to 2014–15.

Corporate plan

5.9 In addition to the fund-specific performance framework, the regulator's *Corporate Plan 2015–19* published in August 2015 (the first produced under the *Public Governance, Performance and Accountability Act 2013*) contains a list of KPIs—some of which relate either directly or indirectly to the fund—identified for each of the regulator's functions.⁵² The regulator has since commenced the development of a framework to collect and monitor performance against its Corporate Plan KPIs on a quarterly basis. In this context, the regulator's first quarterly report for 2015–16 was reviewed by an external consultant to determine the robustness of each KPI's source data. The review identified a number of proposed refinements to the underlying assumptions, definitions and data requirements for performance measures, but broadly concluded that data integrity would not prevent the regulator from producing and publishing a robust performance report for the year ended June 2016.

Portfolio Budget Statements

5.10 The regulator's 2016–17 PBS includes a specific measure relating to the operation of the fund—the *proportion of contracted abatement delivered*. A target of ≥ 80 per cent of cumulative contracted abatement is delivered on time has also been established.

⁵² The regulator's *Corporate Plan 2015–19* identifies KPIs by functions common to its schemes (for example: engagement and guidance; registration, accreditation and approvals; and monitoring and compliance) rather than indicators tailored for each of its schemes.

Regulator Performance Framework

5.11 In October 2014, the Department of the Prime Minister and Cabinet released the Regulator Performance Framework, which outlines obligations to be met by all Commonwealth regulators. The framework requires regulators that administer, monitor or enforce regulation to undertake an annual self-assessment against six common KPIs outlined in the framework that articulate the Government's overarching expectations of regulator performance.⁵³

5.12 The framework also requires an expert panel to review and agree the evidence to be collected for the annual self-assessment prior to the commencement of the reporting year (2015–16). To this end, in April 2015 the regulator identified outputs and activity-based indicators it intended to use to self-assess its regulatory performance against each of the six KPIs, which have been published on the regulator's website. The regulator informed the ANAO that drafting of the 2015–16 self-assessment report had commenced, the entities that will validate the report had been identified and the final validated self-assessment report was scheduled for publication by the due date of 31 December 2016.



Grant Hehir
Auditor-General

Canberra ACT
12 September 2016

53 The six KPIs are: regulators do not unnecessarily impede the efficient operation of regulated entities; communication with regulated entities is clear, targeted and effective; actions undertaken by regulators are proportionate to the risk being managed; compliance and monitoring approaches are streamlined and coordinated; regulators are open and transparent in their dealings with regulated entities; and regulators actively contribute to the continuous improvement of regulatory frameworks.

Appendices

Appendix 1 Entity response



EC16/43

Ms Michelle Kelly
Group Executive Director
Performance Audit Services Group
GPO Box 707
Canberra ACT 2601

Dear Ms Kelly

ANAO Performance Audit: Abatement Crediting and Purchasing under the Emissions Reduction Fund

Thank you for your letter of 22 July 2016 enclosing the Australian National Audit Office (ANAO) Proposed Audit Report on *Abatement Crediting and Purchasing under the Emissions Reduction Fund*.


The Clean Energy Regulator welcomes the findings of the report. We are pleased that, after a thorough sampling and review of our files related to both the original Carbon Farming Initiative and its successor the Emissions Reduction Fund, the ANAO has found that the arrangements and processes implemented by the Clean Energy Regulator are sound.

We note that this assessment was conducted on the basis of processes in place during the first four years of the two schemes. Our systems and processes continue to mature, as does our approach to the management of risk and identification of potential non-compliance.

The Clean Energy Regulator was established in 2012 to administer a range of climate change laws, including the newly introduced Carbon Farming Initiative. Each of the schemes we administer has been significantly amended since then, requiring a series of new systems and processes to be in place to meet legislated deadlines, including the commencement of the Emissions Reduction Fund in December 2014.

From the beginning, the agency designed the end to end controls and standard operating procedures for the Emissions Reduction Fund to ensure both compliance with the legislated purchasing principles and an appropriate balance between scheme risk and client burden. We believe that our controls encourage high levels of participation in the scheme, while ensuring that risks are managed appropriately. The Clean Energy Regulator has the ability, both in law and in practice, to step in at any time to ensure the integrity of the crediting scheme and purchasing process. We communicate extensively to ensure that our clients understand their obligations and have the necessary information to comply accordingly. We have specific processes and tools to ensure that any non-compliance is addressed quickly and effectively, often before it occurs or before a risk can manifest.

At the date of this letter, there are now 631 registered projects – 450 of which were registered under the Emissions Reduction Fund, with the balance (181) registered during the Carbon Farming Initiative. The



auctions have resulted in 309 contracts for more than 142 million tonnes of abatement at a contracted value of \$1.7 Billion. We have issued over 26 million Australian carbon credit units, of which over ten million have been delivered under contract. These substantial achievements are testament to the expertise and experience of our workforce, our investment in robust systems and processes and a strong ethos of client communication and engagement.

The audit findings confirm that the Clean Energy Regulator has created an appropriate awareness of Emissions Reduction Fund processes and has established effective arrangements to inform potential participants. This is evident in the high levels of participation and also from the quality of feedback we receive through our annual client survey.

As the volume of activity ramped up, the agency established a routine and complex project assessment triage system, where basic project applications are assessed by a dedicated assessment team and more complex project applications are processed by technical experts in the relevant field. As the ANAO noted, this system has allowed for more streamlined project assessments, decreasing application processing time, reducing third-party data checks and improving the experience for clients.

A key aspect of the Emissions Reduction Fund is the competitive auction process, which enables abatement to be purchased at lowest cost. Participants must qualify for participation in an auction. Over the three auctions, the process for auction qualification and registration has also been streamlined, with a similar triage system now in place for auction qualification as for project registration.

The agency welcomes the findings of the ANAO audit which concludes the first two Emissions Reduction Fund auctions were conducted effectively and in accordance with published auction guidance.

The stock of projects and contracts under our management will continue to rise over time. As projects deliver, a rapidly increasing proportion of our work will be in the crediting part of the scheme. We will engage with these changes, reallocate our resources as appropriate, and regularly review the application of our risk appetite. In this context, we fully accept the single recommendation from the performance audit, which focusses primarily on the opportunity to improve record keeping around decision making in the crediting part of the scheme. We are already working on this important measure and are confident that our changes will ensure even more robust and transparent administration of the Emissions Reduction Fund.

The Clean Energy Regulator will always seek to improve the administration of its schemes and engagement with its clients to achieve its objectives. The ANAO performance audit has provided a valuable reflection on our approach and I would like to thank you and your team for your careful assessment and constructive comments on our work.

Yours sincerely



Chloe Munro
Chair, Clean Energy Regulator
22 August 2016

