

## **EXPLANATORY STATEMENT**

Issued by the Minister for Energy and Emissions Reduction

*Carbon Credits (Carbon Farming Initiative) Act 2011*

*Carbon Credits (Carbon Farming Initiative) Amendment (Audit) Rule 2021*

### **Purpose of Amendment Rule**

The *Carbon Credits (Carbon Farming Initiative) Amendment (Audit) Rule 2021* (the **Amendment Rule**) provides more flexibility to ensure that the mechanisms for providing assurance for an Emissions Reduction Fund (ERF) project are proportionate to risk and take advantage of technological or other lower cost tools to provide assurance that the project is meeting the relevant requirements.

Currently, the number of scheduled audits required for an ERF project is set by a combination of the *Carbon Credits (Carbon Farming Initiative) Rule 2015* (the **Principal Rule**), made by the Minister, and the *Carbon Credits (Carbon Farming Initiative) (Audit Thresholds) Instrument 2015* (Audit Thresholds Instrument), made by the Clean Energy Regulator (the Regulator). The Principal Rule requires each ERF project to be the subject of at least three audits and then empowers the Audit Thresholds Instrument to specify that certain classes of project are subject to more than three audits if they exceed certain thresholds based on the annual average volume of abatement. Both the legislative rules and Audit Thresholds Instrument are disallowable legislative instruments.

The Amendment Rule creates a new category of “alternative assurance projects” which may be subject to fewer or no audits and enables the Regulator to set requirements for a project to be an alternative assurance project through the Audit Thresholds Instrument. Alternative assurance projects can be projects which are considered to be low risk because of the attributes of the project, combined with other mechanisms to provide appropriate alternative assurance to audits at a lesser cost, or both.

### **Background: Emissions Reduction Fund**

In 2014, the Australian Government amended the *Carbon Credits (Carbon Farming Initiative) Act 2011* (the Act) with the *Carbon Farming Initiative Amendment Act 2014* (CFI Amendment Act). The CFI Amendment Act established the Emissions Reduction Fund to support investment in carbon abatement projects across all sectors of Australia’s economy.

The Act is supported by subordinate legislation, including the Principal Rule and the *Carbon Credits (Carbon Farming Initiative) Regulations 2011* (the Regulations). The Principal Rule and the Regulations provide detailed explanations of the way in which the Act is administered by the Regulator. The Minister for Energy and Emissions Reduction is empowered to make legislative rules under section 308 of the Act.

The ERF is a key component of the Government’s policy agenda to drive emissions reductions across the economy and to fulfil Australia’s international commitments under the Paris Agreement.

## Reasons for amendment

The 2020 *Report of the expert panel examining additional sources of low cost abatement* (the King Review), made several recommendations to reduce administrative costs and encourage greater uptake of ERF projects by farmers and small landholders, including:

- Recommendation 6.7 – reducing transaction costs to drive participation from small agriculture projects.
- Recommendation 6.10 – continue efforts to streamline ERF audit requirements at an administrative level and to explore the potential to use alternatives to more traditional audit processes.

Integrity of abatement is a key element of the ERF. Since the inception of the scheme, audit has been a core integrity and assurance measure for all projects. The Amendment Rule and proposed related amendments to the Audit Thresholds Instrument are intended to recognise that, as industry innovates and technologies develop, there are opportunities to recognise alternatives to audits<sup>1</sup> that provide a level of assurance that is fit for purpose and does not reduce scheme integrity. Such alternatives can reduce administrative burden for participants and open up scheme participation, including for small-scale projects for which the audit costs are a barrier, in line with the King Review recommendation.

In addition, the CFI Amendment Rule and proposed amended Audit Thresholds Instrument are intended to support the Carbon + Biodiversity Pilot (C+B Pilot) administered by the Department of Agriculture, Water and the Environment (DAWE). The C+B Pilot provides financial support for farmers and landholders to improve on-farm biodiversity together with carbon abatement benefits under the ERF. One of the core elements of the C+B Pilot is that participants register an ERF project using the *Carbon Credits (Carbon Farming Initiative) (Reforestation by Environmental or Mallee Plantings—FullCAM) Methodology Determination 2014* (the environmental plantings method). Audit costs have been raised by stakeholders as an impediment to participation in the C+B Pilot.

## Outline

The Principal Rule includes the circumstances where the Regulator can set and amend audit thresholds in the Audit Thresholds Instrument. The Amendment Rule allows a new category of project, alternative assurance projects, to be exempt from the minimum audit requirements and enables the Regulator's Audit Thresholds Instrument to set conditions and alternative assurance mechanisms for projects to be alternative assurance projects.

The Amendment Rule amends Section 73 of the Principal Rule to set out the criteria which projects must meet to be a low risk “alternative assurance project” for audit purposes, in reference to specific matters which the Regulator will be permitted to set out in the Audit Thresholds Instrument under amended subsection 75(4). The criteria also set out that a project will only be eligible to be an alternative assurance project on the request of the project proponent.

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<sup>1</sup> In this case audits refers to ERF audits as defined in the *National Greenhouse and Energy Reporting Act 2007*.

Emissions Reduction Fund projects are subject to a minimum of one initial audit and two subsequent audits. Amendments to subsection 74(1) and 75(1) of the Principal Rule make it clear that alternative assurance projects can be excluded from these minimum audit requirements. The amendments will empower the Regulator to amend the Audit Thresholds Instrument to set the applicable method determination, criteria and conditions to be considered an alternative assurance project and set the number (including zero) of initial and subsequent audits for these alternative assurance projects.

The proposed amendments to the Audit Thresholds Instrument set out the requirements for an initial class of alternative assurance projects to include certain small projects using the *Carbon Credits (Carbon Farming Initiative) (Reforestation by Environmental or Mallee Plantings—FullCAM) Methodology Determination 2014*. In this case, the Regulator considers the relevant attributes to include the type of proponent, size and type of the project, as well as the ability to monitor the project via geo-spatial monitoring. Under the amended Audit Thresholds Instrument, projects that meet these criteria will not be subject to any scheduled audits. The Amendment Rule enables the Audit Thresholds Instrument to add further classes of alternative assurance projects in future, with the intention of reducing the compliance burden on other low risk projects.

Alternative assurance projects will still be subject to obligations in relation to triggered audits covered by sections 77, 78 and 79 of the Principal Rule, and compliance and other audits covered by sections 214 and 215 of the Act. Under these provisions the Regulator can conduct a range of audits as appropriate. There are also a range of assurance measures the Clean Energy Regulator can undertake in addition to geo-spatial monitoring. This may include audits of alternative assurance projects under the annual assurance program funded by the Clean Energy Regulator.

The amendments to section 75 of the Principal Rule insert risk-based principles which the Regulator must take into account in making the Audit Thresholds Instrument to ensure that the proportionality of burden to risk is appropriately balanced. Specifically, these principles include the proportionality of audit burden to risk, and whether particular classes of projects should have more, less, or no audits, the effectiveness of alternative assurance processes prescribed, and that the cost of being an alternative assurance project is less than the cost of ordinary audit requirements.

Subsection 73(5) of the Principal Rule is amended to expand the situations in which the Regulator may vary an audit schedule to facilitate the removal of regulatory burden for pre-existing projects that meet the criteria for alternative assurance projects or change so that they become an alternative assurance project, after a schedule is set. This includes allowing the removal of one or more audits that would not be required if the Regulator amends the Audit Thresholds Instrument, or if the project becomes a low risk alternative assurance project.

Amendments to section 73 also allow the Regulator to vary the audit schedule to require audits where a project changes so that it is no longer an alternative assurance project, or does not meet the conditions of an alternative assurance project. The Regulator would only be allowed to add audits that would have otherwise been required if the project was not an alternative assurance project. This type of decision would be a reviewable decision.

Other amendments to the Principal Rule deal with administrative matters related to alternative assurance projects, including obligations for project proponents when applying for, and reporting on alternative assurance projects. The Amendment Rule requires that project proponents provide information and documents set out in offsets reports, where required by the conditions of an alternative assurance project in the Audit Thresholds Instrument. This information in the offset report allows the Regulator to monitor the integrity of abatement claimed from alternative assurance projects.

### **Detailed description of the Amendment Rule**

Attachment A outlines and describes the sections in the Amendment Rule.

### **Public consultation**

In September 2020, the Regulator undertook a round of public consultation seeking industry's views on ways in which audit requirements in the Emissions Reduction Fund could be streamlined to reduce costs while maintaining an appropriate level of scheme integrity. This consultation contributed to the proposal to create a new category of eligible offsets projects that would be subject to lower audit obligations.

Joint consultation between the Regulator and the Department of Industry, Science, Energy and Resources on alternative assurance projects was undertaken from 25 May 2021 to 7 June 2021. An exposure draft of proposed amendments to the Principal Rule and the Audit Thresholds Instrument were included as part of the consultation on the Regulator's website for comment and feedback. Comments and advice received were taken into account in finalising the Audit Thresholds Instrument. 21 submissions were received.

Most submissions were supportive of the proposed amendments, referencing the appropriate balance of reducing barriers to participation, particularly for small projects, while maintaining scheme integrity. Other submissions were primarily concerned with the proposed amendments to the Audit Thresholds Instrument, and what project types might be included as alternative assurance projects in future.

Some submissions raised concerns that the removal of all scheduled audits, such as that proposed for "Low Risk Environmental Planting Projects" in the amended Audit Thresholds Instrument, may negatively impact scheme integrity. The Regulator will retain a range of existing auditing, monitoring, and information gathering powers which are available to maintain scheme integrity, in addition to prescribed alternative assurance mechanisms.

The Amendment Rule makes clear that the Regulator may specify that an alternative assurance project is not required to undertake an initial audit. Submissions raised specific concerns in relation to this amendment, on the basis that it may increase the risk that project proponents may not have the legal right or appropriate eligible interest holder consents to undertake a project. However, ERF project proponents are required to satisfy the Clean Energy Regulator that they meet all eligibility criteria required at registration or at crediting, rather than this being tied to the audit schedule. The amendments allow the Regulator discretion to require initial audits for classes of alternative assurance projects, depending on risks of the specific project category.

### **Regulatory impact**

The Office of Best Practice Regulation has confirmed that a Regulatory Impact Statement is not required, because the proposal is unlikely to have more than a minor regulatory impact.

**Statement of compatibility with human rights**

A statement of compatibility with human rights for the purposes of Part 3 of *the Human Rights (Parliamentary Scrutiny) Act 2011* is set out at Attachment B.

**Details of the sections in the *Carbon Credits (Carbon Farming Initiative) Amendment (Audit) Rule 2021***

1. Name

Section 1 provides that the name of the Amendment Rule is the *Carbon Credits (Carbon Farming Initiative) Amendment (Audit) Rule 2021*.

2. Commencement

Section 2 provides that the Amendment Rule would commence on the day after it is registered.

3. Authority

Section 3 provides that the Amendment Rule would be made under section 308 of the Act.

4. Schedules

Section 4 provides that the Amendment Rule would, when made, amend the *Carbon Credits (Carbon Farming Initiative) Rule 2015 (the **Principal Rule**)* in the manner set out in the schedules. The power to make rules in section 308 of the Act includes the power to amend or revoke rules that have already been made, with any doubt about this resolved by subsection 33(3) of the *Acts Interpretation Act 1901*.

Schedule 1—Amendments

Item 1: Subsection 4(1)

This item adds a definition to locate the new definition of alternative assurance project in subsection 73(7).

Item 2: At the end of subsection 13(1)

This item adds new paragraph 13(1)(r) to ensure that a project proponent includes appropriate supporting information when applying for the declaration of a project which they consider to be an alternative assurance project as defined under the new subsection 73(7). The project proponent is best placed to provide information which supports the classification of a project as an alternative assurance project, and to ensure that any requirements or conditions for the project to be an alternative assurance project are met. This information will be used to determine if the project is an alternative assurance project and ensure the appropriate alternative assurance, if required, is in place for the particular project.

Item 3: At the end of subsection 70(2)

The Amendment Rule enables the Audit Thresholds Instrument to specify that a project proponent must meet certain conditions related to reporting in order to be an alternative assurance project. This item adds new paragraph 70(2)(m) to ensure proponents set out required information in an offsets report, where the project proponent is required to provide information to be consistent with any conditions to be an alternative assurance project.

#### Item 4: Paragraph 71(c)

This item makes a minor punctuation change to allow for the insertion of new paragraph 71(d).

#### Item 5: At the end of section 71

This item adds new paragraph 71(d) to ensure proponents provide required documents accompanying an offsets report, where the project proponent is required to provide that document to be consistent with any conditions to be an alternative assurance project.

#### Item 6: Paragraph 73(2)(a)

The Regulator must give an audit schedule to a project proponent when the Regulator declares a project to be an eligible offsets project, in order to give project proponents certainty on how many scheduled audits a project will be subject to. Item 6 inserts the words 'if any' to provide clarity that an audit schedule may set out that no scheduled audits are required for the project. This will enable audit schedules to be made for alternative assurance projects which are subject to zero scheduled audits, if prescribed by the Audit Thresholds Instrument.

#### Item 7: At the end of subsection 73(2)

Minimum audit requirements for projects are set out in the Principal Rule, being at least one initial audit and two subsequent audits. The Amendment Rule enables the Audit Thresholds Instrument to specify that an alternative assurance project is not subject to the minimum number and type of scheduled audits. This allows the Audit Thresholds Instrument the flexibility to require, or not require, a certain type of audit for an alternative assurance project where appropriate assurance mechanisms can reduce the audit burden. This item adds new paragraph 73(2)(d) to recognise that the audit schedule for each project will make clear whether or not the first audit of an alternative assurance project is an initial audit or a subsequent audit. There are different requirements for each of these audits in the Principal Rule

#### Item 8: Paragraph 73(5)(a)

This item expands the situations in which the Regulator may vary an audit schedule consequential to the creation of alternative assurance projects. It replaces paragraph 73(5)(a) with new paragraph 73(5)(a) and (aa) to facilitate the removal of scheduled audits for pre-existing projects that become alternative assurance projects due to an amendment to the Audit Thresholds Instrument, or elect to become an alternative assurance project after a schedule is set. This ensures that projects which pre-date an amendment to the Audit Thresholds Instrument to reduce audit burden, or change in nature to meet the criteria for an alternative assurance project, are able to transition to the new arrangements and are not disadvantaged compared to new projects.

New paragraph 73(5)(ab) deals with situations where a project changes so that it is no longer an alternative assurance project or fails to meet the conditions for an alternative assurance project. An example of such a circumstance is where only projects under a certain size are alternative assurance projects, but the project expands by deciding to add project areas such

that it exceeds the relevant size threshold. In these cases, it enables the Regulator to vary the audit schedule to require audits that would have otherwise been required if the project was never an alternative assurance project. This amendment maintains scheme integrity by ensuring that only projects which continue to meet the criteria and conditions to be an alternative assurance project are eligible for reduced audits.

This paragraph only applies where the *project* changes, and does not apply where the *eligibility criteria* in the Audit Thresholds Instrument changes. Accordingly, amendments to the eligibility criteria in the Audit Thresholds Instrument are not intended to result in additional audits being imposed under this paragraph.

#### Item 9: At the end of section 73

This item adds two subsections to section 73. New subsection 73(7) sets out the factors for a project to be an alternative assurance project. Under paragraphs 73(7)(a) to 73(7)(c), an alternative assurance project must meet the applicable method, any criteria for the projects covered by that method, and any conditions related to operating, monitoring and reporting, prescribed by the Regulator in the Audit Thresholds Instrument. This item allows the Regulator flexibility to update the Audit Thresholds Instrument with new categories of alternative assurance projects, where technological or methodological progress allows for appropriate assurance to be obtained from means other than audits. It also enables the Regulator to ensure that sufficient information is available to provide appropriate assurance, by prescribing that an alternative assurance project must meet conditions related to the operation, monitoring, or reporting for a project.

Paragraph 73(7)(d) ensures that a project will only be an alternative assurance project at the request of the project proponent, in their application or otherwise. This ensures that proponents are not forced to undertake an alternative assurance process which is not appropriate for their circumstances.

The note provides a definition of what an alternative assurance project will generally be, to provide clarity for the principles informing the creation of the new project type.

Subsection 73(8) makes a decision to vary an audit schedule under paragraph 73(5)(ab) a reviewable decision under section 240 of the CFI Act, to ensure appropriate means of review are available to project proponents. This process allows for reconsideration of decisions and appeal to the Administrative Appeals Tribunal.

Item 13 of the Amendment Rule empowers the Regulator to prescribe the matters relating to the new subsection 73(7) in the Audit Thresholds Instrument.

#### Item 10: Subsection 74(1)

This item repeals and replaces subsection 74(1) to confirm that the requirement for the first scheduled audit to be an initial audit does not apply to alternative assurance projects. As initial audits have a broader scope, they are often more costly and burdensome to complete. The note provides clarity that the audit schedule will specify whether an alternative assurance project will be subject to an initial audit, if audits are required.

#### Item 11: After subsection 74(3)



Section 74 provides for the number and scope of initial audits, where required. This item inserts new subsection 74(3A) to deal with consequential arrangements for initial audits, following a variation decision by the Regulator to add audits to an audit schedule under new paragraph 73(5)(ab). This is because it is unlikely to be possible or useful to audit the initial period of the project if the audit is only triggered a number of years after the project was declared.

#### Item 12: Subsection 75(1)

Section 75 deals with the number of subsequent audits required for an eligible offsets project. Item 11 adds words to clarify that an alternative assurance project is not subject to the minimum requirement of two subsequent audits set out in subsection 75(1).

#### Item 13: Subsection 75(2)

This item repeals subsection 75(2), to remove the minimum requirement of three subsequent audits for transitioning projects that are not required to have an initial audit. This was a transitional provision from the move from the Carbon Farming Initiative to Emissions Reduction Fund and is no longer necessary.

#### Item 14: After paragraph 75(4)(b)

This item adds two new paragraphs to subsection 75(4), which is the power for the Regulator to make the Audit Thresholds Instrument as a legislative instrument under the Principal Rule. The power to make this instrument has existed since the commencement of the Principal Rule and is consistent with the power in sections 304 and 308 of the Act. The Audit Thresholds Instrument is disallowable in accordance with the ordinary processes in the *Legislation Act 2003*.

Paragraph 75(4)(ba) will be inserted to allow the Regulator to set out the specific matters relating to the considerations for an alternative assurance project in the Audit Thresholds Instrument. This will enable the Regulator flexibility to prescribe matters relevant to subsection 73(7) as new alternative assurance processes emerge.

Paragraph 75(4)(bb) allows the Regulator to prescribe whether the first audit must be an initial audit for an alternative assurance project that is required to undertake scheduled audits. As initial audits have a broader scope, they are often more costly and burdensome to complete. This amendment allows the Regulator to choose whether or not to prescribe an initial audit, depending on relevant risk factors and alternative assurance available for the particular type of project.

#### Item 15: After subsection 75(4)

This item inserts the new subsection 75(4A) outlining principles which the Regulator must take into account in making the Audit Thresholds Instrument to ensure that the proportionality of burden to risk is appropriately balanced. Specifically, these principles include the proportionality of audit burden to risk, whether particular classes of projects should have more, less, or no audits; the effectiveness of alternative assurance processes prescribed; and that the cost of being an alternative assurance project is less than the cost of ordinary audit requirements.

Additionally, the Regulator will be empowered to take into account any other relevant matters.

The principles ensure the Regulator's expanded discretion is exercised in line with the policy intent of the Amendment Rule to reduce compliance costs and ensure that the assurance process is appropriate and proportionate to the risks of the project.

**Statement of Compatibility with Human Rights**

*Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011*

***Carbon Credits (Carbon Farming Initiative) Amendment (Audit) Rule 2021***

The *Carbon Credits (Carbon Farming Initiative) Amendment (Audit) Rule 2021* (the ***Amendment Rule***) is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

**Overview of the Legislative Instrument**

The *Carbon Credits (Carbon Farming Initiative) Act 2011* (the ***Act***) enables the crediting of greenhouse gas abatement from emissions reduction activities across Australia. Greenhouse gas abatement is achieved either by reducing or avoiding emissions, or by removing carbon from the atmosphere and storing it.

The *Carbon Credits (Carbon Farming Initiative) Rule 2015* details additional administrative procedures under the Act, including information and audit requirements for project applications and reports, the fit and proper person test for participants, procedures for parts of the carbon abatement purchasing process, the length of reporting periods, and notification and record-keeping requirements. It also sets out certain audit requirements for eligible offsets requirements, and provides for a head of power for the Clean Energy Regulator to create an audit thresholds instrument: *the Carbon Credits (Carbon Farming Initiative) (Audit Thresholds) Instrument 2015* (the 2015 Audit Thresholds Instrument).

The Amendment Rule introduces a new concept of “alternative assurance projects” that would be subject to fewer audits, and in some cases, no audits. The Amendment Rule allows the Audit Thresholds Instrument to set criteria for a project to be an alternative assurance project and what, if any, alternative assurance process the project proponent is required to undertake. The intention is for the Rule change to reduce compliance costs of participation in the ERF, such that alternative assurances will be less costly and burdensome than the audits they replace.

The Amendment Rule also deals with administrative matters related to alternative assurance projects, including obligations for project proponents when applying for and reporting on alternative assurance projects.

The Amendment Rule does this by amending the *Carbon Credits (Carbon Farming Initiative) Rule 2015* (the ***Principal Rule***). The Amendment Rule should be viewed in combination with the proposed amendment to the Audit Thresholds Instrument.

**Human rights implications**

The Amendment Rule does not engage any of the applicable rights or freedoms.

A detailed statement of compatibility of the provisions of the Emissions Reduction Fund is provided in the Explanatory Memorandum for the *Carbon Farming Initiative Amendment Bill 2014*:

<https://www.legislation.gov.au/Details/C2014B00129/Explanatory%20Memorandum/Text>.

## **Conclusion**

The Amendment Rule is compatible with human rights because it does not limit any human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.