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EFRAG workstreams on SMEs – Cover Note

Objective

- 1 The objective of this cover note is to:
 - a) describe the background and rationale of the EFRAG workstreams on SMEs
 - b) propose an ESRS building block system that would cover both the listed SMEs ESRS and the Voluntary Standard for non-listed SMEs

Background and rationale

- 2 EFRAG work on SMEs comprises of:
 - (a) A mandate for technical advice for simplified listed SMEs ESRS (art 29c CSRD) stemming from the Corporate Sustainability Reporting Directive (CSRD)¹. On its basis the European Commission will adopt delegated act by June 2024. The listed SMEs ESRS will be legally binding. The methodology for developing the listed SMEs ESRS and the analysis of the related CSRD provisions are provided in Issue Paper 04-01 and its Appendix 1.
 - (b) A recommendation to develop a Voluntary Sustainability Reporting Standard for non-listed SMEs, that are outside the legal scope of the CSRD. EFRAG technical advice on this voluntary standard is not legally framed. The European Commission may adopt EU voluntary guidelines on its basis by June 2024.
- 3 The following paragraphs explain why EFRAG is working on the voluntary standard for non-listed SMEs since this is not a legal mandate stemming from CSRD.
- 4 The following sources have been reviewed by the secretariat as a base for the work on a voluntary standard for non-listed SMEs:
 - [EU Commission Impact Assessment accompanying the CSRD proposal](#) (April 2021)². In its analysis the EU Commission explains that SMEs are increasingly exposed to sustainability information requests (Taxonomy, SFDR, Sustainable finance legislation, due diligence...). from their stakeholders (larger companies in

¹ Adopted Text, P9_TA(2022)0380, Corporate Sustainability Reporting Directive- European Parliament legislative resolution of 10 November 2022 on the proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting (COM(2021)0189 – C9-0147/2021 – 2021/0104(COD))

² [COMMISSION STAFF WORKING DOCUMENT EXECUTIVE SUMMARY OF THE IMPACT ASSESSMENT](#) Accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU, Directive 2004/109/EC, Directive 2006/43/EC and Regulation (EU) No 537/2014, as regards corporate sustainability reporting

the value chain, financial institutions, public administration or other). For this reason, the EU Commission had originally considered the option of extending the scope of CSRD to non-listed medium sized enterprises (option 4 in EU Commission Impact Assessment). This option was finally disregarded as the cost-benefit analysis would not justify it. Importantly the EU Commission indicates in its analysis that *“reporting raises companies’ awareness of sustainability-related risks and improves risk management. It should also lead to advantages for more sustainable companies, since sustainability front-runners will be more easily identifiable. The reporting requirements would not apply to SMEs, except listed SMEs. However, simplified reporting standards will be developed for SMEs to use on a voluntary basis. These should enable SMEs to meet information demands from large company clients and banks, and will facilitate their contribution to and participation in the transition to a sustainable economy.”*

- EFRAG PTF-ESRS (cluster 8) and Expert Group on SMEs (June 2021- July 2022) reviewed the proposal on SMEs by the EFRAG Lab (February 2021), conducted analysis, released a questionnaire on SMEs reporting practices and a questionnaire on user needs, reviewed all existing legislation likely to impact SMEs, and collected feedbacks from a large number of stakeholders via outreaches. On this basis it concluded that a bottom-up approach is needed for a voluntary standard for non-listed SMEs (about 22 million in Europe, 99%² are micro with less than 10 employees). This would consist of minimum voluntary disclosures that are conceived as a self-standing standard adapted to the particularities and capacities of non-listed SMEs, micro and small enterprises. A standard originally conceived for listed SMEs would be too complex for non-listed micro and small enterprises. The Voluntary Standard for non-listed SMEs drafted by PTF cluster 8 is presented in Issue Paper 03-01 and its Appendix 1.

- Answers to the EFRAG public consultation on ESRS, and outreaches event on SMEs (June 2022 - August 2022). The secretariat has reviewed the answers to the EFRAG consultation identifying the references to reporting standards for SMEs. About 100 answers contained references to SMEs. The majority raised concern on value chain and the trickle-down effect on SMEs and the high complexity and costs. Respondents were generally in favour of simplified and proportionate standards for SMEs. Some respondents suggested that a separate voluntary standard for non-listed SMEs shall be defined beside the listed SMEs ESRS in a modular system. This would provide a consistent framework suitable for all undertakings, from the largest to the smallest.

- Commissioner Mc Guinness in her speech of 3 November 2022³ indicates that *“We’re working on developing standards that SMEs will be able to use on a voluntary basis, so simplified sustainability reporting standards. The European Financial Reporting Advisory Group is already working on these.”*

- 5 On the basis of the above the secretariat is presenting to the SR TEG the proposal to develop a voluntary standard for non-listed SMEs beside the listed SMEs ESRS. Moreover, the secretariat suggests that both proposals would be part of a ESRS building block system that would also include the ESRS for large undertakings.

ESRS Building Block System

- 6 In the light of what described in the previous section the secretariat proposes that the ESRS building block system takes the shape of a modular system. This may result as follows:

³ Speech “Beyond the horizon, the future of financial services” at Central Bank of Ireland, 3 November 2022

- i) voluntary standards for non-listed SMEs would be minimum content “building block”,
 - ii) the second building block would consist of the “listed SMEs ESRS” and
 - iii) the third building block would be the ESRS for large undertakings.
- 7 Under the modular ESRS system, the SMEs VSRS could be designed as a first steppingstone for non-listed SMEs in their journey towards transparency on ESG matters. The advantage of the building block system according to stakeholders in EFRAG ESRS public consultation and the EU Commission is to create a framework that is consistent and that allows non-listed SMEs to voluntarily and progressively adjust their reporting through successive steps. The existence a core voluntary standard as part of the system would incentivise SMEs preparers to use the European system of ESRS in complement or as alternative to current used framework.
- 8 The ESRS building block system could be visualised as follows

