

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG SR TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG SRB or EFRAG SR TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG SRB, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

Background

- 1 During the SR TEG on 2 February 2023, the members have discussed in a public session a first working paper for the cross-cutting LSME contents. In the same meeting, EFRAG SR TEG discussed in a closed session how the content of the Set 1 topical standards for metrics could be simplified for the purposes of preparing LSME..
- 2 The present draft v1 LSME ESRS integrates the comments received by SR TEG on 2 February on
 - section I “General requirements”
 - section II “General Disclosures”

– And the key issues emerged in SR TEG breakout sessions on the following topical sections:

 - section III “Environmental disclosures”;
 - section IV “Social disclosures”;
 - section V “Business conduct disclosures”.
- 3 The aim of circulating the questionnaire on v1 LSME ESRS is to receive comments from SR TEG on selected questions ahead of the next session on draft LSME ESRS.

Selected questions in the excel questionnaire

Section 2 “General disclosures”

- 4 ESRS 2 Disclosure Contents (CC-P, DC-A and DC-T) have been eliminated. They are mentioned (via a cross-reference to draft ESRS 2 as a source of guidance to be applied on a voluntary basis).
- 5 Instead, the standard would require reporting a statement on policies, targets and actions, limited to matters assessed as material, plus climate. The undertaking would comply with a statement that it has not adopted targets and may report a timeline for adoption, where appropriate.
- 6 This centralised disclosure requirement is to be found in
 - Disclosure Requirement IR¹-3 – Policies adopted to manage material sustainability matters

¹ IR stands for Impact and Risk management. In LSME the proposal is to have requirements for I and R and to have O covered on a voluntary basis.

- Disclosure Requirement IR-4 – Actions and resources in relation to sustainability matters
 - Disclosure Requirement IR-5 – Targets in relation to sustainability matters
- 7 To note that the undertaking may disclose the information either centrally or in the topical part of the report.
- 8 **SR TEG members are requested to provide specific feedbacks on IR-3, IR-4 and IR-5 in the excel questionnaire.**

Topical sections – General overarching questions

- 9 During the breakout room discussions, SR TEG members discussed some possible simplifications to the Environmental standards, including possible simplifications of Scope 3 disclosure.
- 10 The EFRAG Secretariat provides below its understanding and recommendations.
- 11 An overarching standard setting guideline and constraint for LSME is, as discussed in many previous meetings, the ‘cap’. The CSRD identifies the content of the LSME standards as setting the reference point for what can be and cannot be required in Set 1, for the value chain. In particular, Set 1 cannot require to large undertakings to cover value chain information for a datapoint that is not a required datapoint in LSME.
- 12 EFRAG will issue in 2024 an Amendment to the topical standards (and to ESRS 2 if relevant) to adjust the contents of Set 1 standards, so that the standards do not result in requiring value chain information for datapoints that are not covered in LSME.
- 13 Operationally this means that if, for example, EFRAG does not include as a datapoint a given breakdown in the LSME standards, the corresponding breakdown in Set 1 can be required to large undertakings ONLY for own operations.
- 14 Accordingly, the margin of manoeuvre for simplifications in the LSME standards is limited, in particular for metrics datapoints that cover value chain information.
- 15 Another complication relates to the SFDR, Pillar and Benchmark datapoints. These datapoints have been incorporated in ESRS Set 1 without providing interpretation or guidance, as their content, including whether and to what extent they do cover value chain, is in the remit of the respective authorities and respective ITSS. This has been specifically discussed during Set 1 finalization. This also means that in order not to create a prejudice to the integral preparation of the SFDR datapoints by large undertakings, the datapoints in appendix C of ESRS 2 cannot be simplified in LSME.
- 16 SR TEG are invited to consider alignment of draft LSME ESRS with IFRS. Do you think that this alignment is reflected and to what extent it shall be included when balancing the proportionality element?

Section III Environmental Disclosures

- 17 The disclosures on policies, actions and targets related to environment have been centralised in Section II General Disclosures under Disclosure Requirement IR-3 – Policies adopted to manage material sustainability matters, Disclosure Requirement IR-4 – Actions and resources in relation to sustainability matters, and Voluntary Disclosure IR-5 – Targets in relation to sustainability matters.

18 Based on the results of the SR TEG breakout session held on February 02. 2023, the following simplifications were proposed during the breakout. They need to be reassessed in the light of what reported above.:

- Disclosure Requirement E1-2– Energy consumption and mix. Proposal to simplify paragraph 11 (breakdown total energy consumption from non-renewable sources for high climate impact sectors). This is assessed by the secretariat as impacting the value chain cap and the consistency of breakdown of disclosures through the value chain for SFDR datapoints.
- Disclosure Requirement E1-3–GHG Scope 3 emissions: the proposal elaborated by SR TEG in the breakout session to limit scope 3 to “relevant scope 3 information “and refer to GHG protocol was reassessed by the secretariat. The formulation of the text is therefore unchanged compared to set 1 to ensure consistency in the value chain cap for SFDR and Benchmark datapoints.
- Disclosure Requirement E1-5 Potential financial effects from material physical and transition risks and potential climate-related opportunities is simplified, as opportunities are voluntary content.
- Disclosure Requirement E1-4 – GHG removals and GHG mitigation projects financed through carbon credits: delete par 27(b) and shortened . This DR is not SFDR datapoint. The secretariat considers that the extent of the impact on the value chain cap is limited, so proposes to implement this change.
- E 1-1: transition plans: orientation is sought on whether to maintain this DR in the metric topical section or move it to section II under SBM3.
- For potential financial effects in E2 to E3: the proposal of an alternative text with disclosure limited to exposed turnover or assets in the current financial year has been reconsidered by the secretariat. Turnover and assets are two dimensions of the financial effects, but they are not the only dimensions (cash flows, including liabilities, financial position, access to capital, cost of capital, etc.), consistent with ESRS 1 and the entire standard is built to be consistent with the key principles of ESRS 1 (narrowing down the definition of financial materiality would conflict with this principle).
- To note that the ARs and the Appendix in current v1 of Section III need further adjustments.

Section IV Social Disclosures

19 Based on the results of the SR TEG breakout session held on February 02. 2023, EFRAG Secretariat has introduced the following changes and seeks SR TEG views on the following aspects:

- The proposal to centralise all disclosures on policies, actions and targets in Section II was adjusted for the social topics. Some SR TEG members have highlighted that the centralised approach significantly reduces the content that is mandated by due diligence in human rights requirements.

- Regarding the metrics in Own workforce (S1), it has also been suggested to simplify the content and reduce the granularity/breakdowns, rather than eliminating whole disclosure requirements. This is particularly important considering that the LSME ESRS will be the cap on value chain for large undertakings. However, there might be more space for simplification.
- EFRAG Secretariat was requested by SR TEG to do the following in depth analysis:
 - Confirmation with European Commission of the co-legislators intent regarding due diligence disclosures by the CSRD for LSMEs versus those required for the full ESRS. Article 19a (6) does not mention it specifically but includes some notions of this process in letter (c): principal actual or potential adverse impacts on sustainability matters; as well as actions taken to identify, monitor, prevent, mitigate or remediate.
 - Three possible interpretations have been considered: 1) the due diligence process and steps have been excluded by not mentioning it specifically as for large undertakings (article 19a (2) (f) (i)); 2) only two steps in the due diligence process have been included (i.e., identification and assessment of adverse impacts, and taking actions to cease, prevent, mitigate, and remediate adverse impacts) and no description of the process required; or 3) the whole spirit of the due diligence process has been considered under a simplified language, since the steps of the process are not meant to be considered individually, however no disclosure of the process per se required.
 - If not mentioning due diligence in the article 19 a (6) for LSMEs was an intentional choice of the legislator (interpretation 1), one SR TEG member suggested to consider including the processes for engagement with stakeholders and processes to remediate, as voluntary disclosure requirements. If it is intended to consider due diligence in the LSME standard (option 3), further simplifications could be envisaged for the disclosure requirements that have not been included in the working paper. Such simplifications would be twofold; on the one hand, rationalisation/streamlining of disclosure requirements for “shall disclose” datapoints and, secondly, allowing LSMEs to voluntarily disclose some of the full ESRS datapoints on due diligence (for example, those that are additional to the GRI management of material topics in the universal standards). The location of such disclosure requirements in social would present two options. Option 1 would be within the ESRS 2 centralised disclosures and Option 2 would be to have a “centralised social disclosure” that would cover ESRS S1-S4.

Questions to SR TEG Members and observers

1. Please provide written comments to the questions in the annex Excel questionnaire by 17 February (noon)
2. Please consider the overarching questions in paragraph 9 to 16 above (value chain cap and alignment with IFRS) for discussions at the next SR TEG session on draft LSME ESRS