

SME standards: approach and methodology

Background

- 1 EFRAG work on SMEs comprises of a mandate for technical advice for simplified listed SMEs ESRS (art 29c CSRD) (LSME Standard), which will be legally binding (delegated acts), and a recommendation to develop a Voluntary Sustainability Reporting Standard for non-listed SMEs (VSME Standard), that the European Commission (EC) would adopt/endorse (as « recommendation » of the EC, not a delegated act, not binding).
- 2 In the EC's impact analysis accompanying the CSRD it is stated that *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.*

Objective

- 3 During this session the SRB members and observers will receive an update on the SR TEG discussions and content of the SR TEG papers and will have an initial exchange of views on the approach and methodology for the two SME standards.

SR TEG discussion and papers – VSME Standard

- 4 On 17 November the SRB discussed the contents of the working paper developed by Cluster 8 of the EFRAG PTF ESRS to support the preparation of the voluntary standard (ESRS VSME). The total number of SMEs in Europe is estimated to be around 1.5 million (23 million if including micro); some of them (not possible to quantify how many) could consider using this standard. It is generally considered that such a standard would meet expectations as expressed by SME representative, would avoid excluding the SMEs from the ESG momentum and facilitate a reasonable flow of ESG data between undertakings in the CSRD scope and SMEs outside the scope while addressing the concerns in terms of proportionality.
- 5 The key process question is whether the working paper could be considered as a basis for the forthcoming ED to be exposed for comments in 1H23 and which changes are needed before the finalisation of the ED. SR TEG members were invited also to reply on the key question in writing. In addition the SRB is expected to consider in due course the desirable level of consistency between the VSME Standard and the LSME Standard.
- 6 The papers for this meeting are accessible at the following links:

<https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FMeeting%20Documents%2F2211041503270617%2F03-01%20Cover%20Note%20EFRAG%20workstreams%20on%20SMEs%20-%20SR%20TEG%2017112022.pdf>

<https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FMeeting%20Documents%2F2211041503270617%2F04-01%20Issue%20Paper%20-%20Approach%20to%20EU%20Voluntary%20Reporting%20Standard%20for%20SMEs%20outside%20the%20scope%20of%20CSRD%20and%20Appendix%201%20-%20SR%20TEG%2017112022.pdf>

- 7 On 12 December 2022 a summary of the written input received was presented and is available at the following link. 10 Members replied. The majority of the respondents agreed that the draft proposal is a good basis, however they considered in general necessary to amend the draft before the consultation. In particular, five of them did not agree to use the draft as a basis for the consultation, as it lacks the necessary alignment with the main ESRS. Two of them agreed to use it as a basis after certain adjustments. A verbal update will be provided to the SRB on the content of the discussion that took place on the 12 December 2022.

https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FMeeting%20Documents%2F2212081403230833%2F04.01%20EFRAG%20SR%20TEG%20121222_SR%20TEG%20Feedbacks%20VSRS%20non%20listed%20SMEs_17%20November%202022%20REV.pdf

<https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FMeeting%20Documents%2F2212081403230833%2F04.02%20EFRAG%20SR%20TEG%20221212%20Detailed%20table%20comments%20VSRS.pdf>

SR TEG discussion and papers – LSME Standard

- 8 On 5 December and 12 December 2022, SR TEG members discussed the approach to the Development of ESRS for Listed SMEs (ESRS LSME). A verbal update will be provided to the SRB on the content of the discussion that took place on the 12 December 2022.

- 9 The two papers discussed at these meetings are available at the following links:

[Download \(efrag.org\)](#)

<https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FMeeting%20Documents%2F2212081403230833%2FAppendix%201-%20Issues%20Paper%2003-01-%20CSRD%20provisions%20listed%20SMEs%20TEG%2005122022%20Revised.pdf>

- 10 The standard will be applied by approx. 1.1 thousand companies listed in the EU.

- 11 Art 19a (6) of the Accounting Directive as modified by the CSRD specifies the content of simplified sustainability reporting for listed SMEs. This is a list broadly aligned with the reporting areas for the main standards in the CSRD. However:

- (a) many of the detailed reporting contents applicable to the large undertakings within those reporting areas are not explicitly required for listed SMEs, i.e.

- (i) resilience,
- (ii) opportunities,
- (iii) transition plans in line with Paris agreement, climate law and exposure to coal and mining,
- (iv) how the business model and strategy take account of the interests of the undertaking's stakeholders,
- (v) implementation of the strategy,
- (vi) own operations and value chain, including its products and services, its business relationships and its supply chain in adverse impact,
- (vii) dependencies.

- (b) the following identified reporting areas are not explicitly included in the list of reporting areas to be covered by listed SMEs:

- (i) description of due diligence process
- (ii) role of administrative, management and supervisory bodies in

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sustainability matters,

- (iii) targets and progresses,
- (iv) financial plans and resources.

- 12 It is key to bear in mind that the content of ESRS LSME will set the 'cap' to the information that can be required by Set 1 ESRS in relation to the value chain.
- 13 ESRS LSME shall also consider article 29 b (par. 2 to 5), i.e. it should take into account the international initiatives and EU regulation listed in art 29b (5) like the ESRS for large undertakings. ESRS LSME shall include the information related to SFDR PAI and art 8 Taxonomy Regulation [Recital 17 and 21].

Proposal by the EFRAG Secretariat

- 14 The proposal of the EFRAG Secretariat foresees the following approach:
 - (a) With reference to targets and financial plans, the reporting would be limited to state whether the undertaking do has targets and plans and expand the content only when such targets/plans do exist;
 - (b) Role of the administrative, management and supervisory bodies: to completely exclude this point would limit the coverage of governance matters. The EFRAG Secretariat proposes to include a simplified version of GOV 1 in the standard for listed SMEs. This would also allow to cover the ratio male/female members in the board;
 - (c) Due diligence: as part of the required statement on policies, actions and targets (limited to matters that are assessed to be material – see paragraph on Architecture below), the undertaking would be required to disclose whether and to what extent it has implemented sustainability due diligence processes as defined in the relevant OECD, UNGP and ILO instruments (to be able to comply with the SFDR and Benchmark Regulation datapoints).
 - (d) With reference to the topical standards, the EFRAG Secretariat would propose the following: policies, targets and actions would be covered by a centralised disclosure covering material matters to the extent that the undertaking has implemented policies, targets and actions (see paragraph on Architecture below). This would allow to simplify the chapters dedicated to each topic and in particular, the only additional content required would be the datapoints in Appendix C ESRS 2 (mandatory for EU regulation).
- 15 The proposal of the EFRAG Secretariat foresees the following Architecture:

ESRS 1	<p>To incorporate by reference ESRS 1, while amending some of the principles in ESRS 1 to listed SMEs peculiarities (i.e. proportionality as core principle for listed SMEs, approach to due diligence, value chain, materiality and stakeholders interest).</p> <p>Characteristics of quality in ESRS 1 applicable.</p> <p>Entity-specific disclosure applicable.</p> <p>List of sustainability matters in ESRS 1 App. B applicable.</p>
ESRS 2	<p>This would imply rewrite of ESRS 2 with adaptation required by CSRD on listed SMEs. That would lead to the following potential table of content: BP1 General basis for preparation of the sustainability statements; BP2 Disclosures in relation to specific circumstances; D GOV1 The role of the administrative, management and supervisory bodies (inc. male female ratio, SFDR); SBM1: Market position, strategy, business model(s) and value chain (simplified and include the breakdown of revenue by sector); SBM 3 Material impacts, risks and opportunities and their interaction with strategy and business model(s); IRO1: simplified; IRO2: entire. DC-A, DC-P and DC-T , DC-M would not be included.</p>

	Instead, the standard would require to report 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.
Environmental Disclosures	Metrics only: SFDR PAIs, Taxonomy and Benchmark Regulation (plus EBA Pillar 3 ESG risk), always to be reported. The disclosure requirement would match the disclosure requirements and datapoints listed in Annex C of ESRS 2.
Social Disclosures	Metrics only: SFDR PAIs and Benchmark Regulations, always to be reported.
Social Governance	Metrics only: SFDR PAIs and Benchmark Regulations, always to be reported.

Key points of attention for the SRB discussion

- 16 A first key question for the SRB to consider is to determine if the ESRS LSME should be based on the SME parameter (a listed SME remains an SME in terms of characteristics until the moment it potentially becomes « large ») or rather on the Listing parameter (a listing creates a public interest dimension), bearing in mind that:
- (a) listed SMEs would always have the option to choose, or transition to, the full ESRS (designed for large undertakings);
 - (b) in the interest of the development of financial markets the reporting burden should not discourage SMEs from opting for an IPO/public listing;
 - (c) the number of undertakings concerned is at one and the same time very diverse and limited; and
 - (d) the content of LSME defines the limit of the value chain information to be included in Set 1 (ESRS for large undertakings), as it will result from an Amendment that will be exposed for comments in Set 3.
- 17 A second question for the SRB to consider is, as mentioned above, the desirable level of consistency between the standard for listed SMEs (mandatory) and the standard for non-listed SMEs (voluntary).

Main messages from the SR TEG meeting

- 18 Though the SR TEG discussions are not yet finalised the following key messages emerged by the meeting on 5 December (12 SR TEG members attended) – unapproved summary. A verbal update will be provided on the outcome of the meeting on 12 December 2022.
- (a) Members expressed support with the structure of the proposal, but would need to see in detail the disclosures required from listed SMEs.
 - (b) Members agreed that the metrics required in SFDR, Pillar 3 and benchmark will be mandatory, which is a good position to preserve the value chain cap.
 - (c) Some members supported the idea that the list for the listed SMEs should not be different from the list applicable to large undertakings and it would be a question of materiality.
 - (d) Members considered that sector-specific requirements are needed also for listed SMEs. They agreed with the suggested approach to define first a sector-agnostic ESRS for listed SMEs, and to consider, in conjunction with the preparation of the sector-specific standards, the question to whether and which simplifications are needed for listed SMEs in each and every sector. Accordingly, specific questions

would be included in the consultation of the sector specific draft ESRS. In practical terms, this would mean that the listed SME standard issued as part of Set 2 would be sector-agnostic and, depending on the outcome of the consultation on each sector-standards, specific guidance could be considered (in subsequent sets and not already in Set 2) on how the content of the sector specific draft ESRS would be applied by listed SMEs. One EFRAG SR TEG member asked whether the list of listed SMEs could be analyzed to understand from which sectors the listed SMEs are mainly belonging too. EFRAG secretariat confirmed ongoing work on this.

- (e) One EFRAG SR TEG member challenged the proposal that in the social section of the standard for listed SMES « the number of DRs shall be limited to ...SFDR PAI indicators and Benchmark Regulation » and asked what is considered “disproportionate” in the mandatory social disclosure requirements for large undertakings that were not retained for listed SMEs. He suggested to add at least the GRI universal standard DRs (number of employees, non-employee workers, collective bargaining coverage). He added that, on the basis of the experience in Set 1, the decisions on which DR are to be included needs to be supported by a consistent methodology.
- (f) Some EFRAG SR TEG members underlined that the approach to proportionality may need further elaboration. The following was noted:
 - (i) Simplification is justified provided that the SMEs occupy a ‘simpler’ place in the value chain, i.e. proportionality should not override materiality.
 - (ii) One EFRAG SR TEG member suggested that that proportionality is driven by materiality, i.e. SMEs should be allowed to apply a higher threshold of materiality (e.g. report only the most material impacts/risks/opportunities). Other SR TEG members/observers questioned this concept. One EFRAG SR TEG member wondered whether this approach is consistent with impact materiality, as significant impacts should be reported even in the case of SMEs (same approach for listed SMEs and large undertakings). One EFRAG SR TEG member said the approach to set a higher bar for materiality is conceptually appealing but in contradiction with the spirit of CSRD.
 - (iii) One EFRAG SR TEG member considered that for the sake of proportionality, materiality assessment should not be required from listed SMEs (i.e. only mandatory DRs) as it is an overly sophisticated process.
- (g) One EFRAG SR TEG member said that one important issue will be to ensure the consistency of sectorial standards across the value chain. This is an additional argument to have more consistency in the sectorial standards between SMEs and large undertakings, than in the agnostic standards.
- (h) One EFRAG SR TEG member raised a concern related to the proposal on policies and action plans. Considering the interaction between the listed SME standard and the main standards due to the cap, for large companies, getting quantitative data from listed SMEs will be more useful than getting information on policies. The fact that the information required will be more qualitative than quantitative is a challenge. This member suggested to require to listed SMEs to disclose a map of the business partners of the listed SMEs (amount spent, geography and sector). This approach however was questioned by other members, as this would result in requiring to listed SMEs a disclosure that is currently not required in the main standards.

Timeline for the draft ESRS

- 19 ESRS LSME has to be included in Set 2 (consultation in 1H23, issuance in November 2023). ESRS VSME on the contrary will not be issued as a Delegated Act, but as a separate document and, as such, could be put in consultation later than Set 2, allowing to discuss and approve the ED at SR TEG and SRB during the

consultation of Set 2. As the period needed by the EC to finalize this document is in principle shorter than the issuance of a Delegated Act, ESRS VSME could be issued as final at the same time or few months later than ESRS LSME.

- 20 The amendment to Set 1 in order to implement the 'cap' would take place as part of Set 3 (consultation in 1H24, issuance in November 2024). It cannot be initiated before the finalization (after the consultation) of ESRS LSME.

Questions to SRB members and observers

- 21 Do you agree with the development of ESRS LSME in Set 2 and with the issuance of ESRS VSME for consultation after Set 2, to allow for a better allocation of the efforts by the EFRAG Secretariat and SR TEG and SRB?
- 22 Do you agree with overall approach proposed by the EFRAG Secretariat for the ESRS LSME?
- 23 Do you have any specific suggestion on how to improve the proposed proposal and implement it?