

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG SR Board. 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.

Cover Note on the LSME Working paper V2.1

Objective of the session

- 1 Discuss the version 2.1 of the draft LSME ESRS and address remaining questions or possibility for simplifications.

Background

- 2 The SR TEG last discussed LSME working document v2 on 13 March 2023. The proposals made by SR TEG on 13 March 2023 have been incorporated in the package v2.1 LSME that is provided as background for the session on 03 April 2023.
- 3 SRB discussed additional proposals for simplification on 22 March 2023 based on the following agenda paper 03-01:
<https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FMeeting%20Documents%2F2303200843371523%2F03-01%20Cover%20Note%20SR%20Board%2022032023.pdf>.
- 4 Hence the secretariat has incorporated additional questions for discussion with SR TEG for this session.

Summary of the changes in V2.1 LSME

- 5 The following changes have been integrated in v2.1 LSME compared to previous version v2, reflecting the last SR TEG discussion on 13 March 2023. To note that Application Requirements and Appendixes are still subject to revisions, as better specified below.

Section 1 “General requirements” and section 2 “General disclosures”

- Items outside the materiality assessment: (E1 Climate - section 3, corresponding ESRS E1 - and General Disclosures - section corresponding to ESRS 2). Clarification added that this is limited to the chapters in Section 2 corresponding to ESRS2. Hence the new centralised disclosures on policies, actions and targets remain under materiality assessment (it is not outside materiality only because it is sitting centrally).
- IR3, IR4, IR5: policies, actions and targets, clarification added that the location of the disclosure can either be in centralized section of the sustainability report or in the relevant topical section of the sustainability report.
- Interests and views of stakeholders. No voluntary disclosure on this point, no mandatory disclosure when there is no engagement. SBM 2 has been modified to say that “when the undertaking engages with stakeholders to incorporate its views and interests as part of its materiality assessment, it shall disclose a), b), c)”.
 - GOV1: simplifications were introduced to reduce the granularity of par. 20.

- Regarding the human rights due diligence, the two disclosure requirements related to (i) processes for engaging with stakeholders about impacts, and (ii) processes to remediate negative impacts and channels to raise concerns have been merged and simplified for S1 to S4. In line with SR TEG orientation, they have been moved to Section 2 as centralised disclosures'. In this way all the content on policies, actions and targets for all the topics will be centralised.
- V2.1 LSME ESRS also includes SR TEG recommendation that “reasonable effort” is used instead of “impracticable” for i) Presenting comparative information (section 1, 6.1ii); and ii) Changes in preparation and iii) Reporting errors in prior periods (section 1, 6.4 and 6.5).
- For policies, the same definition as set 1 has been reinstated in line with SR TEG request. Application Requirements have been modified to include illustrative examples of when policies are not formalised but actions and /or targets documented.
- Section 2, Appendix D “Disclosure/Application Requirements in [draft] topical ESRS that are applicable jointly with [draft] ESRS 2 General Disclosures” would not be applicable due to the fact that GOV, SBM and IR have been centralised in Section 2 and deleted from topical sections (if confirmed). The proposal is to replace this Appendix with a table showing the list of DRs according to whether they are mandatory / subject to materiality / voluntary. This table could be a useful guide for undertakings in understanding the 3 categories of DRs. This change has not yet been implemented in v2.1.

6 Topical Sections (environment, social, governance): unchanged compared to v2.

Additional issues for discussion in this session

- 7 Following the EFRAG SRB meeting on 22 March, the following issues for discussions are addressed in this paper/session.
- 8 Approach to SFDR/Benchmark/Pillar 3 ESG risk: mandatory versus materiality assessment. A mixed approach that balances proportionality with user needs was put forward by the secretariat as follows (based on feedbacks from SR Board, SR TEG and from financial market participants as in [Agenda Paper 03-02 of SRB meeting 22 March](#)):
- Table 1 SFDR Principal Adverse Impacts (PAI) Indicators: always to be reported mandatorily.
 - Table 2 and Table 3 SFDR Principal Adverse Impacts (PAI) Indicators + Benchmark + Pillar 3: materiality assessment, under the assumption that this allows to preserve the datapoint along the value chain of the large undertakings (value chain cap).
- 9 While there is support for the mixed approach with regards to the SFDR datapoints, the secretariat was asked to perform further analysis to argue why Benchmark and Pillar 3 datapoints shall be subject to materiality assessment and not mandatory, considering that for financial market participants and banks they are mandatory. This further research is in progress. Do SR TEG members have technical input or analysis to share on this point?
- 10 SBM1: par. 29(b) currently requests “a breakdown of total revenue, as included in its financial statements, by significant ESRS sectors”. In line with SRB request for simplification, the secretariat suggests that “the breakdown by revenue” is deleted and replaced with the requirement to include a list of the sectors where the company is active in, identified using para. 29a and AR 5 (corresponding to par. 38a of ESRS 2 and AR 12 of ESRS 2 in Set1). This change has not yet been implemented in the current working document LSME ESRS v2.1. Will this approach be sufficient to

comply with the SFDR datapoints on exposure to fossil fuels, tobacco, chemicals and weapons included in par. 29 (c)?

11 Intellectual property and exposure of sensitive information by an undertaking. The secretariat has considered the argumentation that for SMEs (including start-ups) the issue of sensitive information may be proportionally more important compared to large undertakings. For small start-ups it may even be a pervasive competitive advantage¹. Hence, to simplify requirements for LSMEs, the following options are put forward by the secretariat in addition to what already exists in Section 1, chapter 6.7 Information on intellectual property, know-how or results of innovation:

a) Reference is made to the [IFRS Staff Paper “Commercially sensitive information about opportunities”](#) in General Sustainability-related Disclosures, January 2023. The staff recommends the ISSB to introduce an exemption in [draft] S1 that would permit entities, in limited circumstances where information is not already publicly available, to exclude information about a sustainability-related opportunity when the information is commercially sensitive (it should not be used as general non-disclosure and defined conditions apply). The document showcases similar exceptions granted in TCFD and SEC. It also reviews similar approaches for financial reporting (i.e IFRS, IR, EBA). It finally illustrates advantages and disadvantages, suggesting that when designing the exception, the ISSB shall consider current guidance on the topic (i.e. mere possibility of negative consequence is not sufficient for the use of the exemption). The suggestion is made to permit entities to not disclose a particular item of information in situations when disclosing that item of information related to an opportunity ‘can be expected to prejudice seriously’ the economic benefits the entity is able to realise in pursuing the opportunity. When considering the application of this option to LSME, EFRAG secretariat notes that the IFRS proposal focuses on opportunities only. How could this be translated as simplification in the current v2.1 LSME if broadening the range beyond opportunities?.

b) Reference is made to CSRD art. 19a(3), “ Member States may allow information relating to impending developments or matters in the course of negotiation to be omitted in exceptional cases where, in the duly justified opinion of the members of the administrative, management and supervisory bodies, acting within the competences assigned to them by national law and having collective responsibility for that opinion, the disclosure of such information would be seriously prejudicial to the commercial position of the undertaking, provided that such omission does not prevent a fair and balanced understanding of the undertaking’s development, performance and position, and the impact of its activity.” In Set 1 ESRS reference is made to ESRS 2, 5d that requires “ for undertakings based in an EU member state that allows for the exemption from disclosure of impending developments or matters in course of negotiation, as provided for in articles 19a (3) and 29a (3) of the CSRD, a statement on its use of the option”. For LSME ESRS adjustments could be explored for a more prominent use of the Member State exemption.

- The secretariat would like to get SR TEG views on the two options and explore if further specific adjustments are needed for LSME.

12 Science based targets. The disclosures on targets are proposed (CSRD art 19a6) so that science-based targets are to be reported if the undertaking has set targets. SRB asked further research to assess if such an approach would be feasible for LSME. The secretariat has reviewed the DRs and ARs where the science-based approach is specified in current LSME v2.1:

¹ This is also illustrated in the 2022 INTELLECTUAL PROPERTY SME SCOREBOARD, EUIPO.

- DR IR5, par.68: (...) whether the GHG emission reduction targets are science-based and compatible with limiting global warming to 1.5°C (...);
 - AR 126: GHG emissions, reference to the Science-based Target Initiative (SBTi) using the Sectoral Decarbonisation Approach (SDA) if available, and/or the Absolute Contraction Approach (ACA);
 - AR 131: Pollution. Reference to guidance provided by TNFD on the use of the methods by the Science-Based Targets Initiative for Nature (SBTN) or other guidance with a scientifically acknowledged methodology.
 - AR 135: Water and Marine Resources. Reference to guidance provided by TNFD on the use of the methods by Science-Based Targets Initiative for Nature (SBTN), other guidance with a scientifically acknowledged methodology.
 - AR 140: Biodiversity and ecosystem. Reference is made to guidance provided by TNFD on the use of the methods by Science-Based Targets Initiative for Nature (SBTN), and to Sustainable Development Performance Indicator (SDPI) online platform or other guidance with a scientifically acknowledged methodology.
 - AR 144: Resource use and circular economy. Reference is made to by TNFD on the use of the methods by Science-Based Targets Initiative for Nature (SBTN), or any other guidance with a scientifically acknowledged methodology.
- 13 The secretariat suggests that given that the science-based targets are integrated in the Application Requirement related to environment, the reference may rather be helpful for SMEs who could rely on existing scientific methodology. It would also seem justified to have the reference to science-based targets for GHG emissions, that is the only reference made in the Disclosure Requirement. As the targets are to be disclosed only when they are used, there is not additional burden for the LSME that do not have targets. For the LSME that do have target the science-based framework would provide for robustness and facilitate comparability. The secretariat has also reviewed available ad-hoc tools for SMEs such as the science-based targets initiative for SMEs² (CDP, WWF, UN global compact and World Resource Institute) or the SME Climate Hub³ that may facilitate the disclosures. SR TEG views are sought on this matter.
- 14 Topical sections 3, 4 and 5 (environment, social and governance): the secretariat has not identified further possibilities for simplification considering that the metrics included in these sections are either included for the purpose of preserving EU datapoints, value chain cap or to cover the topics defined in art 29b. Orientation is sought from SR TEG on further suggestions for simplifications of DRs (metrics)
- 15 Art 29c(2) of the CSRD indicates that Sustainability Reporting Standards for small and medium sized undertakings (...) shall also, to the extent possible, specify the structure to be used to present this information. The SRB orientation is to confirm the content of Set 1, including appendix G as non-mandatory.

Questions to EFRAG SR TEG members and observers

- 16 With reference to discussion points in par. 7-15, the following questions are put forward:

² Science Based Targets, SMEs FAQ, April 2022, SBTi CDP, UN Global Compact, World Resources Institute and WWF

³ Also mentioned in the OECD Report, Financing SMEs for sustainability: Drivers, Constraints and Policies, December 2022

- | | |
|----|---|
| 17 | Benchmark and Pillar 3 datapoints subject to materiality assessment versus mandatory, considering that for financial market participants and banks they are mandatory. Further research is in progress. Do SR TEG members have technical input or analysis to share on this point? |
| 18 | SBM ₁ : proposal that “the breakdown by revenue“ is deleted and replaced with the requirement to include a list of the sectors where the company is active in in par. 29b and 29 c. Will this approach be sufficient to comply with the SFDR datapoints on exposure to fossil fuels, tobacco, chemicals and weapons included in par. 29 (c)? |
| 19 | On Intellectual property, two options are put forward by the secretariat in addition to what already exists in Section 1, chapter 6.7 Information on intellectual property, know-how or results of innovation. The secretariat would like to get SR TEG views on the two options and explor if further specific adjustments are needed for LSME |
| 20 | Science based targets. The secretariat suggests maintaining the approach in V2.1 LSME. Having also reviewed available ad-hoc tools for SMEs for science based targets. SR TEG views are sought on this matter. |
| 21 | Do EFRAG SR TEG members have suggestions for additional simplifications? |