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EFRAG SR TEG on [Draft] VSME ESRS V2 – Proposal on simplified language working paper Cover Note

Objective

1. The purpose of this session is to discuss with SR TEG the proposed working paper on simplified VSME ESRS. EFRAG Secretariat has identified the need to explore simplification of the language of draft VSME ESRS based on stakeholders' feedback and SR TEG and SRB discussions in September. On this basis EFRAG secretariat has drafted a simplified language version of VSME with the aim to make it more understandable for micro undertakings and non-listed SMEs. The working paper includes two columns, one with the current language and the second one with the simplified text.

Reasoning for a simplified language VSME

2. Some SR TEG and SR Board members indicated the need for simplified language in VSME as part of the internal feedback process in summer 2023. EFRAG Secretariat has also received detailed comments on the draft VSME from banking representatives for



language simplification that have been analysed and included as much as possible, without compromising the clarity of the defined terms and the consistency of terminology with Set 1 ESRS.

3. The need for simplifications in materiality approach and simplification of language also emerged as key take aways of the second VSME Community workshop and other outreaches conducted between August and September (with i) SME United and its national members and iii) EBF, ESBG, EACB and their members.

Approach to simplify the language

4. In this context , it was decided at SR TEG on 20 September (SoD to be approved) to proceed to language simplification.
5. The SRB also discussed on 22 September (SoD to be approved) that the draft VSME simplified language should be accompanied by a ‘reconciliation’ with ESRS language to maintain the building block approach that is widely supported.
6. EFRAG Secretariat has compared the two VSME versions: i) column 1 showcasing the content of draft VSME ESRS V2 (current language) and ii) column 2 showcasing the new simplified text of VSME. Please refer to paper 04-02. Both VSME versions in this paper only cover the cross-cutting parts and both incorporate the SR TEG and SRB already discussed and approved in previous SR TEG sessions.
7. Please note that the content of the paper has not yet been rearranged to follow the progressive content of Module Basic + Module PAT + Module SF, in order to facilitate the reading in two columns having the content of VSME as it is (before the language simplification) on the left column. The content will be rearranged in the next version. Contents not intended to be used in the Basic module are identified as such in the paper.
8. EFRAG secretariat would like to validate with SR TEG the approach taken in simplifying VSME.

Materiality approach

9. **Basic module** does not require a materiality analysis but the KPIs in it are being reworded in such a way that they incorporate an element of proportionality and relevance (i.e., when appropriate/applicable).
10. **PAT Module** includes the definition of financial and impact materiality and requires to perform materiality analysis in order to disclose which of the sustainability matters listed in AR 16 of ESRS 1 are material to the undertaking. This will allow users to also understand for which material matters there the undertaking does not have PAT in place.
11. **Sustainable Finance Module** requires to perform a materiality analysis in order to disclose only the material KPIs. Same approach as in ESRS Set 1 for disclosing ‘not material for the undertaking’ for EU datapoints.



Modularity

12. While the Basic module is targeted to micro-undertakings (but still being possible for other SMEs to apply it), the application of the PAT module is expected to support the disclosure of small and medium undertakings that have PAT in place (so have a certain level of involvement in sustainability management). The Sustainable Finance Module is expected to be used by small and medium undertakings that are required by their business counterparties (banks, investors, clients) to provide sustainability data. The Sustainable Finance module is expected to be able to satisfy the users' needs of such counterparties.
13. EFRAG Secretariat is currently performing outreach with banks and corporates, that could bring additional input on the feasibility of covering the needs of business counterparties as part of the Sustainable Finance module.
14. The EFRAG Secretariat understands that there is a significant sector-specific component in the detailed data requests from companies (value chain) and expects to consult on the approach to SME sector-specific modules that would result from the EFRAG Standard setting process on sectors.

Definition of Stakeholders

15. One of the questions risen in outreaches is whether the Stakeholders definition is too broad for use in VSME. The following definition is in Set 1:
Stakeholders are those individuals or groups of people who can exercise influence over the SME and/or be affected by the activities of the SME. There are two main groups of stakeholders:
 - a) *affected stakeholders: individuals or groups of people whose interests are affected or could be affected – positively or negatively – by the SME's activities and its business relationships. ; and*
 - b) *users of sustainability statement: primary users of financial reporting (investors, lenders and other creditors, including asset managers, credit institutions, insurance undertakings), as well as other users, including business partners, trade unions and social partners, civil society and non-governmental organisations, governments, analysts and academics.*
16. The EFRAG Secretariat considers that the concept of affected stakeholders is an integral component of the definition of an impact: if a company has a potential or actual impact, there are affected stakeholders; in order to identify whether it has a potential or actual impact, the company has to look at potentially affected stakeholders. We consider that departing from the definition in Set 1 would raise conceptual questions on consistency between the different standards. For this reason, the EFRAG Secretariat would welcome advise from SR TEG members on whether there should be a component of 'proportionality' in the scope of potentially affected stakeholders captured by the definition in VSME, reflecting the lower strength of the impact and capacity of influencing.



17. At the same time, the ‘users of sustainability statement’ may be seen as less relevant in VSME than in the other ESRS. This is because this standard serves a purpose of supporting the dialogue of the VSME with a specific group of business partners: banks and clients.

Agenda Papers

18. In addition to this cover note, agenda paper for SR TEG members in this session is Agenda paper 04-02 – Working paper simplified language VSME_Comparison_table (Cross-cutting).

Questions to SR TEG

1. Do SR TEG members agree with the language simplification applied to VSME in agenda paper 04-02?
2. Do SR TEG members have suggestions on how to refine the materiality section to enhance feasibility and understandability?
3. Do SR TEG members consider that the definition of stakeholders should be amended to take into consideration the observations above?
4. Are there any additional comments or suggestions that shall be taken into account by EFRAG secretariat in finalising the drafting of VSME simplified language in the run-up to the Exposure Draft VSME and of the approval process?



Annex 1 - Proposed modular approach as presented in SRB 22 September

VSME – proposed modular approach

