

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.

## Draft ESRS LSME ED - Approval Cover Note

### Objective

1. The objective of this session for SR TEG is to approve the draft ESRS LSME Exposure Draft (ED) as a technical recommendation to be issued by EFRAG SRB for public consultation, subject to further editorial changes that may be identified during this meeting.

### Overview of the changes to the ED after the internal survey

2. EFRAG SR TEG and SRB discussed progressive versions of LSME working paper from February to July 2023. On the 24 July an internal consultation was launched to collect editorial comments and suggested fundamental changes, that were subsequently discussed in SRB and SR TEG meetings in September 2023.
3. The draft LSME ESRS ED presented for approval in this meeting has been updated based on the feedback received in the internal consultation (SR TEG and SRB comments) and the decisions taken on LSME in 12 and 18 September 2023 SR TEG meetings.
4. The analysis of the EFRAG SRB and and SR TEG comments is available in the agenda papers for the SRB on 13 September 2023 (as background).
5. A full overview of the simplifications implemented in ESRS LSME ED compared to ESRS Set 1 (delegated act) and of the decisions taken in the key meetings is presented the cover page of each LSME Section (Agenda Papers from 06.02/06.06).
6. Changes to the draft that result from SR TEG and SRB feedback and SR TEG decisions implemented in the standard are highlighted in green in papers 06-07 to 06-11 as markup versions of LSME.



7. A brief overview of the decisions taken by SR TEG in meetings on 12 and 18 September implemented in the ED is presented in the table below.

|                                                                                  |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
|----------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p><b>Section 1 – General requirements</b></p>                                   | <p><b>Entity specific:</b> same approach as Set 1<br/> <b>Material matters and materiality of information:</b> aligned with Set 1<br/> <b>Reporting undertaking and value chain:</b> same as in Set 1 but deleted the reference to accounted at equity methods<br/> <b>Value chain cap:</b> the list of value chain cap datapoints in SET 1 ESRS have been identified and assessed against relevance and user needs. Whenever possible, they have been simplified.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                          |
| <p><b>Section 2 – General disclosures</b></p>                                    | <p><b>GOV-1:</b> Simplified, but stick with AMS bodies term and added the skills and expertise.<br/> <b>SBM-1:</b> Simplified the assessment of significant products/services, markets and groups in relation to sustainability goals / added “if applicable” in the subsidiaries that are connected with material impacts and risks<br/> <b>SBM-2:</b> Simplified (deleted or merged roman letters)<br/> <b>SBM-3:</b> Simplified. Deleted “whether and how its material impacts originate from or are connected to the undertaking’s strategy and business model; and iii. whether the undertaking is involved with the material impacts through its activities or because of its subsidiaries or other business relationships (describing the nature of the activities or business relationships concerned and where in its value chain material impacts are concentrated;” and added reasonably expected time horizons.</p> |
| <p><b>Section 3 – Policies, Actions, Targets, Engagement and Remediation</b></p> | <p><b>IR-1:</b> Kept ‘may’ datapoints in the main body of LSME<br/> <b>Policies, Actions and Targets:</b> Included MDRs in the main body of LSME as ‘shall’. Other requirements related to a material topic are included in ARs as additional information to be disclosed.</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
| <p><b>Section 4 – Environment</b></p>                                            | <p><b>Reconciliations in Energy intensity based on net revenue and GHG intensity based on net revenue:</b> Included a sentence which asks (when proper reconciliation not feasible) an explanation of where the relevant amounts can be found in financial statements / also added the agreed 1-year phase-ins for these reconciliations for undertakings that decide to not opt-out<br/> <b>Impact metrics on Biodiversity:</b> reintroduced invasive alien species as a “may” in the main body of LSME.<br/> Resource outflows: S</p>                                                                                                                                                                                                                                                                                                                                                                                         |
| <p><b>Section 5 – Social</b></p>                                                 | <p><b>Characteristics of own employees:</b> Datapoint on employee turnover was reintroduced.<br/> <b>Training metrics:</b> A phase-in for gender breakdown was introduced in Section 1 (Appendix C).<br/> <b>Incidents and severe human rights impacts:</b> A sentence was included for cases where a proper reconciliation is not feasible. In addition, a phase-in was introduced in Section 1</p>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |



|                                     |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
|-------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|                                     | (Appendix C) for the reconciliation datapoints (only for undertakings that do not opt-out).                                                                                                                                                                                                                                                                                                                                                                                     |
| <b>Section 6 – Business conduct</b> | <p><b>Management of relationship with suppliers:</b> deleted the part about impacts and supply chain and redrafted management of supply chain</p> <p><b>Anti-corruption and Anti-bribery:</b> Added “if any” on actions taken to address breaches in procedures and standards of anti-corruption and anti-bribery.</p> <p><b>Political influence and lobbying activities:</b> Added “if any” on the activities and commitments related to exerting its political influence.</p> |

Additional topic (for information of SR TEG): Relocation of Processes for engaging and Processes to remediate negative impacts and channels to raise concerns

8. Respecting the architectural logic of only having topic-agnostic Policies, Actions and Targets in Section 3, the content of “Processes for engaging” and “Processes to remediate negative impacts and channels to raise concerns” has been moved to the Application Requirements of Policies related to own workforce, value chain workers, affected communities and consumers and end-users. The status of the requirement (“shall” or “may”) has not been changed.
9. The Application Requirements originally proposed for “Processes for engaging” and “Processes to remediate negative impacts and channels to raise concerns” have been moved accordingly under the subtitle of “Guidance”.
10. This allows to achieve a more consistent architecture, using the same approach as for other topical disclosures, such as climate transition plan, which content is also located in the Application Requirements related to Targets.

Methodological background

11. **General approach and decision three:** The draft ESRS LSME ED has been developed as a simplification of the ESRS Set 1, following the content of the specific provisions in the CSRD related to the minimum content of LSME, its individual statement perspective and its role in defining the ‘value chain cap’. The Appendix to this paper reports the decision three used in the technical deliberations that led to the content in the draft.
12. **Individual perspective:** Based on Article 29a of the Accounting Directive, only parent companies of large groups are required to publish a consolidated sustainability statement (in accordance with the ESRS Set 1). This means that parent companies of SME groups are not required to publish any consolidated sustainability statement under the Accounting Directive. However, they could indeed decide to comply on a voluntary basis. A proposal for a simplified Exposure Draft of VSME-LSME on a consolidated basis will be provided for this meeting (refer to Agenda papers for VSME). The reason for this is that the ESRS for listed



SMEs should contain only the standards that listed SMEs have to use when they choose to report a limited set of information at individual level (as an alternative to using the ESRS Set 1). If we include in the ESRS for listed SMEs the guidance for voluntary consolidated disclosure this goes beyond the mandate for the EC delegated act that should adopt the ESRS for listed SMEs.

13. **Third-country SMEs** that are listed on the EU regulated markets are required to carry out sustainability reporting based on Article 4(5) of the Transparency Directive. In principle, these third-country listed SMEs should be subject to the same rules set out for the EU SMEs listed on the EU regulated markets. This means that also third-country listed SMEs will have the option to use the ESRS LSME ED as an alternative to ESRS full, when disclosing their individual sustainability statement. Article 40a of the Accounting Directive – which requires the disclosure at group level of a subset of the information listed in Article 29a (following the to be developed ESRS for non-EU undertakings) - is not meant to apply to third-country companies that are listed in the EU regulated markets (because in that case the rules of the Transparency Directive would apply). The future ESRS for non-listed EU undertakings applies only to (non-listed) third-country companies with a net turnover above EURO 150 million that have in the EU territory either EU subsidiaries (that are large undertakings or listed SMEs) or branches (with a net turnover above EURO 40 million). Based on Art. 40a, it is in any case the EU subsidiary/branch that has to publish the sustainability report (which has to be prepared in accordance with the future ESRS for non-EU undertakings).
14. **Key simplifications implemented** in ESRS LSME ED compared to ESRS Set 1 are:
  - a. the voluntary nature of positive impacts and opportunities;
  - b. a ‘report if you have’ approach to targets, due diligence, stakeholder engagement, processes to engage with affected stakeholders, processes to remediate negative impacts and channels;
  - c. simplified architecture, with centralised topical specifications to ESRS 2, centralised disclosure on policies, actions, targets, processes to engage and to remediate and topical sections that include only metrics;
  - d. other simplifications and reduction of datapoints are described in the cover page to papers 06.02/06.06.
15. **Value chain cap:** At the beginning of the drafting the SRB agreed to use the value chain cap as a driver for the content (as part of the decision tree). This concept is illustrated below:
  - a. the sustainability reporting standards for large undertakings (ESRS Set 1 issued as delegated act in July 2023) shall not specify disclosures that would require undertakings to obtain information from small and medium-sized undertakings in their value chain that exceeds the information to be disclosed pursuant to the LSME ESRS (art 29b 4). We refer to this as the ‘value chain cap’, i.e. the disclosures in LSME ESRS determine what is the maximum detail of information that large undertakings shall be required to collect from SMEs in their value chain in order to prepare their ESRS sustainability statement;



- b. to implement this provision, the ESRS LSME ED has been developed in a way that preserves the integrity of the value chain information to be disclosed by large undertakings, as defined in the Delegated Act issued by the European Commission in July 2023 (in this sense it is an integral component of the decision tree);
  - c. the content of the ESRS for large undertakings issued as Delegated Act in July 2023 has been deeply scrutinised during the drafting of LSME, to separately identify the disclosures for which obtaining value chain information is deemed essential in order to fulfil the policy objectives and to meet the users’ needs for the reporting of large undertakings. Only the remaining datapoints (i.e. those essential for users needs) have been included in LSME ESRS, in order to enable large undertaking to collect the necessary data. A specific question will be included in the consultation. The remaining value chain cap datapoints included in ESRS LSME ED are the following (metrics).
    - i. Scope 3 GHG emissions (E1-2);
    - ii. GHG removals (E1-3);
    - iii. Substances of concern and substances of very high concern (E2-2);
    - iv. Impact metrics related to biodiversity and ecosystems change (E4-1); and
    - v. Resource inflows (E5-1) and Resource outflows (E5-2) (only for qualitative information).
16. **The alignment with IFRS S1 and S2** is technically not possible, due to the choice of the CSRD not to cover opportunities. Trying to pursue alignment on other points would be costly (would impair the possibility to further simplify the standard) without any concrete benefits, as missing the opportunities in the requirements would anyway impair the alignment. In conclusion, the legislator has made a conscious decision to prioritise simplification over alignment with ISSB for LSME.

## Approval of draft LSME ESRS ED in this SR TEG meeting

- 17. The Secretariat will go through the content of draft LSME section by section, also considering the updates in the draft.
- 18. Remaining comments of SR TEG members and observers in the draft ED will be collected section by section; this is expected to only include elements of substance or potential blocking factors for the approval. Remaining editorial comments, if any, are welcome by the EFRAG Secretariat by the 20 October 2023.
- 19. As per article 42 of EFRAG Internal Rules<sup>1</sup>, in all decisions of EFRAG SR TEG, a simple majority will apply. However, as always in practice the EFRAG SR Chair is

---

1

<https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FSiteAssets%2FEFRAG%2520Internal%2520Rules%2520-%2520Approved%2520by%2520the%2520GA%252028%2520April%25202022-%2520.pdf>



committed to promote a consensus approval to the maximum extent possible. Only if consensus is not possible, the majority vote will apply.

20. In a vote on draft technical advice on EU sustainability reporting standards for submission to the EFRAG Reporting Board, **EFRAG Reporting TEG members are not permitted to abstain.** The EFRAG Reporting Board is informed about the voting choices.
21. Members that cannot attend this meeting are invited to provide their written intention of vote head of the meeting.
22. EFRAG SR TEG members may either approve or dissent. A dissent may only be justified by a disagreement on fundamental elements of the ED. A dissenting on a ED will have to be justified by the dissenting member. Members that intend to dissent will have to provide an explanation that will be reported to the EFRAG SRB.
23. Once draft LSME ESRS ED is approved, Secretariat will proceed with further editorial changes and improvements (formatting, merging of sections, potential spelling errors, references to number of paragraphs, etc.) and then will submit the ED for approval by the EFRAG SRB.



## Questions for EFRAG SR TEG

### *Transitional provisions and phasing in*

24. ESRS Set 1 has a transitional provision related to the future issuance of sector standards (ESRS 1 paragraph 130, 131). The approach to sectors for SMEs will be one of the aspects on which the consultation on LSME ED will focus on, with specific questions. The corresponding transitional provision has been drafted in LSME (chapter 9.1 of ESRS LSME ED – Section 1), in case the consultation would confirm that, jointly with and as a by-product of the sector ESRS, EFRAG will also issue sector standard annexes (e.g. list of sustainability matters and/or list of metrics). Do you agree with this approach?
25. Do you consider that the transition provision on value chain for the first 3 years (see Chapter 9.2 of ESRS LSME ED) should be available to all first applicants, or only to those that apply the standard from 2026 (so excluding those that opt-out or cannot use the derogation for the first 2 years)?
26. In terms of phasing-in, the ED includes the same provisions as in ESRS Set 1, adjusted for 50 employees instead of 750 and available only for those LSME that do not opt-out and thus apply the standard from 2026. Few additional phasing in have been added (e.g. reconciliations). The list can be found in Section 1, appendix C. Do you agree with the phasing provisions in proposed in the ED?
27. **Sector specific guidance:** a question will be included in the consultation as to whether EFRAG should develop as part of its work on developing sector ESRS specific modules for SME (that would support both LSME and VSME). Pending this step no sector specific material is mentioned in the draft. Do EFRAG SR TEG members consider that in the period before the issuance of such potential SME sector modules paragraphs 130 and 131<sup>2</sup> of ESRS Set 1 should be also imported in ESRS LSME ED? If no, how would suggest to proceed in terms of guidance for the period before sector guidance is available?

### *Remaining comments and approval*

28. Do you have any remaining comments of substance that would affect your approval of the ED? Please explain.
29. Do you approve to recommend that the EFRAG SRB issues this ED for public consultation?

<sup>2</sup> The extent to which sustainability matters are covered by ESRS is expected to evolve as further Disclosure Requirements are developed. Therefore, the need for entity-specific disclosures is likely to decrease over time, in particular as a result of the future adoption of sector specific standards.

131. When defining its entity-specific disclosures, the undertaking may adopt transitional measures for their preparation in the first three annual sustainability statements under which it may as a priority:

(a) introduce in its reporting those entity-specific disclosures that it reported in prior periods, if these disclosures meet or are adapted to meet the qualitative characteristics of information referred to under chapter 2 of this Standard; and

(b) complement its disclosures prepared on the basis of the topical ESRS with an appropriate set of additional disclosures to cover sustainability matters that are material for the undertaking in its sector(s), using available best practice and/or available frameworks or reporting standards, such as IFRS industry-based guidance and GRI Sector Standards.

## Agenda Papers

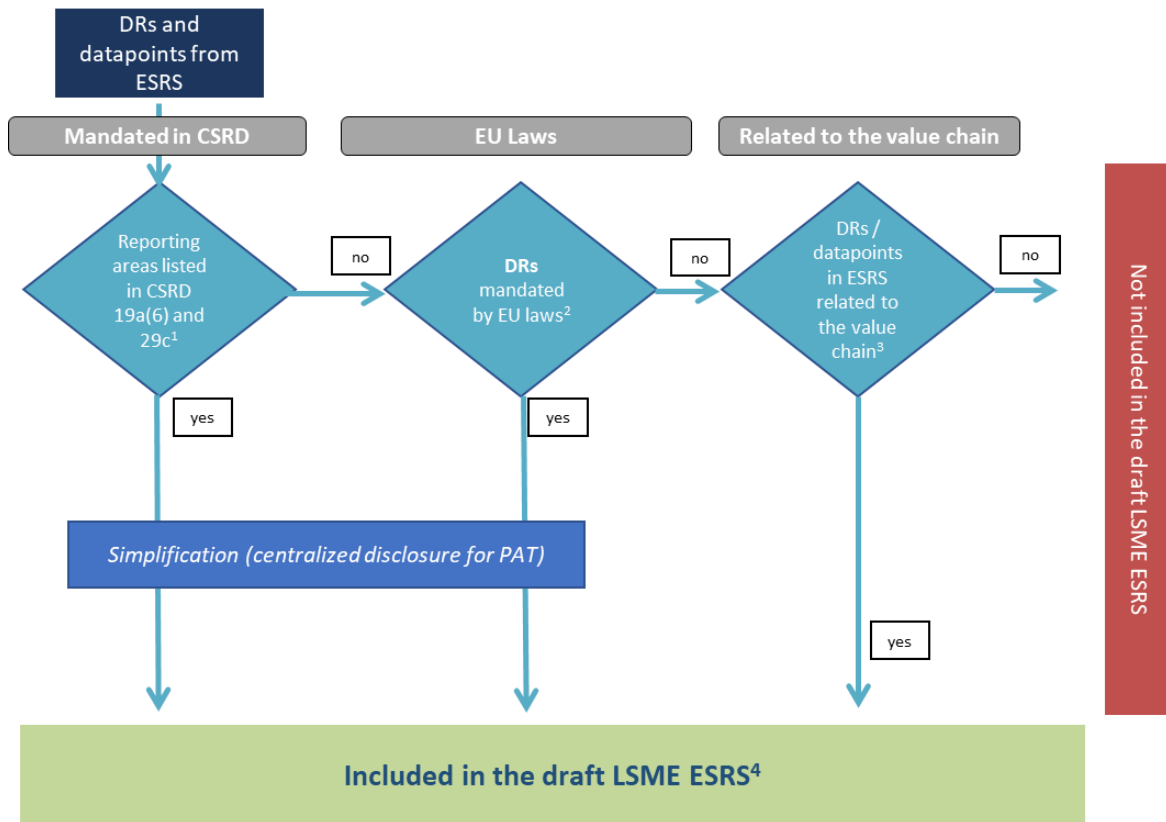
30. In addition to this cover note, agenda papers for this session are:
- a. Agenda paper 06-02 – LSME ED Section 1 General requirements;
  - b. Agenda paper 06-03 – LSME ED Section 2 General disclosures and Section 3 Policies, Actions, Targets, ;
  - c. Agenda paper 06-04 – LSME ED Section 4 Environment;
  - d. Agenda paper 06-05 – LSME ED Section 5 – Social; and
  - e. Agenda paper 06-06 – LSME ED Section 6 – Governance.
  - f. Agenda paper 06-07 – LSME ED Section 1 General requirements; - – markup from version used for internal consultation 24 July 2023;
  - g. Agenda paper 06-08 – LSME ED Section 2 General disclosures and Section 3 Policies, Actions, Targets, – markup from version used for internal consultation 24 July 2023
  - h. Agenda paper 06-09 – LSME ED Section 4 Environment – markup from version used for internal consultation 24 July 2023;
  - i. Agenda paper 06-10 – LSME ED Section 5 – Social; markup from version used for internal consultation 24 July 2023;
  - j. Agenda paper 06-11 – LSME ED Section 6 – Governance – markup from version used for internal consultation 24 July 2023
  - k. Agenda paper 06-12 – LSME ESRS Defined terms
  - l. Agenda paper 06-13 – LSME Comment log SR TEG and SRB feedback (LATE UPLOAD for SR TEG)





## Appendix: LSME decision tree

12. The graphic representation of the LSME ESRS Decision tree is as follows:



Note 1: Art. 29c refers to the criteria set out in Art. 29b point 2 to 5

Note 2: EU laws limited to SFDR, Pillar 3, benchmark regulation, climate law and Taxonomy Regulation art. 8

Note 3: Is the DR / datapoint in ESRS essential for the depiction of the matter, or essential for the « value chain cap »?

Note 4: VSME [draft] working paper has considered also EFRAG PTF cluster 8 proposal as a possible minimum content

13. In developing the Decision tree and the standard itself, EFRAG Secretariat took into consideration the document drafted by EFRAG PTF cluster 8<sup>3</sup>, regarding the proposal EU Voluntary Sustainability Reporting Standard for non-listed SMEs that are outside the scope of CSRD (VSME). General and disclosure metrics indicated in such document were also considered as the 'baseline' for identifying the minimum elements of disclosure requirements to be included in the LSME ESRS (as a sort of 'floor' for the requirements).

14. It was finally agreed to include the value chain cap in the Decision tree, also considering that the 6 datapoints included for value chain dimension were assessed as important metrics by SR TEG and SRB. To implement this provision, the LSME

3

<https://www.efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FMeeting%20Documents%2F2301251434396169%2F03-05%20SR%20TEG%20230202%20EFRAG%20PTF%20ex%20cluster%208%20proposal%20EU%20Voluntary%20Reporting%20Standard%20for%20SMEs%20outside%20the%20scope%20of%20CSRD%20%28Appendix.pdf>



Exposure Draft was developed in a way that preserves the integrity of the value chain information to be disclosed by large undertakings, as defined in the Delegated Act issued by the European Commission in July 2023 (in this sense it is an integral component of the decision tree).

