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ESRS LSME ED – Final Discussion

Cover Note

Objective

1. The objective of this session for SRB is to have a final discussion on the ESRS LSME Exposure Draft (ED) as approved by SR TEG as technical recommendation on 17 October 2023. The outcome of SR TEG vote will be verbally provided and summarised below. The SRB approval of the LSME ED to be issued for public consultation is planned on 29 November 2023.

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 final discussion 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 SR TEG comments is available in the agenda papers for the SRB (as background). A brief overview of the comments received on LSME:

LSME	
Total number of comments in LSME¹	602
Total number of selected comments discussed at SR TEG (12 and 18 September)	31
Total number of selected comments shared only to inform SR TEG (12 and 18 September)	14

¹ The comments that Secretariat did not share in those SR TEG meetings were included in the draft proposal or not included based on previous discussions, the decision tree and the approach taken. This number of comments also includes a small number of detailed comments from the SRB.



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 in the cover page of each LSME Section (Agenda Papers from 05.02/05.06).
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 05-07 to 05-11 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>Section 1 – General requirements</p>	<p>Entity specific: same approach as Set 1 Material matters and materiality of information: aligned with Set 1 Reporting undertaking and value chain: same as in Set 1 but deleted the reference to accounted at equity methods Value chain cap: 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>Section 2 – General disclosures</p>	<p>GOV-1: Simplified, but stick with AMS bodies term and added the skills and expertise. SBM-1: 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 SBM-2: Simplified (deleted or merged roman letters) SBM-3: 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>Section 3 – Policies, Actions, Targets, Engagement and Remediation</p>	<p>IR-1: Kept ‘may’ datapoints in the main body of LSME Policies, Actions and Targets: 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>Section 4 – Environment</p>	<p>Reconciliations in Energy intensity based on net revenue and GHG intensity based on net revenue: 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 Impact metrics on Biodiversity: reintroduced invasive alien species as a “may” in the main body of LSME. Resource outflows: Added “own operations” in the metrics of inflows Simplification of metrics in inflows: Simplification of language on biological material exposure, with deletion of application of cascading principle / simplification of language on use of secondary materials</p>



	<p>Simplification of metrics in outflows: kept metrics but focused on % of products and services designed to be durable and repairable</p> <p>Simplified the metrics on waste: simplified language and the data point on total amount of non-recycled waste was deleted as it is also asked the percentage on non-recycled in face of total. Only the % of total that is non-recycled is asked</p>
Section 5 – Social	<p>Characteristics of own employees: Datapoint on employee turnover was reintroduced.</p> <p>Training metrics: A phase-in for gender breakdown was introduced in Section 1 (Appendix C).</p> <p>Incidents and severe human rights impacts: A sentence was included for cases where a proper reconciliation is not feasible. In addition, a phase-in was introduced in Section 1 (Appendix C) for the reconciliation datapoints (only for undertakings that do not opt-out).</p>
Section 6 – Business conduct	<p>Management of relationship with suppliers: deleted the part about impacts and supply chain and redrafted management of supply chain</p> <p>Anti-corruption and Anti-bribery: Added “if any” on actions taken to address breaches in procedures and standards of anti-corruption and anti-bribery.</p> <p>Political influence and lobbying activities: Added “if any” on the activities and commitments related to exerting its political influence.</p>

Additional topic (for information of SRB): 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 for 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 tree:** 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.
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 05.02/05.06.

EFRAG Secretariat estimates a total of 47% reduction in the number of datapoints compared to Set 1, -49 DRs compared to Set 1 (86 DRs in Set 1 and 37 DRs in LSME) and a reduction of 100 pages compared to the draft ESRS released to the European Commission (November 2022).

In details:

- “May” datapoints from Set 1 that were kept in LSME: 99
- From “Shall” in Set 1 to “May” in LSME: 89
- Total “May” in LSME: 188

More in details EFRAG Secretariat estimates the following reductions in ESRS LSME ED compared to Set 1:



Set 1 DR	% of reduction in LSME
ESRS 2	-38%
E1	-33%
E2	-30%
E3	-43%
E4	-60%
E5	-52%
S1	-50%
S2	-50%
S3	-52%
S4	-63%
G1	-68%
TOTAL	-47%

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 preserve the



integrity of the value chain dimension. Only those datapoints have been included in LSME ESRS. A specific question will be included in the consultation of LSME. The remaining value chain cap datapoints included in ESRS LSME ED are the following (metrics).

- i. Material impacts and risks and their interaction with strategy and business model (SBM-3) (+Voluntary disclosure on material opportunities)²
- ii. Transition plan for Climate Section 3 (centralised and simplified);
- iii. Scope 3 GHG emissions (E1-2);
- iv. GHG removals (E1-3);
- v. Substances of concern and substances of very high concern (E2-2);
- vi. Impact metrics related to biodiversity and ecosystems change (E4-1); and
- vii. 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.

SR TEG approval of LSME ESRS ED on 17 October 2023

17. The Secretariat will debrief the SRB about the outcome of SR TEG vote and approval of draft LSME ED, using this cover note as a support. Due to the tight timeline between the SR TEG and SRB meeting, a markup version of LSME that reflects the SR TEG discussion is not yet available. The SR TEG vote is based on article 42 of EFRAG Internal Rules³.

18. Key discussion points were:

- a. Value chain cap: Secretariat explained the approach and the specific datapoints in the DRs that require coverage of VC information. The SR TEG approved the approach.
- b. Sector approach: the EFRAG Secretariat asked whether and how paragraphs 130 and 131 of ESRS 1 (transition provision that points to the use of other sector frameworks incl. SASB and GRI as guidance for entity specific disclosure in the transition period before the issuance of ESRS sector standards, i.e. standards addressed to large companies as opposed to SME). This is also connected with the question(s) to be included in the consultation, such as:
 - i. Should EFRAG issue sector-specific modules to LSME as part of the sector work, or should LSME use the sector ESRS designed for large undertakings?
 - ii. If EFRAG had to issue these sector-specific modules for SME, should them be the same for VSME and LSME?

² The undertaking shall describe its material IROs and report where in the Value Chain they arise. Large undertakings reporting under main ESRS do not need to ask direct information from their value chain to disclose accordingly.

³

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



- iii. If EFRAG had to issue these sector-specific modules for SME, should they be issued as Delegated Act, being the CSRD silent on this aspect?

Some of the SR TEG members considered that LSME should use the sector ESRS for large corporates, while others had a different view. Also, the different nature and level of sophistication of VSME and LSME was also mentioned as an obstacle to use the same sector standards in both cases. These questions require SRB orientations.

For the time being paragraphs 130 and 131 would be maintained and in the ED and the consultation questions would clarify that their content will depend on the outcome of the consultation on the SME approach to sectors.

- c. Phase-in: Secretariat explained that the LSME ED includes the same provisions as in ESRS Set 1, adjusted for 50 employees (subject to modification after some analysis) instead of 750, and available only for those LSME that do not opt-out (or cannot⁴ opt-out) and thus apply the standard from 2026. Few additional phase-ins have been added:
 - i. DR S1-6 Training metrics: Phase-in introduced for the gender breakdown (Appendix C, Section 1) (after SRTEG discussion on September 18)
 - ii. DR S1-9 Incidents and severe human rights impacts: Phase-in introduced for the reconciliation of monetary amounts (Appendix C, Section 1) (after SRTEG discussion on September 18)
 - iii. DR E1-1 Energy consumption and mix (Energy intensity based on net revenue): Phase-in introduced for the reconciliation of monetary amounts (Appendix C, Section 1) (after SRTEG discussion on September 12)
 - iv. DR E1-2 Gross Scopes 1, 2, 3 and Total GHG emissions (GHG intensity based on net revenue): Phase-in introduced for the reconciliation of monetary amounts (Appendix C, Section 1) (after SRTEG discussion on September 12).

19. After the discussions on the above points, the majority of SR TEG members participating to the meeting approved the LSME ED (17 members approved / 2 dissented) to be submitted as a technical recommendation to the SRB.

20. Luc Hendrickx and Eric Duvaud did not approve the LSME ED. They provided the following explanations⁵:

- a. Eric Duvaud (French liaison member) had already provided a very high number of comments on the version put in internal consultation in July; (substantially) all of them were either accepted and reflected in the LSME ED in its current version, or discussed in the September SR TEG meetings and in some cases the consensual decision of SR TEG was to reject those comments. This member dissents as:
 - i. he considers that the standard has still too many datapoints and he has in particular some 50 datapoints that he considers not necessary (e.g. carbon credits, due diligence, connectivity, references to JVs and associates, etc.);

⁴ This applies to Small and non-complex financial institutions as defined in point (145) of Article 4(1) of Regulation (EU) No 575/2013 and captive insurance and reinsurance undertakings as defined in point (2) of Article 13 of Directive 2009/138/EC of the European Parliament and of the Council

⁵ Please note that a formal written justification will be collected but for timeliness reasons we provide here EFRAG Secretariat understanding the explanations, but the text has not been approved by those two members.

- ii. he considers that the standard fails to provide to banks, insurers and investors a sector specific perspective.

The EFRAG Secretariat pointed out that incorporating a sector perspective in LSME is technically not feasible at this stage, as the FI sector standards will only be ready later in 2024.

- b. Luc Hendrickx disagreed with:
 - i. the methodological approach, as it fails to follow the recommendations of the EFRAG PTF to build a standard truly designed for SME instead, instead of being the result of a 'reduced' ESRS Set 1 standard;
 - ii. acknowledging that the standard has been designed to meet the users' needs of investors as the entities in scope are listed, the purposes a standard like LSME cannot be considered as the value chain cap;
 - iii. the standard is long, the language and style too complex for SME.

Questions for EFRAG SRB

Topics discussed in the last SR TEG meeting

- 21. Do you have any comment on the SR TEG discussion described above?

EFRAG SRB remaining comments of substance (if any)

- 22. Do you have any remaining comments of substance that could affect your vote on the content of LSME ED this ED on the 29 November? Please explain.
- 23. Should you have any editorial comments, please send them to the Secretariat by 3 November 2023.

Agenda Papers

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

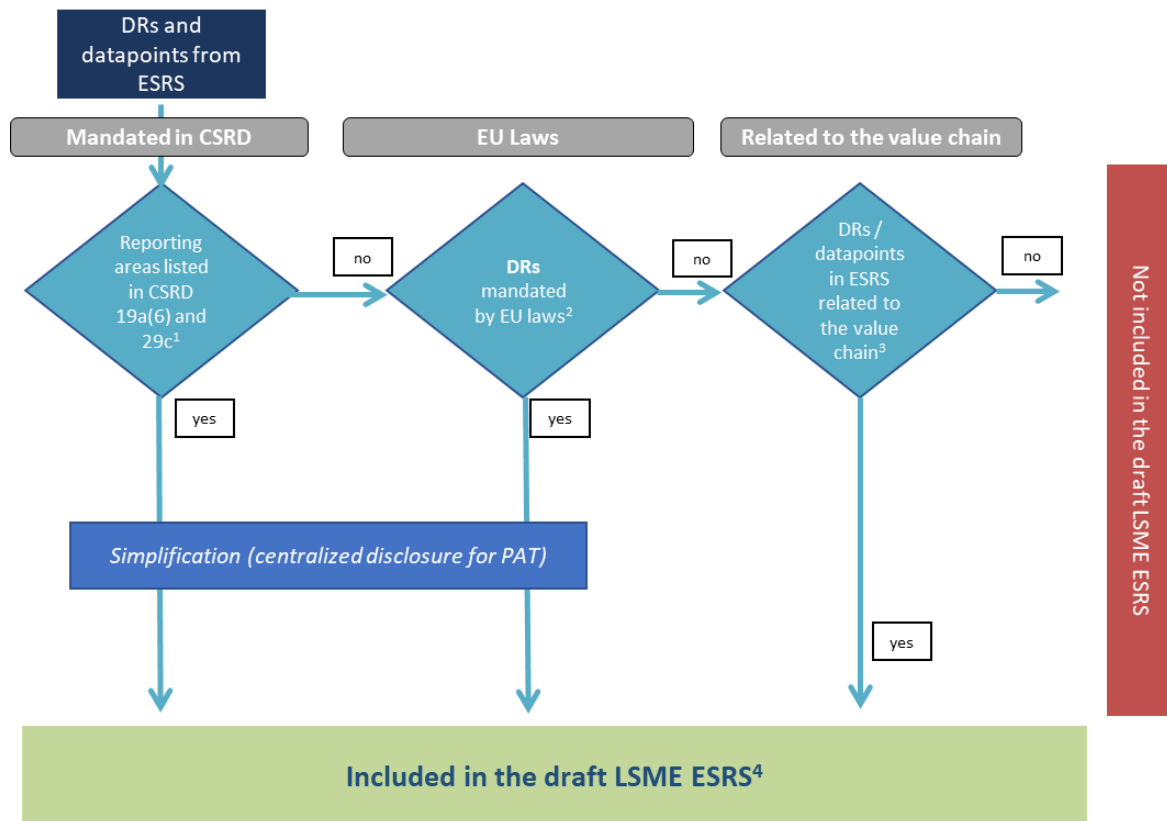


m. Agenda paper 05-14 – LSME ED comparison with Set 1 (*LATE UPLOAD*).



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 8⁶, 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).

6

<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>