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LSME ESRS ED – SR Board approval

Cover Note

Objective

- 1 The objective of this session for SR Board is to approve the LSME ESRS Exposure Draft (LSME ESRS ED, or LSME ED) to be issued for public consultation, subject to editorial changes.

LSME methodological approach (see also the cover note of the SRB 24 October 2023)

- 2 The methodological approach was shared and agreed with SR TEG and SRB between December 2022 and February 2023, based on questionnaires and meetings, including input from the LSME community and the SME EWG, as well as orientations received by EFRAG SRB¹ and detailed input from SR TEG.
- 3 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 tree used in the technical deliberations that led to the content in the draft.
- 4 Value chain cap (VC cap): while most of the suppliers in the value chain of large companies are non-listed SMEs, the CSRD identifies LSME and not VSME as the standard that defines the data requests that are possible from large undertakings in the value chain. Please refer to **Agenda Paper 04.07**. The approach to VC cap will be the subject of specific questions in the consultation.
- 5 Key simplifications implemented in ESRS LSME ED compared to ESRS Set 1 are:
 - (a) Individual perspective (as per CSRD), subsidiaries included as business relationship (through value chain dimension);
 - (b) the voluntary nature of positive impacts and opportunities;
 - (c) a ‘report if you have’ approach to:
 - (i) targets;
 - (ii) due diligence;

¹ Please also refer to [paper 03-02](#) for an overview of the methodological approach presented to the SRB in June 2023 (background reading).

- (iii) stakeholder engagement;
 - (iv) processes to engage with affected stakeholders; and
 - (v) processes to remediate negative impacts and channels.
- (d) introduction of “reasonable effort” principle in some cross-cutting Disclosure requirements
- (e) 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;
- (f) more voluntary Disclosure requirements (from “shall” in Set 1 to “may” in LSME)
- (g) other simplifications which are described in the cover pages of each LSME sections.

SR TEG Approval of LSME ED on 17 October 2023

6 SR TEG approved LSME ED to be issued for consultation (recommendation from SR TEG to SRB). The key points discussed at that meeting were the following²:

- (a) Value chain cap:
- (i) the Secretariat and SR TEG scrutinized in conjunction also with the development of the value chain guidance the Set 1 VC datapoints. This allowed to identify a small number of VC cap datapoints in LSME that are essential for the purpose of this Standard (i.e. needed for investors purposes). Those datapoints also help to preserve the info needed in Set 1. **See Agenda Paper 04.07.**
 - (ii) Secretariat also clarified that the resource inflows and outflows are only qualitative because the quantitative inflow and outflow is on ‘own operations’. Secretariat clarified that the drop from the value chain cap of the quantitative metric on the inflows and outflows for value chain is not going to affect the cap: the text in Set 1 E5 paragraph 30 sector agnostic is only on own operations. Secretariat also clarified that the quantitative dimension (own operations) of the two datapoints is kept in the standard, when they the respective datapoint is material.
- (b) On the transitional provision related to the future issuance of sector standards (ESRS 1 paragraph 130, 131):
- (i) SR TEG discussed the approach to follow on the drafting of the current transition provision of Set 1, pending the consultation.
 - (ii) Two SR TEG members agreed to keep the transition provision as it is on the basis that there is no need for LSME sector standards. SR TEG Chair clarified that one of the questions in the public consultation will be what people think should be the approach to sectors for SMEs (LSME and VSME separately) – pros and cons to be illustrated in the consultation questionnaire:

² The content of the summary of discussions is not yet approved by SR TEG.

- ☐ Option 1: as a byproduct of the sectors we issue some guidance for SMEs (however this would not allow to appreciate the differences in approach between VSME and LSME) or
 - ☐ Option 2: LSME should refer to the sector standards for large undertakings (however this would not allow to appreciate the difference in approach between Set 1 and LSME).
- (iii) Most SR TEG members support the idea to ask in the consultation the questions separately for LSME and VSME.
- (iv) With reference to what to do in LSME for paragraph 130 and 131, SR TEG Chair clarified the need to link it to the consultation. If the outcome of the consultation is that we will have sector LSME modules, then the transition provision will be applied until the issuance of the sector module LSME. If the outcome of the sector of the consultation is that there are no LSME specifications of the sector standards, then these paragraphs would continue to refer to the Set 1 ESRS.
- (c) On the approach to phase-ins:
- (i) SR TEG Chair reminded the approach agreed in the last TEG discussion, as there was a clear majority for keeping in LSME the same flexibility that we have in the Delegated Act, but only for the companies that will not choose to opt-out for the first 2 years (i.e. that will not report in 2026/27).
 - (ii) SR TEG acknowledged that there was not a particular rationale behind the threshold of 50 employees to adjust the phase-in Set 1 threshold of 750 employees. Members agreed to include it in the LSME ED draft, however the Secretariat will check the proportion of entities below 50 employees in scope of LSME (with all the limitations that this exercise may have – e.g. databases of listed debt securities across Europe not available, need to run different queries for different markets, unavailability of the information about the number of employees in databases so need to look for the financial statements, etc.). A specific question in the consultation will be asked on the threshold of 50 employees.

For illustrative purposes the EFRAG Secretariat investigated on the number of employees of the simple non complex financial institutions (SNCI) in scope and 24% of them have less than 50 employees, which confirms on this sample that a good proportion would be captured by the threshold of 50 employees.

TOTAL CREDIT INSTITUTIONS	1869
less than 10 employees	68
between 10 and 20	94
between 20 and 50	337
between 50 and 100	289
between 100 and 250	442
between 250 and 500	348

between 500 and 1000	196
Greater than 1000	95

(iii) Secretariat noted that there are additional phase-in compared with Set 1:

- ☐ DR S1-6 Training metrics: Phase-in introduced for the gender breakdown (after SRTEG discussion on September 18)
- ☐ DR S1-9 Incidents and severe human rights impacts: Phase-in introduced for the reconciliation of monetary amounts (after SRTEG discussion on September 18)
- ☐ two new phase ins on the reconciliations with financial statement of energy intensity based on net revenue and GHG intensity based on net revenue.

7 Voting by SR TEG:

- (a) The ED was approved by a large majority, with 17 positive votes (Klaus Hufschlag, Signe Andreasen Lysgaard, Philippe Diaz, Julie Marie, Luca Bonaccorsi, Piermario Barzaghi, Belen Anta, Julian Muller, Katerina Katsouli, Carlota de Paulo Coelho, Piotr Biernaki, Thomas Smotz, Sigurt Vitol, Giulia Genuardi, Maria Mora, Chiara Del Prete), subject to the changes agreed above and further editorial changes.
- (b) Luc Hendrickx and Eric Duvaud did not approve the LSME ED. They provided the following explanations:
- (i) 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:
- 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.);
 - he considers that the standard fails to provide to banks, insurers and investors a sector specific perspective.
- (ii) 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.
- (iii) Luc Hendrickx dissented with the ED, due to:
- the methodological approach, as it fails to follow the recommendations of the EFRAG PTF to build a standard truly designed for SME, instead of being the result of a ‘reduced’ ESRS Set 1 standard;

- 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;
 - the standard is long, the language and style too complex for SMEs.
- (iv) SR TEG Chair reminded that the identification of LSME as value chain cap is not in the remit of EFRAG (as it is set in the CSRD) and that the approach to start from Set 1 and simplify was selected in order to meet the requirements in the CSRD (the CSRD identifies a list of points to be covered as a subset of what is to be covered in Set 1).

Questions for SRB in this meeting – refer to LSME ED in markup (Papers 04.02/04.06)

1. Changes suggested by individual SRB members on 24 October (in grey in the markup)

- 8 The SRB discussed the content of LSME on 24 October. The draft approved by EFRAG SR TEG was made available for that SRB meeting. The following changes have been made in markup to the text approved by the SR TEG and are available in Agenda Papers 04.02/04.06:
- (a) Section 1 (Paper 04-02): Paragraph 114: connectivity: specific consideration on connecting the monetary amounts in sustainability statements (individual perspective) with the consolidated financial statements;
 - (b) Section 2 (Paper 04-03): Paragraph 8: the disclosure of the reasons to deviate from standard time-horizons has been included;
 - (c) Section 2 (Paper 04-03): Paragraph 20: Paragraph 20: content about GOV 1 has been enhanced, Paragraph 20: content about GOV 2 has been included;
 - (d) Section 2 (Paper 04-03): AR 11: editorial (alignment with Set 1);
 - (e) Section 5 (Paper 04-05): Para. 3: clarification that the detailed requirements in metrics in the Section are applicable only to Own workforce (editorial).

Question 1: Does EFRAG SRB agree with the inclusion of these changes in the LSME ED?

2. Comments stemming from bilateral exchanges with ANC that are presented as markup in papers 04-02/04-06

- 9 EFRAG Secretariat received several comments and suggestions from the SRB ANC's representative (Laurence Rivat) regarding the content of LSME, in the direction of achieving a further streamlining and reduction of the disclosures. Among the other changes that are visible in the markup documents, we bring to the attention of the SRB the following changes that change the substance of some of the requirements as approved by the EFRAG SR TEG:

Section 1

- 10 Par. 61: the description of the approach to associates and joint ventures that are also actors in the value chain has been replaced with an illustration, in order to clarify the concept;
- 11 Tentative redrafting of chapters 6.1-6.5
- 12 Par. 87: 'reasonable effort' facilitation introduced for events after the end of the reporting period;

- 13 Par. 113: connected information: removal of the guidance that illustrates the different methodologies for connectivity;
- 14 Please note that par. 66 has been deleted as it will be moved in Basis for Conclusions where there will be an illustration of the value chain cap.

Section 2 and 3

- 15 The elimination of the following AR paragraphs have been suggested: Climate, AR 17, 18, 19. EFRAG Secretariat considers that this may be counterproductive, as these paragraphs are ‘may’, so they do not add burden, and actually help to contextualise what the undertaking is supposed to do when preparing the relevant disclosure. Should the SRB accept these changes, EFRAG Secretariat suggests to cover these 3 ARs specifically in the consultation to check their usefulness with entities in scope.
- 16 The following modify the digital tagging of the disclosure. If the SRB accepts to take onboard these suggestions, the EFRAG Secretariat recommends a specific question in the consultation on whether this creates a reduction in digital usability:
- (a) Par. 19: the grouping of different original datapoints about diversity in the administrative management and supervisory body into a single datapoint, that will trigger less granularity in the XBLR tagging;
 - (b) Par. 32 (a): the grouping of different original datapoints into a single datapoint, that will trigger less granularity in the XBLR tagging;
 - (c) Par. 35 (a) (i): the grouping of different original datapoints into a single datapoint, that will trigger less granularity in the XBLR tagging. In addition in the SRB meeting on 24 October one SRB member was against the merger of these.
- 17 In addition, on SBM-1 par. 28 b) significant ESRS sectors: Included “where the company or its subsidiaries operate or can potentially have a material impact”

Section 4

- 18 Addition of “if applicable” principle in EU ETS, market based methods and GHG removals ;
- 19 Par. 30: monetary amount of net revenues at risk may be disclosed in ranges instead of a single amount;
- 20 Par. 55 Resource inflows: reworded the text clarifying what is asked by this DR. This does not change, merely clarifies, the spirit of what is required;
- 21 AR 56 E4-1 Biodiversity impact metrics: added an AR on managed sites based on the definitions in Set 1.
- 22 E2-1 EPRTTR: explained in AR 44 how the pollutants should be calculated.

Section 5

- 23 S1-2, paragraph 11, rewording (text in bold) to make it clear that undertakings are not to disclose “all key characteristics” of non-employees, but rather the specific datapoints requested under this Disclosure Requirement.
- 24 S1-3, paragraph AR 23, specification that the coverage includes the different levels at which collective bargaining agreements can be discussed and agreed (e.g., national, sectoral, undertaking levels).

- 25 S1-9, paragraph 48, merging of the paragraphs on discrimination and severe human rights incidents but keeping both requirements.
- 26 Appendix B1, alignment of text as per Appendix B2-B4 to replace “to be considered” for “supports the application of the requirements”.

Question 2: Does EFRAG SRB agree with the inclusion of these changes in the LSME ED?

3. Comments from SRB members that necessitate of an explicit decision before the ED is modified

A) Report if you have

- 27 One of the SRB members indicated that he had a red flag related on the inclusion of the following ‘report if you have’ disclosures as ‘shall’. He considers that as the legislators have done a conscious choice to eliminate them from the list of explicit content to cover in LSME, EFRAG cannot include them as a shall. He proposes instead to include them in the ED as a ‘may’. They are:
- (i) Targets (Disclosure Requirement 12 (IR-4) – Targets in relation to sustainability matters);
 - (ii) due diligence (Section 2 - Disclosure Requirement 4 (GOV-2) - Due diligence);
 - (iii) stakeholder engagement (Section 2 Disclosure Requirement 6 (SBM-2) – Interests and views of stakeholders;
 - (iv) processes to engage with affected stakeholders (Section 4 - Processes for engaging with value chain workers about impacts (under Disclosure Requirement 11 (IR-3) – Policies and actions in relation to sustainability matters); and
 - (v) processes to remediate negative impacts and channels (Section 4 - Processes to remediate negative impacts and channels to raise concerns (under Disclosure Requirement 11 (IR-3) – Policies and actions in relation to sustainability matters).
- 28 The EFRAG Secretariat notes that the datapoint about the implementation of due diligence is an SFDR indicator, so its elimination would go against the general rule (and CSRD provision) to cover the SFDR indicators.
- 29 The EFRAG SR TEG discussed lengthly the issue of these disclosures, as they are not explicitly in the list of contents to be covered in the CSRD. It was noted their role in supporting a more reliable reporting and comparable reporting, as when they are in place the respective disclosure provides relevant information for the users. They constitute a key component of the management of sustainability matters. The EFRAG SR TEG was split on whether they should be included or excluded from the ED. At the end a compromise was reached and these disclosure were kept, on the basis of a ‘report if you have’ approach. So they are required only when the respective actions and processes are in place (except for due diligence where the text of the SRDP PAI ‘disclose whether due diligence is in place is kept).

Question 3: Does EFRAG SRB agree with the inclusion of these changes in the LSME ED on the ‘report if you have’ approach or should these be voluntary items (‘may’)?

B) Granular datapoints in SBM 3 (conflicting views)

- 30 Paper 04.03 paragraph 35 shows in markup a possible simplification of the text. In particular, this results in merging different datapoints in a single datapoint. In the SRB meeting on 24 October on this specific simplification proposals there were conflicting views of different SRB members.

Question 4: Does EFRAG SRB agrees with the proposed simplifications?

C) SBM 3 financial effects

- 31 The EFRAG Secretariat understand that ANC suggests to:
- (a) require only one datapoint for financial effects, which would merge current and anticipated financial effects;
 - (b) delete the requirement to disclose: *the material risks for which there is a significant risk of a material adjustment within the next annual reporting period to the carrying amounts of assets and liabilities reported in the related financial statements;*
- 32 Should the SRB accept these suggestions, the EFRAG Secretariat recommends to include specific questions in the consultation to users to understand if they perceive a loss of information.

Question 5: Does EFRAG SRB agree with the inclusion of these changes in the LSME ED?

D) Climate financial effects

- 33 The EFRAG Secretariat understand that ANC suggests to:
- (a) merge in one single datapoint 31 a) and 31 b): reconciliation with financial statements of significant amount of assets, net revenues (and liabilities for transition risk) at material physical risks and at material transition risk (i.e. require only one single amount at risk without differentiation between amount at risk for physical and for transition risk);
 - (b) Paragraph 31: the requirement to disclose a reconciliation of financial effects with financial statements would be replaced by the requirement to explain the linkages with the financial statements [please note that this is in yellow in the markup file].

Question 6: Does EFRAG SRB agree with the inclusion of these changes in the LSME ED?

E) Elimination of intensity ratios for GHG and water (SFDR datapoints)

- 34 The ANC suggests to delete Paragraph 20,21 and 45 on GHG intensity and water intensity per net revenue. The rationale for eliminating the intensity ratios is that the user can calculate the ratio using the disclosure already provided under other datapoints (numerator and denominator). This would allow preparers to save the cost of auditing the ratio separately. These two ratios are SFDR indicators and this is the reason why SR TEG didn't accept this suggestion, in order to stick to the general rule of maintaining SFDR indicators explicitly in the text.

Question 7: Does EFRAG SRB agree with the inclusion of these changes in the LSME ED?

F) Non-guaranteed hours (see paper 04-08, which includes pros/cons table):

- 35 The ANC suggests to merge in a single request the number of employees that are in a precarious situation (sum of temporary contacts and non-guaranteed hours). The EFRAG

Secretariat considers that these are two different concepts and belong to two different categories (duration of the contract and working time). To discuss at SRB whether it is relevant to differentiate between temporary and non-guaranteed hours employees, or if it would be possible to consider non-guaranteed hours a subset or breakdown of temporary employees.

Question 8: Does EFRAG SRB consider appropriate merging the breakdowns for temporary and non-guaranteed hours employees?

G) Social protection (major countries):

36 The ANC proposes to limit this disclosure only for 'major' countries. The EFRAG Secretariat notes that the introduction of 'major' countries can be confusing. However, it has been introduced in paragraph 9a) as an alternative when the threshold (50 employees countries representing at least 10% of the total number) is not appropriate. Discuss at SRB to disclose only "major countries" where employees don't have social protection for this MAY datapoint.

Question 9: Does EFRAG SRB agree with having S1-5 as a requirement that should be disclosed with a "major country" criteria for the may datapoint?

H) Adequate wages (major countries):

37 The ANC proposes to limit this disclosure only for 'major' countries. The introduction of 'major' countries can be confusing. However, it has been introduced in paragraph 9a) as an alternative when the threshold (50 employees countries representing at least 10% of the total number) is not appropriate.

Question 10: Does SRB agree with having S1-4 as a requirement that should be disclosed with the same threshold as characteristics of employees being 50 employees representing 10% of its employees and, if not applicable "major country" criteria for this may datapoint?

Datapoint count of LSME

38 Please refer to Paper 04-10 (LATE UPLOAD)

Approval of LSME ESRS ED

39 EFRAG Secretariat will ask SRB members if they approve the content of LSME ESRS ED on a section-by-section basis. Remaining editorial comments, if any, are welcome by the EFRAG Secretariat by **6 December 2023**. To also note that Secretariat will merge the sections of LSME in one single document.

Questions for EFRAG SR Board – see above in green +

40 Does EFRAG Board approve to issue for public consultation the LSME ED subject to the changes agreed today and subject to editorial changes?

Next steps

41 Secretariat will focus on the following steps:

- (a) Finalise the Basis for Conclusions for the LSME ESRS ED – **the plan is to ask for written input at the same time at SR TEG and SRB, as no approval is required for this document;**
- (b) preparation for the public consultation, particularly the draft questionnaire for LSME ESRS ED;
- (c) apply potential editorial changes in the LSME ESRS ED;
- (d) explore possibilities for LSME user tests, including SNCI³ and Captive insurance and Reinsurance undertakings – **the plan is to issue a call for candidates for the field test as soon as the ED is approved and before its issuance to accelerate the recruitment of companies and users;** and
- (e) engage with the awarded third-organisation for the Cost Benefit Analysis on LSME.

Agenda Papers

42 In addition to this cover note, agenda papers for this session are:

LSME ED approved by SR TEG shared on SRB 24 October available at this [link](#)⁴ (papers 05-02 to 05-06 of SRB meeting 24 October) +

- (a) Agenda paper 04-02 – LSME ESRS ED Section 1 General requirements (mark-up from SRT approval + ANC comments);
- (b) Agenda paper 04-03 – LSME ESRS ED Section 2 General disclosures and Section 3 Policies, Actions and Targets (mark-up from SRT approval + ANC comments);
- (c) Agenda paper 04-04 – LSME ESRS ED Section 4 Environment (mark-up from SRT approval + ANC comments);
- (d) Agenda paper 04-05 – LSME ESRS ED Section 5 Social (mark-up from SRT approval + ANC comments);
- (e) Agenda paper 04-06 – LSME ESRS ED Section 6 Business conduct (mark-up from SRT approval + ANC comments);
- (f) Agenda paper 04-07 – LSME ESRS Approach to Value Chain Cap;
- (g) Agenda paper 04-08 – Non-guaranteed hours employees;
- (h) Agenda paper 04-09 – Two column LSME/Set 1 comparison; **(LATE UPLOAD)**
- (i) Agenda paper 04-10 – Datapoint count **(LATE UPLOAD)**.

³ SNCI: Small and Non-Complex Credit Institutions

⁴ These papers were shared and discussed in SRB 24 October 2023