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Revised LSME

Objective

1. The objective of this paper is to present the results of the field test and public consultation of the ESRS LSME ED sections¹ (cross-cutting and topical) and to get EFRAG SR TEG input/approval of the strategic directions proposed by EFRAG Secretariat.
2. The purpose is to define in this meeting a way forward for a substantial part of the re-drafting, so that before September the EFRAG Secretariat can progress in producing a revised LSME.

Structure of the paper

3. This paper contains:
 - a. Background
 - b. Summary of LSME field test and public consultation respondents' views and proposed orientation from EFRAG Secretariat. This is further divided into the six ESRS LSME ED sections:
 - i. Section 1 General requirements
 - ii. Section 2 General disclosures
 - iii. Section 3 Policies, actions and targets
 - iv. Section 4 Environment
 - v. Section 5 Social
 - vi. Section 6 Business conduct

Background

4. The EFRAG Secretariat has analysed and summarised the responses received on the ESRS LSME Exposure Draft (LSME ED) received both via online questionnaire and via comment letters. The LSME ED was subject to public feedback from the 22 January 2024 to 21 May 2024. In parallel to the public consultation, EFRAG Secretariat has conducted a field test with preparers and users of the LSME ED to further test the usability of the standard.

¹ This document does not include the analysis of the feedback received on Part A. "Key questions about ESRS LSME ED" of the public consultation questionnaire, because already shared during the SRB meeting held on 4 July (See Agenda [paper 04-02](#))

5. The detailed analysis of the feedback from the field test and public consultation has been summarised in the Executive Summary reports of both the field test [\(link\)](#) and public consultation [\(link\)](#). To note that the results from the public consultation also include the answer received via comment letters. Those are not counted in statistical part of Executive Summary, but are taken into account in the table below when indicating whether the position was expressed by most, a majority, some or a few.

EFRAG SRB tentative decision on architecture / strategic direction from SRB

6. This paper does not cover Question 1 of the consultation questionnaire, i.e. standard setting decision tree and architecture. That question and the associated strategic directions have been covered by the SRB discussion on 4 July (refer to Agenda [Paper 04.02](#) of that meeting). The key message is that either starting from LSME (reducing the datapoints/further streamlining) or of starting from VSME (adding the components that are required by the CSRD in LSME but are missing in VSME), the ED needs to be significantly simplified to meet the cost-benefit profile, due to the low number of entities in scope and therefore limited societal benefits. The EFRAG Secretariat proposed to the SRB to start from VSME and add the CSRD requirements for LSME. The paper [04-02](#) of SRB 4 July 2024 highlights some areas where a detailed gap analysis is needed to be sure that essential information in accordance with the CSRD is maintained in the LSME.
7. The following key elements were discussed in the SRB meeting (unapproved summary):
 - a. **Value chain cap:** paper 04.02 SRB 4 July 2024 shows a list of potential additional elements to be included in VSME to cover the value chain cap, given the role of LSME in setting the legal requirements. Due consideration should be paid not to complexify the value chain requirements in LSME, as well as to avoid too many differences between the requirements on VSME and in LSME. While LSME sets the legal cap, in practice VSME is expected to protect SMEs from excessive requests. The Secretariat reassured members that a few datapoints are to be added: no additions will arise from adding risks and impacts, as well as policies, actions and targets, as these are already explicit requirements of the CSRD for LSME. In addition, substances of concern and other similar disclosures will be subject to the “if applicable” filter. The EFRAG Secretariat will discuss with SR TEG further these datapoints and any simplifications regarding transition plan and OPEX/CAPEX.
 - b. **SFDR:** The consultation and cost benefit analysis shows that a much simpler approach than LSME ED is needed for proportionality. At the same time, information that are critical for users, such as SFDR indicators, will need to be preserved. Support to keep the SFDR table 2 and 3 PAIs (possibly as a “may”).
 - c. **IFRS interoperability** The SRB agreed with the relatively lower priority of interoperability with ISSB compared to proportionality.
 - d. At the start of the project a decision was taken to follow different approaches for LSME and VSME. There are two possible ways to execute a simplification: reduce

LSME or add elements in VSME. SRB members inquired on the feasibility of VSME+ approach, as opposed to streamlining LSME, due to the hard deadline and other concurring deadlines. The EFRAG Secretariat expressed a preference for VSME+ (while noting that the acronym might not be appropriate since it has to be full fledged LSME standard to be adopted via delegated act) in terms of feasibility, as it has the advantage of developing synergies with VSME (which is due with the same deadline) and an already simplified language. The EFRAG Secretariat noted that there is no capacity to implement two approaches at the same time.

- e. The EFRAG Secretariat clarified that VSME and LSME would continue to be two different and separate documents. Once VSME is defined in its content, the different elements will be copied in a new LSME document, following the current table of contents of LSME (cross cutting / E/ S/ G) and the necessary adjustments will be implemented to deliver LSME compliant with the CSRD and to the feedback of the consultation.
8. **Conclusion:** The EFRAG SRB supported the development of VSME+ approach, however some SRB members would prefer to receive a draft proposal with the new structure before giving final feedback. For the next steps, the term VSME+ may be misleading. The aim is for VSME+ to be a middle ground. EFRAG does not intend to lower the bar at a point that it is incompatible with the CSRD. Next step: further SR TEG discussions and decisions on the “revised LSME”.
9. **Due process considerations:** the SRB members agreed that there would be no need to re-expose the standard, because no new feedback can be expected to emerge from an additional consultation at this stage given the clear feedback already received. EFRAG Secretariat may have targeted outreaches (workshop/interview) in due course before the finalization.

EFRAG Secretariat approach to Revised LSME

10. Starting from the SRB decision on 4 July as described above, the EFRAG Secretariat intends to adopt a pragmatic approach: analyse per each disclosure whether to streamline LSME it would be more appropriate to start from VSME (and add the elements required by the CSRD for LSME), or to start from LSME ED (and simplify significantly the content/language).
11. The preliminary CBA results show that a significant streamlining is needed to land in positive territory (benefits that exceed costs): to have an indication, assuming an increase in the estimated cost of VSME ED by 80% to 100% due to the additional datapoints that are needed in VSME ED+ (compared to VSME ED), the net effect of LSME would be positive (net benefit). In other terms, the preparation efforts for LSME Revised should be less than twice the effort to prepare VSME ED (as exposed for comments). This is only a preliminary indication.

Summary of ESRS LSME ED respondents' views and proposed orientations from EFRAG's Secretariat

12. In this section, an overview of the main points emerged from the LSME Field Test (highlighted in grey) and Public Consultation (including comment letters) together with the proposed EFRAG Secretariat orientation is provided.
13. Furthermore, in the table there are the following additional columns:
 - “VSME reference”, (where applicable) there is a reference to a paragraph / DR in VSME corresponding to the LSME topic with an indication of the main gaps
 - “Feasibility of VSME”, estimates how the content of VSME could fulfil the LSME objective defined in CSRD and could support to respond to user`s needs, considering the public accountability angle of LSME (Low - VSME should be integrated with LSME content; Medium - VSME to be complemented with additional info; High - VSME content is substantially enough to fulfil the LSME objective defined in CSRD).
 - “Loss of information for users”, estimates the risk of losing relevant information for users should we implement the EFRAG Secretariat suggestions.
 - “EFRAG Secretariat”, summarises the reasoning of the EFRAG SRB/ EFRAG SR TEG in finalizing the ED before the consultation in May 2024 and the EFRAG Secretariat proposal or points to be discussed in this meeting.

SECTION 1 General requirements

LSME Topic / Par.		Preparers	Users	Other	VSME reference	Feasibility of VSME	Loss of information for users (Proposed action)	EFRAG Secretariat
Chapter 2 Qualitative characteristics of information	FIELD TEST	na	na	na	Par. 10 (missing the definitions)	Low	None, if LSME Revised keeps the content of LSME ED on Qualitative characteristics of information (with streamlining of Appendix B to the extent possible).	The EFRAG SR TEG and SRB considered that the same characteristics as in the ESRS for large undertaking would be needed in order to achieve a similar level of quality in the resulting disclosure. This was considered essential to meet the objective of this standard and the auditability of the related information. Keep Appendix B of LSME ED but explore the possibility to simplify the language of Appendix B: Qualitative characteristics of information.
	CONSULTATION	na	na	na				
Section 1 Chapter 3 Double materiality	FIELD TEST	Highly costly. double materiality process needs to be more interconnected with what the LSMEs have to report on. Need for more guidance that is tailored to smaller undertakings in different sectors.	na	na	Materiality par. 42 – 55	Medium (missing ARs with explanations)	None, LSME will have to keep double materiality	Keep materiality (including AR 10/18) as a key principle that informs mandatory sustainability reporting, according to the CSRD. Cutting the content would be detrimental for implementation, making the

SECTION 1 General requirements

LSME Topic / Par.	Preparers	Users	Other	VSME reference	Feasibility of VSME	Loss of information for users (Proposed action)	EFRAG Secretariat
<p style="text-align: center;">CONSULTATION</p>	<p>Most (85% of those who responded) agree with the approach adopted consisting of maintaining the same approach for materiality as in ESRS Set 1. Additional guidance on how to conduct double materiality is needed.</p> <p>None of the comments received disagree with the materiality approach.</p> <p><u>Detailed suggestions (to be implemented)</u></p> <p>A) Positive impacts and opportunities: keep them in brackets throughout Section 1 as a way to ensure more standardised disclosures when voluntarily provided by the undertaking</p> <p>B) Par. 33: suggest deleting the requirement in the final sentence of Section 1 par. 33 regarding the forward-looking analysis of the conditions under which climate could become material in the future.</p> <p><u>Detailed suggestions (to be discussed)</u></p> <p>C) Impact materiality and VC (par. 45): focus of LSME in terms of actions should primarily be on own operations and direct relationships in the value chain (employees, clients and suppliers tier 1)</p> <p>D) UN / OECD guidelines (par. 47): delete the reference to due diligence and UN/OECD guidelines. CS3D does not apply directly to LSMEs</p> <p>E) Material IRs arising from actions addressing sustainability matters (par. 55-56): Suggestion to delete this chapter in line with proportionality principle. Mitigation actions of LSMEs will have limited rebound effects compared to those of large undertakings. It could be let at entity-specific level for LSMEs</p> <p>F) Level of disaggregation (chapter 3.7): Suggestion to give more flexibility to LSMEs and make the disaggregation of IRs optional, in line with proportionality principle. Disaggregation is less relevant for LSMEs as their geographical scale is generally limited</p>						<p>reporting even more challenging.</p> <p>SRT to discuss to Keep chapter 3 with language simplification.</p> <p><u>Proposal to accept proposals:</u> A, B, including the related AR, E and F.</p> <p><u>To be discussed:</u></p> <p>C) for impacts materiality and VC impacts arising from business relationships possibility to apply the same approach adopted for VSME, apparently limiting the VC scope to direct relationships (suppliers) as suggested by a comment letter</p> <p>D) deletion or inclusion in AR of reference to UN / OECD guidelines. Considering that Section 1 has been amended and does not include a specific paragraph on due diligence (simplified in impact materiality)</p>
	<p>More tailored guidance is needed</p>		<p>The standard should include a list of topics that could be material per sector.</p>				

SECTION 1 General requirements

LSME Topic / Par.		Preparers	Users	Other	VSME reference	Feasibility of VSME	Loss of information for users (Proposed action)	EFRAG Secretariat
Section 1 Chapter 4 Value chain	FIELD TEST	Difficult to understand the value chain implications in relation to the MA and material IRs. Need for more guidance and examples on VC and boundaries (with focus on VC for SNCIs)	na	Na	NA Definition only in Appendix A "Defined terms"	Low	None, if LSME will continue to have the reference and the definition of VC in relation to material IRs	The underlying principles are the same as Set in 1, with value chain coverage driven by the outcome of the materiality assessment. This is necessary as Art. 29c refers to art 29b (2-5), which includes value chain. SRT to discuss to keep chapter 4 with language simplification (building on VSME VC definition). In relation to par. 66, see link Annex .
	C CONSULTATION	na	na	<u>Detailed suggestions (to be discussed) on par. 66 with splitted views:</u> A) suggestion to delete the para. as no added value B) to be provided more detail on the "clear indications that material impacts and risks are not addressed appropriately", including situations of qualified opinions of the auditor C) suggestion to delete the wording "same level of assurance" + risk of shifting the assurance burden in the LSME's value chain.				

SECTION 1 General requirements

LSME Topic / Par.		Preparers	Users	Other	VSME reference	Feasibility of VSME	Loss of information for users (Proposed action)	EFRAG Secretariat
Section 1 Chapter 5 Time horizons	FIELD TEST	na	na	na	Par. 40 - time horizons (missing linkage between retrospective and forward-looking information; Reporting progress against the base year)	Medium	None, if LSME will keep the information on linkages between retrospective and forward-looking information; Reporting progress against the base year. Furthermore, LSME gives more flexibility to adopt different definition of m/l term and the possibility)	Keep the same definitions and requirements for time horizons as defined in ESRS for large undertakings for consistency and to ensure comparability among the sustainability statement SR TEG to discuss to keep chapter 5 with language simplification (building on VSME par. 40).
	C CONSULTATION	na	na	na				
Section 1 Chapter 6 6.1 Presenting comparative information	FIELD TEST	na	na	na	Par 17 comparative information (missing change in comparative information from the	Medium	If replaced with VSME par. 17, missing information on changes	<u>To be discussed with SR TEG:</u> Option 1) Disclose restated comparative information when such restatement is achievable with reasonable effort. It is judgemental to assess what reasonable is. Users do not lose information about changes.

SECTION 1 General requirements

LSME Topic / Par.	Preparers	Users	Other	VSME reference	Feasibility of VSME	Loss of information for users (Proposed action)	EFRAG Secretariat
	C CONSULTATION	General agreement on the content. Need of clarification on the meaning of the terms “reasonable effort”/” when impractical” Requirement to disclose instances where providing information is impractical, along with an explanation. <u>Detailed suggestions (to be discussed)</u> A) Suggestion to delete chapters 6.1 to 6.5 as in VSME. The information should be entity-specific for LSMEs		previous period)			Overall quality of reporting more robust. Option 2) No provision on restatement of comparative. Information loss for users. Option 3) Restatement is voluntary.
Section 1 Chapter 6 6.2 Sources of estimation and outcome uncertainty 6.3 Updating disclosures about events after the end of the reporting period 6.4 Changes in preparation or presentation of sustainability information 6.5 Reporting errors in prior periods	FIELD TEST	na				None, if LSME will include the chapters. Otherwise, there could be loss of information for users (considering also that LSME information will be audited and has to support the public interest dimension of the disclosures)	Keep the content as in Set 1 and introduce proportionality to grant more flexibility with the concept of ‘reasonable effort’. SR TEG to discuss how the chapters could be simplified without losing relevant information for users and considering the public relevance of LSME
	C CONSULTATION	General agreement on the content. Need of clarification on the meaning of the terms “reasonable effort”/” when impractical”		No reference in VSME	Low		

SECTION 1 General requirements

LSME Topic / Par.	Preparers	Users	Other	VSME reference	Feasibility of VSME	Loss of information for users (Proposed action)	EFRAG Secretariat
Section 1 Chapter 6 6.6 Classified and sensitive information, and information on intellectual property, know-how or results of innovation	FIELD TEST	na					
	C CONSULTATION	General agreement on the content. Need of clarification on the meaning of the terms “reasonable effort”/” when impractical”		Par. 16	High	None	Change for para. 16 of VSME
Section 1 Chapter 6 6.7 Matters in the course of negotiation	FIELD TEST	na					The CSRD provides the possibility for member states to allow undertakings that apply the ESRS for large undertakings to omit information related to impending developments or matters in the course of negotiation that are exceptional.
	C CONSULTATION	General agreement on the content.		na	na	None It gives additional flexibility to SMEs	Decision taken to introduce the same option in the text of the LSME ESRS ED to provide additional flexibility to SMEs. Keeping this paragraph offers an additional flexibility, so suggested to keep it (it does not result in additional costs).

SECTION 1 General requirements								
LSME Topic / Par.		Preparers	Users	Other	VSME reference	Feasibility of VSME	Loss of information for users (Proposed action)	EFRAG Secretariat
Section 1 7. Structure of the sustainability statement	FIELD TEST	na			Par. 13-15 (inclusion in the management report only optional)	Medium	None, if LSME will keep the reference to qualitative characteristics, information to be included in a dedicated section of the management report according to a suggested structure, reference to EU Taxonomy, reference to other general accepted frameworks	Keep Set 1 content with simplifications, also considering the CSRD provisions SR TEG to discuss how to build on VSME content keeping the necessary compliance with CSRD
	C CONSULTATION	na						
Section 1 8.1 Incorporation by reference	FIELD TEST	na			Par. 41	High (the individual perspective of LSME need to be considered)	None	Simplify the language along the lines of para. 41 of VSME. Keep reconciliations with financial statements as optional.

SECTION 1 General requirements

LSME Topic / Par.		Preparers	Users	Other	VSME reference	Feasibility of VSME	Loss of information for users (Proposed action)	EFRAG Secretariat
	C CONSULTATION	Received one comment to further simplify the chapter in the direction of VSME:						
Section 1 9. Transitional provisions	FIELD TEST	SNICs underlined that the defined threshold of 50 employees is too low and suggested to review it. This threshold could result in being more restrictive than the one defined for Set 1.						Decision taken to grant the same list of the phase-in defined in Set 1, adding also four additional phase-in to give more flexibility. SR TEG to discuss if to grant more flexibility the phase-ins could be applicable to all undertakings starting their first reporting period.
	C CONSULTATION	Most of preparers agreed with the approach taken on phase-ins in the LSME ED. Suggestion to extend the phase-ins to all enterprises for the first two years of listing	Most of users agreed with the approach taken on phase-ins in the LSME ED.	Some of the participants agreed but other criticized the approach and suggested a dynamic phase-in provision allowing all undertakings in scope to use phase-ins for their first reporting periods and grouping all transitional provisions in a dedicated section for more clarity	na	na	None, if LSME will comply with CSRD provisions	