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VSME ED APPROVAL

Cover Note

Objective

1. The objective of this session for SR TEG is to approve the draft VSME Exposure Draft (VSME ED) as a technical recommendation to be issued by EFRAG SRB for public consultation, subject to further editorial changes.
2. Due to its ‘users-focused perspective’, some of the aspects of this standard are particularly difficult to assess, without an extensive consultation. This cover note identifies in green the methodological aspects that will be in the focus in the consultation.

Users’ perspective of this standard

3. In the [EC Q&A accompanying the adoption of the Delegated Acts ESRS in July 2023](#), it is specified that *EFRAG is developing simpler, voluntary standards for use by non-listed SMEs. These voluntary standards should enable non-listed SMEs to respond to requests for sustainability information in an efficient and proportionate manner, and so facilitate their participation in the transition to a sustainable economy.*
4. The [EC SME Relief Package of September 2023](#) refers to **VSME as a measure to support SMEs in accessing sustainable finance**. In Par. 4 - it is mentioned that *the Commission will ensure that SMEs have a simple and standardized framework to report on ESG issues [.....], and ensuring the rapid delivery of voluntary standards for non-listed SMEs.*
5. Reflecting the above, the logic followed in the standard setting has been to give priority to the identification of a proportionate set of indicators that would be a credible replacement for at least a substantial component of the questionnaires that are currently used by lenders, investors and corporate clients. The societal angle of standard setting, i.e. providing a complete picture of the ESG impacts that would inform stakeholders other than lenders, investors and corporate clients in



keeping the SME accountable for its impacts is not the focus of this standard. **This will be a key question in the consultation.**

Key methodological decisions taken in preparing VSME ED

6. **General approach:** The draft ESRS VSME ED has been developed as a standalone document to provide a simple reporting guidance for SMEs that are outside the scope of CSRD. The aim is to allow them to: i) start their sustainability journey, ii) monitor their sustainability performance with few indicators and iii) replace the multitude of questionnaires from lenders, investors and corporate clients.
7. **CSRD Scope:** EFRAG’s work on a voluntary standard for non-listed micro, small and medium companies (VSME) is outside the mandate in the CSRD. The CSRD provides however certain indications for non-listed small and medium companies.
 - a. Art 29b4 indicates that LSME will set a reference for large undertakings that are within the scope of the CSRD regarding the level of sustainability information that they could reasonably request from SME suppliers and clients in their value chains (value chain cap). Accordingly, VSME does not have a legal role in setting the cap, despite the fact that in practice the vast majority of undertakings in the value chain of large undertakings are non-listed SMEs not in scope of LSME.
 - b. Recital 21 indicates that small and medium-sized undertakings that are not listed on a regulated market in the Union should also have the possibility of choosing to use the simplified LSME on a voluntary basis. However, EFRAG was requested by several stakeholders to develop a separate standard that would consist of minimum voluntary disclosures adapted to the particularities and capacities of non-listed SMEs, micro and small enterprises because a standard originally conceived for listed SMEs would be too complex to apply for non-listed micro and small enterprises.
 - c. Recital 22 says that Member States should be free to assess the impact of their national transposition measures on small and medium-sized undertakings, to ensure that they are not disproportionately affected, with specific attention to be given to micro-undertakings and to avoiding an unnecessary administrative burden. Member States should consider introducing measures to support small and medium-sized undertakings in applying the sustainability reporting standards.
8. **EFRAG SR TEG, SRB, SME EWG, VSME and LSME communities** confirmed that EFRAG’s work on VSME derives from the market need for a point of reference to be used by counterparties in the upstream value chain of SMEs and by lenders, when they define their data requests from non-listed SMEs and to support non-listed SME in the start of their sustainability journey.
9. **Building Block and methodology:** The VSME proposal was discussed by SR TEG, SRB, EWG and VSME and LSME communities on the basis of the document put forward by former [EFRAG PTF cluster 8](#) that was considered a valuable basis. The key recommendation to EFRAG secretariat was to ensure overall conceptual coherence with the ESRS Set 1 and LSME ESRS ED, while achieving the appropriate proportionality and focus on the users’ needs (we refer to the coherence with



ESRS Set 1 and LSME ESRS as ‘building block approach’). Hence, the building block approach was conceptually integrated in the design of the draft LSME ESRS and the VSME ED as part of the methodology established in January and February 2023. The components of this building block can be summarized as follows:

- a. VSME divided in three modules: Basic Module, Narrative-PAT module (additional), Business Partners module (additional)
 - b. LSME: All VSME modules + other EU SF datapoints (e.g. Table 2 of SFDR) + additional datapoints due to the minimum content of LSME dictated by the CSRD (and adjustments due to the consolidated view in VSME vs individual view in LSME)
 - c. ESRS Set 1 (EC DA June 2023).
10. **Terminology:** The coherence between VSME and LSME has not impaired the ability to achieve a more simplified language, in particular in the Basic Module. Where relevant the Appendix A Defined Terms of VSME LSME ED has been enriched by additional explanations to bridge the language between VSME and the rest of ESRS literature. When appropriate, explanations on the meaning of a term have been included in the main body of VSME or in the Guidance to the Basic Module.
11. The building block approach was also incorporated in the outcome of SRB meeting of 27 January 2023, that established to:
- a. start with LSME;
 - b. keep LSME proportionate- but within the remit of the CSRD constraints;
 - c. once LSME basis is stabilized, consider VSME (incl. the current draft) from a consistency and additional proportionality perspective;
 - d. potentially consider merging LSME and VSME if appears relevant;
 - e. the overall purpose is to make available a standard for the two populations (listed and non-listed SME) in the same timeframe.
12. **VSME Structure:** Following the SRB meeting on 13 September 2023, the a 3 module approach was adopted:
- a. **Basic module:** it is the entry level for non-listed SMEs and has a highly simplified language. Ideally the company should be able to produce it without the help of a consultant. No materiality assessment required as all the datapoints are to be reported. This module is the target approach for micro-SMEs.
 - b. **Narrative- Policies, Actions and Targets (PAT) Module:** includes the definition of financial and impact materiality and requires to perform materiality analysis in order to disclose which of the sustainability matters listed in AR 16 of ESRS 1 are material to the undertaking. This will allow users to also understand for which material matters the undertaking does not have PAT in place. This module leverages on the definitions used in Set 1 ESRS, that are designed to result in balanced and reliable depiction of what the company is doing to address sustainability matters, avoiding greenwashing. At the same time this module only requires to report the PAT that the company has in place and no info is required when they have no PAT in place for a material matter (in addition to the list of material



matters themselves). This module is expected to be used by companies that have already started their journey on sustainability and have PAT to describe.

- c. **Business Partners Module:** it includes the metrics that are required to financial market participants (SFDR PAI – only Table 1 - , pillar 3, benchmark regulation) for the EU Sustainable Finance plus other metrics relevant for business counterparts. It requires to perform a materiality analysis in order to disclose only the material KPIs. Same approach as in ESRS Set 1 for disclosing ‘not material for the undertaking’ for EU datapoints. SMEs will use this module only when they have requests to do so from banks or corporates. The company is expected to apply this module when it receives requests from its banks or corporates; these metrics are expected to be the data needed for banks and corporates to manage their sustainability profile for aspects that arise from the business relationship with clients (banks) and suppliers (corporates). The assumption (to be tested in the consultation) is that the EU SF datapoints are able to satisfy the data needs of banks or corporates.
13. **Consolidated perspective:** VSME ED requires to disclose whether the report is prepared under a consolidated or individual basis (as reminder LSME is on individual basis only due to CSRD provisions).
14. **Entity Specific information:** The VSME ED does not require entity specific information. However it states that *depending on the activity of the undertaking, the inclusion of additional information (metrics and/or narrative disclosures) not covered in this Standard is appropriate, in order to disclose about issues that are common in the undertaking’s sector, as this supports the preparation of relevant, faithful, comparable, understandable and verifiable information.*
15. **Language in the Business Partner Module:** The EFRAG Secretariat considered that departing from the language in the relevant Sustainable Finance regulation of the Business Partner module would be less appropriate, as the relevant KPIs have already technical standards issued by ESAs that define them. Hence the module has achieved only a minimum level of simplification. EFRAG Secretariat made an effort to achieve a balance between simplification and the language used in Set 1 for this module. This approach was supported by SR TEG and SRB. Moreover the stakeholders outreaches indicated that certain datapoints could be withdrawn, such as energy intensity and GHG intensity. SR TEG also agreed to add specific questions in the consultation on each datapoint in BP Module to assess which ones could be further deleted and/or which ones are missing from the business partners perspective.
16. **Scope 3:** Scope 3 GHG emissions and taxonomy disclosures were considered too complex and premature in the initial SR TEG and SRB discussions and in the outreaches, as at this stage adapted tools for SMEs are not yet available. However, in the SRB meeting of 24 September the SRB discussed the red flags of SRB members. One of the changes proposed was to include a reference in the standard similar to the one for the entity specific. **As dedicated question will be included in the consultation to cover this point.**



17. **Materiality:** Concerning materiality, SR TEG agreed on **asking questions in the consultation for the Narrative- PAT module and the Business Partners Module**. In particular:
- a. Can PAT be prepared without materiality assessment? – i.e. report only what you have? This would result in not disclosing the list of material matters. Is this appropriate?
 - b. Does the Standard achieve the maximum possible proportionality in terms of embedding the ‘if applicable’ logic?
18. **Guidance for Basic Module Environmental and Social metrics:** As requested by SR TEG and from what emerged in outreach meetings, guidance on both environmental and social metrics was developed. EFRAG Secretariat, following the latest TEG meeting, tried to further simplify where possible.

Outreach Meetings

19. Within the drafting of the VSME ESRS, EFRAG Secretariat has conducted in-depth analysis of existing voluntary reporting framework for SMEs, it analyzed a wide range of existing banks ESG questionnaires or corporates supply chain management questionnaire addressed to SMEs clients to identify current ESG data request. A series of outreach meetings have been held to define to what extent VSME may replace those questionnaires:
- a. First VSME Community Workshop (31 January 2023)
 - b. Discussion Vienna Initiative (10 February 2023)
 - c. Second discussion with Vienna Initiative (14 March 2023)
 - d. Vienna Initiative Questionnaires Gap Analysis (30 August 2023)
 - e. First Bank Workshop on VSME (1 September 2023)
 - f. First SMEunited meeting (4 September 2023)
 - g. Second VSME Community Workshop (7 September 2023)
 - h. CSR Europe Meeting (5 October 2023)
 - i. Business Europe Meeting (13 October 2023)
 - j. Second SMEunited meeting (20 October 2023)
 - k. Second Bank Workshop on VSME (23 October 2023).
20. In the outreaches the three modules of VSME have been recognized by business partners as relevant. On the specific question if VSME- and in particular the Business Partner Module - can replace existing business partners questionnaires, EFRAG secretariat did not receive an exhausting answer (sector specific dimension, contractual or ad-hoc needs will remain). A final answer on this is expected from the outcome of the public consultation.
21. **One of the key questions to address to lenders/investors/corporate clients in the consultation will be:** would you be able and willing to replace a substantial part of your questionnaires with the content of VSME? If yes, what is your estimated proportion of additional datapoints that you would nevertheless continue to ask outside VSME – please use ranges: less than 20%; from 20 to 50%; between 50% and 80%; more than 80%.



Overview of the changes to the ED after the internal survey and latest SR TEG and SRB decisions – **latest EFRAG secretariat considerations in red**

- 22. Following preliminary presentation of ex-FRPTF cluster 8 proposal in November 2022 and January 2023, EFRAG SR TEG and SRB discussed progressive versions of VSME working paper from June 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 and October 2023.
- 23. The draft VSME 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 VSME in SR TEG meetings (20 and 29 September, 2 and 26 October 2023) and in SRB meetings (13 September and 24 October). A brief overview of the decisions taken is provided in the table below.
- 24. The analysis of the EFRAG SRB and SR TEG comments is available in the agenda papers for the SRB on 13 September 2023 (as background).

<p>Simplified Language</p>	<ul style="list-style-type: none"> - Extensive simplification of the language to minimize reporting efforts and abate/eliminate if possible external consulting costs to the undertakings. A number of editorial sessions have been held. - Detailed comments from banking representatives and SMEs representatives in SRB and in SR TEG have been included to ensure all possible language simplifications without compromising the clarity of the defined term and consistency with Set 1 ESRS. - Due to the specific nature of the Business Partner module (legal consistency/ SF legislation), only minimum level of language simplification could be achieved. - VSME ED also clarifies how the three modules (Basic, Narrative and Sustainable Finance/Business Partner) can be combined and specifies for which materiality applies.
<p>Materiality</p>	<p>EFARG secretariat has simplified to maximum extent the paragraph on materiality. SR TEG and SRB agreed on:</p> <ul style="list-style-type: none"> o The need to ask in the consultation a specific question on materiality for Narrative and Business Partner Module o capture both financial and impact materiality (double materiality approach); Sticking to “potential impacts” o On Stakeholders: agreement to stick with Set 1 definition with limited simplification (e.g. no reference to academics).
<p>Entity-specific</p>	<p>See key metodologic decisions above.</p>



<p>Location of sustainability report</p>	<p>SRT and SRB agreed on the need to be flexible on alternative locations, due to national legislation including existence of management report for micro, small or medium companies and national aspects including auditing requirements of management report.</p>
<p>Basic Module</p>	<ul style="list-style-type: none"> - SRT and SRB agreed to: <ul style="list-style-type: none"> o Provide flexibility by adding the possibility to include “entity-specific metrics” in Basic Module that may be selected from metrics in Business partner module, Narrative or sectorial. o Provide opportunity to complement the metrics with contextual qualitative information when appropriate. o Add possibility to report in BM on “practices” for the SME that do not have formalized PAT in place. - In the Basic Module 7 DRs out of 11 DRs coincide with Sustainable Finance requirements (SFDR and Benchmark). Refer to Agenda Paper 03-04.
<p>BM- Environment</p>	<ul style="list-style-type: none"> - SRT and SRB agreed to: <ul style="list-style-type: none"> o add guidance on how to calculate certain E metrics. o Following SRB recommendation, refer to other sources of guidance on Scope 3 when Scope 3 is provided. o add per each metric, “if applicable” or “if you have a manufacturing/packaging process” [referring to NACE], as guidance. Further clarification on the “if applicable” approach have been included as requested by SRB.
<p>BM - Social</p>	<ul style="list-style-type: none"> - SRT and SRB agreed to: <ul style="list-style-type: none"> o Add guidance on calculation and presentation of metrics o On Disclosure B 10 , SRT agreed to include: <ul style="list-style-type: none"> o lowest entry wage o a threshold of 150 employees for gender pay gap - collective bargaining coverage - Some SR TEG members explained that the balance between Social and environmental metrics could be improved by putting more emphasis on ESRS S2-S4.
<p>Business Conduct</p>	<ul style="list-style-type: none"> - On Disclosure B 11, views were split, with some SR TEG members and messages from outreaches (including with SME associations) in the camp of not including, as it would in essence result in a self-incrimination. The datapoint has been kept, as this was indicated as a red flag for some SRB



	<p>members. The argument of avoiding a self-incrimination does not seem to be pertinent, as it is a concept that is applicable in criminal law but not in reporting. A specific question will be asked in the consultation.</p>
<p>Narrative Module</p> <p>PAT</p>	<p>- SRT and SRB agreed to:</p> <ul style="list-style-type: none"> ○ Distinguish between “affected stakeholders” and “other stakeholders” in N 4 and using the term affected stakeholders ○ Provide a definition of governance (N 5) ○ Add an explicit DR on S2, S3 and S4 (refer to point above in Basic Module Social as it is the same concern expressed). The SR TEG member and SRB members that expressed this concern provided suggested wording, in the direction of an SMB 3-like datapoint (i.e. disclose whether there are material impacts in relation to matters in Appendix B and if there are, describe them). The EFRAG Secretariat notes that VSME does not ask for the list of material impacts (SBM -3 like) but it only asks (in the PAT) the list of material matters. The EFRAG Secretariat also notes that N3 requires to disclose PAT for material matters and refers to Appendix B for the list of matters. So implicitly, S2-3-4 are covered. As the focus of this standard is on users’ needs, it is important to note that none of the questionnaires from banks and from corporates that EFRAG has seen cover these matters. However, in order to accommodate the request of these members that consider that there should be an explicit mention of S2-3-4, a new datapoint has been included in paragraph 61. A specific question will be add to consult on this datapoint. ○ Noting that there has been strong reluctance from some SR TEG and SRB members to contemplate references to due diligence for SMEs as they are outside the scope of the future CS3D directive, following the indication of some members, we explicitly include in the ED the word ‘due diligence’ next to the language in N3 which is already aligned with the terms used in international instruments in para. 59. <i>If applicable, the undertaking may refer to the sustainability due diligence or risk management processes implemented;</i> ○ Add question in the consultation on the materiality approach and on the approach for sectors



	<ul style="list-style-type: none"> - In the Narrative Module 1 DR coincides with a Sustainable Finance requirement.
<p>Business Partner Module</p>	<ul style="list-style-type: none"> - SRT and SRB agreed to: <ul style="list-style-type: none"> ○ Change name from Sustainable Finance to Business partners module on assumption that SF PAIs provide sustainability data needed to manage both the sustainability risks in the lending and investment portfolios or in the supply chain (as per outreaches) ○ to keep the board gender diversity ratio and ask specific question in consultation. There were split views in previous discussions. The datapoint has been moved to Business Partners module as it is an SFDR indicator ○ delete the energy and GHG intensity disclosures (can be calculated by business partners on physical production) ○ not include scope 3 GHG emissions and taxonomy disclosures (too complex, no adapted tools) as a 'shall', however (see above) state that Scope 3 is relevant depending on sectors ○ On apprentices, clarification on the metric which is number of apprentices in the reporting period ○ To add guidance on BP disclosures in the ED (a specific chapter of guidance has been added) and explore whether EFRAG should have a role in providing practical tools to calculate the metrics ("how to report") after the public consultation ○ To add question in public consultation on materiality regime and potential sub modules that may increase flexibility (i.e. climate sub-module"or "due diligence sub-module" or "lenders"or corporates"). This may be explored also via field tests. ○ To add questions for each datapoint in consultation to test if BP module can replace existing multiple questionnaires. - Simplifications for SMEs have been applied in 3 DR of the Business partner module. This led to partial misalignment compared to Set1 Sustainable Finance datapoints (clearly indicated) – See Agenda Paper 03-04 1. The disclosure on "climate opportunities" (Benchmark regulation) was removed from the Business Partner module for simplification purposes. The EFRAG Secretariat has included a disclosure on opportunities



	<p>on a voluntary basis: <i>financial opportunities related to a sustainability matter may, like risks, generate financial effects. Reporting on financial opportunities is optional when preparing a sustainability report under this Standard. A specific question will be asked in the consultation.</i></p> <ul style="list-style-type: none"> - BP 11 work-life balance and BP 12 – apprenticeship to be subject to specific questions in the consultation. - Some SRB members asked to explore the possibility to further split the BP module in sub modules. The EFRAG Secretariat considers that this could be done by topic (i.e. ‘climate module’/‘other environmental matters’/‘social module’). The alternative to split between datapoints that are useful for lenders and datapoints that are useful for corporates may be tested in the consultation but for the time being it would contradict the purpose of the entire module, i.e. explore whether the same module may actually serve the two different groups of users.
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Approval of draft VSME ESRS ED in this SR TEG meeting

1. The Secretariat will ask the questions listed below, as they focus on the key changes made to the document since the last TEG discussion.
2. **Remaining editorial comments, if any, are welcome by the EFRAG Secretariat by the 14 November 2023.**
3. As per article 42 of EFRAG Internal Rules¹, in all decisions of EFRAG SR TEG, a simple majority will apply. However, as always in practice the EFRAG SR Chair is committed to promote a consensus approval to the maximum extent possible. Only if consensus is not possible, the majority vote will apply.
4. 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.
5. Members that cannot attend this meeting are invited to provide their written intention of vote head of the meeting.
6. 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

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



- 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.
7. Once draft VSME ESRS ED is approved, the EFRAG Secretariat will proceed with further editorial changes and improvements (formatting, 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

With reference to Agenda Paper 03-02– [Draft] VSME ESRS ED:

A) Do you agree with the following latest technical updates to the ED? In case you do not agree, will your dissent on these specific points be so important that you will dissent on the entire standard?

2. Inclusion of the **entity specific** dimension not as a shall but as ‘depending on the sector...it may be appropriate’
3. In the outreach activities so far it has emerged that the calculation of Scope 3 emissions is considered too complex for SMEs. **Scope 3 GHG** emissions has been added in the draft following the indication in the last SRB orientation session on 24 October 2023. It is not a shall, but it refers this metric providing relevant information depending on the sector of activity.
4. To address concerns of some SR TEG/SRB members, a reference to sustainability **due diligence** and risk management has been included in para. 59: *If applicable, the undertaking may refer to the sustainability due diligence or risk management processes implemented.*
5. Keep BP 11- **Convictions and fines** for corruption and bribery and ask specific questions in the consultation (see considerations of EFRAG Secretariat above)
6. Keep BP 2- **gender ratio in the board**, and ask specific questions in the consultation.

B) Please provide your view on some remaining aspects that we did not explicitly consider in previous sessions

1. In VSME ED paragraph 5 entities outside CSRD scope have the possibility to apply ESRS Set 1 on a voluntary basis. VSME points to the ESRS Set 1 instead of LSME on a voluntary basis as an alternative to VSME for those undertakings that are ready for a more sophisticated and comprehensive report. The reason why LSME is not considered in this context is its ‘individual’ perspective. The preference for a consolidated perspective is justified by the fact that such perspective is more complete and relevant. In addition, VSME is a simplification of Set 1, as also LSME. It is therefore logic to refer to a more ambitious set as an alternative to VSME. Do you agree with this approach?
2. Paragraph 58: a list of material matters has been explicitly included only in the PAT and not in BP. Do you agree?
3. Financial opportunities are optional in PAT and BP (para. 52), do you agree?



4. Consolidated approach: The standard does not explicitly prescribe the use of a consolidated approach. It only requires to disclose whether it is prepared on consolidated or individual basis. Should the Standard recommend the use of a consolidated approach, when the company has subsidiaries?
5. Do you agree not to split the BP module in sub-modules for the time being but ask a question in the consultation?

C) Do you approve to recommend that the EFRAG SRB issues this ED for public consultation?

Agenda Papers

25. In addition to this cover note, agenda papers for this session are:
 - a. Agenda paper 03-02 – [Draft] VSME ESRS ED;
 - b. Agenda paper 03-03
 - c. Agenda paper 03-04 VSME ESRS ED Comparison between Business Partners Module and ESRS SET 1 Definitions.
 - d. Agenda paper 03-05 Bank Workshop Summary 23 October 2023 (Draft)
 - e. Agenda paper 03-06 Business Partners Module: Additional guidance (LATE UPLOAD)

