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Need to know

EFRAG proposes *ESRS for listed small- and medium-sized enterprises*

Contents

This *Need to know* outlines the exposure draft *ESRS for listed small- and medium-sized enterprises* ("draft ESRS LSME") that was published by EFRAG on 22 January 2024.

- EFRAG has launched a consultation on a draft *ESRS for listed small- and medium sized enterprises*
- Entities[1] in scope of the draft ESRS LSME are small- and medium sized entities (SMEs) whose transferable securities are admitted to trading on a regulated market in the European Union (EU), plus certain small and non-complex institutions, as well as certain captive insurers and reinsurers
- The draft ESRS LSME mirrors the structure of the **first set of European Sustainability Reporting Standards (ESRS)** and is divided in six sections: general disclosures; disclosures on policies, actions and targets; environmental disclosures; social disclosures; and disclosures on business conduct
- As per the **Corporate Sustainability Reporting Directive (CSRD)**, the effective date of the standard is for financial years starting on or after 1 January 2026. However, for a transitional period of two years until 1 January 2028, entities in scope of the draft ESRS LSME are allowed to opt out of the reporting requirements if an explanation of why the required information is not provided is given in their management report
- Comments on the draft ESRS LSME can be submitted until 21 May 2024.

Background

The CSRD requires certain SMEs, small and non-complex institutions, and captive insurance and reinsurance entities to provide sustainability information as part of their management report from 1 January 2026, with a possibility to opt out until 1 January 2028. Entities in scope of the draft ESRS LSME can choose to prepare their sustainability reporting using either **the first set of ESRS published in December 2023** ("ESRS Set 1") or ESRS LSME. In addition, the V*oluntary ESRS for non-listed small and medium sized enterprises* (VSME standard) can be applied voluntarily by SMEs that are not in scope of the CSRD (see box below).

For more information please see the following websites:

www.ukaccountingplus.co.uk
www.deloitte.co.uk

1. The draft ESRS LSME uses the term 'undertakings'. This has been replaced throughout this publication with the term 'entities'.

The European Commission will adopt a delegated act for the ESRS LSME by 30 June 2024. The delegated act will subsequently be submitted to the European Parliament and to the Council of the EU for a scrutiny period of two months, which can be extended by another two months. If not rejected, the delegated act will enter into force after the publication in the Official Journal of the EU. The delegated act would be binding in its entirety and directly applicable in all member states. It has not yet been decided whether sector disclosures will be required for entities within scope of the draft ESRS LSME.

VSME standard
Alongside the draft ESRS LSME, EFRAG has published an exposure draft titled **Voluntary ESRS for non-listed small and medium sized enterprises (VSME ED)**.

The proposed VSME standard is designed to support SMEs in accessing sustainable finance and to set out the limit with regard to the information that entities applying ESRS Set 1 should request from SMEs in their value chain. The ED proposes a simple reporting tool to assist micro-, small- and medium-sized entities not in scope of the draft ESRS LSME in responding to requests for sustainability information from business counterparts (e.g. banks, investors or larger companies for which those entities are suppliers) in an efficient and proportionate manner. The proposed VSME standard is also intended to facilitate participation of these entities in the transition to a sustainable economy.

Observation
The draft ESRS LSME is based on ESRS Set 1 but does not include all of the requirements in ESRS Set 1. The basis for conclusions to the exposure draft states that the draft ESRS LSME requires 466 datapoints, while ESRS Set 1 requires 823 data points. Therefore, the draft ESRS LSME requires 357 (or 43%) less datapoints than ESRS Set 1. This has partly been achieved by making mandatory disclosure requirements of ESRS Set 1 voluntary in the draft ESRS LSME.

The following are the key similarities and differences between the ESRS Set 1 and the draft ESRS LSME:

Similarities	Differences
• The draft ESRS LSME uses the same glossary of definitions as ESRS Set 1, and therefore, the definitions (such as 'users') are identical for the draft ESRS LSME and ESRS Set 1 • Both ESRS Set 1 and the draft ESRS LSME include the concepts of double materiality and value chain, as required by the CSRD • Both ESRS Set 1 and the draft ESRS LSME require disclosures on governance, strategy, and impact and risk management (i.e. policies, actions, targets and metrics) • Both ESRS Set 1 and the draft ESRS LSME require consideration of a similar list of sustainability matters • Both ESRS Set 1 and the draft ESRS LSME require entity-specific disclosures where it is necessary information for users • Both ESRS Set 1 and the draft ESRS LSME include the disclosure requirements from other EU regulations such as the Sustainable Finance Disclosure Regulation (SFDR), Pillar 3, the Benchmark regulation and the EU Climate Law.	• The draft ESRS LSME does not require the disclosure of material positive impacts and material opportunities—it is optional • Under the draft ESRS LSME an entity is only required to provide disclosures for certain items (such as targets, due diligence process, stakeholder engagement process) if the entity has these items • The draft ESRS LSME only requires the sustainability reporting to be prepared at the individual entity level, even if the entity controls or jointly controls other entities • As a consequence of the previous bullet, the draft ESRS LSME includes subsidiaries in the value chain • The draft ESRS LSME introduces the concept of 'reasonable effort' to give more flexibility when the entity is required to disclose comparative information, errors from prior periods, changes in preparation or presentation of sustainability information.

Implication for UK companies

The CSRD will directly affect UK companies if they have securities (shares or debt) listed on EU regulated markets. It will also apply directly to EU subsidiaries of UK companies. In addition, EU subsidiaries or branches of UK parent companies are required to report on the group wide information if the UK-headed group generates more than EUR 150 million net turnover in the EU (for each of the last two consecutive financial years) and has at least one EU subsidiary (large or listed on an EU regulated market) or EU branch (with more than EUR 40 million net turnover in the preceding financial year).

In April 2023, the UK government published a new policy paper, ***Green Finance Strategy—Mobilising Green Investment*** ("the 2023 Strategy"), building on the previous Green Finance Strategy which was published in July 2019. The 2023 Strategy re-emphasises the government's commitment to the sustainability disclosure requirements (SDR) set out in its ***Greening Finance: Roadmap to Sustainable Investing***, published in October 2021, including its support for UK adoption of the ISSB standards and the development of an endorsement mechanism. The UK has already taken a number of steps in developing the SDR, including the Financial Conduct Authority (FCA)'s Listing Rule for premium and standard listed companies to make disclosures consistent with the recommendations of the Task Force on Climate-related Disclosures (TCFD), and government legislation to require certain AIM listed and unlisted companies and LLPs to include climate-related financial disclosures in their annual report.

The UK government aims to introduce the SDR in a way that complements the UK's wider non-financial reporting framework, minimises duplication with other forms of corporate reporting and gives businesses enough time to implement the new requirements. However, where the requirements of the CSRD go beyond the reporting requirements in the UK, additional disclosures will need to be made by UK companies in scope of the CSRD to comply with EU requirements. The additional disclosures could be significant. Furthermore, the disclosures will be subject to mandatory assurance.

Given the extensive disclosure requirements, UK companies should consider early how the CSRD may impact them. This extends to consideration of other EU regulations, such as the EU Taxonomy Regulation which introduces disclosures for companies in scope of the CSRD. Under the EU Taxonomy Regulation, non-financial entities must disclose "green" turnover, capex and opex indicators and financial entities need to disclose ratios relevant to their industry that relate to the proportion of environmentally sustainable economic activities in their financial activities, such as lending, investment and insurance. Determining what activities are "green" according to the specific technical screening criteria associated with the EU Taxonomy Regulation is not straightforward and will require careful consideration.

For further information, please see:

- ***Need to know*** discussing the final text of the CSRD
- ***Need to know*** discussing the UK Government's Green Finance Strategy—Mobilising Green Investment
- ***Need to know*** discussing the EU Taxonomy Regulation

Scope

The following entities are in scope of the draft ESRS LSME:

- small[2] and medium-sized entities (except micro-entities) that are governed by the law of a member state and whose transferable securities are admitted to trading on a regulated market[3] of any member state
- small and non-complex institutions[4], provided they are large entities or that they are SMEs which are public-interest entities and which are not micro entities
- captive insurance entities[5] and captive reinsurance entities, provided that they are large entities or that they are SMEs which are public-interest entities and which are not micro entities.

The CSRD and the draft ESRS LSME requires the sustainability reporting to be prepared at the individual entity level, even if the entity controls or jointly controls other entities. It does not require preparation of the sustainability reporting at consolidated level.

Under the CSRD, a listed SME that is a parent entity of a large group is required to prepare a consolidated sustainability statement under ESRS Set 1. The proposed ESRS LSME does not apply to such entities.

2. The size criteria are set out in the Accounting Directive (Directive 2013/34/EU).
3. Regulated market is defined in the Markets in Financial Instruments Directive (Directive 2004/39/EC).
4. Small and non-complex institution is defined in Regulation 575/2013.
5. Captive insurance entities and captive reinsurance entities are defined in Directive 2009/138/EC.

Structure of the draft ESRS LSME

The draft ESRS LSME is an adapted version of ESRS Set 1 and is structured in the following six sections:

- Section 1—General requirements (adapted from ESRS 1 *General requirements)*
- Section 2—General disclosures (adapted from ESRS 2 *General disclosures)*
- Section 3—Policies, actions and targets (adapted from ESRS 2)
- Section 4—Environment (adapted from ESRS E1 *Climate change*, ESRS E2 *Pollution*, ESRS E3 *Water and marine resources*, ESRS E4 *Biodiversity and ecosystems*, and ESRS E5 *Resource use and circular economy*)
- Section 5—Social (adapted from ESRS S1 *Own workforce*, ESRS S2 *Workers in the value chain*, ESRS S3 *Affected communities*, and ESRS S4 *Consumers and end-users)*
- Section 6—Business conduct (adapted from ESRS G1 *Business conduct*)

Sections 1-3 apply to the sustainability matters covered in the topical sections. Sections 1-2 are cross-cutting sections. All sections are sector-agnostic, meaning that they apply to all entities regardless of the sector or sectors they operate in.

Section 1—General requirements

Objective of the draft ESRS LSME

The objective of the draft ESRS LSME is to specify the sustainability information that entities in scope of the draft ESRS LSME are required to disclose in their individual sustainability statement. The draft ESRS LSME aims to establish sustainability reporting requirements for SMEs that are proportionate and relevant to their capacities and characteristics, and to the scale and complexity of their activities.

Impacts and risks

In the draft ESRS LSME, the term "impacts" refers to sustainability-related impacts connected to the entity's business as identified through an impact materiality assessment process (see below under **Impact materiality**). It refers to both actual impacts and potential future impacts. The draft ESRS LSME only requires disclosure of negative impacts. Disclosure of positive impacts is voluntary.

The term "risks" refers to the entity's sustainability-related financial risks, including those deriving from dependencies on natural, human and social resources as identified through a financial materiality assessment process (see below under **Financial materiality**).

Collectively, these are referred to as "impacts and risks". They reflect the double materiality perspective of the draft ESRS LSME described below under **Double materiality.**

The disclosure of material opportunities is voluntary.

Stakeholders

Stakeholders are defined as those who can affect or can be affected by an entity. The draft ESRS LSME identifies two main groups of stakeholders:

- affected stakeholders: individuals (or groups of individuals) whose interests are affected or could be affected—whether positively or negatively—by the entity's activities and its direct and indirect business relationships across its value chain
- users of the sustainability statement: primary users of general-purpose financial reporting (i.e. existing and potential investors, lenders and other creditors, including asset managers, credit institutions, insurance entities), and other users, including the entity's business partners, trade unions and social partners, the civil society and non-governmental organisations, governments, analysts and academics.

Structure of the disclosure requirements

The disclosure requirements in the draft ESRS LSME cover the following areas:

- governance: the governance processes, controls and procedures used to monitor, manage and oversee impacts and risks
- strategy: how an entity's strategy and business model interact with its material impacts and risks, including how the entity addresses those impacts and risks
- impact and risk management: the process(es) by which an entity:
  - identifies impacts and risks, and assesses their materiality
  - manages material sustainability matters through policies and actions
  - discloses information about targets if it has set them
  - engages with own workers, workers in the value chain, affected communities, consumers and end-users, and their representatives on such impacts to the extent that it has stakeholder engagement in place

 - remediates negative impacts and implements channels for own workers, workers in the value chain, affected communities, consumers and end-users to raise concerns to the extent that it has remediation activities and channels in place

- metrics: how the entity measures its performance.

Materiality

The draft ESRS LSME specifies the information that an entity would be required to disclose about its material impacts and material risks in relation to environmental, social and governance (ESG) sustainability matters. If an entity determines that a topic is not material, it would not be required to disclose any information for that topic.

Materiality assessment

Performing a materiality assessment is necessary for an entity to identify the material impacts and risks to be reported. An entity is required to report on sustainability matters using the double materiality principle (see below).

Under the draft ESRS LSME, entities are not required to disclose their material positive impacts and/or opportunities. If an entity chooses to disclose those, the materiality principle applies.

Minimum disclosure requirements

Irrespective of the outcome of the materiality assessment, an entity is always required to disclose the information required by Section 2—General disclosures of the draft ESRS LSME. If the entity concludes that climate change is not material and therefore omits all disclosure requirements related to climate change, it is required to provide further disclosures (see box below under **Section 2**).

When an entity assesses that a sustainability matter is material, it is required to disclose information on policies, actions and targets in relation to that sustainability matter as set out in Section 3—Policies, actions and targets of the draft ESRS LSME related to that matter and the corresponding minimum disclosure requirement on policies, actions and targets required in Section 2. If the material sustainability matter is either not covered by the draft ESRS LSME or is covered with insufficient granularity, entity-specific disclosures may be required.

Metrics for a material sustainability matter are required to be included if the entity assesses such information to be material. They can otherwise be omitted as long as the metrics are not needed in order to meet the objective of the relevant disclosure requirement.

If the entity omits the information prescribed by a datapoint that derives from EU legislation listed in Appendix B of Section 2 of the draft ESRS LSME (such as from the Sustainable Finance Disclosure Regulation (SFDR)), it is required explicitly to state that the information in question is "not material" (see box below under **Section 2**).

Double materiality

Double materiality has two dimensions: impact materiality and financial materiality. A sustainability matter is "material" for the entity when it meets the criteria defined for impact materiality or financial materiality or both.

Impact materiality and financial materiality
Impact materiality and financial materiality are defined in the draft ESRS LSME as follows:

Impact materiality
A sustainability matter is material from an impact perspective when it relates to the entity's material actual or potential impacts on people or the environment over the short, medium or long term. For actual negative impacts, materiality is based on the severity of the impact, whereas for potential negative impacts it is based on the severity and likelihood of the impact. Severity is based on the scale and scope of the impact, and whether the impact is irremediable (i.e. whether and to what extent the negative impacts could be remediated).

Impacts include those connected to the entity's own operations and to its upstream and downstream value chain, including through its products and services, as well as through its business relationships. Business relationships include those in the entity's upstream and downstream value chain and are not limited to direct contractual relationships.

When identifying and assessing the impacts and risks in the value chain in order to determine their materiality, the entity is required to focus on areas where they are deemed likely to arise, based on the nature of the activities, business relationships, geographies and other relevant risk factors.

Financial materiality
The scope of financial materiality for sustainability reporting results from the expansion of the scope of materiality used for determining which information should be included in the entity's financial statements.

The financial materiality assessment corresponds to the identification of information that is considered material for primary users of general-purpose financial reporting in making decisions relating to providing resources to the entity. In particular, information is considered material for primary users of general-purpose financial reporting if omitting, misstating or obscuring that information could reasonably be expected to influence decisions that they make on the basis of the entity's sustainability statement.

Interdependency
The draft ESRS LSME states that impact materiality and financial materiality assessments are interrelated and that an entity is required to consider the interdependencies between the two dimensions. In general, the starting point is the assessment of impacts. A sustainability impact may be financially material from inception or become financially material, when it could reasonably be expected to affect the entity's financial position, financial performance, cash flows, its access to finance or the cost of capital over the short, medium or long term. Impacts are captured by the impact materiality perspective regardless of whether or not they are financially material.

Qualitative characteristics of information
When preparing its sustainability statement, an entity is required to apply:

- fundamental qualitative characteristics of information: relevance and faithful representation
- enhancing qualitative characteristics of information: comparability, verifiability and understandability.

Reporting entity
For the purposes of reporting sustainability information, the scope of the sustainability statement includes information on the material impacts and risks connected to the individual entity through its business relationships in the upstream and/or downstream value chain. Value chain is defined in the glossary of definitions as "[t]he full range of activities, resources and relationships related to the undertaking's business model and the external environment in which it operates." The draft ESRS LSME allows a transitional relief for gathering value chain information (see below under **Transitional provisions–Value chain)**.

If subsidiaries, associates or joint ventures are part of an entity's value chain, for example as suppliers, the entity is required to include information on them consistent with other business relationships in the value chain.

Reporting period and time horizons
The reporting period for an entity's sustainability statement should be consistent with that of its financial statements.

When preparing its individual sustainability statement, an entity is required to adopt the following time intervals as at the end of the reporting period:

- short term: the period adopted by the entity as the reporting period in its financial statements
- medium term: from the end of the short term reporting period for short term up to five years
- long term: more than five years.

There may be circumstances when the use of the defined medium or long term time horizons would result in information that is not relevant. This may be the case when an entity uses a different definition for (i) its processes of identification and management of material impacts and risks or for (ii) the definition of its actions. In these circumstances, an entity may adopt a different definition of medium and long term time horizons.

Preparation and presentation of sustainability information
The draft ESRS LSME includes general principles for the preparation and presentation of sustainability information including:

- comparative information
- sources of estimation and outcome uncertainty
- events after the reporting period
- changes in preparing or presenting sustainability information
- prior period errors.

These principles are similar to those typically applied for preparation of financial statements.

Classified or sensitive information
An entity is not required to disclose classified information or sensitive information, even if such information is considered material. Sensitive information is defined as information and data, including classified information, that is to be protected from unauthorised access or disclosure because of obligations laid down in EU or national law, or in order to safeguard the privacy or security of a natural or legal person. The entity is also not required to disclose information related to impending developments or matters in the course of negotiation, even if such information is considered material.

When omitting sensitive information, the entity is required to make every reasonable effort to ensure that the overall relevance of the disclosure in question is not impaired.

Linkages with other parts of corporate reporting and connected information
An entity is required to provide information that enables users of its sustainability statement to understand the connections between different pieces of information in the statement, and the connections between the information in the sustainability statement and other information that the entity discloses in other parts of its corporate reporting.

Location and structure of the sustainability statement
The CSRD requires that information about sustainability matters is presented in a dedicated section of the entity's management report, regardless of the entity's size.

The statement should include the disclosures relating to the Taxonomy Regulation. An entity is required to ensure that these disclosures are separately identifiable within the sustainability statement. Disclosures relating to each of the environmental objectives defined in the Taxonomy Regulation are required to be presented together in a clearly identifiable part of the environmental section of the sustainability statement.

When an entity includes additional disclosures in its individual sustainability statement stemming from other legislation which requires the entity to disclose sustainability information, or generally accepted sustainability reporting standards and frameworks, including non-mandatory guidance and sector-specific guidance, published by other standard-setting bodies (such as the International Sustainability Standards Board (ISSB) or the Global Reporting Initiative (GRI)), the entity is required clearly to identify such disclosures with an appropriate reference to the related legislation, standard or framework. In addition, the disclosures must meet the requirements for qualitative characteristics of information specified in the draft ESRS LSME.

An entity is required to structure its sustainability statement in four parts, in the following order:

- general information
- environmental information (including disclosures pursuant to Article 8 of the Taxonomy Regulation)
- social information
- governance information.

Incorporation by cross-reference
A disclosure requirement of the draft ESRS LSME (including a specific datapoint) may be incorporated in the sustainability statement by reference to:

- another section of the management report
- the financial statements
- the corporate governance report (if it is not part of the management report)
- the remuneration report
- the universal registration document
- pillar 3 disclosures in the Capital Requirements Regulation (reflecting Basel III rules on capital measurement and capital standards).

Incorporation by reference to these documents is only allowed if the disclosures incorporated by reference meet all of the following criteria:

- they constitute a separate element of information and are clearly identified in the document as addressing the relevant disclosure requirement (or the relevant specific datapoint)
- they are published before or at the same time as the management report
- they are in the same language as the sustainability statement
- they are subject to at least the same level of assurance as the sustainability statement
- they meet the same technical digitalisation requirements as the sustainability statement.

In the preparation of its sustainability statement using incorporation by cross-reference, the entity is required to consider the overall cohesiveness of the reported information and ensure that the incorporation by reference does not impair the readability of the sustainability statement. The appendix to Section 1 of the draft ESRS LSME includes an illustrative example of incorporation by cross-reference.

Transitional provisions
Value chain
For the first three years of the sustainability reporting under the draft ESRS LSME, if not all the necessary information regarding its upstream and downstream value chain is available, the entity is required to explain the efforts it has made to obtain the necessary information about its value chain, the reasons why not all of the necessary information could be obtained, and its plans for obtaining such information in the future.

Therefore, for the first three years of the entity's sustainability reporting under the draft ESRS LSME, an entity:

- may limit upstream and downstream value chain information to information available in-house, such as data already available to the entity, and publicly available information (when disclosing information on policies, actions and targets in accordance with Section 3 of the draft ESRS LSME)
- is not required to include upstream and downstream value chain information, except for datapoints derived from other EU legislation (when disclosing metrics).

Disclosure requirements that are phased in
Appendix C of Section 1 of the draft ESRS LSME sets out phase-in provisions for the disclosure requirements or datapoints of disclosure requirements in the draft ESRS LSME which may be omitted or which are not applicable in the first year(s) of preparation of the sustainability statement under the draft ESRS LSME. However, these provisions are not available to entities in scope of the draft ESRS LSME that opt out of the sustainability reporting before 1 January 2028.

Observation

The CSRD sets out the effective date for the ESRS LSME which is applicable for financial years starting on or after 1 January 2026.

However, for a transitional period of two years until 1 January 2028, entities in scope of the ESRS LSME are allowed to opt out of the reporting requirements if they explain, in their management report, why the sustainability information is not provided.

The ESRS LSME will only be available to individual entities. The CSRD does not include any reporting requirements for small- and medium-sized groups.

Comparative information

An entity is not required to disclose the comparative information required by Section 1 of the draft ESRS LSME in the first year of preparation of the sustainability statement. This provision also applies to phased-in disclosure requirements in the first year of disclosure.

Section 2—General disclosures

Objective

Section 2 of the draft ESRS LSME covers governance, strategy, and impact and risk management areas defined in Section 1. The requirements in Section 2 should be considered with the requirements relating to policies, actions and targets (Section 3) and topics in Sections 4-6.

Irrespective of the outcome of its materiality assessment, an entity is always required to disclose the information required by Section 2. However, the level of detail to be included depends on the significance of the information and the capacity of such information to meet users' decision-making needs.

Basis for preparation

An entity is required to disclose the general basis for preparation of its sustainability statement. The objective of this disclosure requirement is to provide an understanding of how the entity prepares its individual sustainability statement, including the upstream and downstream value chain information, and, where relevant, whether the entity has used any of the options for omitting information in Section 2 of the draft ESRS LSME.

Section 2 of the draft ESRS LSME requires additional disclosure in relation to the basis for preparation in the following specific circumstances:

- the entity has deviated from the medium or long term time horizon as defined in Section 1
- metrics include upstream and/or downstream value chain data, including data of subsidiaries, estimated using indirect sources such as sector-average data or other proxies
- significant estimation uncertainty or significant outcome uncertainty exists
- changes in the preparation and presentation of sustainability information occur compared to the previous reporting period
- material prior period errors exist
- the entity includes in its individual sustainability statement information stemming from other legislation or generally accepted sustainability reporting standards and frameworks in addition to the information required by the draft ESRS LSME
- the entity incorporates information by reference
- the entity applies phase-in provisions (see above under **Section 1—Transitional Provisions**)

Governance

An entity is required to disclose the following information to provide an understanding of the governance processes, controls and procedures put in place to monitor, manage and oversee sustainability matters:

- the composition of the administrative, management and supervisory bodies, their roles and responsibilities and their access to expertise and skills with regard to sustainability matters
- whether the entity has adopted a due diligence process with regard to sustainability matters.

Sustainability due diligence

Due diligence is defined as the process by which entities identify, prevent, mitigate and account for how they address the actual and potential impacts on people and the environment connected with their business.

Strategy

An entity is required to disclose information that enables an understanding of:

- the elements of the entity's strategy that relate to or affect sustainability matters, the entity's business model(s) and its value chain
- how the interests and views of stakeholders are taken into account in the entity's strategy and business model, if the entity engages with stakeholders
- the outcome of the entity's assessment of negative material impacts and risks, including how it informs its strategy and business model(s).

The entity may disclose its material sustainability-related positive impacts and/or its material sustainability-related financial opportunities.

Impact and risk management

Disclosure of the materiality assessment process

An entity is required to:

- provide a description of the processes it uses for identifying its impacts and risks and for assessing which ones are material
- report on the disclosure requirements complied with in its sustainability statement.

The objective of the requirement to report on the materiality assessment process is to provide an understanding of the disclosure requirements that are included and the topics that have been omitted as the entity has assessed them as not material.

The entity is required to include a list of the disclosure requirements complied with in preparing the sustainability statement, following the outcome of its materiality assessment, including the page numbers and/or paragraphs where the related disclosures are located in the sustainability statement. This list may be presented as a content index. The entity is also required to include a table featuring all the datapoints that derive from other EU legislation (e.g. requirements under the SFDR) as listed in Appendix B of Section 2 of the draft ESRS LSME, indicating where they can be found in the sustainability statement and including those that the entity has assessed as not material, in which case the entity is required to indicate this as "not material" in the table.

If the entity concludes that climate change is not material and therefore omits all disclosure requirements in relation to climate change, it is required to disclose a detailed explanation of the conclusions of its materiality assessment with regard to climate change, including a forward-looking analysis of the conditions that could lead the entity to conclude that climate change is material in the future.

If the entity concludes that a topic other than climate change is not material and therefore omits all the disclosure requirements in Sections 3-6 of the draft ESRS LSME, it may provide a brief explanation of the conclusions of its materiality assessment for that topic.

The entity is required to provide an explanation of how it has determined the material information to be disclosed in relation to the impacts and risks that it has assessed to be material.

Section 3—Policies, actions and targets

Section 3 of the draft ESRS LSME sets out the information required:

- in relation to policies, actions and targets to prevent, mitigate and remediate actual and potential material negative impacts and to address material risks for a material matter
- about the entity's processes for engaging with own workers, workers in the value chain, affected communities, consumers and end-users, and their representatives on impacts if the entity has those processes in place
- about the entity's processes to remediate negative impacts and channels for own workforce, value chain workers, affected communities, consumers and end-users and to raise concerns if the entity has those processes in place.

An entity is required to apply the requirements in Section 3 of the draft ESRS LSME when it concludes that the corresponding topic is material. The entity should include, in the sustainability statement, those disclosures that provide material information.

In addition, the requirements in Section 3 of the draft ESRS LSME should be considered when the entity reports on a voluntary basis on material positive impacts and/or opportunities.

An entity is required to disclose information on policies it has adopted and its actions to manage material sustainability matters.

If an entity has sustainability-related targets, it is required to disclose information on those targets. Section 3 sets out minimum disclosure requirements for each material sustainability matter.

Section 4—Environment

Section 4 of the draft ESRS LSME requires disclosures that are intended to enable users of sustainability statements to understand:

- how the entity, actually or potentially, negatively impacts the following environmental topics:
  - climate change
  - pollution of air, water and soil
  - water and marine resources
  - biodiversity and ecosystems
  - resource use and circular economy
- the plans and capacity of the entity to adapt its strategy and business model(s) in line with the transition to a sustainable economy and international environmental agreements, goals and initiatives
- any actions taken by the entity, and the result of such actions to prevent, mitigate or remediate potential negative impacts on environmental topics, including to:
  - reduce GHG emissions and increase energy efficiency
  - prevent, control and reduce pollution of air, water and soil
  - reduce water consumption and to protect water and marine resources
  - protect and restore biodiversity and ecosystems
  - prevent and decrease resource depletion, increase resource efficiency and decouple economic growth from use of materials
- the nature, type and extent of the entity's material risks arising from its impacts and dependencies on environmental topics, and how the entity manages them
- the short, medium and long term financial effects on the entity of material risks arising from the entity's environmental impacts and dependencies.

Section 5—Social

Section 5 of the draft ESRS LSME requires disclosures that are intended to enable users of sustainability statements to understand:

- how the entity affects its own workforce, workers in its value chain, affected communities and consumers and end-users in terms of material negative actual or potential impacts
- any actions taken, and the result of such actions, to prevent, mitigate or remediate actual or potential negative impacts, and to address risks
- the nature, type and extent of the entity's material risks on its own workforce, workers in its value chain, affected communities and consumers and end-users; and how the entity manages them
- the financial effects on the entity over the short, medium and long term of material risks arising from the entity's impacts and dependencies on its own workforce, workers in its value chain, affected communities, and consumers and end-users.

Section 6—Business conduct

Section 6 of the draft ESRS LSME requires disclosures that are intended to enable users of sustainability statements to understand the entity's strategy and approach, processes and procedures as well as its business conduct performance.

Section 6 focuses on the following matters:

- anti-corruption and anti-bribery
- the management of relationships with suppliers, including payment practices
- political influence and lobbying activities.

Comment period

The comment period for the draft ESRS LSME ends on 21 May 2024.

EFRAG is seeking feedback on key aspects of the draft ESRS LSME, including:

- the proposed architecture
- the implementation of the CSRD requirements for the draft ESRS LSME, including the role of the draft ESRS LSME in setting the value chain cap for information to be reported by large entities
- the relevance of the proposed disclosures
- the simplifications achieved.

Respondents are encouraged to provide their responses to the public consultation questions by using an online questionnaire.

Further information

If you have any questions about the draft ESRS LSME, please speak to your usual Deloitte contact.

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