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Polish Association of Listed Companies (SEG) is pleased to provide comments on the draft LSME standard, we also provided input to the position of European Issuers on the LSME.

We appreciate the work done by EFRAG on LSME and VSME.

However, in our view the draft LSME standard, which has been designed as a mere simplification of full ESRS and not a standard specific for SMEs, is too demanding taking into account the practical possibilities and resources at the disposal of small and medium-sized listed undertakings. We already see how large listed undertakings face many problems with the implementation of full ESRS (designed for large companies and large groups) and how they struggle with many ambiguities around the provisions included in 12 standards. Having this in mind we are concerned that smaller issuers expected to apply draft LSME (being a reduction of full ESRS but still very close to full ESRS requirements) will not be able to meet too sophisticated and demanding analytical tasks and disclosure requirements.

On the other hand, the use of the (draft) VSME standard, which has been designed from scratch and specifically for SMEs on the basis of frequently observed data requests from lenders, investors and corporate clients, can be undermined by the 'value chain cap issue': that is, the cap to requests that large undertakings can make to small and medium-sized undertakings in their value chain. Also, it should be noted that the vast majority of SMEs in Europe are not-listed and the information cap was intended to be set out in the proportionate standard for all SMEs that would be issued under Article 29c of the Accounting Directive as amended by CSRD.

In addition, we fear that the draft LSME standard may disincentivize companies that consider a public listing from going public at a time, when they have tremendous financing needs due to the sustainable and digital transition which cannot be successfully managed with credit or bank finance alone. The LSME standard should not hamper the objectives of the EU Listing Act and the Capital Markets Union (CMU).

If we want to have meaningful disclosures prepared by listed and also non-listed SMEs they have to be better equipped with useful and practical guidance for example on how to conduct materiality assessment, how to map the material IR(O)s in their value chain and how to set the thresholds for impact/financial materiality.

Therefore, in our view the VSME which is the real proportionate standard for SMEs, should be completed by adding a fourth module for listed SMEs and other entities allowed under CSRD to use the option from Art.19a par.6 of limited scope of ESG reporting. The modified VSME would then constitute the simplified ESRS to be issued under Art.29c of the Accounting Directive (modified by CSRD).

In other terms, we suggest to fully apply the building block approach adopted for draft VSME standard, by developing a single (modular) standard for all SMEs based on 4 steps:

1. VSME (Basic metrics module)
2. VSME (Narrative PAT module);
3. VSME (Business partner module);
4. ESRS LSME: All VSME modules + other EU datapoints + additional datapoints due to CSRD and users' needs

According to this model, non-listed SMEs could apply, on a voluntary basis, the first three modules (step 1 at least to be compliant with the standard and maintaining flexibility in the adoption of steps 2 and 3), and even the module 4 if they want to prepare for future listing - while listed SMEs when they choose to report ESG issues in a limited scope under Article 19a par. 6 should apply, on a mandatory basis all the four steps.

We also suggest that the Business partner module could be articulated for non-listed SMEs in three sub-modules, for each macro-categories of users (lenders, investors and corporate clients) to allow them to adopt only the sub-modules functional to the nature of their actual relationships.

Our rationale for that proposal is based on interlinked factors which taken together justify this move in our opinion.

- **The idea of proportionality in CSRD** - one of the misleading arguments used when developing LSME was that listed SMEs should have report as much as possible ESG data in order not to be discriminated by financial market participants and other investors, whereas the idea in the CSRD was quite opposite: listed SMEs should not be discriminated by FMP when they choose to report ESG data in a limited scope – therefore the limited scope has been explicitly added to the text of CSRD (Article 19a par. 6 containing the description of this limited scope did not exist at the time of the EC legislative proposal and by many Member States has been also added in order to significantly limit the scope of disclosure requirements in future simplified ESRS. Moreover, the CSRD addresses only one proportionality of disclosure requirements – in recital 21 in CSRD the simplified ESRS should be proportionate to the capacities and resources, and relevant to the scale and complexity of the activities of all SMEs and used by listed SMEs on mandatory basis (when to choose to use the option of limited ESG reporting under Article 19a par. 6) and by non-listed SMEs on a voluntary basis. There are no two dimensions of proportionality of simplified ESRS - one for listed SMEs and another one for non-listed SMEs. The idea of proportionality was directed not to the issue whether an undertaking is listed or not, it was directed to the size of undertakings which under the Accounting Directive have the same thresholds concerning the number of employees, balance sheet total and net turnover, regardless whether listed or not. That is also why the EC legislative proposal contained the full exclusion of listed micro undertakings from the CSRD scope and envisaged only two ESG reporting regimens – the high demanding regime for all large undertakings and large groups and the simplified regime for all other smaller entities to be available for listed SMEs (covered

by CSRD) and fully voluntary for all other entities not covered by CSRD (listed micro undertakings, non-listed micro, small and medium-sized undertakings).

- **The idea of one common value chain information cap in CSRD for all SMEs** - even by the split of simplified ESRS into LSME and VSME there remains one common value chain information cap set out by CSRD for all listed and non-listed SMEs (micro included) in Article 29b par. 4 of the Accounting Directive (as amended by CSRD). The common value chain information cap in CSRD was fully consistent with the idea of simplified ESRS to be developed for all listed and non-listed SMEs. Having VSME with the fourth module as we propose allows to have a common value chain information cap in one standard. It will be also much easier for non-listed SMEs to see meet the information cap by using to the full extent VSME (composed of four modules) than to look for particular disclosure requirements in LSME in order to meet the value chain information needs of large undertakings reporting under full ESRS.
- **The real proportionate standard** - As Polish Association of Listed Companies we represent also smaller issuers and we see that the draft VSME has been prepared as the real proportionate reporting standard and having in mind that listed SMEs are covered by the CSRD there should be a fourth module added to the draft VSME with some more additional disclosure requirements for listed SMEs making this standard to play the role of the “simplified ESRS” with a clear legal status as it was envisaged by the Article 29c in CSRD. There would be clear benefits of such an approach for at least five groups of stakeholders:
 - 1) **Regulators** – two tier legislative system is always more transparent and understandable to the market than three-tier system with three disclosures regimes; one simplified standard is in line with the CSRD and respects the idea of proportionality – there was no idea in CSRD to develop a niche standard referring to very small number of companies across the EU (699 listed SMEs according to EFRAG’s list) and in 17 Member States to less than 20 listed SMEs;
 - 2) **Listed SMEs** – their ESG reporting would be less costly; they would apply more proportionate reporting requirements and they would not face the incentives to delist on the grounds of too burdensome, excessive and too costly reporting requirements; the transition towards climate-neutral economy and sustainable development require from listed SMEs costs and additional resources that are disproportionately higher than in case of large undertakings/groups, therefore the ESG reporting should not add too much to this burden; moreover they will bear unproportionately higher costs of audit of their ESG reporting as the LSME standard would be applicable only by about 699 listed SMEs (the EFRAG’s estimations on the scope of LSME application by other types of entities allowed under CSRD to report ESG data in a limited scope as SNCI might be overestimated since some countries will probably use the option in CSRD to fully exempt some large number of SNCI, for example credit unions);
 - 3) **Non-listed SMEs** – any future decision about entering regulated market would be eased by staying with the same well-known ESG reporting standard with the need to add only one additional module (the fourth module of VSME);
 - 4) **Capital Market** – if the current split into LSME and VSME is maintained then the capital market will not grow because mainly SME enter the regulated market and in that case for non-listed SMEs the gap between VSME and LSME will be too broad and discouraging from listing, in effect the LSME will impede the further development of capital markets across the EU;

- 5) **Investors** – the more fragmented landscape in undertakings' ESG reporting the more resources have to be used by investors in order to analyse the ESG data provided by different types of undertakings, having only full ESRS and simplified ESRS (VSME containing four modules) would decrease the additional costs devoted to the understanding of ESG reports prepared by different investee companies;
- 6) **Auditors** – as they would engage in verification of ESG reports prepared under full ESRS but also many voluntary reports prepared under VSME (for example by medium-sized non-listed companies which probably will seek assurance of their ESG reporting in order to stay in a value chain of a large client) they would focus on two reporting standards instead of three, moreover the LSME would be used by so small group of undertakings that getting familiar with this standard will not bring any benefits of scale for auditors.

Apart from benefits of our proposal we envisage following costs burden for listed SMEs when there is no further simplification of LSME either based on modified VSME or based on further significant reduction of draft LSME provisions:

- Advisory services - high external advisory costs on LSME compared to full ESRS and VSME being far more widely used
- IT solutions - high costs due to very narrow consumer market for IT solutions designed for reporting under LSME standard
- Problems with mandatory verification by auditors

- high audit costs – statutory auditors will have to get familiar with LSME standard applied by very small number of companies

- problem with availability of auditors after 2025 when all large companies will make their ESG reports subject to mandatory verification

- more estimations to be verified due to less potential of listed SMEs to gather ESG data directly from the actors in their value chain

If the draft LSME is not further simplified the EU reporting standards landscape will consist on the one hand of full ESRS applied by many thousands of large undertakings and large groups and very user friendly VSME applied on a voluntary basis by millions of non-listed SMEs in the EU and on the other hand – of complicated LSME applied by 699 listed SMEs. In that case listed SMEs will have problems with access to affordable consulting services and the audit prices will also be high because statutory auditors will have to get familiar with LSME standard which will be applied by very limited number of listed SMEs in most Member States (except for Germany and Poland).

We are of the opinion that the draft LSME standard is too complicated for listed SMEs. Although the number of disclosures has been cut by about 44% (from 827 to 466 according to EFRAG estimations) compared to full ESRS, the disclosure gap that should be taken into account should refer to the comparison between VSME and LSME, because the VSME is really focused on SMEs and their capacities. Listed SMEs have no bigger capacities than non-listed smaller undertakings. Therefore, the CSRD did not envisage two types of reporting standards for SMEs – it has referred to one really simplified reporting standard for SMEs and one common value chain information cap.

Thus, we would like to stress the need for at least further significant simplifications and disclosure reductions in LSME towards VSME. The idea should be to have LSME and VSME as close as possible

instead to have LSME as a smaller copy of full ESRS, due to the fact that the gap between LSME and VSME might discourage SMEs from listing or lead them to delist.

In case there will remain two separate standards for SMEs we would like to stress our concerns regarding the draft LSME standard:

1) For listed SMEs all disclosure requirements involving value chain information will be difficult to provide – the number of mandatory DR with VC component should be reduced to minimum.

2) Any complicated estimations and for example analysis of climate-related scenarios might be too burdensome for listed SMEs – further simplifications should be considered.

3) The requirement to provide still some information and metrics when using phased-in options (point 15 in Section 2 LSME) should be deleted – because this is a copy of point 17 in ESRS 2, however, listed SME do not have experience in reporting ESG data before CSRD will cover them and therefore when using the phased-in option with regard to one or more material ESG topics they will not be able to provide data requested by point 15 – so the omission of all disclosure requirements on such topics from LSME will not result for listed SMEs in any real simplification as they would be obliged to provide some minimum of ESG data required by point 15 in Section 2 of LSME.

4) The table in Appendix C (List of phased-in disclosure requirements) containing in some cases the employee threshold shall refer exclusively to the average number of employees of an undertaking and not of the group – as listed SMEs being parents of small or medium-sized groups are not covered by the CSRD requirement on consolidated ESG reporting and they have the obligation to report only individual sustainability information and not consolidated information – they shall have the access to the phased-in options being assessed only under the criterion of the number of 50 employees of the undertaking and not of its entire group. Deleting the reference to the “group” in this table will enable more listed SMEs to use the phased-in options and avoid the unjustified discrimination of listed SMEs being parent of small or medium-sized group.

5) We have doubts whether the requirement in AR 14 in Section 2 to provide certain mandatory data needed for SFDR is justified as there is already a table in Appendix B in Section 2 which contains “List of datapoints in cross-cutting and topical sections that derive from other EU legislation” and the corresponding point 37 in Section 2 which allows the undertaking to complete this table by inserting “not material” when this is the case – so we do not see the reason why some disclosures are nevertheless mandatory in the similar but much shorter table in AR 14 (for example the same questions regarding for example SFDR Tab. 3 KPI 13 - incidents of operations at significant risk of incidents of forced labour or compulsory labour).

6) In draft LSME and draft VSME there is a technical error – in the list of ESG issues for Pollution there is missing the sub-topic of “microplastic” – although there are references to this sub-topic in the draft standards.

7) In Basis for Conclusions there is a misinterpretation of CSRD – the issue of Art.19a par.6 starting with the words “By way of derogation from par.2 to 4 (...)” – has been interpreted not by analysing what does this derogation mean for obligations set out in par. 2 to 4 – instead EFRAG concentrated on the false interpretation that listed SMEs derogate from the possibility to omit ESG disclosures when they are in the course of negotiations – however, this is not an obligation but an exemption to be available for all entities covered by CSRD (including listed SMEs) via a Member State option and in draft LSME this provision should be incorporated with the same wording as in full ESRS. Interpretation drawn by

EFRAG is false also due to the fact that in the same derogation from par.2 to 4 there is a 3-year transitional period for collecting and presenting value chain information – it is also granted to all entities covered by CSRD and it will be transposed into the national law and be available directly also for listed SMEs. Applying EFRAG's logic of interpretation "by way of derogation from par.2 to 4" would mean that listed SMEs have no transitional period for value chain information which is simply not in line with the CSRD. The problem with interpretation may stem from the fact that par.6 in Art. 19a in CSRD has been proposed by the EC at a later stage and there was no sufficient time to reflect on what should be moved to other paragraphs in order to omit any interpretative problems.

Due to the fact that draft LSME has been prepared by reducing the requirements of full ESRS and sometimes by not real simplifications (merging of some separate DRs in one DR), the text of LSME is not user friendly and the standard is not proportionate to the size of listed SMEs. They have limited human resources to deal with new ESG reporting requirements, therefore we would see an added value in analysing the VSME disclosure requirements as starting point to draft the LSME (or to add the fourth module to VSME for listed SMEs) in order to meet the limited disclosures required by Art.19a par. 6. This provision sets out the legal frame for listed SMEs to report ESG data in a limited scope and this legal frame will be transposed to all national legal frameworks. Whereas Article 29c sets out the boundaries for standard setting and requires a proportionality approach when developing simplified ESRS.

If the draft LSME is not further simplified the EU reporting standards landscape will consist on the one hand of full ESRS applied by many thousands of large undertakings and large groups and very user friendly VSME applied on a voluntary basis by millions of non-listed SMEs in the EU and on the other hand – of complicated LSME applied by 699 listed SMEs. In that case listed SMEs will have problems with access to affordable consulting services and the audit prices will also be high because statutory auditors will have to get familiar with LSME standard which will be applied by very limited number of listed SMEs in most Member States (except for Germany and Poland).

We kindly ask EFRAG to take into consideration the above arguments and remarks and we would appreciate more proportionate approach towards listed SMEs.

Yours faithfully

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SEG

Annex:

Ad. Recital 21 (CSRD):

In the EFRAG's working paper on "LSME and VSME as separate standards" (Paper 04-02 of 12 January 2023) in point 11 there is one important part of the cited recital 21 of CSRD missing that provides clear evidence that the ESRS prepared under Art.29c were to be designed for any SMEs (listed and non-listed):

" (...) Small and medium-sized undertakings whose securities are admitted to trading on a regulated market in the Union should be given the possibility of reporting in accordance with standards that are proportionate to their capacities and resources, and relevant to the scale and complexity of their activities. Small and medium-sized undertakings whose securities are not admitted to trading on a regulated market in the Union **should also have the possibility of choosing to use such proportionate standards on a voluntary basis."**