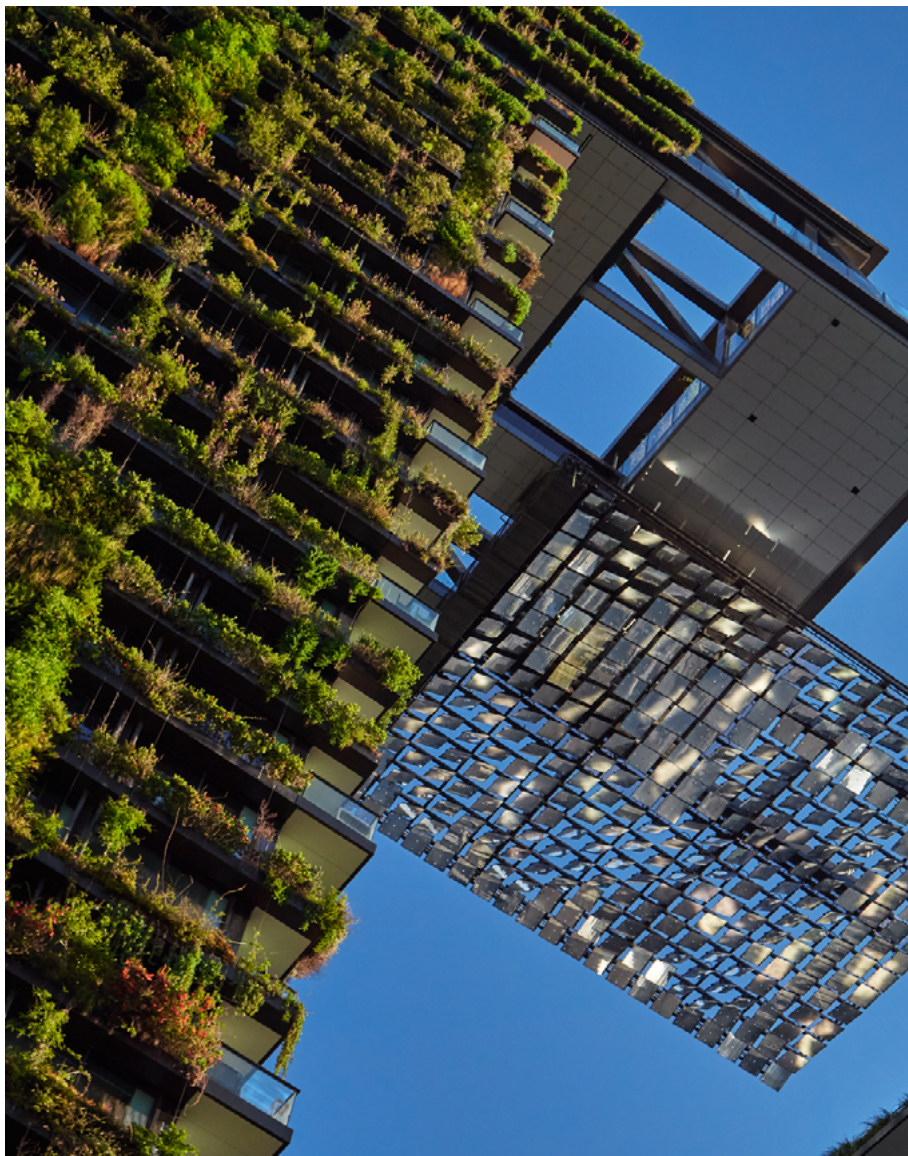


Assessment of the Principal Adverse Impact Indicators by the DRSC/RNE pilot group “SME Reporting”

Pilot group of the Deutschen Rechnungslegungs Standards Committee (DRSC)
and the German Council for Sustainable Development



Introduction



Proposals for sustainability reporting standards for small and medium-sized enterprises (SMEs) are currently being discussed in different contexts. The so-called Indicators for Principal Adverse Impacts on Sustainability factors (PAIs) play a special role in this discussion. According to the EU Sustainable Finance Disclosure Regulation (SFDR), disclosures on investment decisions of financial market participants are based on information on PAIs in order to highlight potential adverse impacts on sustainability. They are also an important part of the information required for sustainability reporting by SMEs.¹

EFRAG in particular is currently working on EU-wide SME sustainability reporting standards. The standard that EFRAG develops for capital market-oriented SMEs (known as ESRS for listed SMEs, LSME) stipulates that PAIs are to be disclosed by these companies. In addition, PAIs also play a central role in the conception of the VSME. The VSME is a sustainability reporting standard which EFRAG develops for the many thousands of SMEs that are not subject to mandatory sustainability reporting but may voluntarily report on sustainability (ESRS for voluntary application by SMEs, VSME). Based on the assumption that information on PAIs is particularly relevant for business partners of SMEs, for example for banks in connection with financing SMEs or for large companies in the context of necessary value chain information, various PAIs are required to be reported as part of the VSME's Business Partner Module². Since the SFDR is currently being revised, PAIs might be adjusted as a result of this revision.

Against this background, the pilot group took a closer look at the current status of PAI requirements and assessed them from the SMEs' perspective with respect to "demand/relevance" as well as "difficulty of implementation". The heat map tool was chosen with the aim to visualise

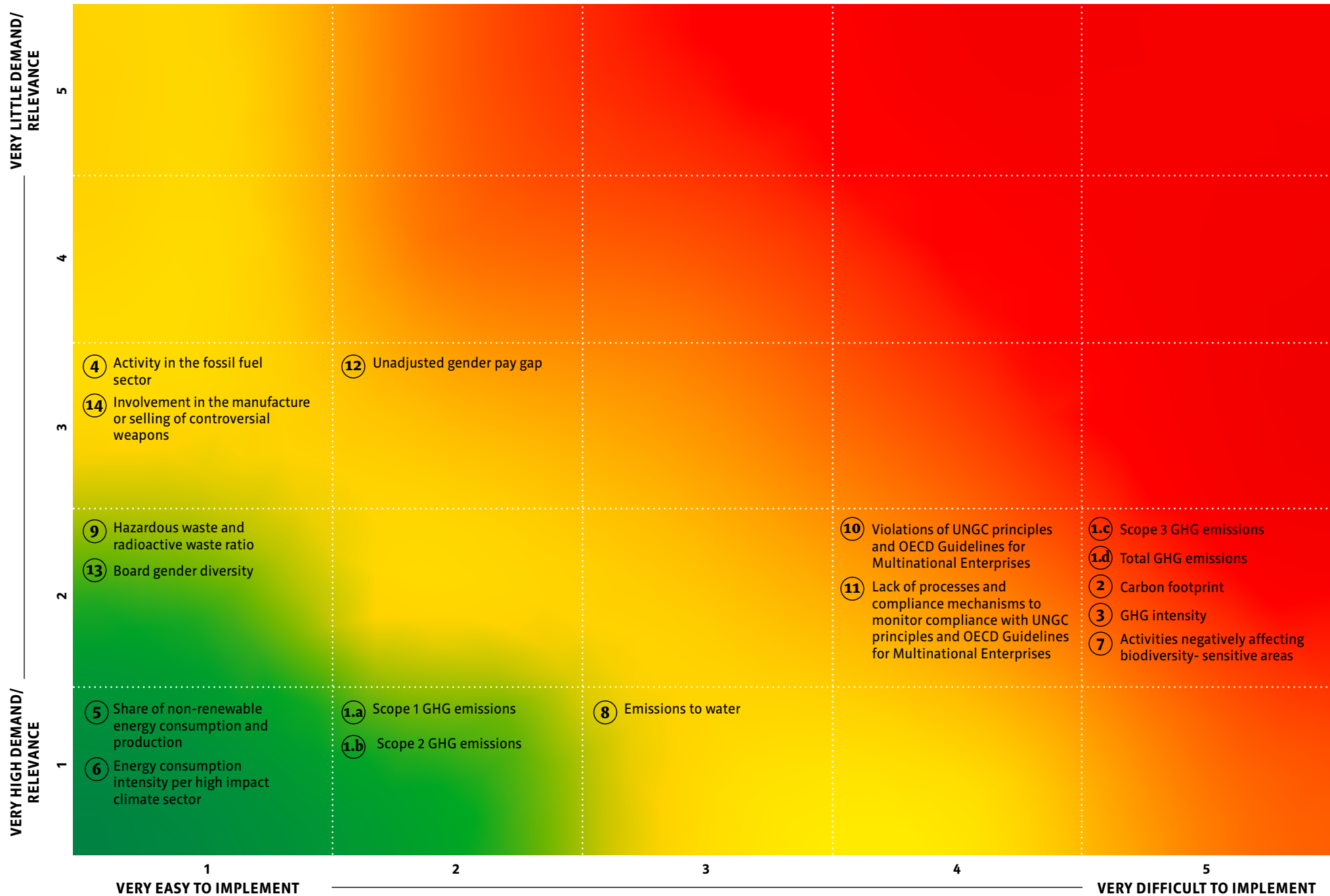
the results of the analysis. On the one hand, the “demand/relevance” criterion is plotted on a scale of 1-5 (“very little” to “very high”). This refers to the need for SMEs to provide the relevant sustainability information and therefore to this aspect of sustainability being considered particularly important. This importance can be reflected in corresponding enquiries from stakeholders (demand). Besides, the importance can also be assessed as relevant information assessing the sustainability of the company’s activities (relevance). On the other hand, the matrix is supplemented by the criterion of “feasibility for SMEs” (scale of 1-5, “very easy” to “very difficult”), which refers to the various challenges for SMEs in providing this sustainability information. This can include, for example, understandability of the indicator, data availability or the burden on the financial and/or staff capacities of SMEs.

The chosen categorisation is intended to illustrate the practical handling with the indicators. Firstly, it illustrates which sustainability information is both particularly relevant and relatively easy for SMEs to implement (“green area”). Secondly, it shows which information poses challenges for SMEs that should nevertheless be addressed due to the relevance of this information (“yellow/orange area”). Finally, information is shown that is either not very relevant or very difficult to implement for SMEs. In this case, relevance and implementation challenges must be weighed against each other. Where appropriate it should be assessed whether it is possible to specify the requirement, to provide assistance or even to amend the indicators in order to address the challenges for SMEs and at the same time consider the relevance of the information. However, as the information requirements should always be orientated towards the actual demand/relevance, a (temporary) waiver of the indicators could also be considered (“red area”). These assessments should be reviewed over time.

THE FOLLOWING MAIN FINDINGS CAN BE DERIVED FROM THE HEAT MAP BELOW:

- high and very high demand/relevance of these indicators (all PAIs are assigned to categories (1)-(3)),
- certain indicators pose major implementation difficulties for SMEs,
- PAIs in the “red area” and possibly also in the “orange area” should be discussed further and adapted if necessary.

This presentation is intended as a contribution to the discussion on the design of sustainability reporting standards for SMEs. To this end, however, the suitability of this sustainability information from the user’s perspective must be closer examined in a next step. Sustainability information should also be necessary and relevant for the users of SME sustainability reporting, e.g. banks lending to SMEs or large companies requiring sustainability information for value chain information obligations. It should be noted that the assignment of the individual PAIs vary depending on the industry in which a company operates.



Explanations of the PAI assessment made by the DRSC/RNE pilot group:

- a PAI (1a), (1b):** Information on Scope 1 and Scope 2 GHG emissions is considered basic information that should be expected from all companies.
- b PAI (1c), (1d), and (2):** The determination of Scope 3 GHG emissions imposes major difficulties due to the need to take account of emissions along the value chain (e.g., defining the value chain, data/information collection). Information based on this indicator (total GHG emissions and carbon footprint) is therefore assessed identically. A standardised understanding of the content and determination of this information between industries and the financial sector is essential. **PAI (3):** GHG intensity. This is an indicator to be provided by the financial market participants. It is based on total GHG emissions (PAI (1d)). Therefore, PAI (3) is not separately evaluated.
- c PAI (6):** It is necessary to clearly define “climate-intensive” sectors.
- d PAI (7):** Biodiversity is recognised as being of very high importance. However, there is still a lack of meaningful indicators or methods for determining indicators. From the point of view of SMEs, this information need would have to be specified. This also applies to specifications such as “areas with biodiversity in need of protection” or areas “near” those. In addition, the availability of data is low.
- e PAI (8):** Currently very limited data availability. Alternative indicators such as “water consumption” or “water withdrawal” could be used.
- f PAI (10) und (11):** For SMEs in Germany, addressing these principles is typically part of their business activities, but compliance with these principles (such as protection of human rights, labour relations, compliance with environmental regulations, combating bribery/corruption, competition regulations) is often the subject of regulations in Germany. Many aspects of this guidance are important indicators for assessing the business activities of SMEs. However, this canon of regulations is not managed or assessed jointly in SMEs. Data availability on selected topics is also low. A summarised assessment of whether these principles and guidelines have been breached is therefore very time-consuming. In view of the density of regulation in the EU, it could be discussed to provide this information limited to companies outside the EU.
- g PAI (12):** An “adjusted” gender pay gap (i.e. comparison of pay gap only at the same company level) is considered more meaningful than the “unadjusted” pay gap provided for in PAI (12).

Principal Adverse Impact Indicators (PAI)

The PAIs listed below are defined in the Delegated Regulation supplementing the SFDR (see (EU) 2022/1288 supplementing (EU) 2019/2088, Annex 1, Table 1). The document, dated 6 April 2022, can be downloaded [here](#). The following indicators for principal adverse impacts on sustainability factors are presented in that table 1 together with metrics for the indicators.

PRINCIPAL ADVERSE IMPACTS ON SUSTAINABILITY FACTORS, THE NUMBERING OF PAIS CORRESPONDS TO ANNEX 1, TABLE 1 OF (EU) 2022/1288			IF PROVIDED IN TABLE 1: METRIC FOR THE PAI
Greenhouse gas emissions	PAI (1)	GHG emissions	Scope 1 GHG emissions* ("PAI (1.a)" in the Heat Map above)
			Scope 2 GHG emissions* ("PAI (1.b)" in the Heat Map above)
			Scope 3 GHG emissions* ("PAI (1.c)" in the Heat Map above)
			Total GHG emissions ("PAI (1.d)" in the Heat Map above)
	PAI (2)	Carbon footprint*	
	PAI (3)	GHG intensity*	
	PAI (4)	Active in the fossil fuel sector*	
	PAI (5)	Share of non-renewable energy consumption and non-renewable energy production	Share of non-renewable energy consumption and non-renewable energy production compared to renewable energy sources, expressed as a percentage of total energy sources
	PAI (6)	Energy consumption intensity per high impact climate sector*	Energy consumption in GWh per million EUR of revenue, per high impact climate sector
Biodiversity	PAI (7)	Activities negatively affecting biodiversity- sensitive areas*	Companies with sites/operations located in or near to biodiversity-sensitive areas where activities of those investee companies negatively affect those areas
Water	PAI (8)	Emissions to water*	Tonnes of emissions to water generated, expressed as a weighted average
Waste	PAI (9)	Hazardous* waste and radioactive* waste ratio	Tonnes of hazardous waste and radioactive waste generated, expressed as a weighted average

Social and employee matters	PAI (10)	Violations of UN Global Compact principles* and Organisation for Economic Cooperation and Development (OECD) Guidelines for Multinational Enterprises*	
	PAI (11)	Lack of processes and compliance mechanisms to monitor compliance with UN Global Compact principles* and OECD Guidelines for Multinational Enterprises*	Companies without policies to monitor compliance with the UNGC principles or OECD Guidelines for Multinational Enterprises or grievance/complaints handling mechanisms to address violations of the UNGC principles or OECD Guidelines for Multinational Enterprises
	PAI (12)	Unadjusted gender pay gap*	Average unadjusted gender pay gap of investee companies
	PAI (13)	Board gender diversity	Average ratio of female to male board members, expressed as a percentage of all board members
	PAI (14)	Exposure to controversial weapons (anti- personnel mines, cluster munitions, chemical weapons and biological weapons)	Companies involved in the manufacture or selling of controversial weapons

*These terms are defined in Annex 1 of the Delegated Regulation (EU) 2022/1288 – in part by reference to other EU regulations. For example, "scope 1, 2 and 3 GHG emissions means the scope of greenhouse gas emissions referred to in points (1)(e)(i) to (iii) of Annex III to Regulation (EU) 2016/1011 of the European Parliament and of the Council" or the "unadjusted gender pay gap means the difference between average gross hourly earnings of male paid employees and of female paid employees as a percentage of average gross hourly earnings of male paid employees".

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Background to the DRSC/RNE pilot group

The “SME Reporting” pilot group initiated by the DRSC and RNE in September 2022, with Prof Dr Alexander Bassen as the chair of this group, discusses sustainability reporting by SMEs. This discussion is being held in the context of the expansion of requirements regarding sustainability reporting and the dynamic developments in the regulation of sustainability reporting for SMEs. These often pose challenges for SMEs due to their limited resources. The pilot group’s work aims at defining conditions for practicable and at the same time ambitious sustainability reporting standards. The pilot group consists of representatives from SMEs and various SME sustainability reporting stakeholder groups. The pilot group published an interim report in August 2023 on the various information needs for SME sustainability reporting by stakeholder groups. This heat map is based on the assessment of PAIs by the pilot group with the involvement of experts from both SMEs and large companies.

Endnotes

- 1 [↗](#) See DRSC/RNE pilot group (2023) with an overview on the information needs of stakeholders of SMEs.
- 2 The VSME is divided into three modules. The Basic Module forms the foundation of a SME” sustainability reporting. In addition, SMEs can apply the Narrative PAT Module (on policies, actions, targets) and/or the Business Partner Module. [↗](#) See EFRAG Exposure Draft VSME (22 January 2024), to be commented on by 21 May 2024.