

# 3-STEP SUSTAINABILITY ASSESSMENT FOR SMES

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## WHAT IS THE 3-STEP SUSTAINABILITY ASSESSMENT?

Many small and medium-sized enterprises (SMEs) are busy with the day-to-day running of their business. It can be daunting for them to prioritise their business' sustainable transition. This sustainability assessment checklist helps SME accountants and advisors to support their SME clients to build their sustainability profile. It can be the first step to enable a smoother shift to more durable business models and translate these challenges into new opportunities.

This checklist follows-up on our publication [SME risk management: sustainability \(2020\)](#). We encourage users to adjust it according to evolving sustainability related developments, market, partners' and authorities' expectations, and different SMEs' needs<sup>1</sup>.

## WHY IS SUSTAINABILITY IMPORTANT FOR SMES?

SMEs are key to the transition to more sustainable economies. They face external pressure to adapt to the impacts of a changing climate and environmental degradation, but also from external stakeholders (such as banks, supply chain partners, public authorities).

There are several benefits for SMEs to integrate sustainability into their business model and planning (see more in our [paper](#)):

- proactively manage positive and negative societal and environmental impacts generated by the business
- attract capital and financing
- reduce business costs with more sustainable ways of working and doing business
- ensure business succession by reinforcing the business' long-term viability, making it fit for the next generation and increase the business' ultimate sale value
- improve the business brand, which is particularly important for consumer facing businesses
- expand the business, and the range of clients and services

It is also critical for SMEs and their accountants to prepare for sustainability requests that small businesses will face. These requests can come from larger supply chain partners to provide sustainability information about their business, from banks and investors as conditions for financing or even from public authorities in procurement applications. The EU's or national regulatory requirements around sustainability information and supply chain due diligence may not be mandatory for all SMEs. But they can expect these requirements to trickle down on them.

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<sup>1</sup> For example, to align with the EU's Corporate Sustainability Reporting Directive (CSRD) and supply chain due diligence legislation, especially to the degree to which they apply to certain categories of SMEs.



## HOW WILL THE SUSTAINABILITY ASSESSMENT HELP?

This checklist aims to support accountants in helping SMEs to take the first steps towards building their sustainability maturity. The accountant should use it to stimulate and structure a dialogue with their SME clients.

This assessment will build a sustainability profile for the business, and enables:

- the accountant to advise and help introduce new controls and organisational changes that facilitates the monitoring of sustainability factors specific to the business
- to gather relevant sustainability information to help guide SME owner-managers' decision, and eventually to report it to external stakeholders
- to identify where relevant sustainability information on the business is currently not available, and will need to be identified and developed

## 3-STEP SUSTAINABILITY ASSESSEMENT



### STEP 1 – BUILD THE BUSINESS PROFILE

Sustainability profile mapping starts with understanding the SME's business model, value creation process and activity types. This guarantees a business-specific and calibrated approach in a possible sustainability reporting stage, and avoids excessive burdens.

As a first step, the accountant and SME should together gather and document the following key information:

- company size (micro, small or medium, for example on the basis of the European Commission's [SME definition](#))
- economic sector and business model e.g. sources of revenue, customer base, products and financing details
- relationship and degree of dependency on banks<sup>2</sup>
- already available data on the business sustainability (ESG) and economic impacts e.g. energy consumption, gender balance in management positions, equity ratio
- the SME's knowledge of and involvement in national and voluntary initiatives specific to the activity sector (e.g. climate laws, sectoral agreements to target the Paris objectives, sustainable business certificates)
- degree of alignment of activities with the [EU taxonomy regulation](#)
- business' position within its supply chain, key customers and suppliers, their location (e.g. in/ outside of the EU, stable/unstable regions)

<sup>2</sup> This is important to be aware of how likely the SME is to receive sustainability related requests from its banks, and to then prepare accordingly.

## STEP 2 – CONDUCT A SUSTAINABILITY MAPPING

Sustainability mapping starts with identifying possible sustainability risks and vulnerabilities. This risk assessment's main purpose is to provide the SME owner-managers with information about their business risks that will enable them to take decisions towards sustainable transition. It will also allow to identify where sufficient information for a risk analysis may be missing, thus indicating where further work to find or generate that information will be needed.

The grid below provides indicators of key topics for the accountant to discuss with the SME:

	<b>Risk type</b>	<b>Inherent risk A</b>	<b>Financial risk B</b>	<b>Control risk C</b>	<b>Overall risk A+B+C</b>	<b>Comments</b>
<b>ENVIRONMENT</b>	<b>Carbon footprint</b> <i>incl. greenhouse gas emissions</i>					
	<b>Energy use</b> <i>incl. energy consumption, energy type used</i>					
	<b>Environmental damage</b> <i>incl. contamination, air pollution and toxins</i>					
	<b>Waste</b> <i>incl. waste reduction and recycling</i>					
	<b>Resource and raw material use</b> <i>incl. dependency on scarce natural resources and raw materials, resource conservation, use of renewables</i>					
	<b>Product lifecycle</b>					
	<b>Water use</b>					
	<b>Stranded assets</b>					
<b>SOCIAL</b>	<b>Product safety, recyclability and quality</b>					
	<b>Employee relations and engagement</b> <i>incl. employment contracts types</i>					
	<b>Health and safety at work</b>					
	<b>Working conditions</b> <i>regular and open communication, flexible working schedules, living wage</i>					
	<b>Human rights and modern slavery</b>					
	<b>Fraud, corruption and money laundering</b>					
	<b>Cybersecurity</b>					
<b>GOVERNANCE</b>	<b>Data privacy and protection</b> <i>incl. the handling and securing of data from customers, business partners</i>					
	<b>Management structure and control</b> <i>incl. gender balance</i>					
	<b>Key person issues</b> <i>incl. incoming younger generation, succession planning</i>					
	<b>Suppliers</b> <i>criteria for selection and control of suppliers, sustainability information provided by suppliers</i>					
	<b>Outside shareholders</b>					
	<b>Ownership</b>					
	<b>Main sources of financing</b>					
	<b>Any additional client-specific risk areas</b>					



## HOW TO COMPLETE THE GRID?

### Existing information and available resources

The grid should be completed as much as possible with information already available. The SME owner and accountant should also take into account measures previously in place under existing national and EU requirements<sup>3</sup>.

Difficulty to fill out certain parts may indicate that key sustainability information is lacking. In such cases, the accountant can reach out to relevant specialists in their networks or rely on existing resources to help fill in sections e.g. [SME sustainability roadmap](#) by the Canadian government, the [B-Impact Assessment tool](#) or [Ecopreneur's Circularity Check](#). Country specific tools are also available e.g. [Danish climate compass](#).

### Business specificities and size

Consider each item's relevance and materiality for that particular business and sector. For example, for a low-risk micro-business with an owner-manager and one employee, completing all the sections may not be relevant. Whenever a section is not filled in, the reasons should be explained in the *comments* box.



*Consider each item's relevance and materiality for that particular business and sector.*

### Risk categories

In the grid, the risk should be assessed based on three elements:

- **Inherent risk**<sup>4</sup> (A) of the business model/sector – rate 1 for low risk of causing or being affected by sustainability factors to 3 for high risk e.g. energy intensive industries or those reliant on scarce resources. Inherent risks can be internal, come from the supply chain or be external to the business
- **Financial risk**<sup>5</sup> (B) to gauge the risk element's financial impact – rate 1 for minimal potential consequences to 3 for existential potential consequences
- **Control risk** (C) to assess the existing procedures in place to deal with risk - rate 1 for strong, formal controls regularly reviewed and tested, rate 2 for informal but effective, well-communicated controls, rate 3 for no existing internal controls

### Risk scoring

The highest **overall risk** score of 8-9 would signify a **critical risk** that should be addressed immediately. Lower scoring risks should be addressed in turn and order of severity, meaning from **high risk** for an overall score range of 5-7 down to **low risk** of 3-4.

The types of measures to take will depend on the specific risk type and business conditions. The immediate aim should be to set up internal procedures with regularly reviewed and tested formal controls. Measures taken to address the identified risks should lead to a lower risk score.

As the scoring exercise will be based on the accountant's and the SME client's judgment, it should not be considered as an objective exercise. The accountant should consider drawing on their professional network and consult with specialists in the field on the scoring they have devised to improve its accuracy.

<sup>3</sup> For example Art 9(1)(c)(d) of [Directive \(89/391/EEC\)](#) on the introduction of measures to encourage improvements in the safety and health of workers at work.

<sup>4</sup> The inherent risk analysis should consistently also factor in regulatory interventions or litigation related to sustainability problems, as well as potential reputational risks.

<sup>5</sup> The financial risk analysis should also take into account opportunity costs – i.e. missed opportunities that could have led to potential revenue and cost savings. For example, an energy intensive business model may be able to save money in the long-term by switching to a more efficient manufacturing process or machinery.

### STEP 3 – MONITOR, IMPROVE AND TAKE FIRST STEPS TOWARDS REPORTING

For each item identified in the risk scoring exercise as being of **critical** or **high** relevance for the business, and starting first with the highest scoring critical risks, the accountant should advise and help the business to:

- conduct a ‘strengths, weaknesses, opportunities and threats’ (SWOT) analysis for the business
- decide on objectives for improvement
- define the key performance metrics to achieve these objectives
- set up monitoring processes

This will enable tracking progress and gathering information relevant for owner-managers’ decision-making and, eventually, for external disclosure.

After covering all critical and high-risk areas, the accountant should help the SME take first steps towards external reporting of the identified sustainability matters. They should advise the SME to reflect on what is relevant to report, why, how and to whom.

To achieve this, the accountant should discuss with and advise the owner-managers to:

- present *their understanding* of sustainable development goals (SDGs) and how the business can contribute to achieving them
- present *their performance* with reference to sustainable development indicators and goals, and how they contribute to (un)sustainability
- describe how sustainability topics relate to their *long-term organisational strategy*, risks and opportunities, including supply chain topics
- describe and map the stakeholders to whom they consider themselves accountable
- take into account current topics and issues that they feel represent significant risks for their organisation and area of operation, drawing on the results of the step 2 above
- consider the sustainability impacts within and outside their organisation. Cover and prioritise all relevant information on the basis of the materiality principle
- not omit information that influences or is needed for stakeholder assessments or decisions, or that reflects significant ESG impacts

“SMEs represent the local economy. For most European co-operative banks they are the key customer group. Especially on the local level is where the transition to a more sustainable economy has to take place. To properly steer their companies towards sustainability, entrepreneurs need a clear picture of their ESG performance like of their financial situation. And banks require their clients’ ESG data to comply with requirements on sustainability reporting and to properly manage the risks of their loan book. It is therefore key to provide appropriate tools for SMEs, realistic and hands-on solutions that can be applied in a voluntary, balanced and proportionate manner. Imposing complicated, costly burdens must be avoided. Solely in this way, we can take SMEs with us on the journey to a sustainable economy. We are confident that the checklist will be useful in this regard. EACB members were glad to bring expertise and views along the process.”

Nina Schindler, EACB CEO