Forvis Mazars' contribution to the Public Consultation on the ESRS-40a Exposure Draft for Certain Non-EU Undertakings

29 October 2026

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We pride ourselves on being a different kind of firm – one that contributes to a fair and prosperous world by caring for the success of our people and clients, the health of financial markets, and the integrity of our profession. This is why we take every opportunity to contribute our knowledge and expertise to the regulatory and public policy issues affecting auditing and corporate reporting around the world.

We are pleased to provide feedback on EFRAG's proposals on the ESRS-40a standards. This feedback has been prepared gathering expertise at EU and non-EU level within the Forvis Mazars Group.

We fully acknowledge the challenges relating to the sustainability reporting standards for non-EU groups falling within the scope of the CSRD, given the aim of ensuring a level playing field between third-country companies and EU-based companies, while simultaneously limiting the additional reporting burden put on third-country companies.

In this context, we would first of all like to encourage EFRAG to **provide clarification on who the users of the ESRS-40a report are, and on the objectives served by the report**. Such clarifications are essential to ensure the information provided is fairly presented and useful.

Regarding the importance of avoiding duplicative reporting whenever possible, we encourage EFRAG to **further clarify that an undertaking already preparing an IFRS sustainability report (either on a voluntary or a mandatory basis) can use this report to prepare its ESRS-40a sustainability report given the interoperability between both frameworks and the flexibility allowed for the presentation of the ESRS-40a report**. In order to further facilitate the implementation of an "ISSB+" approach, we strongly recommend that EFRAG (and the ISSB) publish updated interoperability guidance as soon as possible.

While we understand that the mixed approach has been introduced in response to third countries' specific constraints and needs, we believe **the current drafting of the ESRS-40a will give rise to implementation questions that may impair consistent application by companies**. The lack of clarity in some definitions and the absence of application guidance, notably with respect to use of allocation keys, undermines the overall robustness of the standards which might lead to inconsistent understanding and implementation. **While we do not oppose the mixed approach as such, and understand the objectives it responds to, we believe there is room for clarification and improvement in order to ensure that EU-related impacts are faithfully presented**.

Finally, whilst we are well aware that this matter falls within the remit of the European Commission rather than EFRAG, we would like to point out that, in our view, **it is important for the European Union to take a swift decision on the equivalence of the ESRS with other recognized sustainability reporting frameworks in order to make a tangible contribution to reducing the reporting burden**. The conditions for such equivalence will, of course, need to be assessed so as to ensure a level-playing field between EU and non-EU companies.

(I) On the possibility to adopt an "ISSB+ approach"

Since many non-EU companies falling within the scope of the CSRD are already subject to, or should soon be subject to, other sustainability reporting requirements, it is essential that EFRAG uses every available means to make things easier for these companies by ensuring they do not have to duplicate their reporting efforts.

In particular, we encourage EFRAG to clarify that undertakings already preparing a sustainability report in accordance with the IFRS Sustainability Disclosure Standards may use this report as the basis for their ESRS-40a report. This would be consistent with the high degree of interoperability between IFRS and the revised ESRS on which ESRS-40a are based. Whilst ESRS-40a focus solely on impacts whereas IFRS focus on risks and opportunities, it should be recognized that there are many commonalities in terms of general disclosures and climate-related disclosures and that IFRS also cover impacts to some extent.

We encourage EFRAG to further facilitate the implementation of an "ISSB+ approach" by:

- **Developing updated interoperability tables**: we strongly recommend that the interoperability guidance previously issued by EFRAG and the ISSB be updated to take account of the revision of the ESRS on which ESRS-40a are based. New correspondence tables between, on the one hand, the revised set of full ESRS and the ESRS-40a and, on the other hand, the ISSB's requirements, are needed for reporting undertakings to clearly identify which ESRS and ESRS-40a datapoints are common to IFRS Sustainability Disclosure Standards.
- **Clarifying the flexibility in the presentation of sustainability information set out in the ESRS-40a Exposure Draft**:
    - To further alleviate reporting burden of undertakings reporting under both frameworks, EFRAG should consider stipulating directly in the ESRS-40a that reporting undertakings are allowed to use their IFRS reporting as the basis for their ESRS-40a report and to add ESRS-40a-specific reporting requirements ("ESRS-40a top-up"), which would be clearly identified by EFRAG in order to supplement their ESRS-40a report.
    - We note that paragraph 109 of draft ESRS-40a 1 allows an undertaking to deviate from the required four-part structure for its ESRS-40a sustainability report, under the condition that this undertaking can justify the need for an alternative structure. Our understanding is that this flexibility enables undertakings to structure their reports in a way that distinguishes the information required on the one hand by IFRS Sustainability Disclosures Standards (as paragraph 110(ii) of draft ESRS-40a 1 allows to add supplementary information stemming from generally accepted reporting standards or frameworks, published by other standard setting bodies) and, on the other hand, by the ESRS-40a for the information that is not already presented within the IFRS disclosures. If our understanding is correct, we believe EFRAG's intent should be clarified.
    - We also note that according to paragraph 124 of draft ESRS-40a 1, and without prejudice to paragraph 123 of the same standard, reporting undertakings are allowed to incorporate a significant part of their ESRS-40a report by reference. It is thus our understanding that an undertaking, reporting under both IFRS and ESRS-40a, could incorporate the information that is required by both frameworks in its ESRS-40a sustainability report, by reference to its IFRS report.
    - Reading paragraph 124 in conjunction with paragraph 109, as mentioned above, we understand that a company reporting under both the IFRS and ESRS-40a, could:
        - in a first clearly identified part of its ESRS-40a report, incorporate all the information required by both frameworks by reference to its IFRS report, which would prevent it from having to duplicate information. We note however that the condition listed under paragraph 121(a) may be very burdensome in case of incorporation by reference of a substantial amount of information;

- add, in a second part of its ESRS-40a report, all the information solely required by the ESRS-40a standards which comes "on top of" IFRS information.

If our understanding is correct, **we believe this should be reflected with clear wording in the ESRS-40a 1 standard**.

- Finally, we understand from paragraph 125 of draft ESRS-40a 1 that the requirement to include a table of contents pointing to the location of the information incorporated by reference, is reserved to undertakings who incorporated a substantial part of their ESRS-40a report by reference and who prepare a sustainability statement based on sustainability reporting standards enacted in the third-country jurisdiction, such as ISSB Standards. We believe that the fact that this requirement only applies to undertakings who are compelled to prepare a sustainability statement based on their own jurisdiction's reporting standards, and thus not to undertakings who prepare a voluntary sustainability statement, could be misleading. It might indeed be understood from paragraph 125 that only undertakings who are compelled to prepare a sustainability statement based on their own jurisdiction's reporting standards are allowed to incorporate a substantial part of their ESRS-40a report by reference.

  To clarify its intent, we encourage EFRAG to modify paragraph 125 by deleting "*enacted in the third-country jurisdiction where it operates*", and in doing so, to extend the requirements to include a table of contents pointing to the location of the information incorporated by reference to all undertakings incorporating a substantial part of their ESRS-40a reporting by reference.

(II) On the mixed approach

1. General considerations

The mixed approach, introduced in paragraph 28 of draft ESRS-40a 1, provides that reporting undertakings can choose to only report on their EU-related impacts, for all material topics except climate. While we do not fundamentally oppose the mixed approach, **we believe significant clarifications and additions are needed for the information reported under the mixed approach to faithfully represent EU-related impacts and to be useful, easily understandable and auditable**.

The "customer-based approach" described in paragraph 28 of draft ESRS-40a 1 seems judgmental ("*can be reasonably assumed to be sold*") and value-chain dependent. We believe the current definition of EU-related impacts and the related customer-based approach should **specify the level of detail to which the undertaking must go in identifying its EU-related products or services** (product or service line, individual product or service, …). Such clarifications would be useful for the enforcement of the customer-based approach. In addition, **it should be clarified whether the mixed approach can be applied to some, but not all EU-related impacts identified under the customer-based approach** i.e. whether all products and services sold are to be analysed and covered by the carve-out where relevant.

The "location-based approach" (paragraph 28 (b) in draft ESRS-40a 1) also lacks clarity as **it is unclear how "the undertaking's European Union activities" should be understood**. To ensure consistent application, we therefore recommend adding a definition to better explain this key concept.

At this stage, we understand that the location-based approach aims at capturing activities that are physically based within EU borders (if not already captured by the customer-based approach). If this is the case, we believe this should be made clearer, **in a way that clarifies how to address the multiplicity of possible organisational settings which include for example**:

- Remote workers based outside the EU but working for the EU-based entity, although not specifically on EU-products or services as defined in paragraph 28 (a) and their impacts.

- Impacts of an EU-based plant manufacturing products that are solely destined to export outside the EU.
- Impacts of a leased EU-based office and its related employees.
- Impacts related to the employees of an EU-based subsidiary or branch, but who frequently travel outside of EU borders and do not work on EU-related products or services as defined in paragraph 28 (a).

We also believe that the extent to which the value chain outside of the EU should be taken into account when defining EU-related impacts should be clarified. Although specifications are provided in topical standards beyond what is written under paragraph 28 (a) of draft ESRS-40a 1 (for example: ESRS-40a E2 AR 4, AR 9 and ESRS-40a S1 paragraph 8), we believe clarifications are needed at the level of the definition of EU-related impacts itself. A clear indication, embedded within the definition of the mixed approach in the ESRS-40a 1, of whether EU-related impacts also include the whole value chain outside of the EU of EU-related products, services etc. is needed for undertakings to perform their materiality analysis and properly define their reporting scope, including entity-specific information.

In addition, we are concerned that **there may be difficulties in gathering the relevant information to support the segmentation of EU-related versus global impacts**.

Overall, we stress the **importance of having EU-related impacts reflect as much as possible the way impacts are effectively managed by the company**. We observe that global companies' impacts are often globally managed, at least partially. Carving out EU-related impacts where they are not locally managed could be artificial and difficult to do in practice with no dedicated data system.

2. **On the concept of "meaningful identification"**

Paragraph 29 draft of ESRS-40a 1 stipulates that the carve-out of EU-related impacts can only be done where a "meaningful identification" of EU-related impacts is possible. Although AR 6 to paragraph 29 provides useful information as to how to appreciate if a "meaningful identification" is possible, we believe that this concept is not yet clear enough.

The term "meaningful" is judgmental and can be understood in several ways. In the absence of a clear definition and/or mandatory and sufficiently detailed criteria, undertakings are likely to apply their own interpretations and develop entity-specific thresholds or methodologies for determining what is "meaningful", **which may lead to inconsistent application of the mixed approach.** The diversity of approaches might also lead to uncertainty as to whether the identification of the EU-related impacts has been made in accordance with the applicable requirements. To support meaningful identification of EU-related impacts, we believe EFRAG should notably further emphasize the importance of aligning as much as possible with the way such impacts are effectively managed by the undertaking.

A further challenge arises where the same products or services are sold both within and outside the EU. In such cases, it is unclear how impacts should be attributed to EU-related and non-EU-related activities. **The proposed requirements do not establish straightforward principles for allocating impacts associated with products and services that serve multiple markets**. For example, a product manufactured in a single facility and sold partly in the EU and partly in other markets may be associated with environmental, social or human rights impacts that cannot be objectively attributed to individual sales destinations. Similar challenges arise for shared supply chains, production facilities, logistics networks, global policies and centrally managed functions. In the absence of prescribed allocation principles, undertakings may apply different methodologies, such as allocation based on revenue, sales volumes, production capacity, customer base or other proxies. It is also unclear whether proportional allocation, full inclusion or full exclusion of an impact would best support faithful representation. A better definition of the audience and purpose of the ESRS-40a report, as called for in the opening section of this comment letter, would assist undertakings and assurance providers in assessing this specific issue.

In particular, if it is EFRAG's intention to authorise the use of pro rata methodology, for example allocating an impact based on the weight of the EU in the undertaking's global sales, we believe this should be made clearer. **To the extent pro rata methodologies are permitted, we believe clear guardrails and disclosure expectations will be important to promote consistency, comparability, assurance readiness and, overall, that EU-related impacts are fairly presented**. In some circumstances, a pro rata approach may provide a materially accurate result with significantly less effort than a more granular calculation. However, in other cases, the underlying impacts may not scale proportionately, resulting in a materially different outcome. Additional guidance on when pro rata methodologies are appropriate, and the factors preparers should consider in assessing their reasonableness, would therefore be helpful.

3. **On the selective scope**

The current wording of the carve out does not include any provisions requiring consistency over time or even explanation when the scope of the carve out is changed. If such changes are allowed (with no restatement requirements) it would reduce the consistency of data over time and weaken the controls over data quality. To cover this risk, **EFRAG should introduce principles ensuring the consistency of reporting methods and boundaries**. We believe including a requirement for consistent application of the carve-out option over time is important. EFRAG could, for example, specify the circumstances under which an undertaking is allowed to change its reporting boundaries from one reporting period to another.

Finally, the mixed approach creates **a risk of fragmentation of disclosures on overarching reporting requirements such as policies, actions and targets** which often cover multiple sub-topics or groups of impacts, eventually **increasing the risk of misunderstanding of such information**.

4. **On the concept of fair presentation under the mixed approach**

Paragraph 5 of draft ESRS-40a 1 states that the objective of the report is to fairly present material impacts of the group (where relevant) and how it manages them. While paragraph 28 specifically overrides the provisions of paragraph 27 with respect to covering the same undertaking as those covered by the group financial statements, it does not explicitly override the objective presented in paragraph 5. As a consequence, the objective, to present fairly all the parent undertaking or group's material sustainability-related impacts, and how the parent undertaking or group manages them, remains the same, yet we understand this not to be possible under the mixed approach. **Hence, we encourage EFRAG to clearly indicate in the ESRS-40a Exposure Draft how the mixed approach can achieve fair presentation**.

Given the difficulties anticipated in properly identifying EU-related impacts, **it is important to emphasize the need for the company to take a step back in order to ensure that these impacts are correctly identified in the company's ESRS-40a report and that all material information relating to them is disclosed**.

(III) Other comments

We note that the practical ability of an EU subsidiary or branch to comply with the Article 40a reporting requirements may depend significantly on the availability of information from the third-country parent undertaking. **Where not all the necessary information is made available, despite the subsidiary's or branch's best efforts (see recitals (20) under the CSRD), we encourage EFRAG, together with the European Commission where appropriate, to provide further guidance on what constitutes "best efforts" to obtain the necessary group-level information and on how the reporting obligation should be fulfilled in such circumstances**.

Where the third-country parent undertaking does not provide all the information necessary for the preparation of the Article 40a sustainability report, **further guidance would be helpful on the content and level of detail of the statement to be issued by the EU subsidiary or branch.** In particular, such guidance could clarify how the reporting undertaking should transparently explain the information that could not be obtained and the efforts made to obtain it.