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European Financial Reporting Advisory Group
35 Square de Meeus
1000 Brussels
Belgium

GOVERNMENT OF JAPAN

Comment on the European Sustainability Reporting Standards (ESRS) for certain non-EU Undertakings (ESRS-40a) Exposure Draft

The Government of Japan appreciates the opportunity to comment on the Exposure Draft of European Sustainability Reporting Standards (ESRS) for certain non-EU Undertakings (ESRS-40a) developed by the European Financial Reporting Advisory Group (EFRAG). In light of the reduced disclosure burden for EU companies, the Government of Japan is of the view that a level playing field needs to be ensured between EU companies and non-EU companies subject to CSRD Article 40a. EU companies disclose sustainability information under the ESRS and do not separately disclose sustainability information in line with the IFRS Sustainability Disclosure Standards published by the International Sustainability Standards Board (ISSB). By contrast, Japanese companies subject to CSRD Article 40a are required to prepare two sets of sustainability reports—an ISSB-aligned report for Japanese regulatory purposes and an ESRS-40a report for European regulatory purposes—which results in an additional administrative burden.

Non-EU companies consider that preparation of two sets of sustainability reports would be undue burden. We believe that it is particularly important to ensure the level playing field between EU companies and non-EU companies subject to CSRD Article 40a. Furthermore, whilst ESRS-40a has not yet been finalized, it has been announced that the application of CSRD Article 40a will begin in 2028. Preparation time is very limited for non-EU companies subject to CSRD Article 40a. In effect, there are significant concerns about whether non-EU companies would be able to meet CSRD Article 40a requirements without delaying its mandatory application date¹.

¹ The Government of Japan submitted a comment letter on the Draft Delegated Regulation on

We therefore appreciate and support the following proposals in the Exposure Draft:

- incorporation by reference of group sustainability reports using jurisdictionally mandated standards that are functionally aligned with ISSB Standards (paragraph 124 and BC79 of ESRS-40a 1 Exposure Draft); and
- mixed approach (paragraph 28 of ESRS-40a 1 Exposure Draft).

We consider that the proposals above have some potential to facilitate the application of ESRS-40a by non-EU companies. However, we have identified application issues in the proposals. We consider that the following additional measures are necessary to make these proposals operational.

- (1) Clarifying top-ups in incorporation by reference
- (2) Company-based mixed approach

(1) Clarifying top-ups in incorporation by reference

We appreciate EFRAG's efforts to improve the efficiency of reporting and reduce duplicative efforts for the companies that already prepare group sustainability reporting using jurisdictionally mandated standards that are functionally aligned with ISSB Standards (BC 79 of ESRS-40a 1 Exposure Draft). In the Exposure Draft, a company that is subject to mandatory sustainability reporting in accordance with applicable jurisdictional requirements based on the ISSB Standards is permitted to cross-reference that information in its ESRS-40a report (paragraphs 120-125 and BC 78-81 of ESRS-40a 1 Exposure Draft). This approach is called incorporation by reference.

We believe that clarification should be provided regarding how a company would be expected to address disclosure requirements that are substantially similar but not identical between the ISSB Standards and ESRS-40a. Given that EFRAG's objective is to improve reporting efficiency and reduce duplicative efforts for companies (BC 79 of ESRS-40a 1 Exposure Draft), we understand that the intention is to avoid duplicative disclosures in relation to similar but slightly different disclosure requirements. Clarification on this point would help achieve the objective of the proposal.

In relation to the point above, certain additional guidance would be very helpful for companies to prepare for the ESRS-40a disclosures in such a short time frame. When a company already prepares a group sustainability report using jurisdictionally mandated standards that are functionally aligned with ISSB Standards, the first step in complying with ESRS-40a would be to identify the disclosure requirements in ESRS-40a that are not already covered by the ISSB Standards (“top-ups”). Because of the similar but slightly different disclosure requirements between ESRS-40a and ISSB Standards, the identification of the top-ups would be quite challenging for companies. If ESRS-40a were to include, in an appendix, a list of disclosure requirements that represent ESRS-40a-specific top-ups to the ISSB Standards, such guidance would significantly accelerate companies' preparation for compliance with ESRS-40a, while meeting the objectives of the CSRD.

(2) Company-based mixed approach

We appreciate EFRAG's decision to include the mixed approach for topical standards other than climate-related standards as an option. In the Exposure Draft, the mixed approach is proposed to allow an undertaking to limit the scope of the reported information to (a) impacts that arise from products and services that were or can be reasonably assumed to be sold or provided in the EU market, including by third parties (downstream value chain actors such as distributors and traders) and (b) impacts of the undertaking's European Union activities, if not already included in (a) (paragraph 28 of ESRS-40a 1 Exposure Draft). Furthermore, the Exposure Draft states that this approach is applicable only where a meaningful identification of the EU-related impacts is possible, enabling a faithful representation of those impacts for the purpose of ESRS-40a reporting, aligned with (a) how the undertaking's own operations, its products and its service offering are structured or managed; and (b) how its upstream and downstream value chain or chains are structured and operate (paragraph 29 of ESRS-40a 1 Exposure Draft).

Companies told us that preparation for applying the mixed approach based on the paragraphs above requires a significant amount of preparation time and it would not be feasible to comply with CSRD Article 40a beginning in 2028. Needless to say, application of the global approach in 2028 would be even more challenging for many companies.

In order to operationalize the application of the mixed approach while meeting the objectives of the CSRD, we therefore encourage EFRAG to incorporate the alternative

approach discussed in the following paragraphs.

The alternative approach requires companies to include all EU-related impacts in their ESRS-40a reporting, including the impacts that arise from products and services that were or can be reasonably assumed to be sold or provided in the EU market as well as the impacts of the companies' European Union activities. In addition, the alternative approach also allows companies to include some impacts arising outside the EU.

The alternative approach is a company-based approach, classifying each company in the group into one of the following three categories:

- (a) Companies located in the EU;
- (b) Companies located outside the EU that manufacture products or provide services in the EU market; or
- (c) Companies located outside the EU that do not manufacture products or provide services in the EU market.

A parent company applying the alternative approach reports the impacts of subsidiaries in categories (a) and (b). Companies in category (b) generate impacts both within and outside the EU. One of the major challenges faced by companies applying the proposed mixed approach is to allocate impacts between products and services sold in the EU and those sold outside the EU. The alternative approach would substantially reduce this burden. Given that the global approach also permits the inclusion of impacts arising outside the EU, we believe that the alternative approach would remain consistent with the objectives of the CSRD while making the mixed approach more operational and practicable. The alternative approach captures all EU-related impacts while avoiding the costly exercise of allocating impacts between EU and non-EU sales within the same legal entity.

In addition, the general materiality principle should also be applied when an entity classifies companies into category (b) and category (c). For example, a company located outside the EU may primarily manufacture products or provide services for non-EU markets, while only a very small proportion of its products or services are sold in the EU. In such circumstances, the general materiality principle should be applied when determining whether that company should be classified as a category (b) or category (c) company.

We believe that operationalizing the proposals on incorporation by reference and the mixed approach, discussed above, would facilitate the application of ESRS-40a by non-EU companies, while meeting the objectives of the CSRD. These observations reflect concerns and suggestions consistently raised through our ongoing dialogue with Japanese companies that are expected to fall within the scope of ESRS-40a.

In developing the final standard, we encourage EFRAG to carefully consider the feedback provided by companies and other stakeholders, including non-EU undertakings that will be directly affected by the requirements.

We appreciate the opportunity to provide our comments and would be pleased to discuss these matters further should that be helpful.