

Directors' Alert 2014

Greater oversight,  
deeper insight:  
Boardroom strategies in  
an era of disruptive change



# Contents

- 1 **Greater oversight, deeper insight:**  
Boardroom strategies in an era of disruptive change
- 2 **Innovation**  
How innovative is your organization about innovating?
- 4 **Technology**  
Is your organization at risk of being a cyber-crime victim?
- 6 **Productivity**  
It's about doing better, not more
- 8 **Strategy**  
Volatility isn't just economic when setting strategy
- 10 **Growth strategies**  
Is your organization aligned for growth?
- 12 **Leadership**  
Developing the leaders of tomorrow
- 14 **Regulatory**  
The pace of change continues
- 16 **Integrated reporting**  
Are you telling your story...the whole story?
- 18 **Taxation**  
Could tax be dangerous to your brand's health?
- 20 **Board composition**  
Balancing diversity and expertise to maximize board effectiveness
- 22 **Recognizing and responding to disruptive change**
- 23 **Resources**
- 24 **Contacts**

# Greater oversight, deeper insight: Boardroom strategies in an era of disruptive change

“All is flux, nothing stays the same”

Heraclitus c. 535-475 B.C.

Change is something that every organization faces dozens or even hundreds of times each day. Usually, these changes relate to the ongoing challenges of operating the organization – negotiating with new suppliers, entering new markets, implementing new technologies, hiring new employees, and so on. Most organizations have management teams that are very adept at anticipating and managing these types of changes, which are normally predictable outcomes of their business strategies and operations.

Sometimes, changes occur that are more dramatic. In the past, disruptive changes usually happened only periodically and resulted in a sustained plateau – the automated assembly line, for example, which revolutionized industry in the early twentieth century, continues to be a central feature of modern manufacturing. Today, however, disruptive change has become a perpetual occurrence in which one change instantly sparks a chain of others. What’s more, these changes are being generated by a variety of factors – digital disruption created by continuing technological advances, regulatory reforms, economic turmoil, globalization, and shifting social norms and perceptions.

In this environment, everything and anything may change at any time as category boundaries are blurred, supply chains are disrupted, and long-standing business models become obsolete. With change, however, comes opportunity. Technological advances enable organizations to generate new revenues by targeting new customers, new sectors, and access new geographies while more fully automating back office activities and divesting of declining assets to reduce costs. The challenge for organizations is to recognize when disruptive change is occurring and to act quickly and decisively when it does.

In this environment of ongoing, tumultuous change, organizations and their management and boards of directors must respond quickly and adeptly if they are to effectively address all the disruptive changes that surround and affect them. For boards of directors, this often requires greater oversight – expanding their scope to include activities and areas that were not traditionally part of their mandate. At the same time, boards must ensure

that management provides them with deeper insights into the organization’s activities so directors can clearly understand all of potential opportunities and risks.

This publication examines some of the major changes likely to affect organizations and their boards of directors in 2014.

Our objective is not to provide solutions to the issues discussed since the best approach for every organization will depend on its own particular circumstances. Instead, our goal is to assist directors in identifying the issues of importance to their organizations, and to help promote boardroom discussions around the strategies and options management has put forward to address current and future challenges, mitigate the risks, and seize the opportunities that lie ahead.

Specialists from Deloitte member firms (“Deloitte”) around the globe who work closely with boards of directors were interviewed to help address each of the issues discussed in this publication. They have provided their insights into the opportunities and risks in each area that boards and management must address in order to develop the right strategies.

Each article also includes questions that directors may ask to further explore the issues with their own boards. In addition, articles are supported with tools and resources so directors can “dig deeper” to broaden their understanding of the issues and improve their board’s effectiveness in dealing with them. These additional resources can be obtained by contacting your Deloitte partner.

# Innovation

## How innovative is your organization about innovating?



**Damien Tampling**

Partner

Deloitte Australia

“Organizations’ discipline around innovation and disruptive thinking is becoming sharper, including a better understanding of the different types of innovation, the objectives of each, and how innovative ideas should be measured.

Leaders in this space are also becoming more comfortable driving innovation programs that engage experts and entrepreneurs outside their own organization, even sharing privileged assets with these people. While doing so has its risks, several organizations have found those risks are far outweighed by the quality of the resulting new ideas, products, services, and momentum created.”



### Questions for directors to ask:

- What innovations has our organization developed over the past two years? What innovations have our major competitors developed in the same period? Are we leading, keeping pace with, or falling behind our competitors?
- What are the most disruptive innovations in our industry? How can we better test or harness these emerging business models?
- Globally, what can we learn from other industries that have been materially disrupted?
- Who are considered the brightest and most influential entrepreneurs in our industry? How do we forge stronger relationships with these people?
- On an ongoing basis, how do we better sense and shape the trends in our industry?
- Do we, as a board, have one or more directors with sufficient knowledge about digital disruption to understand how it is affecting our organization and industry and how digital should be integrated into our organization’s business strategy?
- What is our organization’s innovation culture? Are we willing to take innovation-related risks or is our organization too tentative and, therefore, in danger of remaining stuck in the traditional ways that it operated in in the past? Do we encourage orthodoxies to be challenged?
- Are we curious enough about our customers? Do we collect enough data often enough from our customers? Do we make good use of it?

Major disruptive trends are impacting organizations, industries and markets on a global scale. These trends include economic, regulatory, demographic, and other factors that are forcing organizations to innovate more rapidly in order to remain competitive.

One of the biggest impacts is from digital disruption. Digital technologies and digital business models are radically changing the way people access once inaccessible products, blurring the boundaries between industries, altering the way organizations operate, and driving greater disruptive innovation from sometimes unexpected or even unknown sources.

In this environment, an organization can be global from day one, access infrastructure that was once unaffordable, software that was once “closed,” and market itself efficiently with a range of digital marketing tools and channels, including social media. New innovations are also surfacing around the way organizations employ and engage with people on and off “balance sheet” with the emergence of much more flexible and innovative workforce arrangements. Common themes are also emerging around organizations that are looking at ways to better commercialize their data, alternative product and service bundling and pricing models, and the organization’s alliances and role in a broader ecosystem. This last point cannot be understated; in a world where the velocity of change and specialization is increasing, so, too, is the need for organizations to work with others in a broader ecosystem rather than going at it alone.

Many of the most innovative organizations are also making a concerted effort not just in where they innovate, but how. The best are not just encouraging innovation within their own organizations involving their own people, but are combining this knowledge and experience with experts, entrepreneurs, and others from outside their organization. Open source innovation, much like open source software, benefits from the simple concept that a greater cross section of thinkers from inside and outside an organization who come together around a common problem or opportunity will have a much better chance of seeing things differently and identifying disruptive opportunities, which can then be validated in the market and scaled.

Many of these more forward thinking organizations are also going further and approaching innovation much like classic venture capitalists. They are empowering external entrepreneurs by providing them with access to one or more privileged assets – for example, the logistics or supply chain data of an organization – to help them better understand their organization and its operations so they can create new innovations. To further incentivize the external entrepreneurs, the organizations often agree to fund and support the best ideas as external ventures, allowing the entrepreneurs to largely own the new idea they develop and to operate it on behalf of the funding organization. While there are risks to sharing privileged assets with people outside the organization and enabling them to own the ideas whose development the organization has funded, these leading-edge organizations believe the opportunities far outweigh those risks. The process alone also provides them another unique source of ideas and intelligence, better enabling them to sense the trends relevant to their industry, and more easily connect with non-employee talent.

Boards should inquire about their organization’s innovation culture and infrastructure, looking at who the innovation champions are in the organization, what innovation strategies they are pursuing, and how they support and nurture innovative ideas. Boards should also ask management to report on the way digital disruption is affecting their organization and its industry, and how they are responding to threats while also tapping and maximizing the many opportunities presented by this change.

# Technology

## Is your organization at risk of being a cyber-crime victim?



**Nick Galletto**  
Partner  
Deloitte Canada

“ Today, if your organization hasn’t yet been a victim of a cyber attack, it may have been and you haven’t realized it or there is a high probability that it will be a victim in the near future.

Every organization has critical assets that provide it with a competitive edge. Cyber criminals will target critical assets for financial and competitive gain, or for intelligence purposes. Many will succeed because the cyber criminal community is highly organized and very well-funded. It’s also very knowledgeable. We know the recent attacks that targeted financial institutions included people employed in that industry. Why? Because they understood the processes they needed to breach to gain entry.

In this environment, organizations need to proactively manage and monitor their environment. The last thing you want is for your customers to tell you that something has gone wrong and you’ve been a cyber victim. ”



### Questions for directors to ask:

- Does our organization have a strategy for security operations and is it proactively managing cyber threats? What steps has management taken to consistently identify emerging threats and automate and monitor our environment to protect the organization from such threats?
- How well does our organization track digital information? When we share that information with third parties, such as suppliers, are we confident their cyber security programs are at least as robust and effective as our own?
- How well do our people understand our cyber risks, and the nature of cyber attacks that may target them? Do our people need to be better educated about cyber security?
- Has management prioritized the organization’s assets – the key critical information that provides our organization with its competitive advantage – that may be the objective for a cyber attack? Is management managing the security of those assets effectively and the risks associated with them?
- Do we regularly report on the state of security within our organization? Has management identified key risk indicators and track progress? Are we improving our overall security posture? Does the board have visibility to this information?

As each new development in mobile technology, cloud computing, and social media further reshapes the technology landscape, cyber security is becoming an increasing complex challenge for organizations to manage.

What were sufficient computer security and data protection strategies only a few years ago – such as IT perimeter security, regular virus scans, and access management – are no longer enough. As organizations struggle to implement better security measures, many are falling victim to cyber attacks. A recent survey by the Ponemon Institute<sup>1</sup> found that the number of successful attacks on organizations more than doubled between 2010 and 2012 and the financial impact of the attacks increased by almost 40 percent. Organizations also risk reputational damage as a result of a cyber attack if their customers, suppliers, and others lose confidence in these organizations' ability to ensure the security and confidentiality of information they have provided to it.

Today, organizations of all types and in all industries are potential victims of cyber attacks. Some attacks are aimed at committing financial fraud. In other cases, the motivation may be social or political where "hacktivists" target organizations they believe take an unethical stance on certain issues. Regardless of the reasons, such attacks disrupt the normal course of business and cause significant financial and reputational harm. These attacks can also cause significant harm to the individuals whose information may be subject to the attack. The nature of these attacks may include denial of service, defacing web sites or exposing personally identifiable information or other critical strategic business intelligence outside of the organization.

Cyber attacks can be launched by anyone from individual hackers, activist groups, and business or industry insiders to criminal networks and foreign governments. What most of these attackers have in common is that they are well-organized and share both information and malicious software among themselves to help facilitate cyber attacks.

A growing number of cyber attacks target individuals, getting them to perform a specific action, for example, clicking on a link or attachment which provides the attacker with information, a point of entry into the organization's systems, or introduces malicious software into an organization's network. Preferred targets are senior executives who have access to strategic and highly confidential information and people with privileged access who know the passwords that attackers need to gain access to highly sensitive systems. Attackers often use social media to obtain information about their targets, building a profile on these individuals so that the attackers can create bogus messages that appear to be legitimate communications either from the organization or people known to the target.

Faced with well-funded, well-organized cyber attackers, organizations need to protect themselves by being proactive in gathering their own cyber intelligence. What an organization says about itself, the information that it makes available to its supply chain or other partners, and what it discloses to the public at large, may create a threat vector. Individual pieces of information may appear harmless, but collectively they could provide sufficient insights into the organization and its operations to be useful to a cyber attacker. This means organizations must also keep up to date on the threats faced by their industry, know what the underground community is saying specifically about their organization, and keep their exposure within acceptable limits.

An effective cyber security program should be overseen by the board of directors as part of its oversight of the organization's risk management activities. As with other risk programs, the board should set its expectations and accountability for management and ensure there are adequate resources, funding, and focus for its cyber security activities.

<sup>1</sup> Ponemon Institute ([www.ponemon.org](http://www.ponemon.org)) is a Michigan-based organization that conducts independent research on privacy, data protection, and information security policy.

# Productivity

## It's about doing better, not more



**Nicolai Andersen**  
Partner  
Deloitte Germany

“ Organizations in developed countries have comparatively high costs – salaries, materials, and so on. To compete globally, they need to be innovative, and that includes maximizing their productivity levels.

When the organization’s senior leaders talk about the performance of the organization, does that discussion also include their view on trends in the industry and how they are reacting to them? Are they on top of what is gaining speed and impact compared to what may be declining and no longer worth pursuing?

Most importantly, is the organization investing in productivity? Does it have the R&D and other resources to be agile in responding to changes in its market? ”



### Questions for directors to ask:

- How do we define productivity in our organization? Are we sure that that definition is aligned with and encourages activities that create value for the organization? Are we focusing, for example, on activities to drive down our prices when it would be better to build brand value and loyalty?
- What investments is our organization making to improve its capabilities to enhance productivity, and how do our investments compare to other organizations in our industry? Have weaknesses in any of our markets caused us to reduce our investments in recent years? If so, are we in danger of falling behind our primary competitors?
- Have we considered the impact of demographic changes on our organization? For example, if our organization requires workers with specialized skills and capabilities, will we be able to find new employees with the appropriate skill sets to replace our current skilled employees when they retire?
- Has management created an appropriate environment and culture that promotes productivity improvement? Who are the productivity champions in the C-suite?



Continuing technological advances, increasing global competition, high labor rates, aging populations in developed countries, and a variety of other factors are all reasons why productivity is becoming an increasingly important organizational topic.

For many organizations, it can also be a major challenge.

Part of the problem is that productivity isn't always well understood and, therefore, not well measured. Workers who believe increased productivity means "working harder for less pay" might be hesitant to adopt measures introduced to enhance productivity. Organizations that continue to define productivity in industrial-era terms – "doing more for less" – may be generating greater quantity rather than quality. "Doing better" would likely be a more appropriate goal for most organizations, though determining exactly what constitutes as "better" may be a nuanced definition, specific to the organization, its customers, suppliers, and value drivers.

Productivity may lag when organizations don't invest the appropriate resources in research and development, machinery and equipment, and information and communication technologies, as well as other "softer" capabilities needed to drive productivity, such as employee skills training and development. Some organizations deliberately hold off on making these investments, particularly when budgets are reduced, in an effort to improve short-term financial results. Other organizations, however, are unaware that they are under investing in productivity. They believe they are making the appropriate investments but are actually lagging in comparison to their peers – something that could be determined by comparing their investments to their industry norms.

Many organizations' productivity is inhibited by their own culture. Inefficient communications including an overload of emails, multiple and lengthy meetings, task assignments that come from multiple directions with conflicting priorities, and other activities that waste time can all disrupt productivity.

Productivity constraints may also be embedded in protocol. Requiring employees to do things "the way we've always done it" often perpetuates inefficient practices created in an era prior to the tools and technologies of today. Instead, organizations should revisit their protocols and practices on a regular basis with the objective of adopting leading practices wherever possible.

Finally, one of the biggest factors affecting productivity is ensuring that employees feel engaged and empowered to perform work that is clearly connected with their organization's strategy.

# Strategy

## Volatility isn't just economic when setting strategy



**Stefan Dierks**  
Partner  
Deloitte CIS

“ Today, organizations should expect their strategic choices to be challenged at any time by any known or unknown stakeholder. A major infrastructure development project that has been under development for years may suddenly be challenged just as it is nearing completion. Technology enables even the smallest groups to bring a lot of attention to an organization’s activities, which it may need to justify.

Boards have disruption on their side and should make use of it. Organizations should use unstructured data analytics to help them reduce uncertainty and turn unknown risks into known and manageable risks. ”



### Questions for directors to ask:

- What approach and timeframe does our organization take to strategic planning? Are we able to set viable longer-term plans and deliver on them over the short- and long-term? Does the organization have strategic initiatives in place that create platforms for future strategic options? Were the assumptions underlying our recent strategic plans accurate? When circumstances changed, were we able to adjust our objectives and plans quickly and effectively?
- Do we consider the public perception of our strategic choices and whether or not that perception may be changing? Are we prepared to explain our choices if the media were to suddenly draw attention to them? Are we prepared for the possible republication in the media of statements our organization made in the past?
- Is the board playing an appropriate role in overseeing strategy and the execution of its supporting plans? How timely is management’s reporting to the board on the organization’s progress towards achieving its longer-term strategic objectives and its shorter-term tactical ones?
- What analytical tools are used to inform the board, and are they kept up to date? How well does our organization make use of technologies to broaden the view of the board and reduce the unknowns? How agile is our organization in quickly seizing opportunities created by digital disruption?

The challenges created by economic uncertainty when setting a longer-term strategic direction for an organization are not new – organizations have been facing such an environment since the 2008 financial crisis. What is new, however, are the approaches a growing number of organizations are taking to make their strategic planning more nimble by building in greater robustness and flexibility.

These organizations have adopted a dual timeframe for strategy development and execution. They continue to set a longer-term strategy for the organization that sets out aspirational objectives that describe where they want the organization to be in five years' time. That longer-term strategy direction is then supported by a series of shorter term strategic initiatives that focus specifically on things the organization can do in the next six months that will significantly move it forward towards realizing its longer-term objectives in what might be considered a strategic version of rapid prototyping.

The use of strategic initiative timeframes is not intended to be a substitute for a long-term strategy. Instead, they are a way to prioritize efforts towards achieving the longer-term direction by helping organizations better identify and focus on activities that are much more tangible and precise than those that can be built into plans that extend over multiple years. They also help better ensure that the assumptions underlying both the strategic initiatives and the organization's longer-term strategic plan are also real and accurate since the organization has the opportunity to retest and, when necessary, adjust its assumptions on a regular basis. Each "closed" initiative constitutes a new platform on which to develop future initiatives, greatly expanding the organization's options for strategic direction and correction.

When organizations utilize a dual timeframe for setting and executing strategy, the board's role typically evolves from approving the strategic intent of the organization's base plans to also being involved with reviewing and approving the strategic initiatives and their underlying assumptions. As a result, many boards are getting closer to overseeing the execution of their organization's strategy and are in a much better position to identify assumptions and initiatives in need of correction. To do so, however, board members need to have a sound understanding of the operating metrics that have the most significant impact on long-term value creation and be able to balance short-term needs and long-term requirements.

Sudden economic change isn't the only factor that may disrupt organizations' longer-term strategic plans. Today, the once relatively stable stakeholder environment is becoming volatile. The expectations of existing stakeholders may change quickly, while new stakeholder groups with new priorities may emerge at any time. As a result, organizations and their activities are under the close scrutiny of a public that, more than ever before, is judging them in terms of whether or not they are perceived to be acting ethically and morally – a perception that may change from one jurisdiction to another. Through social media and other technologies, even small groups can quickly focus widespread attention on an organization, requiring it to justify strategic choices made now or in the past – and public statements, once made, may reappear in the media at any time.

In this environment, when public perception and economic conditions can change suddenly, boards should revisit their organization's strategy frequently to ensure it continues to be aligned with the risks, opportunities, and other circumstances facing the organization.

The good news for boards is that they have another disruption on their side: technology. The use of big, unstructured data analytics can enable organizations to identify relevant patterns in an otherwise overwhelming flow of data and events, enabling the organization identify potential "black swan" and other previously unforeseen risks. Boards should determine how effectively the organization is making use of data analytics, and whether these technologies can help broaden the board's perspective of the key issues facing the organization and its strategic choices.

# Growth strategies

## Is your organization aligned for growth?



**Gerhard Vorster**  
Partner  
Deloitte Australia

“ With the blurring of boundaries and greater convergence of industries, in order to understand what the next big thing will be in your industry, you’ve got to spend some time outside it.

Boards need to understand the major trends affecting their organizations. These include macroeconomic trends, as well as trends in management, leadership, KPIs to be measured, and so on.

The board should also have clear visibility of the portfolio of new initiatives being pursued by the organization, and should take responsibility for creating an environment where the development and pursuit of these initiatives are encouraged and supported.”



### Questions for directors to ask:

- How well aligned is our organization with the world’s top growth markets? Are there opportunities to better align our organization with these markets?
- What are management’s assumptions about the growth of our organization and our industry? Looking back over the past five years, how well have management’s assumptions matched what actually occurred?
- Is our organization taking steps to maintain the growth potential of our core businesses? Are we investing sufficiently in important areas such as training employees, maintaining our technology infrastructure, and considering strategic partnerships with other organizations?
- How well does management recognize potential digital disruptions in our organization and our industry? When things change, are we confident that we’re not addressing the symptoms of that change – changes in customer demand, profitability, etc. – rather than responding to the fundamental changes in growth opportunities?
- How well has our organization maintained and improved productivity – of people, capital, and productivity and innovation over the past five years?

**G**lobal GDP growth is accelerating according to the Organization for Economic Co-operation and Development, which forecasts 2.7 percent growth for 2013, 3.6 percent in 2014, and 3.9 percent in 2015.

An organization's ability to grow will depend largely on the markets in which it chooses to compete and operate. Organizations that are able to more closely align themselves with countries or industry sectors that grow faster than the global average will almost certainly experience stronger growth rates than those that serve in markets growing at the same pace or slower than average. There is, however, some good news for organizations in slower growing markets – digital disruption may be creating opportunities for them to reinvent and reposition themselves provided they are able to recognize the trends and take advantage of them.

Since the 2008 financial crisis, many developed market countries have experienced some of the weakest annual growth rates since the Great Depression. On the other hand, emerging markets such as Brazil, China, India, Indonesia, the Russian Federation, and South Korea maintained stronger domestic growth rates, and while their growth has slowed recently, these countries are still expected to account for over half of the world's economic growth by 2025, according to the United Nations.<sup>1</sup> Already, the growth of large middle classes in these countries is changing global opportunities in many industries, as this new affluence is creating increased demand in areas such as tourism, education, and wealth management.

Health care services are also expected to grow significantly. The aging populations in developed countries will increase the demand for health and a wide range of health-related, accessibility, and other support services in those nations, as will the growth of a more affluent population in emerging markets.

With the United Nations predicting the global population will grow to 9.3 billion by 2050, an organization's success will increasingly be linked to its ability to operate sustainably. Agribusiness, food security, and significantly improved water conservation practices will become increasingly important. Energy will also continue to experience strong growth, especially in the areas of clean energy and alternative fuels, such as agri-fuels.

Some industries, including retail, financial services, professional services, and real estate among others, are already showing signs of being particularly prone to digital disruption. Many organizations in these industries are seeing their revenue streams and cost structures becoming significantly disrupted, in turn disrupting their business models. The challenge for their boards and management is to recognize when this disruption is occurring. Organizations that get stuck in the business dynamics of the past may find themselves trying to increase productivity in order to arrest declining growth margins while not recognizing that it is the fundamental disruption in their business model that has moved them out of sync with their customers.

<sup>1</sup> [http://esa.un.org/unpd/wpp/other-information/Press\\_Release\\_WPP2010.pdf](http://esa.un.org/unpd/wpp/other-information/Press_Release_WPP2010.pdf)

# Leadership

## Developing the leaders of tomorrow



**Heather Stockton**  
Partner  
Deloitte Canada

“Every organization needs leaders capable of setting the appropriate tone at the top, working collaboratively to build cohesive teams among people from diverse backgrounds, and influencing and inspiring the organization’s broader workforce to successfully execute the organization’s strategy.”

Organizations aren’t static, and the best leader for today likely won’t be the best one for tomorrow. That’s why organizations need to be as predictive as possible about the leaders they need in future, and need to continually revisit and retest these assumptions to keep them aligned with where the organization is today and where it is going.”



### Questions for directors to ask:

- How well do we, as a board, understand how well our organization is executing its succession plan? When we discuss succession planning with management, is it a stand-alone topic or do we discuss it within the context of the organization’s current strategies? How often do we discuss succession planning?
- Does our organization have a well-defined profile of the kind of leaders it needs for tomorrow? Are we capable of developing those leaders in-house, or will we need to recruit from outside the organization? If we expect to look outside the organization, do we maintain an up-to-date list of potential candidates?
- How successfully have we transitioned leaders in the past? How does our organization’s performance compare to that of our primary competitors?
- How effectively does our organization transfer to its leadership candidates the knowledge our CEO and other senior executives have of our organization, its customers, products, and key markets?

Every day, the daily news contains stories about organizations that have had problems sustaining their operations, seen a key initiative fail, or had trouble delivering expected results. Often, those problems arose from, or were exacerbated by, ineffective leadership.

Ensuring that the organization identifies and develops the right leaders – both for today and in the future – has always been one of the board’s top responsibilities. In today’s environment, leadership development and succession is becoming more important than ever, not just because of diminishing CEO tenures, but also because the leaders of the future will be much different than the leaders of today or the recent past.

Leadership is about driving organizational behavior. The best leaders are those who bring people from differing backgrounds together in an environment where they will work effectively as a team to achieve common, shared goals. A decade ago, most leaders took a hierarchical “command and control” approach to leadership – they set strategic objectives and then pushed them through the organization to realize results. While such an approach has its benefits, notably clear accountabilities, it is not the best way to get the organization’s entire workforce to take ownership of and become passionate about achieving the organization’s strategic objectives.

For that reason, today’s leaders are increasingly motivators; people with the ability to influence others to achieve a collective objective, even though the individual approaches taken to get there may differ.

The leadership approach has changed the dialogue around the management table to one of collaboration and contribution. Leadership teams need to be able to engage in healthy debate, without creating winners and losers, in order to build alignment around the best choices for the organization. Yet, leaders must also be decisive. When necessary, they must be agile and bold enough to make decisions quickly to respond to sudden regulatory issues, changes in customer demand, market pressures, and so on.

In this environment, boards need both more oversight and more insight into the way the organization is executing its leadership succession plan. As part of this, the relationship between the board and CEO is moving from a reporting relationship to an ongoing conversation, in which the board and CEO work collaboratively to discuss strategy, results, and risks, and the impact that has on the organization’s leadership pipeline. When new talent comes into the organization – either as a specific hire or part of an acquisition – boards are increasingly looking at the success these individuals have in the organization, and whether they are contributing what was expected of them.

Increasingly, boards want fact-based assurances that the organization has the leadership bench strength it needs to be successful over the next five years, and ensure that the leadership profile is flexible and adapted to reflect changes in the organization, its markets, and other circumstances.

# Regulatory

## The pace of change continues



**Consuelo Hitchcock**  
Principal  
Deloitte United States

“ When directors review their organization’s disclosures, they should step back and look at the total picture to determine how well the organization is telling its story.

It’s easy to get focused on ticking the boxes – making sure the organization complies with all the disclosure rules set out by the regulators. It’s also important to ensure that the organization is providing the information its shareholders need in order to make investment decisions.”



### Questions for directors to ask:

- How closely do we, as a board and as an organization, track the regulatory proposals that may impact our organization? Have we assessed how these proposals, if and when they are implemented, will affect us, including the steps we may need to take to be able to comply with them?
- Are we satisfied with the role our organization plays in providing input to regulators about their proposals? Do we need to become more active in order to ensure that the rules being put forward can be implemented without undue duplications of existing effort?
- What is our position around the voluntary disclosure of information being requested by specific stakeholder groups? Do we include it in our required filings, disclose it separately or not disclose it at all? If we do disclose it, how do we ensure that we are satisfying reasonable stakeholder requests without unduly distracting readers from the story we want to tell about our organization?
- Despite the increased volume of required and voluntary disclosures, are we satisfied with the completeness of our disclosure? Are our disclosures as helpful and understandable as they could be, or is our organization one of those that takes a checklist approach to disclosure?



Legislators and regulators around the globe have implemented a wide range of new disclosure requirements over the past decade, and the pace of regulatory change shows few signs of abating in 2014.

While relatively few unexpected new initiatives were put forward in 2013, the trends from previous years continued without losing pace. Regulators and stakeholders in many jurisdictions are continuing to focus on the relationship between auditors and their clients, including the audit committee's role in overseeing the outside auditor. There has also been an increasing focus on information provided by the auditor about the audit, which includes proposals by many standard setters to expand information provided about the company's audit in the annual auditor's report.

In addition, disclosure initiatives that a few years ago may have appeared to some to be a passing fad – for example, community social responsibility and sustainability reporting – are becoming more widely adopted and formalized.

Another trend from recent years that does not appear to be losing pace is the growing pressure for organizations to address social imbalances – such as the number of women on their boards – and to respond to activist concerns by disclosing information about things such as the organization's political contributions, executive pay ratios, use of conflict minerals, use of offshore tax havens, and so on.

Given the number of new required and proposed disclosures, it is not surprising that the size of many organizations' annual reports and related disclosures have grown significantly over the past decade. But while the volume of information being disclosed has grown, many regulators are concerned that the usefulness of that information has not increased at the same rate.

"The risk is that annual reports become simply compliance documents, rather than instruments of communication," said Hans Hoogervorst, chairman of the International Accounting Standards Board (IASB) in June 2013. "Many preparers will err on the side of caution and throw everything into the disclosures. They do not want to risk being asked by the regulator to restate their financials. And sometimes, it's just easier to follow a checklist rather than put in the effort to make the information more helpful and understandable."

In addition to the IASB, other regulators including the Financial Accounting Standards Board, Securities and Exchange Commission, and the UK Financial Reporting Council are all focusing on measures to reduce excessive disclosures. Organizations can proactively address this issue themselves, by carefully considering the information they disclose. While material items must be included, organizations should take greater care to exclude insignificant details in order to more clearly present their story.

Each year, regulators issue for public comment proposals and concept releases related to required disclosures. While some industry groups and individual organizations actively participate in this process, most individual organizations do not. Boards should consider whether they and their organizations should more closely watch and participate in this debate, either directly or through industry or other business organizations.

# Integrated reporting

## Are you telling your story...the whole story?



**Nina le Riche**  
Director  
Deloitte Southern Africa

“What counts is whether or not a report reaches the targeted audiences and can help create value through better explaining the activities, value system, and behavior of the reporting company. It is key that the report provides the information that captures all of the organization’s relevant business sustainability issues.

Integrated reporting promotes the need to answer the important questions around long-term value creation – and in a world where economic instability and longer-term sustainability threatens the wealth and welfare of society in general, this further push towards improved corporate transparency is definitely welcomed.

Trust in an organization is achieved through transparent behavior and is a key success factor for the business to operate, innovate and grow.

Clear values, principles, and objectives overseen by solid governance structures should lead to clear reporting on values, management practices, and performance.”



### Questions for directors to ask:

- How well do we, as a board and as an organization, understand integrated reporting? Have we considered how it may benefit both the board and management in better understanding our organization, including determining how well our strategies and business models are creating longer-term value?
- What are our shareholders’ and other stakeholders’ expectations? Have we considered how integrated reporting may provide them with a clearer, longer-term picture of our organization and its ability to create value?
- If our organization provides a sustainability report, how effectively do we integrate it with our financial reports? Do we follow a recognized sustainability reporting framework so our report will be comparable from one year to the next and between our organization and others?
- Are we as a board and our key stakeholders’ satisfied with the validity, accuracy, and completeness of the information provided in our sustainability report?
- Do we understand how the full adoption of integrated reporting might affect the board, including the liability of directors and officers?

## The world's continuing transition to International Financial Reporting Standards has marked a major change in financial reporting, but an even bigger change is on the horizon.

For decades, organizational performance has been measured primarily in financial terms that depicted the organization's use of its own assets. Today, however, investors and other stakeholders recognize that an organization's ability to create and sustain long-term value also reflects its use of other resources, such as human, environmental, or intellectual capital.

The International Integrated Reporting Council (IIRC) has published an integrated reporting <IR> framework, which proposes six measures of capital (or resources): financial, manufactured, intellectual, human, social, and natural. An organization's use of all of these capitals are to be combined in a single report that delivers a more holistic and complete view of the organization's performance, providing stakeholders with a greater understanding of its business and strategy.

To date, South Africa is the only country where integrated reporting is mandatory. Other countries are also expected to adopt integrated reporting, though their timing may be affected by various economic, political, social, and other factors. Nevertheless, many organizations outside South Africa are already taking steps towards integrated reporting, recognizing that traditional financial reports only measure the organization's use of its assets in monetary terms. Integrated reporting, which also discusses the social and environmental issues related to the organization's strategic decisions, better enables the organization to tell its full story and explain to stakeholders how it used all of its capitals. This, combined with transparent disclosure of the organization's governance, risk, and ethics management practices, provides a more holistic view of the longer term investment case.

Far from being just another compliance exercise, many organizations view integrated reporting as a process that helps them better identify and respond to opportunities, risks, and changes in their operating environment; achieve competitive advantages through cost savings, operational efficiencies, brand differentiation, and innovation; improve stakeholder relationships by better addressing stakeholder needs and expectations; and better align and simplify their internal and external reporting.

A survey by Black Sun<sup>1</sup> and the IIRC of the 93 organizations in 25 countries that participated in a pilot program found that 93 percent of the organizations indicated that integrated reporting helped them overcome silos between areas such as IT, investor relations, finance, strategy, and corporate communications. In addition, 98 percent of the organizations believe integrated reporting will lead to a better understanding of how the organization creates value, and 95 percent said it will contribute to a better understanding of the organization's business model and help them focus on the right performance indicators.

Since integrated reporting will continue to evolve, boards of directors should ensure that the organization's strategy and its ability to create value in the short, medium, and long term is well defined and measured. Boards should consider whether the organization has the reporting infrastructure to gather all of the required information and the ability to combine that information in a meaningful way – both for reporting purposes and to better support management decision-making.

Boards should also consider how integrated reporting can help the board and the organization build stronger relationships with stakeholders. Because integrated reporting allows for further transparency in its activities and provides stakeholders with a better understanding of the organization's activities, it will lead to clearer performance expectations, less uncertainty, and with that a potential reduction in cost of capital.

<sup>1</sup> *Understanding Transformation: Building the Business Case for Integrated Reporting*, 2012, Black Sun Plc

# Taxation

## Could tax be dangerous to your brand's health?



**Albert Baker**  
Partner  
Deloitte Canada

“Tax law is very complex and tax has often been viewed as a black box, a complicated area that many boards didn’t delve into in the past. That’s changing. Boards recognize they need to understand more than just what the technical risks are, but also the potential reputational risks.

Organizations should begin looking at the OECD *BEPS* proposals and other tax domestic proposals – such as tax reform in the United States – with the objective of getting out in front of them to understand the potential impact of these new rules on their organizations, from a business, financial, tax, and legal perspective.”



### Questions for directors to ask:

- Are we getting enough information about our organization’s tax practices to fully understand all of the potential technical and reputational risks associated with them? Does management need to provide the board with more detailed information about the organization’s tax practices and tax developments that may affect our organization?
- Do we understand our organization’s tax position both in our home jurisdiction and in other countries in which we operate? Are we comfortable with where our organization has positioned its tax practices?
- Are we tracking more than just BEPS-related initiatives and also considering the potential impact of other tax initiatives, such as U.S. tax reform, Canada’s “treaty shopping” initiative, and other domestic law developments?
- Have we examined our tax strategies in light of the way they may be perceived by our stakeholders and the general public? Is there a risk that they may be misunderstood or create a potential for activism and, if so, are we prepared to defend our tax practices? Have we determined the potential financial and reputational impact such activism might have on our organization?

Tax has become a noisy subject – in public, in politics, and in the press. In the United Kingdom, in particular, action groups and the media have drawn attention to the tax strategies employed by multinational organizations that they feel are failing to meet their societal responsibilities by paying “too little” tax. In this environment, even the most benign and commercially legitimate tax planning practices are being portrayed as egregious.

In July 2013, the Organization for Economic Co-operation and Development (OECD) presented an *Action Plan on Base Erosion and Profit Shifting (BEPS)* at the G20 Finance Ministers’ meeting in Moscow. The OECD plan sets out 15 areas to be addressed by new working groups, which are expected to issue their initial reports beginning in early 2014.

The OECD’s objective, with support from the G20, is to have countries adopt a common platform regarding international taxation, thereby eliminating competition between countries based on income taxes. The measures the OECD are proposing will remove some of the sovereignty that countries now have related to income taxes. For the OECD plan to succeed, all countries must agree to adopt the new rules, which will require them to change both their domestic laws and all of their current tax treaties. Since that could be a lengthy process, the OECD is proposing a novel and untried approach of enabling countries to implement a multilateral instrument that would change all of their tax treaties with one measure. Time will tell whether or not all countries will agree to accept the OECD’s plan, and whether the multilateral instrument will prove to be an effective way to amend their tax treaties.

At a minimum, multinational organizations should prepare for an increase in documentation and disclosure requirements. There is a wide-ranging agreement among countries that a high-level map of profits and taxation would help with risk assessments. Organizations and countries are aware of the potential dangers, such as the possible misuse of confidential information, and, as a result, finding safeguards will need to be part of the OECD’s action plan.

At a time when an organization’s tax affairs are in the media spotlight and tax authorities are actively engaged in curtailing perceived abuses, it is essential that organizations implement a robust tax risk management program. Such a program should

ensure the organization’s tax planning is well founded in the law, but the organization must also understand how its tax planning may be perceived in the court of public opinion.

Determining the organization’s tax management strategy is a responsibility that should be undertaken by the Chief Tax Officer and CFO together with the board of directors. They need to ensure that the organization achieves strong financial results that are appropriately measured while employing appropriate governance practices in relation to its tax affairs. A key issue for the board and management to determine is where they want to position their organization on the spectrum of tax planning strategies:

- To follow practices that will never be challenged by the tax authorities, which may result in the organization paying a higher effective rate of tax but avoiding disputes with tax authorities and any negative publicity;
- To follow practices that are legal and take full advantage of tax-saving opportunities, but which will knowingly result in challenges from tax authorities that will need to be settled with them or in the courts, while also possibly attracting unfavorable attention from the media and other stakeholders;
- To follow practices somewhere between the above two extremes.

A potential outcome of the OECD’s project is that multinational organizations that have, for example, taken advantage of the tax incentives available in a particular a country in return for operating in that country may find these arrangements are no longer effective. Boards should carefully determine which of the organization’s tax structures might be affected and in what countries. Boards should ask management to determine the potential impact on the organization’s effective tax rate as well as on its financial statements.

# Board composition

## Balancing diversity and expertise to maximize board effectiveness



**Daniel Aguinaga**  
Partner  
Deloitte Mexico

“ Although a growing amount of attention is being given to the diversity of the board, the key issues for the board remain the same: Do we currently have the right mix of talent and expertise on the board? And, do we have access to the top candidates in order to refresh the board’s membership?

Boards need to have a clear understanding of the expertise, experience, and other attributes they require of their directors. A well defined and regularly updated board ‘profile’ is an essential tool to use for recruiting and building an effective board.”



### Questions for directors to ask:

- How diverse is our board? Does the diversity of our board match the requirements of regulators or the expectations of our stakeholders? Do we measure diversity solely in terms of gender, or do we consider other aspects of diversity? Should the board have a formal diversity policy?
- How effective is our board? Are we recruiting directors with the experience, expertise, and education needed for the collective board to address the key issues facing our organization? Do we need to broaden our search for director candidates beyond the communities from which we have traditionally recruited in order to bring a wider skill set to the board?
- Do we have an effective board evaluation process that examines the performance of the full board, its committees, and individual directors? Do we use the outcomes of this assessment to create a board profile, and regularly update and compare that profile to the desired qualifications for the board?

Regulators, shareholders, and other stakeholders have long expected boards to be comprised of directors with an appropriate range of expertise to be able to effectively address the challenges facing the organization. Increasingly, they also expect the board to reflect the diversity of their broader stakeholder group and even society in general. A growing number of jurisdictions are encouraging – and some, particularly in Europe, are mandating – quotas regarding the percentage of women required on the boards of organizations.

Many boards may find these new diversity requirements to be a significant additional challenge to the already complex task of managing board level qualifications. For example, boards of smaller organizations, or of organizations with a controlling shareholder, often find it difficult to recruit a sufficient number of independent director candidates with the required expertise and willingness to join them. Many boards also have difficulty managing the transition of their directors, with the result that directors whose tenures have lasted decades may have come to perceive a seat at the board table as their right.

While regulators and stakeholder groups are focusing on increasing the percentage of women on boards, diversity entails many more perspectives including ethnicity, age, experience, education, and professional expertise. Some studies of board diversity have found that boards whose members reflect all of these measures of diversity may be higher performing than boards that are less diverse.<sup>1</sup> Greater diversity can help contribute to better decision-making by the board because it reduces the risk of groupthink or expert overconfidence that may be found among more homogenous boards. Such boards may also be able to generate new ideas faster, or bring ideas together in new and better ways, because of the broader insights achieved through greater diversity.

The economic, regulatory, technological, and other changes occurring across industries and markets are creating additional challenges for boards. Boards whose directors had the appropriate range of expertise and experience just a few years ago may no longer be optimally aligned to address the depth and range of issues facing their organizations today. As a result, many boards need to revisit and refresh their membership much more frequently than in the past, not only so the board can continue to address all

facets of changes created by the organization – for example, a shift in strategy – but also changes occurring outside the organization, for example, through the proliferation of social media.

The key to understanding the board's skill requirements, and recruiting candidates with the expertise to fill any skill gaps while retiring directors whose skills are less aligned with the board's needs, is through regular board effectiveness assessments, conducted by the board or a third party. A board profile that is regularly updated to reflect changes in the organization's strategies, industries, markets, stakeholders, and other factors can be used by the board's nominating committee to assess and compare director candidates.

When a need has been identified to bring new qualifications to the boardroom, boards may wish to consider using a third party board recruiting agency to help identify appropriate director candidates. Based on the board's qualifications needs, the agency identifies potential directors, which are presented to the board – sometimes in a “blind” process. This entails having the candidate's resumes show only their experience and expertise, but are cleansed to avoid unconscious biases.

By engaging in productive conversations with their various stakeholders, boards can gain a clearer understanding of their shareholders' and stakeholders' expectations, and at the same time communicate to them about the organization and its strategies and objectives. Such a conversation may also enable the board to discuss its board profile and explain the need for the expertise, experience, backgrounds, and diversity considerations it seeks among its board members.

<sup>1</sup> Anderson, R., D. Reeb, A. Upadhyay and W. Zhao, 2011, The economics of director heterogeneity, *Financial Management*, 40, 5-38.

# Recognizing and responding to disruptive change

The articles in this publication cover some of the opportunities and risks created by the dramatic changes occurring in the global business environment. Disruptive change will affect every industry, though not always in the same way or at the same time. Some industries are already experiencing significant change, while others may not do so until some point in the future. Similarly, in some sectors changes will be greater than they are in other sectors.

To respond effectively to the changes occurring outside their walls, most organizations will need to make internal changes, and often those will include changes at the board. To address a new business reality, boards will often need a different mix of collective expertise and knowledge if they are to successfully understand, address, and respond to all of the issues facing their organization. Many will also need to become more diverse. Boards need directors with differing cultural backgrounds, genders, and ages to not only reflect the diversity of the organization's stakeholders – especially at a time when they are under greater public scrutiny – but also to bring wider points of view to boardroom discussions.

As discussed in this publication, many boards are extending their oversight into new areas, while also examining issues in greater depth. While board education programs have always been important, they are particularly so at a time when directors need to quickly get up to speed with complex new issues, and keep their knowledge current as those issues evolve. As they discuss highly specialized matters, boards should also seek the advice of subject matter experts, both from within the organization and outside it.

Recognizing when disruptive change is occurring and responding effectively will be a challenge for many organizations. We hope the articles included in this publication will help your board succeed in this environment and serve as a catalyst for discussion at your board meetings. We encourage you to contact your Deloitte partner to continue the conversation.



# Resources

## Board Composition

- Consejeros independientes en empresas familiares (Deloitte Mexico)
- The Talent-Intelligent Board: The Essential Resource (Deloitte Global)
- Women in the boardroom: A global perspective (Deloitte Global)

## Growth Strategies

- Connected Small Businesses: How Australian small businesses are growing in the digital economy (Deloitte Australia)
- Growth Strategy and M&A: Environmental Issues Impacting Strategic Decisions (Deloitte United States)
- Making risky growth choices (Deloitte United States)
- UK Futures: Big business optimism returns (Deloitte United Kingdom)
- Bridging the Gap: M&A (Deloitte United States)

## Innovation

- Business Trends 2013: Adapt. Evolve. Transform. (Deloitte United States)
- Millennial (Generation Y) Innovation survey (Deloitte Latin America)
- Ten Types of Innovation: The discipline of building breakthroughs (Monitor Deloitte)
- The Deloitte CIO Survey 2013: Reconnect. Rebuild. Reimagine. (Deloitte Ireland)
- Tracking the trends 2014: The top 10 issues mining companies will face in the coming year (Deloitte Canada)

## Integrated Reporting

- In Focus — The IIRC releases the International Integrated Reporting <IR> Framework (Deloitte Global)
- Integrated Reporting: The New Big Picture (Deloitte United States)
- Telling the story of long term value creation: Insights to the IIRC's Integrated Reporting Framework Consultation (Deloitte South Africa)
- The era of sustainability disclosure (Deloitte United States)

## Leadership

- Human Capital Trends 2013: Seven crucial leadership conversations critical to future business success (Deloitte United States)
- Impact 2013: Summary Report (Deloitte United Kingdom)

## Productivity

- Gov on the Go (Deloitte United States)
- Supply chain resilience: A Risk Intelligent approach to managing global supply chains (Deloitte United States)
- The future of productivity A wake-up call for Canadian companies (Deloitte Canada)

## Regulation

- Enterprise Compliance – the Risk Intelligent approach (Deloitte United States)
- Governance in brief: Audit reports to be more informative (Deloitte United Kingdom)
- In Focus: Compliance Trends Survey 2013 (Deloitte United States)
- Performance (Deloitte Luxembourg)
- Regulatory radar (Deloitte Belgium)
- The audit committee reporting season: New rules or a new regime? (Deloitte United Kingdom)
- The year ahead: regulatory focus in 2013 (Deloitte Australia)

## Strategy

- Dynamic Strategy Implementation: Delivering on Your Strategic Ambition (Deloitte United States)
- Balancing the risk-return equation (Deloitte Global)
- Describing your strategy and business model (Deloitte United Kingdom)
- Exploring Strategic Risk (Deloitte United States)
- Finance business partnering. Making the right move (Deloitte Ireland)
- Shaping a Risk Intelligent strategy: Confronting assumptions to find risk and opportunity (Deloitte United States)
- The rewired customer: Ready. Set. Change. Repeat. (Deloitte United States)
- The Three Rules: How exceptional companies think (Deloitte United States)

## Taxation

- OECD Releases Action Plan on Base Erosion and Profit Shifting – July 2013 (Deloitte Ireland)
- Responsible Tax: Sustainable tax strategy (Deloitte United Kingdom)
- Risk Angle: Five questions on corporate tax (Deloitte Global)
- Tax governance: Bringing tax strategies into focus (Deloitte United Kingdom)
- Tune into the Topic: Global debates on Responsible Tax, Anti-avoidance, and BEPS (Deloitte Global)

## Technology

- Cybersecurity...Continued in the boardroom (Deloitte United States)
- Enabling a world leading digital hub (Deloitte United Kingdom)
- Irish Information Security and Cybercrime Survey 2013. (Deloitte Ireland)
- Is the Cloud Within Your Reach? (Deloitte United States)
- Risk Intelligent governance in the age of cyber threats (Deloitte United States)
- The Connected Workplace: War for Talent in the Digital Economy (Deloitte Australia)
- The scale paradox: Analytics disrupts the size factor (Deloitte United States)
- TMT Predictions (Deloitte Global)
- Technology Fast 50 (Deloitte United States)



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