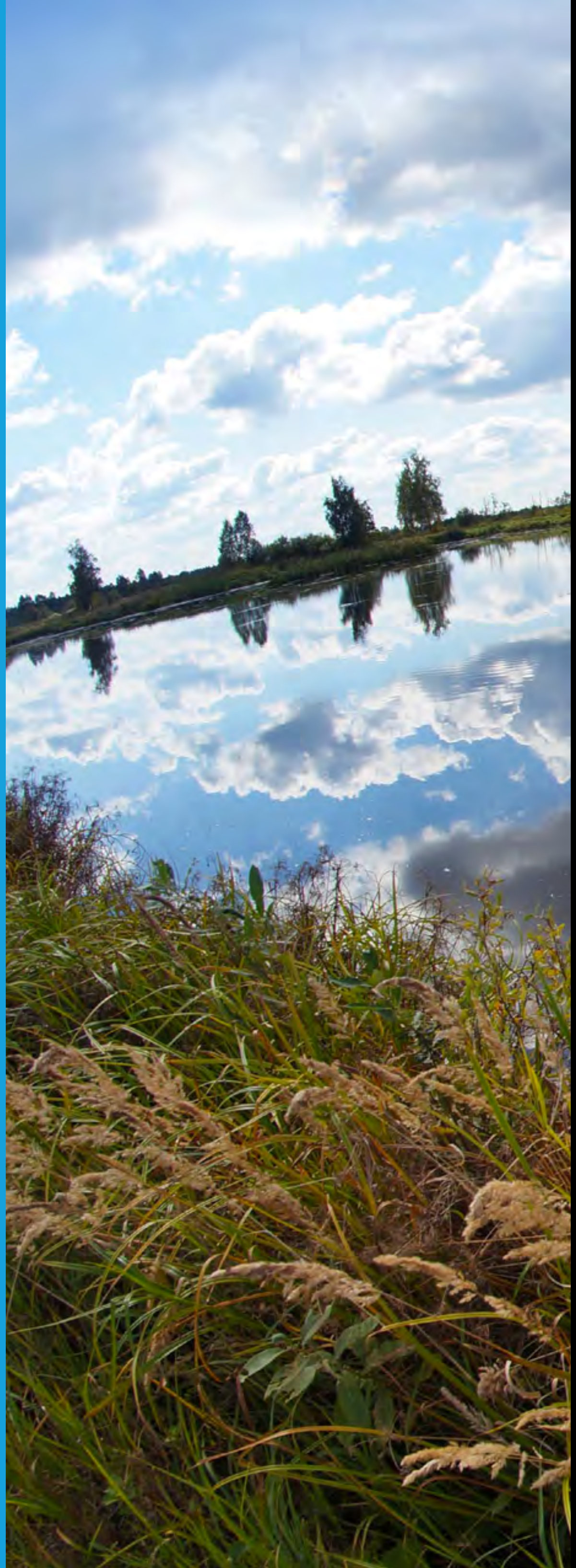
Family office

Family offices have a unique opportunity, and a particular responsibility, to help the families they serve be aware of and prepared for inevitable challenges that arise on the global stage. Whether the result of political and legislative divisiveness, economic or social changes, scientific or technological developments, or a host of other factors closer to home, these challenges can impact family offices and the families they serve, both in the short term and in years to come. In Deloitte's 2017 essential tax and wealth planning guide, we discussed one of these issues: **Fraud in the family office**. Now is a good time to take a fresh look at other important issues family offices could face in coming years and how to prepare for them.



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Preparedness: The death of a principal

Death, unsurprisingly, is a sensitive topic for most people. Yet it raises a significant question for family office executives: How prepared are they and the family office organizations they oversee to address the implications of the death of a principal?

It is an important question because family office executives are likely to be called upon to handle the aftermath. And they are uniquely positioned now to prepare the organization and the family they serve for the disruptions and transitions inherent in a principal's death. By gaining a new perspective on the many issues arising from the death of a principal and being able to assemble the appropriate resources to address them, family office executives have a unique opportunity to support the family and family office during an inevitable time of transition.

The death of a principal doesn't just disrupt the immediate family. Often there are ties to businesses, communities, philanthropic organizations, states, and countries other than where the principal is domiciled, and of course, to the family office organization. All of these ties can be disrupted with potentially profound implications postmortem, especially if there are liquidity implications that could arise following the death.

Some matters may be time sensitive, requiring financial or regulatory filings. Others may take months or years to resolve. Without a detailed preparedness plan, a postmortem resolution process can become chaotic when it should be orderly. It can be more costly and time-consuming than it otherwise might be. Most of all, it can extend and heighten the inherent disruption to the family, family businesses, and the family office during an already difficult period.

Preparedness: The death of a principal

An emerging leading practice for family offices is a series of exercises that can put the family office, family advisers, and the family itself in an effective position to address issues arising from the death of a principal in a timely and effective manner (figure 1). These exercises identify gaps in knowledge, documentation, staffing, and other areas. They also lay out a plan that shows the critical path of steps to be taken after the death of the principal.

Figure 1. Preparedness exercises

- 90-day drill
- Mapping estate administration period
- Family and entity goals and governance
- Financial preparedness
- Asset and liquidity education for heirs
- Risk mitigation

A **90-day drill** and **mapping of the estate administration period** are important because they identify necessary financial, accounting, legal, regulatory, and administrative actions to be addressed following the death of the principal, as well as the staffing requirements to accomplish these actions.

Goals and governance planning is vital for the family, the family office, and any related businesses. It includes developing succession plans to identify the right people for required roles and address structural items associated with family businesses, the family office, and other related entities. Key areas of emphasis are:

- Rallying the family around a shared vision of the future
- Defining the family office's role in carrying out that vision
- Helping the family develop and deploy a plan for carrying out the principal's philanthropic goals, if any
- Preparing plans to address the operation of the family business, family office, and other related entities postmortem
- Identifying who will be the successor in charge of the business and who will manage business operations day to day
- If the business is to be sold, aligning the family on a plan for the disposition process and preparing to address financial and tax-related issues
- Establishing and clearly communicating a plan for the family office postmortem, whether it will continue to serve the family, be divided into two or more family offices, or wrap up operations over time
- If there is an existing or planned family foundation, preparing it to accept (or dispose of) transferred funds and operate in the way the principal envisioned

In each instance, it is important that the family and existing entities have structures in place so they are prepared to operate effectively upon the death of the principal and to carry out the wishes of the principal and family.

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Preparedness: The death of a principal

Financial preparedness is essential on many levels.

A **cash flow and liquidity review** can help determine, based on assets and income streams, whether family needs can be met immediately following the death of the principal and longer term. This involves understanding what cash flow and expenses are expected, what transfer tax liabilities there might be, and what liquidity events or income streams are expected to be available.

A **business entity implications exercise** projects what domestic and foreign business-related financial consequences of the principal's death might be expected and develops action plans to address them.

Asset disposition is an analysis of how assets will be held, disposed of, or distributed postmortem. This includes valuing and planning for the disposition or distribution of large equity positions, real estate holdings, closely held businesses, and hard-to-value and illiquid assets.

Risk mitigation planning can encompass a range of risk and resilience capabilities, including assessments for fraud, cyber, and audit-readiness risks (see separate sections that follow). Beyond protecting and preserving the family's wealth and reputation, these exercises can help family offices identify and develop risk-related considerations for value creation.

Assets and liquidity education for heirs can help the family office develop a plan to inform and educate heirs about the family's holdings, the portion they might receive upon the death of a principal, and how to protect, sustain, and grow their assets.

In summary, few events in the life of a high net worth family can be as challenging and disruptive as the death of a principal. Through the types of preparedness planning described here, family office executives can help the principal, the family, and the family office organization be as prepared as possible, as far in advance as possible, and with a plan to mitigate those challenges and disruptions.

Preparedness: Audit readiness

Tax exposures are a constant source of risk for family offices around the world. Family office executives who look anew for ways to identify and address these potential exposures may be able to help mitigate risk for the family.

One growing area of tax risk in which preparedness is especially important is tax examinations. Revenue authorities around the world are under increased pressure to generate revenues from limited resources, so they are aggressively expanding their scrutiny of the assets, transactions, and locations of high net worth families. They want to learn if they are receiving their portion of a wealthy family's taxes, and they are using increasingly sophisticated methods to make that determination, including family members' social media footprints.

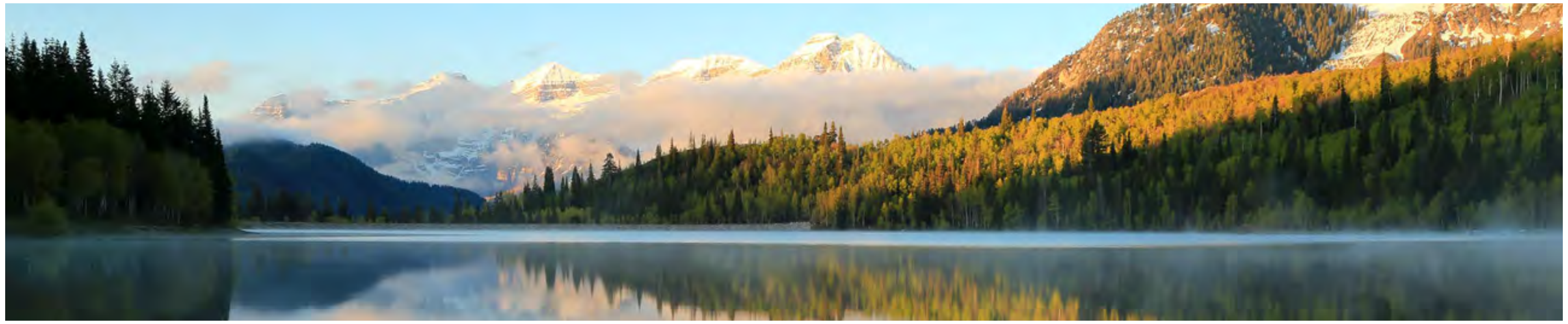
This scrutiny can present financial risks and result in negative public exposure if a family member or the family office becomes the subject of a tax examination, or if a tax assessment is challenged in court, which is in the public domain. There will be instances in which a family office may have inadvertently adopted a tax position that is not supported by existing authority. Audit-readiness exercises can help identify and correct such positions and offer proactive go-forward procedures to mitigate risk.

In addition, once a high net worth family has been audited by revenue authorities, the risk of follow-up scrutiny increases. It is important that family office executives help the family identify, understand, and address tax risks before they become tax controversies. Periodic audit-readiness exercises can help the family office effectively prepare for a tax examination. These exercises can range from simple discussions with internal advisers to more detailed mock examinations.

A new look at an old challenge

Risk management is a top priority for family office executives today. Some risks are hard to detect, but others may be more obvious. The risk of a tax examination is one of the latter. It is important for family office executives to understand where potential pressure points are and how they can be addressed before they grow into problems for the family.

This is why audit-readiness exercises have become a standard practice for many family offices. For a family office that advises a family about potential risks and how to address them, being able to anticipate potential areas of tax controversy and take steps to mitigate the risks associated with them can be a significant value add.



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Preparedness: Audit readiness

Three types of audit-readiness exercises can help position the family office, family advisers, and the family to understand and address the risk of tax examinations:

Identifying material issues that revenue authorities may focus on during a tax examination is the first audit-readiness exercise. Certain areas that can fall under scrutiny are:

- Income tax
- Lifestyle assets
- Residency issues
- Sales and use tax
- Value-added tax
- Common reporting standards
- Foreign Account Tax Compliance Act (FATCA)

Developing a system for handling information requests from revenue authorities is the second audit-readiness exercise for the family office to consider. Communications from revenue authorities can be an early warning sign that a tax examination may be imminent. These communications can anticipate which issues the revenue authority may raise and what documents might be requested. It is important that the family office be prepared to provide a concise response in a timely manner.

Developing an overall examination strategy is the third audit-readiness exercise. The strategy not only includes a proper presentation of positions, but also a system for providing the information that the tax examiner is likely to request. This point is critical because revenue authorities often dig deeply into the documentation behind tax returns and tax positions. Without proper documentation, tax examiners can reject the tax positions, assessing additional taxes, penalties, and interest. A mock tax examination can be a valuable part of the examination strategy and documentation process (see "Putting it to the test").

Putting it to the test

A mock tax examination can help identify the strengths and weaknesses in the tax positions and supporting documentation for the family office and its clients, addressing uncertainty in advance of a tax examination by:

- Checking for documents often requested by tax examiners
- Conducting interviews of family office personnel as examiners might
- Explaining each issue, the law behind it, and the documentation required

Every tax examination is different, and examiners don't necessarily look at every tax position on a return. If a taxpayer receives a "no change" decision on one tax examination, it doesn't mean that the revenue authority won't raise new or recurring issues in later years. This is why audit-readiness exercises, such as an examination strategy, documentation process, and mock examination, are so important: They can help family offices and the families they serve to understand the tax risks they face and prepare to address those risks if they receive a notice from a revenue authority.

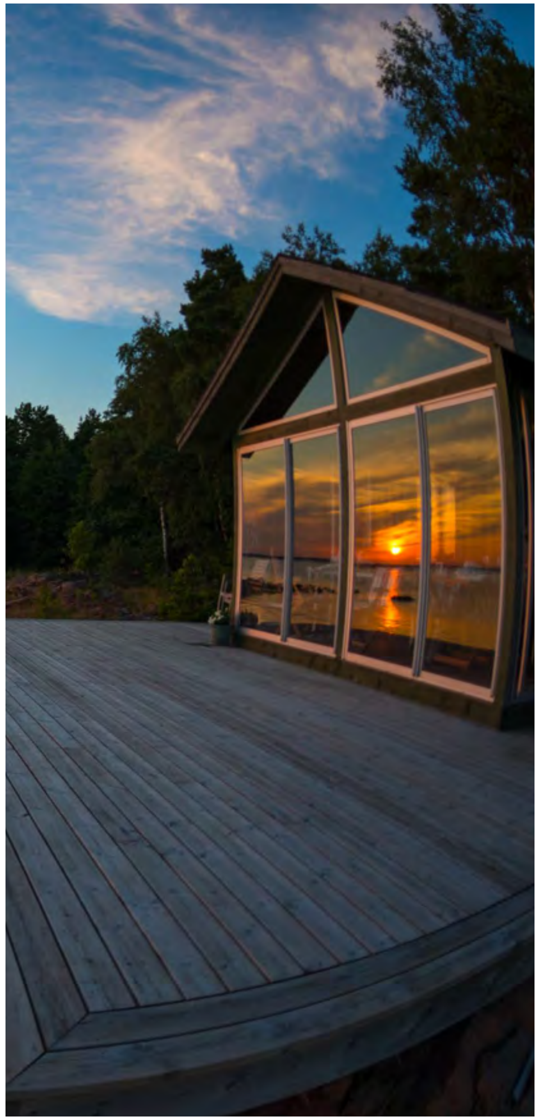
Audits and assessments

Family office priorities can vary widely, but a common objective for all is protecting the family's safety, privacy, reputation, and wealth. Better than any individual family member, adviser, or service provider, the family office is in a position to monitor and manage such risks for the family.

Many factors determine a family office's approach to risk management, including the size of the office, its sophistication, and the experience of its personnel. Yet regardless of the family office's makeup, a sound risk management framework with effective internal controls is essential.

Some family offices are even beginning to look at risk management from a different perspective. They consider it an investment in the future of the family's reputation and well-being and the preservation of the family's assets, rather than an expense. An effective risk management framework can help prepare a family office to withstand market disruptions, cyberattacks, internal fraud, and other relevant threats.

Internal controls are important components of such a framework. The sooner a family office introduces and periodically reviews such controls, the better equipped it can be to manage risk and discourage inconsistency and unreliability in the management of the family's affairs.



The value of audits and assessments
Family office priorities, personnel, and systems change over time, causing risks to evolve. As a result, an effective practice is to conduct periodic formal audits and assessments, tailored to the specific circumstances of the family office, to confirm that controls are focused appropriately. Three types of audits and assessments are particularly effective:

- **Process assessments** focused on effective design and operation of key family office internal processes
- **Annual financial statement audits** for one or more entities, such as foundations, trusts, or the family office
- **Transactions testing** for effective internal control operation and documentation

Cyber risk

In the digital era, family offices and the families they serve face many areas of potential cyber risk exposure, including personal identities and reputations; public and private schedules; business and personal travel; investment accounts; business dealings; political connections; community and philanthropic relations; and interactions with regulators.

Just one lost laptop, a misplaced wallet or purse, a seemingly innocent social media post, or a carelessly opened email can be the trigger point. Suddenly, the very carefully guarded privacy, security, and even safety of the family, its businesses, and the family office may be in jeopardy.

This isn't a hypothetical threat. It is very real, personal, and imminent—played out in the media all too often, and probably even more frequently behind the scenes. The urgent question is how can family office executives, often operating in a smaller enterprise environment with limited resources, gain new insights on and take meaningful action to address cyber risk before it becomes a problem?

Two fundamental cybersecurity questions:

1 What are the digital footprints of the family office and family members—individually, personally, and from a financial perspective?

2 What steps are being taken to manage those footprints?

The first step is to acknowledge, understand, and prioritize specific risks that might confront family members, the family office, and the entities it serves. Large companies and governments aren't the only targets of cyber criminals. Any person or business—especially one with sizable assets, a smaller resource team, and a high public profile—is at risk.

Next, to address these risks it is important to design and implement appropriate cyber risk management solutions, such as identity and access management, data protection, software application security, transaction security, and core systems and device security.

Finally, it is vital that these cyber risk management solutions be monitored, maintained, and improved over time. This can include enhancing security operations, implementing risk monitoring across applications, conducting threat intelligence and analytics, and identifying and remediating vulnerability gaps.

A cyber risk management program should be:

Secure
Having risk-prioritized controls to defend against threats

Vigilant
Committing financial and talent resources to identify harmful behavior

Resilient
Recovering from and limiting the impact of cyber incidents

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Family office transformation

Across the life cycle of wealth, high net worth families face many important decisions. These can include family or business-related events; formation of a family office, foundation, or trust; formalizing an existing family office to provide more services or expand the number of family members it serves; transitioning the family office from one generation to the next; and many others.

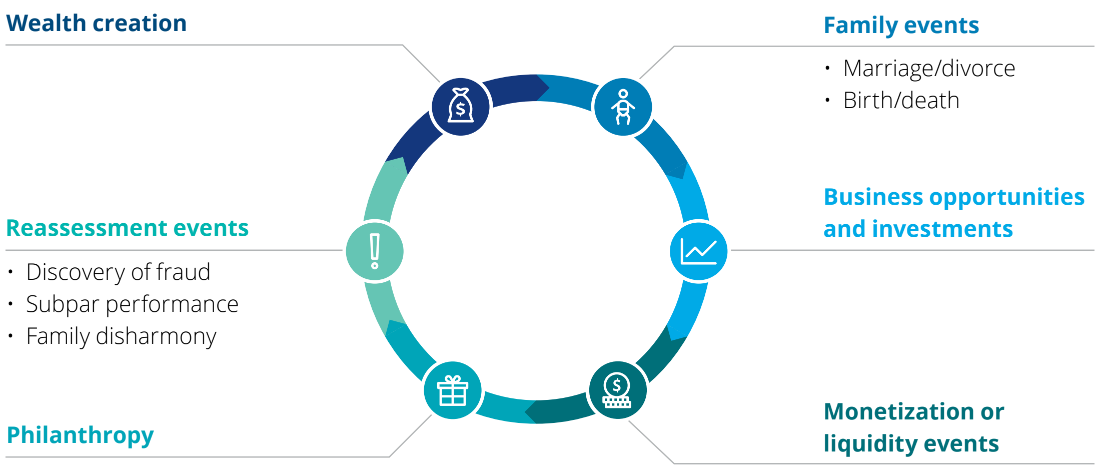
These decisions can involve many strategic, financial, and operational considerations. Careful analysis, planning, and communication are important to facilitate strong alignment both among family members and between the family members and family office that oversees their financial affairs.

An effective practice for addressing these types of events is to bring selected family principals and/or family office executives to an off-site, interactive Family Office Transformation Lab hosted by Deloitte and tailored specifically for the issues at hand. There they can focus, uninterrupted, on taking a new look at key issues, making meaningful headway on tough decisions, and addressing specific challenges associated with the family and the family office.

Driven by major events in the family's life, Deloitte's Family Office Transformation Labs can be specially designed to help the family and family office navigate issues associated with the family's complex financial enterprise and personal objectives across the wealth life cycle (figure 2). Facilitators use tested methodologies to help family members, family office executives, and other key stakeholders align on important expectations and objectives. Opportunities for transformative change are identified and prioritized.

Family Office Transformation Labs can also help address specific issues surrounding the family office itself, whether it's the design and implementation of a new family office organizational structure or the review of any area of an existing family office's operations or performance (see "Family office transformation areas").

Figure 2. Events impacting the life cycle of wealth



Family office transformation areas

- Governance
- Family client relationship management
- Tax efficiencies
- Regulatory compliance
- Accounting and recordkeeping
- Internal controls
- Treasury and cash management
- Human resources
- Succession

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Family office executive transition

Personnel changes are a normal part of any business operation, including a family office. Such changes can be challenging for family office executives who are tasked with leading the organization and driving its success. They must be adept at juggling many different responsibilities and managing a range of challenges.

The importance of finding the right executive to fulfill these obligations cannot be overstated. The family will typically entrust that individual with significant personal information, and that person must be able to work with all family members served by the family office. It is important that the family invest the time necessary to identify the right executive and lay the groundwork for that executive's success.

A Family Office Executive Transition Lab can facilitate that process by helping newly appointed executives make an effective transition into their new role (see "A welcome departure…" also on this page). An important output of a Family Office Executive Transition Lab can be a 180-day action plan, with specific milestones, to pursue the executive's priorities. But what priorities should he or she pursue?

The Family Office Executive Transition Lab can help executives gain an understanding of the critical moments likely to arise in their new role. They can explore current capabilities of the family office and identify and classify issues likely to consume their time and energy, such as talent, systems, processes, relationships, controls, facilities, and communications. The readiness of the family office to execute those top priorities can be explored as well, along with ways to increase the executive's confidence in outcomes. Importantly, the executive can also explore ways to accomplish priorities in alignment with the family's wishes and expectations.

A welcome departure from business as usual

A Family Office Executive Transition Lab allows family office executives to step away from standard flat meetings, mind-numbing presentations, and stale status-quo thinking. Instead, they become immersed in an experience custom-designed to help them dig into complex issues and drive breakthrough results by:

Disrupting ordinary thinking

Instead of jumping right into solutions, step back and first build a rich understanding of challenges and their context.

Revealing new possibilities

Expand beyond the obvious and dive into unexpected, innovative, and creative solutions.

Inciting productive action

Bravely call out real barriers to progress, create ownership, and align the family office vision and 180-day plan on the precise actions required to get results.

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