How family office internal controls safeguard assets and mitigate risks

Families hire family office staff with the expectation that the office keeps their information, assets, and reputation protected. Coming out of the Great Recession, many families and their family offices recognized the need to understand the underpinnings of office operations. But how can the family ensure its interests are being appropriately safeguarded?

The short answer is to fashion a practical, tailored approach for family office internal controls and risk management — not to add red tape — but to create repeatable, transparent, and fundamentally transferable procedures that help manage risk and protect the family's assets.

Internal controls are critical for family offices and a pragmatic approach should start with four main areas: segregation of duties, transaction volume, managing complexity, and succession planning.

Segregation of duties

Segregation of duties is key to protect your family office from the risk of errors and fraud. Lack of segregation of duties in critical process areas can lead to misappropriation of assets or theft, whether intentional or not. But enforcing proper segregation of duties can be challenging for family offices, particularly when staff play multiple roles across the organization.

For example, let's say a staff member has authority to authorize and process payments and sign checks as well as reconcile the bank account. It would be possible for that staff member to authorize a payment for themselves and then process and sign off on the payment and easily "reconcile" the discrepancy with the bank account. Separating these functions reduces the risk of a fraudulent payment being processed.

Other types of controls can be used if your systems are sophisticated enough to implement business rules requiring independent validation or authorization. Requiring family member approval of payments or dual approval of checks or wires would ensure another set of eyes reviews payments before they're processed. Or, minimally, you can implement a detective control in which a disbursements report is reviewed on a weekly or monthly basis by a senior team member outside the payments process.

IF YOU'RE WONDERING WHERE TO START, WE RECOMMEND THE FOLLOWING STEPS:

- Identify areas that are highest risk to the organization, such as cash management or bill payment, and focus segregation of duties efforts on those areas.
- Whenever possible, enforce segregation of duties in your systems rather than manually. For instance, set up independent approval of payments within your bank system so that the wire preparer can't approve the same wire, even if they're a designated wire approver. Most banks also have the ability to require dual approval of wires, which is a best practice particularly for wires over a designated threshold.
- Assess segregation of duties between cash activity and journal entry posting or reconciliations — another high-risk area.

High transaction volume

As family offices evolve and begin serving the family's next generation, we often see the volume of transactions increase. And with increasing transactions processed daily, there is a greater risk of errors and undetected fraud. A strong internal control environment helps to make sure transactions are processed both timely and accurately. More critically, it gives leadership and the family confidence operations are running smoothly.

One high-risk area where we often see the greatest consequences of errors or fraud is cash activity. Errors related to cash not only lead to direct financial loss, but they also quickly erode the reputation of the family office.

Monthly bank reconciliations are a critical internal control to have in place to detect errors and fraudulent activity. Reconciliations should be prepared by someone independent of the day-to-day accounting activity and independently reviewed.

It’s also important to have proper approval controls in place around bill payment and other disbursements to ensure payments are accurate and appropriate.

Balancing risk and efficiency in family office internal controls

A challenge clients face is finding the right balance of appropriate approval without causing inefficiencies in processing. We’ve seen many family offices that require so many levels of approval that it results in inefficient operations. Other organizations require some level of approval but might not have appropriate parties designated as approvers for higher risk transactions.

Consider designing a delegation of authority policy, in which dollar thresholds or key decisions determine the approvers required for various types of payments. A delegation of authority policy helps ensure appropriate levels of approval are maintained for a strong internal control environment and efficient operations. Offices can enhance this with a RACI chart: Responsibility, Authority, Consulted with, and Informed.

Leveraging technology to strengthen family office internal controls

Many technology tools and systems can create efficiencies and strengthen your control environment. Strong system controls and reporting can allow you both to prevent risks on the front-end through user access and segregation of duties, as well as on the back-end through review of system data. Advancements in recent enterprise resource planning systems can provide more streamlined transaction processing with enhanced internal controls. But before deciding to implement a new system, it’s important to take a holistic approach to understanding your organization’s current and future state needs to make an appropriate assessment.

RACI Matrix (sample)

	Role 1	Role 2	Role 3	Role 4	Role 5	Role 6
Action/Task 1	R		C			
Action/Task 2	R		A		C	
Action/Task 3	R	R	I	A		I
Action/Task 4			C		R	
Action/Task 5	A	C		I		
Action/Task 6		I	C	C		R

Responsible
Person assigned to the action or task

Authority
Person who makes decisions and have the authority

Consulted
Person who must be consulted when a decision or action has been taken

Informed
Person who must be informed when a decision or action has been taken

Outsourcing high-volume family office transactional processing

Consider whether you could be outsourcing some of the high-volume transactional processing to third-party vendors. Many third parties offer solutions for outsourcing your accounting function, meaning your staff would serve in a reviewer or analyst role while the third-party processes accounting transactions, prepares reconciliations, among other pertinent responsibilities. Outsourcing accounting also creates a better path to maintain segregation of duties as your staff will now serve in an independent reviewer capacity.

Another area to consider outsourcing is your investment administration. We've seen many clients struggle with the increasing number of transactions in this area, resulting in overworked staff and lack of time for projects outside day-to-day processing. Consider whether a fund administrator could reduce the administrative burden on your team and provide an additional level of expertise and independence.

Managing complexity with family office internal controls

As your office continues to grow, so can the complexity of investments, taxes, family ownership structures, and even everyday business processing activities. Greater complexity raises the likelihood of mistakes or misinterpretations of changing regulations. In today's environment, internal controls in the family office become even more important to prevent and detect errors. For instance, financial errors can be caught through review of financials, which should take place at least quarterly or as needed for the family. Additionally, review of monthly account reconciliations by senior financial team members can detect whether any accounting activity throughout the month was incorrect or inappropriate.

It's important to consider whether your office has outgrown the current capabilities of your team and if the family office could benefit from additional expertise to help it continue to grow. Engaging a third party with expertise to guide the office in handling complex transactions and a changing tax or regulatory environment could be a beneficial solution. Alternatively, consider hiring an expert onto your team in areas where you feel most vulnerable.

Internal controls and family office leadership succession

One of the biggest challenges we're seeing family offices face is changes in key leadership and loss of talent across the organization. These transitions may lead to internal controls being lost or disregarded if proper measures aren't taken for smooth transition of leadership. While it can be difficult to plan for loss of talent, you can implement certain measures to better prepare for these transitions — at some point, they will occur.

Documenting policies and procedures around key processes is a great first step to promoting smooth talent transitions. By documenting policies and procedures, you're also promoting common processes and internal control practices and can use these as guidelines so that all staff members understand what's expected. When new staff are hired, it's much easier for them to have policies and procedures to reference as they take on new responsibilities, rather than information that's been verbally transmitted or documented at the time of someone's departure.

Succession planning for key leadership transitions is also critical as you consider the future of your family office. While most significant transitions usually unfold over an extended period, giving you time to prepare and develop a plan, this is unfortunately not always the case. We've seen many clients find themselves in situations for which they are surprised and unprepared. This results in inefficiencies and, too often, even greater problems down the road if the right person isn't appropriately transitioned into the role. As a best practice, you should have a documented succession plan for all key leadership roles, even if leadership has no near-term plans to transition.

Final thoughts

Internal controls, policies, and business processes may not seem like the most exciting topic, but they provide crucial transparency and enable a well-run, highly reputable family office operation. Importantly, family office internal controls help manage risk and protect the family's assets so it can continue to carry out its mission and achieve its goals.

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