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WEALTH MANAGEMENT BUSINESS™

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A NEW GENERATION IN "WORD" TECHNOLOGY HAS ARRIVED

Jonathan G. Blattmachr

Back in the "old" days there were typewriters. Fran Musselman, a partner at my law firm, likely may legitimately claim to be the "parent" of word processing. He nagged a computer company in the 1960s into putting sentences rather than other data on computer punch cards in lieu of numbers. He wanted to be able to substitute different sentences when the "deal" terms changed. Although initially he was rebuffed, it was eventually tried and by the 1970s "word processing" was developed. It allows, as virtually anyone today alive knows, nearly instant revisions to writings. Lawyers today do dozens of drafts of memoranda, letters, court documents or other written instruments to hone them to near perfection; in the typewriter days, three or, maybe, four

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MEETING THE CHALLENGES OF THE 21ST CENTURY FAMILY OFFICE

Jon Carroll and Elvira Orza

Many family offices today are struggling to keep pace with the growing complexity of their operations. In a January 2008 Survey of SFOs conducted by Family Office Metrics, respondents were asked to describe their current challenges. All respondents in the survey listed "the reporting process" as a major challenge. Specifically, their current operating processes and software applications have not kept up with the evolving complexity of their offices.

The operating environment for most family offices has become increasingly complex due to:

- Diversification of investments and investment vehicles,
- Creation of multi-tiered ownership structures and more sophisticated wealth transfer strategies, and

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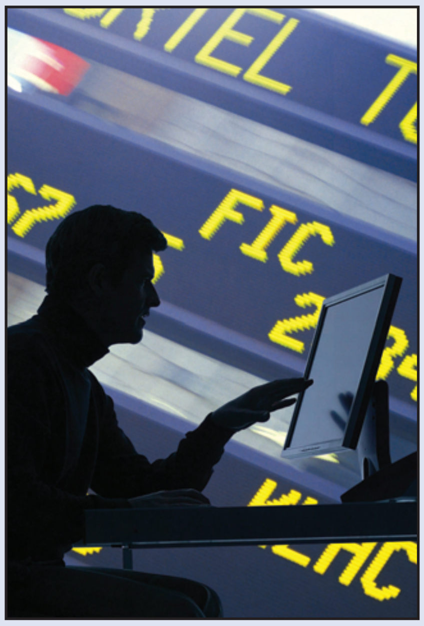


INVESTORS MAINTAIN BULLISH OUTLOOK

Sarasota, Fla. — Sarasota-based MoneyShow.com, the largest multimedia investment education destination for investors, traders, and financial advisors officially announced the results of the Investors' Sentiment Indicator at the Money Show in Las Vegas. Despite a majority of Americans believing we are in a recession, the survey revealed that 56 percent of investors are leaning toward a bullish sentiment for the S&P 500 for the remainer of 2008. Most bullish investors seem somewhat confident about the markets with 43 percent indicating that the S&P 500 will rise less than 10 percent for the remainder of the year, and 13 percent stating that the S&P would rise 10 percent or more.

In line with statements made by the Federal Reserve, 67 percent of investors polled report that they expect the Federal Reserve will keep short-term rates at current levels. With no further rate reductions on the horizon, 79 percent of investors believe inflation will increase compared to only 37 percent from the September 2007 sentiment indicator.

WEAK MARKET HURTS SMALLER NONPROFIT FOUNDATIONS

Atlanta — The volatility of the stock market since August 2007 and a disastrous first quarter for stock markets around the world should be causing some significant hand wringing in the leadership circles of smaller nonprofit community foundations, endowments, and other organizations in Georgia that have traditionally invested in a 60-40 mix of stocks and bonds.

That's the observation made recently by **Ernest V. Montford**, the chief executive officer of Montford Associates. His company provides independent investment advice for endowments, foundations and charitable institutions.

PRIVATELY HELD BUSINESSES EXPECT TO GROW THROUGH ACQUISITION

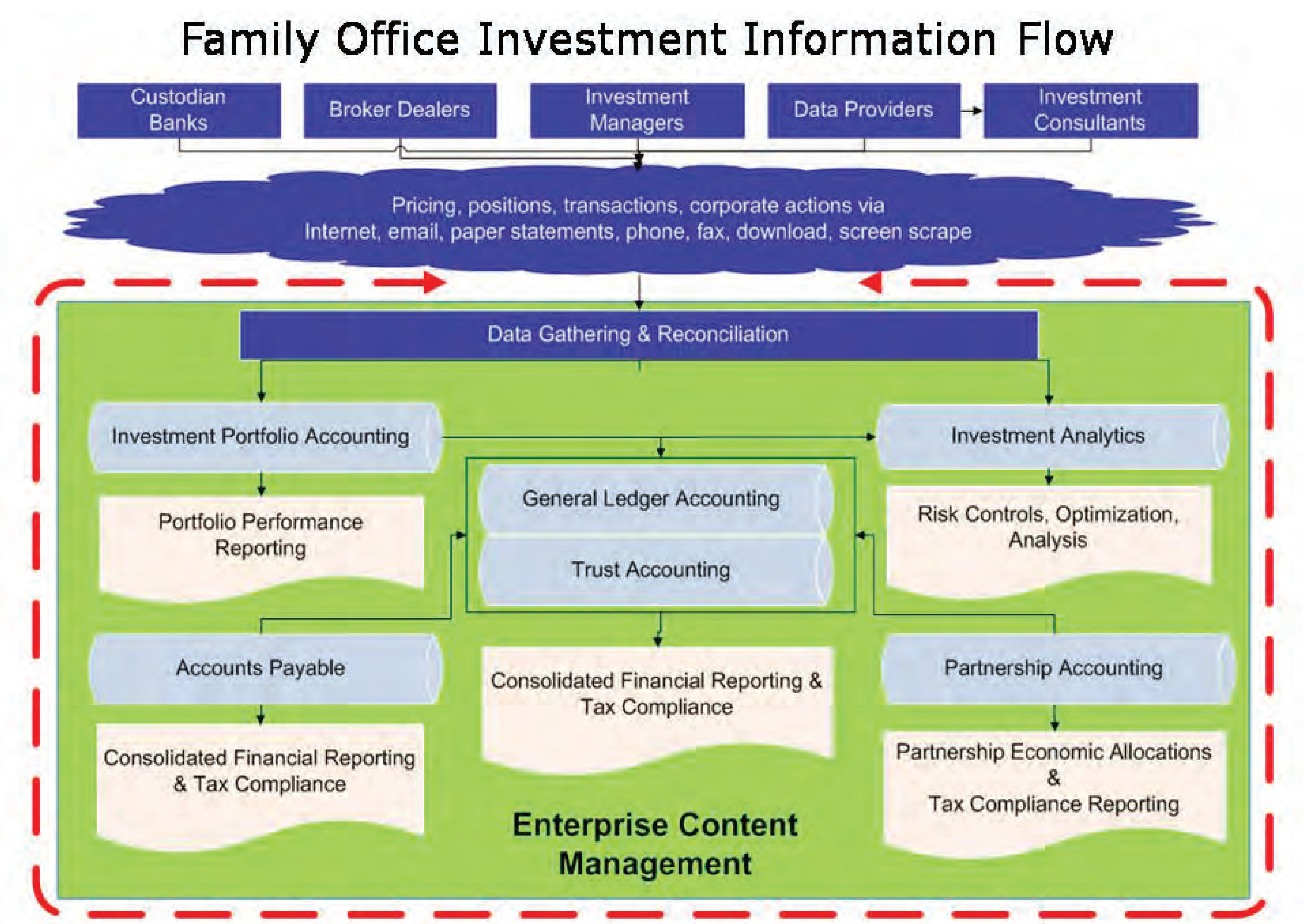
Chicago — Among private businesses in the United States, 48 percent are planning to grow through acquisition in the next 3 years according to the Grant Thornton International Business Report (IBR). While this number is significant, the U.S. trails businesses in the fast growing BRIC (Brazil, Russia, India & China), with 59 percent of BRIC companies reporting an anticipated acquisition in the next 3 years.

With 44 percent of businesses globally expecting to grow through acquisition, the U.S. does not stand alone in this arena. Other countries expecting significant acquisition activity include mainland China (67 percent), Brazil (64 percent), Mexico (50 percent) and the Philippines (48 percent).

MEETING THE CHALLENGES OF THE 21ST CENTURY FAMILY OFFICE: INTEGRATING PEOPLE, PROCESS AND TECHNOLOGY

FAMILY OFFICE *from page 1*

Figure 1



• Demand for better client service and customization.

These factors all combine to put a strain on operations. It can become difficult to track investment returns and report with speed and accuracy on different ownership structures. Systems and processes evolve as the family office grows, often without a strategic plan for growth. Many family offices rely on an assortment of in-house spreadsheets and internal or external applications that are not integrated. Often, technology is purchased on an ad hoc basis, with little consideration for long-term business needs. Additionally, family office staff members frequently establish procedures that are specific to the individual performing them.[1]

Challenges of Managing Family Office Information Flow

Recent developments aside, the typical family office is, by its nature, a very complex organization.

Figure 1 shows the information flow and the major functions of the typical family office. There are many feeds of investment data coming from external sources, including custodial banks, brokers, broker-dealers, investment managers, and investment consultants. There are other types of data sources providing pricing services, corporate actions and other information. Information comes in different ways through the Internet, via email, on a paper statement, by phone, or fax or via downloads and screen scrape from an external source. Downloading data from multiple sources and delivery forms can be error prone, especially when data is entered manually.

The key point here is that different data coming from different sources, and sometimes the same data from different sources, needs reconciliation, and the reconciliation process needs to be automated for review and to correct any errors and omissions. Once the data is "normalized" it can be relied upon for decision making and reporting.

Figure 1 also shows the seven major functions in the investment information flow: data gathering and reconciliation, portfolio management and investment accounting, investment analytics, general ledger accounting, accounts payable, trust accounting and administration and partnership accounting.

Whether assets are traditional or alternative, managed directly or through a fund of funds, analyzed by external investment consultants or in-house staff, the information must be controlled for proper decision making.[2] Indeed, a lack of adequate controls can have serious consequences.

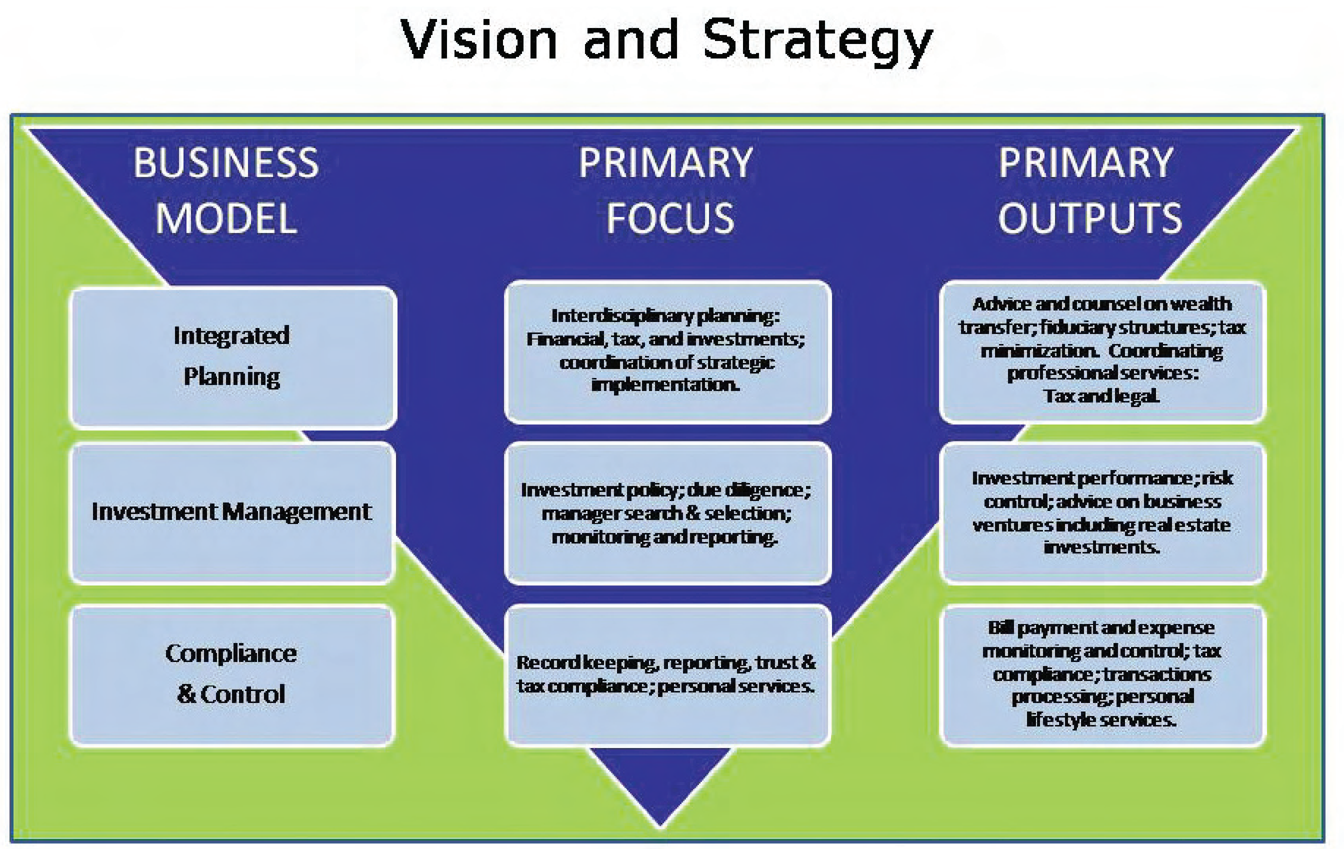


Figure 2

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Figure 3

How do Successful Family Offices Respond to the Challenges of Massive Information Flow and Complexity?

Successful family offices are run like businesses. They have a vision and a strategy, and their goals and objectives are clearly articulated. The primary purpose and function of the office is well defined. They have strong business process and internal controls. They follow prudent business practices and implement technology as a part of a strategic business plan.

Vision and Strategy

The formulation of a strategy begins with a statement of purpose. In the broadest sense, the family office serves to preserve and enhance family wealth. It does so by "providing control over the financial affairs, and a formal communication and customized service framework for the family."[3]

The vision statement reflects the future state of affairs that a family aspires to achieve. An example vision statement might be, "The family office will provide its members the highest quality service through careful oversight of external advisors and its own internally generated work products and services as measured by client satisfaction surveys that exceed 95 percent positive ratings on average."[4]

The successful family office will have a clear vision of the services it should be performing. Not all services will be valued in equal measure by every family. The primary mission of the family office may be as diverse as the education and integration of younger family members, the preservation of the family legacy, or simply to provide superior investment results.[5] In any case a mission or vision statement will dictate the principal services provided by the family office, and will in turn, define the roles, responsibilities, and objectives of its members.

Figure 2 shows the hierarchy of family office services. At the bottom of the hierarchy, a family office can be described as following a Compliance and Control business model, essentially providing a back office for the family. In this case the office provides record keeping, reporting, trust and tax accounting. It may also provide bill paying and other personal services.

Farther up the ladder is the typical investment-based family office, which provides investment management services in addition to the basic services of compliance and control. These will include investment policy, due diligence, manager search and selection, monitoring and reporting.

Finally, some provide what can be described as a fully integrated and interdisciplinary approach incorporating financial, tax and investment planning as well as coordination of strategy. In this approach, planning is the key to successful wealth transfer.

Business Process and Internal Controls

The need for business process and internal controls cannot be understated. Most family offices rely on long-term-trusted employees, and so they frequently lack adequate controls. Successful family offices are run like businesses. They have a formal risk controls process. Their policies and processes are documented for business continuity planning and disaster recovery. They have a rigorous due diligence process and continuous monitoring through an 'in-house' investment tracking system. Successful offices typically follow some or all of the recommended practices of public corporations as outlined below, and adapted from COSO (Committee of Sponsoring Organizations).[6]

Successful Family Offices Manage Spreadsheet Risk

In the 2008 FOM SFO Technology Study, nearly all respondents reported using Excel spreadsheets for investment analytics, financial planning, partnership accounting, client reporting, portfolio accounting or risk analytics. More than 50 percent had concerns about accuracy. In fact, the potential for error can be much greater. Philip Howard of Bloor Research,[7] cited a study by PricewaterhouseCoopers where "the company reported that in a survey of large client spreadsheets it found that 90 percent contained significant errors. KPMG Consulting, more recently, has reported that 95 percent of the financial models that it reviews contain material errors."[8]

What's more, "Time wasted working on bad spreadsheets is a bigger practical problem than errors within Excel models," according to a leading spreadsheet error expert at a recent European Spreadsheet Risks Interest Group conference in London.[9]

Successful family offices recognize the potential for serious risk to their businesses posed by uncontrolled spreadsheet use. They know it is important for organizations to develop a sustainable spreadsheet framework that includes process controls around the development, testing, and use of business-critical spreadsheets, and to create a "golden source" for portfolio and accounting data.

Here's what you can do today to mitigate the risk inherent in uncontrolled spreadsheet use:[10]

1. Identify all spreadsheets in your organization: Who owns them, what they're used for, who uses them and how they are distributed.

2. Prioritize them according to their importance in terms of their impact on corporate strategy and their scope for aiding and abetting fraud.

3. High priority spreadsheets should at least be server-based so there is some form of central control.

4. Establish a way to track and control versions of spreadsheets.

5. Implement a policy for spreadsheet use within the organization.

Successful Organizations Implement Technology Solutions as Part of a Strategic Plan

Successful family offices and other business organizations recognize that technology is only part of a solution that also incorporates people and process. The family office vision drives strategy, which drives the business process, and in turn, the choice of appropriate technology. Technology strategy considers how technology supports business process and always follows a thorough Business Process Review.[11]

The first step in the process is an overview of the business, its objective and current business issues. The next step is to examine the organization, the people and the roles and responsibilities they fulfill. It is important to understand the skills and talents of the family office staff, but also the interests of the family members to manage such things as the investment process or the ongoing operations of the business.

Next, we take a look at the investment process, the accounting, bookkeeping and trust administration process and the reporting process for each key function. In each case we examine the current processes and determine how they are likely to change in the next 3 to 5 years. If growth is anticipated, are the systems and processes in place scalable to meet growth expectations? How much is done in-house versus outsourced? Which technology applications are being used to support which key areas? More importantly, what are the satisfaction levels, issues and concerns of family members and staff? What systems are working, and what are the pain points?

A thorough review of current operations and anticipated growth will lead to recommendations for changes in technology and infrastructure. However, in order to implement specific changes in systems, applications or technology service providers, it is important to follow a procurement process to identify the right solution for your family office. **Figure 4** outlines a 10-step process to successful technology implementation.

Conclusion

Successful family offices are organized and managed as a business. They have strong business processes and internal controls, and use technology to improve productivity. Successful family offices "pay for themselves" through improved performance, risk control and quality.

Jon Carroll is the co-founder of Family Office Metrics, and Elvira Orza is the managing director of Family Office Metrics.

Figure 4

Ten Steps to Successful Technology Implementation

Step 1: Set levels with project stakeholders to obtain agreement on various scope issues.

Step 2: Analyze needs to obtain relevant detail on business plans to develop materials to communicate with potential solution providers.

Step 3: Formalize business requirements using the information already gathered in sufficient detail for the development of an RFP, including prioritizing specific functions and features.

Step 4: Develop RFP for distribution to potential vendors.

Step 5: Identify vendors and filter their initial responses to create a vendor 'short list.'

Step 6: Select the best vendor from the short list by applying the criteria identified in the RFP.

Step 7: Ensure systems readiness by creating a set of tasks that must be completed to guarantee that the system is "qualified" within the customer environment.

Step 8: Ensure organizational readiness for family office by creating a set of tasks that must be completed to guarantee that the office is ready to effectively utilize the system, including policies and procedures.

Step 9: Implement the new system, including legacy systems conversion and user training.

Step 10: Perform a post implementation review to grade the entire RFP process for quality of service, user satisfaction, costs, and timeliness.

End Notes

[1] Elaine Spang, "The Inefficient Office: The Case for a Business Process Review", Family Office Metrics White Paper, July 2003

[2] Jon Carroll, "Is Your Family Office Techno-savvy?", Trust and Estates, August 2005, p.56-62

[3] Jon Carroll, "The Functions of a Family Office", Journal of Wealth Management, Vol 4, No 2, Fall 2001

[4] Jon Carroll, Personal interviews, Spring 2008

[5] Elvira Orza, Family Office Metrics LLC, "2008 Single Family Office Technology Study", Family Office Metrics, Winter 2008

[6] Committee of Sponsoring Organizations of the Treadway Commission, www.coso.org

[7] Philip Howard, "Managing Spreadsheets", Bloor Research White Paper, April 2005, p.3

[8] Philip Howard, "Managing Spreadsheets", Bloor Research White Paper, April 2005, p.3

[9] www.AccountingWEB.com, John Stokdyk, "Spreadsheet Error Research: Wasted Time Worse Than Mistakes", July 27, 2007, searched May 19, 2008

[10] Steven Draper, "Getting Control over Spreadsheets: Implementing a Spreadsheet Control Framework for a Sustainable Family Office", Presentation made at Family Office Metrics' OpsTech 7, New York, NY, November 12, 2007 adapted from Philip Howard, "Managing Spreadsheets", Bloor Research White Paper, April 2005

[11] For a basic discussion of the Family Office Business Process Review, see Family Office Metrics White Paper, "The Inefficient Office: The Case for a Business Process Review", Elaine Spang, July 2003, http://www.fametrics.com/articles/business_process.html