The Future of the Finance Function – Experiences from the U.S. public sector

PRESENTATION FOR GOVERNMENT FINANCE FUNCTION CONFERENCE
Sara Slayton O'Rourke, McKinsey & Company
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About McKinsey’s work on the future of finance in the US government

About me

Sara Slayton O’Rourke
Sara_O’Rourke@McKinsey.com
+1 312 363 7336

- Based in McKinsey’s Washington, DC office
- Core member of Public Sector Practice and Co-Leader of Public Finance, Fiscal Management, and CFO Service lines
- Serves national / federal, state and local clients on financial management, fiscal transformation, and government performance
- Degrees from Harvard and Johns Hopkins in social studies, international finance and economics

About our findings on the future of finance

In 2016 / 2017, we worked with the U.S. Department of Treasury, the Office of Management and Budget, and CFOs / financial managers across 25+ agencies

We focused on challenges and opportunities facing financial managers in the public sector, then identified trends across private and public sector CFO functions to drive the next level of change

Since then, we have refreshed our findings through continued agency engagement as well as evolving trends coming out of the private sector
Globally, government finance functions face a number of core challenges

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rising citizen expectations</td>
<td>Globally, citizen satisfaction with key state services (e.g., transportation, schools, healthcare) is less than half that of non-state providers</td>
</tr>
<tr>
<td>Shrinking and/or highly variable budgets</td>
<td>As of 2017, the world public sector deficit was almost $4 trillion a year – with uncertainty given impending recessions, About McKinsey’s work on the future of finance in the US government</td>
</tr>
<tr>
<td>Pressure to change the talent equation</td>
<td>Need to evolve finance talent to bring on new skills, allow for more flexible arrangements, and blend finance and mission expertise</td>
</tr>
<tr>
<td>Legacy technology and infrastructure</td>
<td>Governments are still operating with myriad systems that are decades old, with processes still heavily paper based</td>
</tr>
<tr>
<td>Limited historical role for finance function</td>
<td>CFOs historically have played the role of transaction manager, without expectation that they have a role in setting strategic priorities</td>
</tr>
</tbody>
</table>


As finance leaders address these challenges, they can shift from basic transaction management to true value management.

Does this represent your own aspiration? If so, where is your organization on the journey?

<table>
<thead>
<tr>
<th>Stage</th>
<th>Focus</th>
<th>Key capabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>01</td>
<td>Transaction management</td>
<td>Reporting and compliance functions</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Transactional financial management, Compliance</td>
</tr>
<tr>
<td>02</td>
<td>Business control</td>
<td>Processes and risk minimization</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Management reporting, Shared services, Optimization of key processes, Cost reduction</td>
</tr>
<tr>
<td>03</td>
<td>Planning and analysis</td>
<td>Sound financial analysis for financial and operating decisions</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Automation, Digital enablement (e.g., end-to-end electronic processes), Routine analytics</td>
</tr>
<tr>
<td>04</td>
<td>Value management</td>
<td>Integral part of leadership team to support value creation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Identifies opportunities and provides information for operating and strategic decisions</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Superior decision support, Advanced analytics, Continuous innovation, Enterprise risk mgmt.</td>
</tr>
</tbody>
</table>
Most finance officers express a desire to shift more toward value management but are stuck spending time on transaction management

U.S. federal CFOs spend the bulk of their time doing transactional work rather than other value add activities

<table>
<thead>
<tr>
<th>Activity</th>
<th>Current time spent on each activity by CFOs</th>
<th>Most value add activities according to CFOs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Other</td>
<td>5</td>
<td>32</td>
</tr>
<tr>
<td>Org Transformation</td>
<td>6</td>
<td>16</td>
</tr>
<tr>
<td>Strat Leadership</td>
<td>14</td>
<td>24</td>
</tr>
<tr>
<td>Reporting</td>
<td>16</td>
<td>5</td>
</tr>
<tr>
<td>Specialty finance</td>
<td>32</td>
<td>4</td>
</tr>
<tr>
<td>Budgeting</td>
<td>23</td>
<td>10</td>
</tr>
<tr>
<td>Traditional Finance</td>
<td>32</td>
<td>9</td>
</tr>
<tr>
<td>(e.g., accounting, controls, etc.)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Other includes: talent, financial system acquisition, tech trends, system implementation, analytics, performance management

- U.S. federal CFOs/DCFOs spend 6% of their time on strategic leadership but believe it constitutes 24% of their role’s value
- 32% of U.S. federal CFO/DCFOs’ time is spent on traditional finance, but they believe it only constitutes 9% of their role’s value
To move toward value management, effective CFOs are adopting new technologies, and taking on a new role in shaping strategy and performance

1. Automating major finance activities to enable new insight and efficiency
   - Implementing Robotic Process Automation and process digitization across core financial management processes to reduce time spent on manual tasks and enable strategic analysis

2. Using new digital tools to modernize processes and transactions
   - Introducing new digital tools like SaaS tools and distributed ledger technology, and taking a citizen perspective to modernize the operating model

3. Employing data and analytics to enhance performance
   - Using big data, machine learning, artificial intelligence to drive new insights to reduce cost and enable performance

4. Evolving the finance talent equation for a digital world
   - Attracting and developing new types of talent to succeed in the digital age

5. Transforming the operating model to be a strategic leader
   - Partnering with the business and using insights to drive strategy to position the finance function as a strategic leader
Several technologies allow for automation at scale

1. **Robotic process automation**
   Automate routine tasks through existing user interfaces (e.g., data extraction and cleaning)

2. **Smart workflows**
   Integrate tasks performed by groups of humans and machines (e.g., month end processes)

3. **Natural language generation**
   Synthesize textual content by combining data and analytic output with contextualized narratives (e.g., data to story translation)

4. **Cognitive agents**
   Build a virtual workforce capable of supporting employees and customers (e.g., employee service centers)
Several major financial processes are over 50% automatable

<table>
<thead>
<tr>
<th>Process</th>
<th>Fully Automatable</th>
<th>Highly Automatable</th>
<th>Somewhat Automatable</th>
<th>Difficult to Automate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Procure to Pay</td>
<td>42</td>
<td>40</td>
<td>6</td>
<td>12</td>
</tr>
<tr>
<td>Bill to Collect</td>
<td>36</td>
<td>52</td>
<td>4</td>
<td>8</td>
</tr>
<tr>
<td>Book to Reimburse</td>
<td>33</td>
<td>16</td>
<td>26</td>
<td>25</td>
</tr>
<tr>
<td>Request to Procure</td>
<td>27</td>
<td>22</td>
<td>25</td>
<td>26</td>
</tr>
<tr>
<td>Acquire to Dispose</td>
<td>22</td>
<td>27</td>
<td>26</td>
<td>25</td>
</tr>
<tr>
<td>Apply to Perform</td>
<td>15</td>
<td>20</td>
<td>15</td>
<td>50</td>
</tr>
<tr>
<td>Budget Formulation</td>
<td>10</td>
<td>20</td>
<td>20</td>
<td>50</td>
</tr>
<tr>
<td>Agree to Reimburse</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>70</td>
</tr>
<tr>
<td>Hire to Retire</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>70</td>
</tr>
<tr>
<td>Apply to Repay</td>
<td>10</td>
<td>10</td>
<td>10</td>
<td>70</td>
</tr>
<tr>
<td>Record to Report</td>
<td>9</td>
<td>32</td>
<td>5</td>
<td>54</td>
</tr>
</tbody>
</table>

1 Based on Common Core definitions; 2% automatable based on private-sector benchmarks; “fully” automatable defined as 75%; “highly” defined as 60%; “automatable” defined as 40%+

SOURCE: Automation Metrics 2016
Finance organizations are employing new digital tools to modernize the operating model

### SaaS-based Enterprise Performance Management Tools
- User-friendly budget planning, modeling, consolidation, and monitoring
  - Real-time access and personalized use / visual for each person
  - Zero-based budgeting and linking funding levels to program results
  - Customized per agency with “hyper-block” that rolls up into an organization-wide standard format
- Real-time planning, reporting, tracking, scenario modeling

### A focus on citizen transactions in digital innovation
- Focus on citizens through mobile / digital payments, common authentication platforms, and benefits administration
- Piloting a common authentication platform, where citizens can go to review status of all govt transactions and services
- Pursuing a “fast payments” initiative to keep up with the likes of Venmo, Zelle, etc.
- Uses behavioral tactics to nudge unemployment insurance claimants toward honest responses

### Distributed ledger technology for transactions and ownership
- Ownership & transfer of assets
- Smart contracts
- Intra-govt transactions
  - U.S. federal agencies have invested $8.4M to pilot blockchain for
    - Digital asset management
    - Anti-forgery and counterfeiting capabilities for digital documentation
  - Delaware and Illinois have launched initiatives testing out blockchain in land records and digital commerce
  - West Virginia has piloted the technology for mobile voting

- SaaS-based Enterprise Performance Management Tools
- Adaptive Insights
- Anaplan
- Deloitte
- Extenso
- Xerant
- Hostanalytics
- GSA
- Federal Reserve

### McKinsey & Company
PRELIMINARY DRAFT
Data and advanced analytics can be employed through the organization to improve performance, drive down cost, and lead to new financial insights

### Potential use cases

<table>
<thead>
<tr>
<th>Scenario planning</th>
<th>Project selection and prioritization</th>
<th>Capital allocation optimization</th>
<th>Identification of fraud, waste and abuse</th>
<th>Performance drivers exploration</th>
<th>Spend analytics on vendor management</th>
<th>Digital interactive dashboards</th>
</tr>
</thead>
</table>

#### Tackling fraud, waste and abuse (FWA) in Veteran’s Affairs Department
- **FWA** within VA has been major focus of media attention
- Secretary tapped CFO to create **Fraud, Waste and Abuse Analytics Center of Excellence**
- Pulled together analytics talent, mission-focused employees, and payments / program data to identify top cases of potential FWA, e.g.,
  - Providers charging for services not delivered, or overcharging for services
  - Identify or eligibility fraud to receive benefits

#### Using data visualization to drive performance within Dept. of Interior
- Dept struggled with how to communicate the impact of their services
- Now, they use real time, automated visual maps, charts and graphs to show service delivery and financial info
- Has led to:
  - Improvement in grants impact monitoring
  - Resolution of accounts payable issue and identification of missing funds

#### Using analytics for risk-based grant application review in the Department of Justice
- Office of Justice Programs distributes $2B in public safety grants to 2000+ grantees
- Used to be fully manual process
- Now use disparate data systems together, and automated its review processes to increase the accuracy and consistency
- Grant reviews can now be performed quarterly rather than annually, and take seconds versus 30 minutes to load grantee info
There are 5 major ingredients for successfully employing analytics at scale:

1. **Access to data/analytics tools with sufficient computing resources / environment**
2. **Integrated cross-functional team of data scientists, engineers, product owners, and technologists**
3. **Data scientists and engineers that cover a broad variety of analytical techniques**
4. **Alignment at the very top that analytics are a priority, budget allocated accordingly**
5. **Clearly defined ownership of payment integrity outcomes with appropriate reporting/escalation path**

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A shared vision and culture that fosters a commitment to collaboration, analytics, and improving outcomes and efficiency:

- **Access to broad sets of quality data**
  - Access to internal, external data that is integrated, standardized, and structured to enable automation
  - Privacy and legal framework for access and use of data

- **Analytic tools and skillsets**
  - Access to data/analytics tools with sufficient computing resources / environment
  - Integrated cross-functional team of data scientists, engineers, product owners, and technologists
  - Data scientists and engineers that cover a broad variety of analytical techniques

- **Domain expertise**
  - Breadth of in-house subject-matter experts (SME) to engage in knowledge sharing
  - SMEs that are understand the business and analytics
  - Structures to support skill development and maintenance

- **Ability to operationalize insights**
  - Analytics-centered solutions teams and processes that provide continuous, holistic coverage of leakage areas
  - Commitment by all parties to execute remediation actions through system & process changes, in order to adapt to new FWA threats

- **Strong executive sponsorship**
  - Alignment at the very top that analytics are a priority, budget allocated accordingly
When developing talent, the CFO should consider how its finance workforce of the future will need to be retooled to embrace digital.

**Resources**
- From homogeneous to diverse
  - Wider range of experience and background
  - More diversity of geography with local Finance Value Leaders embedded
  - New roles required to link advanced analytics with true insights for the business
  - Higher focus on flexibility to attract and retain talents
  - Increasing importance of temporary staff to access specific skills

**Skills**
- From “hands” to “brain”
  - Finance Data Engineering teams established with advanced Analytics, Collaboration, Digitization skills
  - “Problem Solvers” with both finance and deep business knowledge
  - Investments in activities core for the future of Finance

**Operating model**
- From structured to agile
  - Agile pool of Finance professionals
  - Centers of Excellence bundling deep expertise
  - Core shared service center for all highly transactional processes
  - Finance value leaders

Graph of time demanded from various skills:
- Social, creative, problem solving and coordination skills are top needs

Financial managers can move into more of a leadership role by bringing new insights to major strategic / operating model challenges and major transformation efforts

Regulatory agency CFO drives change in operating model to evolve the organization

- A regulatory agency was facing major tumult in their industry and it was threatening their overall business model
- The CFO brought together cost and revenue data in a new way to show the investment and impact of each new entity regulated, and what impacted those factors
- As a result, the agency is re-evaluating its operating model to evolve to face industry needs

DHS and DOT CFOs provide insights to offer steady change leadership in time of uncertainty

With recent uncertainty in budgets and a White House push to drive major reorganization from OMB, many CFOs in the U.S government brought stability and clarity

- Department of Homeland Security finance function formulated a plan to drive affordable changes to long-seated problems, allowing a focus on the long-term while meeting short term targets
- Department of Transportation finance team sized and scored openly sourced creative ideas for change, bringing clear prioritization to strategic plan

In groups of 3-4, take 5-10 minutes to answer the following questions – we will then discuss and note common themes

What are your priorities for innovation within the finance function? What issues are you finding hard to resolve?

Which of these specific initiatives do you believe will have the most impact in helping you innovate or address major issues within the finance function?

What major actions can you or your team take to enable the adoption of some high impact initiatives?

What will you or your organization need to successfully implement relevant initiatives?