WRITTEN TESTIMONY OF ALBERT G. HORVATH, SENIOR VICE PRESIDENT FOR FINANCE & BUSINESS/TREASURER, THE PENNSYLVANIA STATE UNIVERSITY TO THE PENNSYLVANIA SENATE GOVERNMENT MANAGEMENT AND COST STUDY COMMISSION

My testimony is provided on behalf of the Pennsylvania State University. I appreciate the opportunity to provide information on strategies that the University has employed in order to help it address challenging budget constraints, both recently and over a longer period of time. It is hoped that this testimony will contribute to your Commission's objectives of identifying opportunities to reduce costs, increase efficiency, consolidate like functions, return select functions to the private sector, or eliminate functions that are no longer central to the operation of state government. It is with a deep spirit of cooperation that this information is submitted for your consideration.

Background and Context

There is no question that an educated citizenry – particularly in the sciences and engineering – is vital to our economic future. It is no different today than it was 150 years ago when the federal government first established public research universities through the Morrill Act of 1862. Those land-grant universities, of which Penn State was among the nation's first, fueled this country's advancement in the industrial age and have since been joined by other public research universities whose contributions are now equally vital. The mission of those land grant universities has remained the same for 150 years – to create new scientific knowledge through research; to extend that knowledge for the public good; and to provide an accessible and affordable education for all who seek it.

The state's support of public higher education has historically centered on the last of these missions – access and affordability. Long before the establishment of community colleges or the expansion of the mission of the state's teacher colleges, Penn State provided affordable access to higher education by establishing 20 undergraduate campuses spread throughout the Commonwealth. Any student could study for two years at a commonwealth campus and then finish a four-year baccalaureate program at University Park. Hundreds of thousands of Pennsylvanians of modest means took advantage of this low-cost way to get a world-class education – even in the most costly and technical fields. I am one example of a first generation college student who received a baccalaureate degree from Penn State.

While this model is still in place and still offers a lower cost approach to attain such degrees, we are coming perilously close to pricing these programs beyond the reach of most Pennsylvanians. Eroding government support of Pennsylvania's public research universities has been occurring over the past thirty years and has accelerated over the past eight years. Exhibit 1 illustrates how the state's share of the cost of a Penn State education has fallen from 62% to 19% since 1971. Even more troubling is the acceleration of this shift away from state support over the last decade as shown in Exhibits 2 and 3. Exhibit 2 shows that funding for state-related universities has been flat since 2000-01, while funding for basic education and other commonwealth expenditures has increased substantially and exhibit 3 shows how higher education's share of the state investment in public education has fallen more than 20% over the past decade.

Clearly, Pennsylvania's current fiscal problems are not due to the state's funding of public research universities. With the exception of payments to community colleges, public higher education has simply not been a spending priority for the past ten years, and the consequences were predictable. Students who used to be able to pay for a Penn State degree while working part time, or during the summer, are now graduating with an average debt load of $28,700.

Penn State's Approach to Fiscal Responsibility

Penn State has been doing its utmost to manage within an environment of static state support. While this has shifted a greater financial burden onto the shoulders of students and their families through higher tuition, the University has mitigated what would have been even greater increases through a systematic and long-term commitment to efficiency and expense management. These efforts include ongoing controls on expenditures, and emergency measures taken when state support actually dropped due to appropriation rescissions.

- **Budgetary Recycling.** Out of financial necessity, Penn State has had a long-term emphasis on reducing costs and generating efficiency. Since 1992-93, the University has reallocated over $190 million from its academic and administrative operating budgets. A significant percentage of funds have been shifted from non-academic function to academic activities through this process. A recent calculation indicates that if this action had not been taken, tuition would have had to go up by an additional 16 percent over this period.

  In years of extraordinary budget challenges, these reduced budgets have been critical in our ability to implement a balanced operating budget. The current fiscal year is a good example of this. After a six-month delay, the University's 2009-10 state appropriation was approved at $333.9 million, which is equivalent to the appropriation received in 2007-08. As a result, tough measures were necessary to balance the University's budget through expense reductions and cost savings that totaled nearly $50 million. The University did not provide salary increases for faculty and staff, saving approximately $30 million. Reductions of $15 million were made through across-the-board reductions of two percent to all departments, while additional selective budget cuts of $2.8 million were enacted. Reductions of approximately $2 million were also made in the funds planned for maintenance and capital improvements.

  As a result of these budget reductions, the University was able to limit tuition increases to between 3.7 percent and 4.5 percent which represent the lowest increases in recent history.

  Over the past 18 years, steps have been taken to systematically eliminate or merge existing academic programs as new ones have been added to keep pace with changing student demand, trends in academic fields, accreditation requirements, and new knowledge which shape the need for curricular reform. Since 1992-93, 145 programs or majors and 14 academic departments have been eliminated or merged.

- **Continuous Quality Improvement.** Penn State has one of the most effective and long-running continuous quality improvement programs of any university in the country. Since the University began its continuous quality improvement efforts in 1991, 900 CQI teams have identified ways to improve processes and work more efficiently. We have a commitment to continuous quality improvement, creating an environment in which everyone takes ownership of the improved educational enterprise and where high value is placed on teamwork, collaboration, and communication.

  We have undertaken a broad array of initiatives across the institution in our efforts to reduce costs. As part of our ongoing reduction and reallocation process, we have recycled funds on an across-the-board basis annually, usually at the one percent level. In addition, numerous vertical cost reductions have been made that affect some programs and services more than others, based on an evaluation of these areas and the extent to which they support the University's core mission. Exhibit 4 provides a summary of some of the different steps that have been taken over the past few years. While this is not a comprehensive list, it reflects the University's efforts to streamline administration, mitigate rapidly rising health care costs, improve the procurement of goods and services, conserve energy, and enhance revenue.

  Penn State is committed to finding ways to continue its cost reduction efforts. Last May, our Board of Trustees adopted a new five-year strategic plan for the University. One of the overarching goals of the plan is to control costs and generate additional efficiencies.

- **The "Core Council".** An "Academic Program and Administrative Services Review Council" consisting of key faculty and administrative members has been established to help facilitate progress towards achieving this goal. The Council has identified several key areas to focus on initially. A number of the strategies that we are pursuing may be applicable to the Commission's work as it looks to identify cost savings and efficiencies within the Commonwealth's budget. They include:

- **Improvements to employee productivity.** At Penn State, people are our core asset. The effective deployment of our human resources is one of the greatest challenges that the University faces. In order to make the best possible use of their faculty and staff, our colleges and campuses are developing formal and transparent workload policies, taking steps to reduce under-enrolled course sections, and creating greater equity in teaching loads across all disciplines and courses.

The development of formal workload policies and related performance tracking is not only a matter of improving the productivity of our faculty and staff; it is also a matter of equity. Transparency of both the unit's workload expectations and an individual employee's performance will help to ensure greater quality, efficiency, and equity.

- **Better utilization of our facilities.** Over a number of years, Penn State has made a significant investment in physical plant, instrumentation and equipment to accommodate new modes of teaching and learning. It is critical that our facilities are being utilized to optimal capacity.

  We are focused on creating a collaborative model among our colleges and campuses that will help us better recognize consistent efficiency. This includes more effective classroom scheduling and systematic approaches to facilities utilization, as well as greater sharing of core research facilities and instrumentation.

- **Reductions in the rate of increase in health care costs.** Health care is a large and growing component of our institution's spend. Maintaining a quality program for our employees and students while reducing our costs has always been a challenge. We have determined a number of focal points that will be tackled over the next few years and have begun to recognize some of the potential savings that we will achieve. Our main areas of focus are employee wellness, retiree healthcare, health plan design, and the expansion of our Hershey Medical Center's services to the University Park campus.

  A significant step has already been taken to move employees hired effective January 1, 2010, from a defined benefit health care program to a defined contribution approach upon retirement. This change is expected to produce an estimated cumulative savings to the University of $3 billion over the next 30 years.

  To slow the increasing cost of our current Medicare-eligible retiree healthcare, we have initiated increases in medical service and prescription drug copayments in our Medicare-Advantage plan along with an increase in retiree contribution beginning January of 2010. For our active employee health care plan, we are planning similar changes such as increased co-payments, co-insurance, and the implementation of deductibles in January of 2011. Wellness will be an important aspect of our plan design. Employees will be incented to participate in wellness activities and make behavior changes that mitigate lifestyle-style related health risks.

- **More cost effective ways to deliver IT services.** We are considering the right balance between central and distributed IT services, and the most cost effective ways to deliver infrastructure and support services to Penn State's multiple locations across the Commonwealth. This is a major undertaking, but we believe it has the potential to result in considerable savings for a university that is heavily dependent on technology in its work.

- **Increased energy conservation efforts.** Energy conservation is important to the University's fiscal and environmental goals. Over a number of years, we have aggressively undertaken a range of initiatives to lower energy consumption, reduce expenditures on energy and support greenhouse gas reduction goals. Three examples of our current programs, which generate savings of $6 million annually, include:

    - A Continuous Commissioning Program which involves the tune up of existing building systems to ensure that they are operating at peak efficiency.
    - An Enterprise Utility Management System which uses building-based automation systems to read and store "near real-time" interval data on steam, electricity and chilled water consumption for 52 of the largest utility consuming buildings at the University Park campus. This data allows more energy savings opportunities to be identified, and the development of more effective conservation efforts.
    - A Guaranteed Energy Savings Program which identifies facilities that can benefit from an Energy Service Company that will design, implement, and guarantee self-funding energy and utility savings projects. (In some cases, our own Office of Physical Plant serves as the Energy Service Company thus providing additional savings on overhead and labor from outside companies).

    These efforts along with a number of other conservation initiatives, have reduced the university's overall energy consumption to below 2005 levels. In addition, they have significantly extended the life of our existing steam plant and avoided significant capital expenditure that would otherwise have been necessary to support the campus growth.

    We intend to expand our energy conservation efforts over the next several years.

- **Expanded use of strategic sourcing.** We continue to evaluate the right mix of products and services the University purchases, determining appropriate suppliers, and developing the terms and conditions to balance cost, quality and risk.

    Through our electronic procurement platform, for example, we have developed business-to-business purchasing tools that allow end-users to place orders online and invoices to be submitted through the same system. Currently, there are 24 electronic catalogs with major suppliers offering across- the- board low pricing. Suppliers also offer an incentive to the University for the benefit of efficient, timely and paperless processing. Annual savings of $1.8 million result from this program.

Through a highly competitive bidding process, annual savings of nearly $3.7 million have been realized in the purchase of coal, renewable energy and natural gas. As part of our procurement efforts, the University has recently begun to purchase electrical power for the University Park campus on the wholesale market.

As another example, we recognize annual savings of $1.4 million above and beyond Penn State contract pricing by aggregating and standardizing computer purchases university-wide. This involves negotiating aggressive discounts that are available from May - July each year and accounts for almost 50% of the total University computer purchases.

- **Reductions in our travel expenditures.** Continuous steps have been initiated to take a comprehensive look at the University's travel policies and procedures to ensure the University is operating efficiently and as cost effectively as possible.

  Through the use of authorized agencies, we are realizing savings in air travel fares and car rental rates. The University has a supplier contract with one of the major airlines, and a hotel contract that provides a 15% savings off the lowest available rate. We also competitively bid athletic travel including air charters, bus charters, and hotels. The savings we realize each year approach $5 million.

- **Streamlining of payment processes.** In the spirit of looking for more efficient ways to operate, we have identified certain practices that could be streamlined to benefit both the University and the Commonwealth related to the administration of the financial terms and conditions of State grants and contracts. To properly frame these issues I believe it is important to share with you one of our benchmark statistics as perspective. The University office that is responsible for financial and post-award administration of all University sponsored funds tracks certain operating statistics and has informed me of a telling comparison. As of fiscal year ended June 30, 2009, a single FTE employee in the office can oversee $143 million of federally-sponsored programs annually while an employee administering Commonwealth-sponsored agreements generally oversees only about $26 million annually.

  Although there are important regulatory differences in how the University must administer these different funding sources, I believe the disproportional administrative effort reflected in this statistic could probably be reduced to benefit both the Commonwealth and the University.

  It is important to note that most of the practices specified below are in direct contrast to widely accepted practices we utilize for our federal and industrial sponsors. Our specific areas of concern follow.

- **Award Process**
    - Some research grants and contracts are executed very late in the fiscal year, yet maintain a requirement that funds be expended before Fiscal-year ended June 30.
    - Some agencies adhere to the concept of "adverse interest" in regard to prohibiting follow-up awards to an institution that conducted an original study.

- **Expense Documentation / Auditing.**
    - Some agencies require paper ("hard copy") documentation to support every expenditure under a grant or contract before reimbursing the University.
    - Commonwealth reimbursement of University expenses is increasingly delayed for resolution of very minor documentation or reconciliation issues.
    - Agencies will occasionally require documentation of specific project hours worked by faculty as opposed to accepting "percent of effort" methodology.
    - Certain agencies require costly, time-consuming program audits of every award to the University despite existing University oversight already in place.

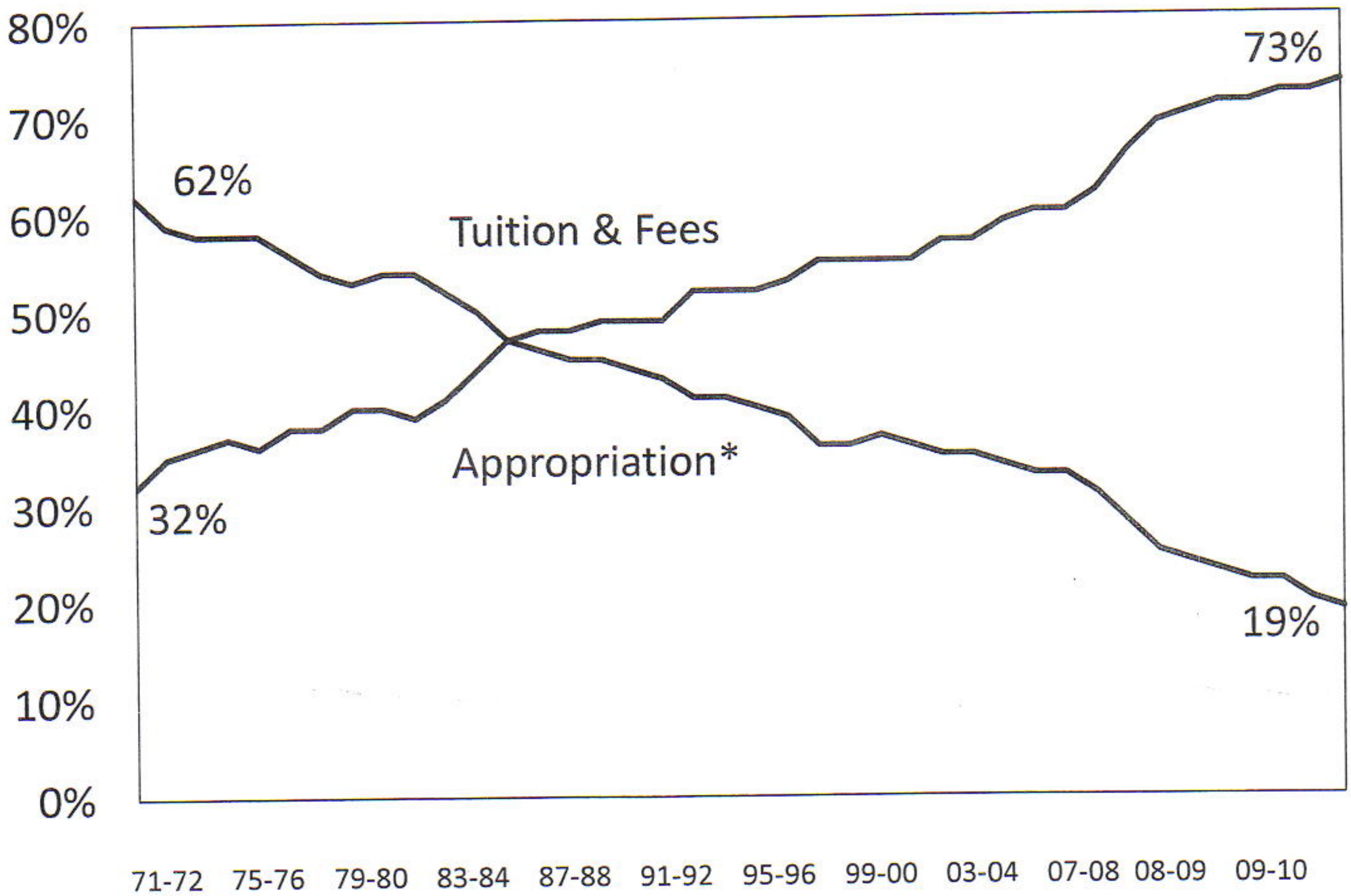
- **Invoicing Requirements**
    - Certain agencies will require widely-varying invoicing formats across different programs within a single agency.
    - Final invoicing is sometimes required within 45 days of completion of a project. In contrast, the typical close-out period on federally-funded awards is 90 days, which allows the posting of all allocable costs to the project account, comprehensive review of all project transactions, and invoice preparation.

Working collaboratively, I believe we might be able to identify more efficient ways to meet the various needs of Commonwealth agencies proper accountability over taxpayer funds without compromising the requisite control needed to administer those funds.

Penn State has been, and will continue to be, a responsible steward of the state funds entrusted to the University and tuition paid by students. I hope my testimony provides a helpful overview regarding our efforts to reduce costs and promote efficiency.

EXHIBIT 1

Penn State University
Appropriation vs. Tuition and Fees as a Percent
of the General Funds Budget



*Includes Federal Stimulus Funds in 2009-10.

EXHIBIT 2

Commonwealth of PA General Funds Budget, Basic Education and State-Related Appropriations Cumulative Percent Change from 2000-01 to 2008-09

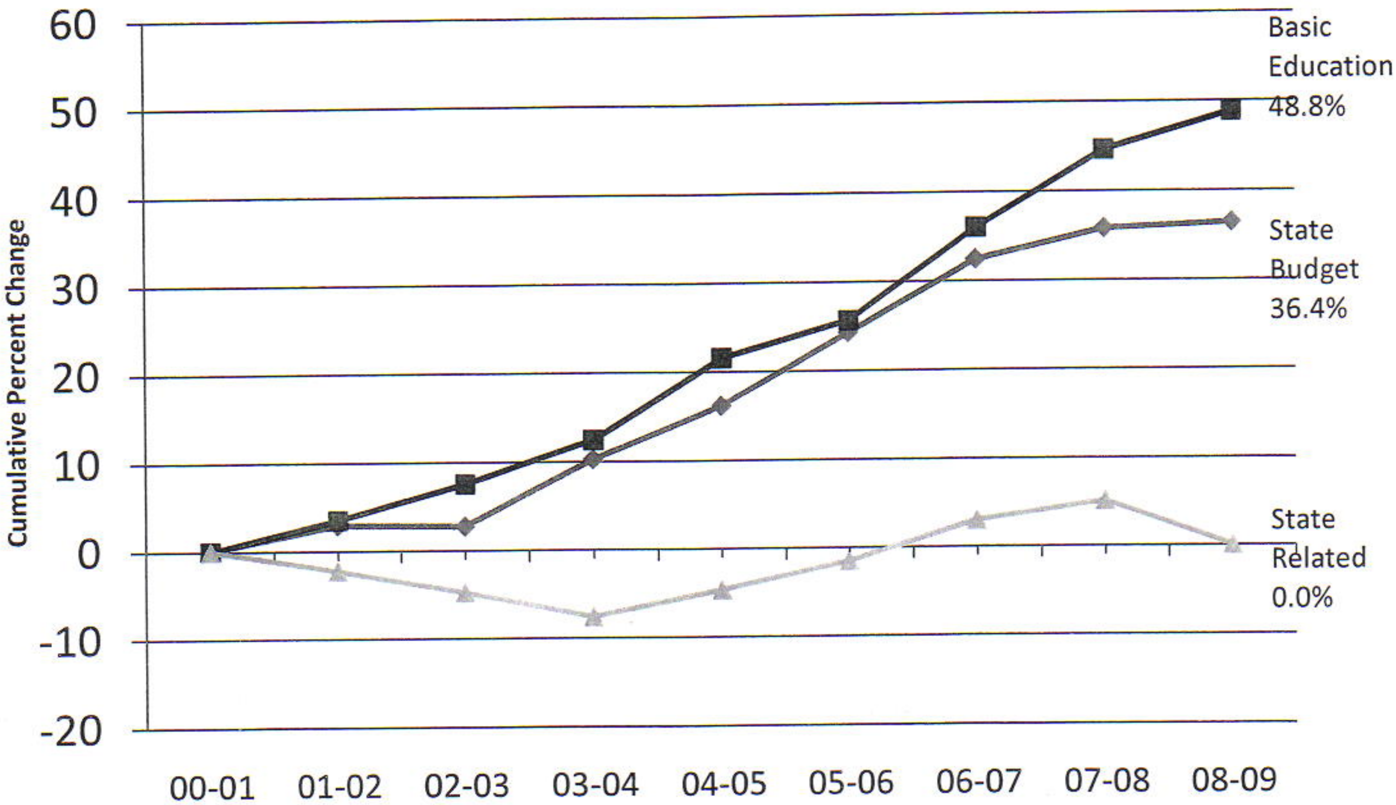
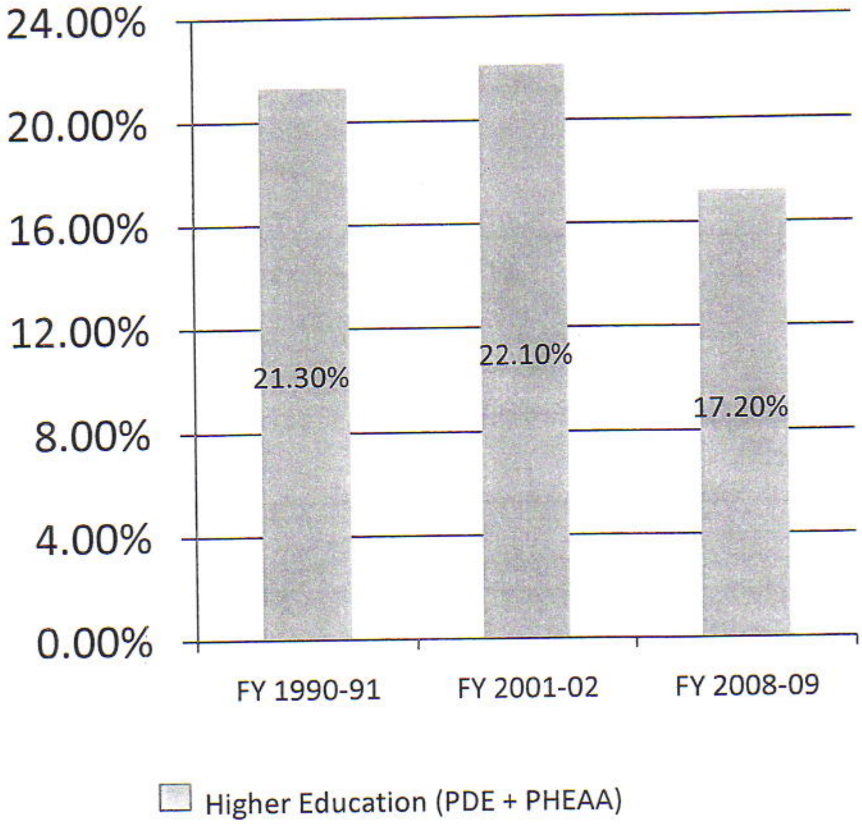


EXHIBIT 3

Pennsylvania State Support for Higher Education, including PHEAA, as a Percentage of Total Education Funding



	($ Millions)	
Fiscal Year	Total Education	Higher Education
1990-91	$5,906	$1,258
2001-02	$8,420	$1,860
2008-09	$11,746	$2,024

Source: Governor's Executive Budgets: 1992-93; 2002-03; 2010-11

EXHIBIT 4

The Pennsylvania State University
Examples of Budget Reductions, Revenue Enhancements and Efficiency Improvements
2003-04 to 2009-10

Budget Reductions and Revenue Enhancements

- Facilities and Administration Cost Recovery
  - Improved efforts to better track and more fully account for costs in support of sponsored research activities
  - Instituted an F&A surcharge for industry-sponsored grants and contracts

- Auxiliary Enterprises and University Services
  - Increased the Administrative Overheard rate charged to auxiliary and university services operations

- University Outreach
  - Program and administrative reductions as steps toward capping E&G subsidy (multi-year initiative)
  - Increased cost recovery
  - Image Resource Center closure

- Physical Plant
  - Janitorial and Landscape staff reductions
  - University-wide energy initiatives, including programs to close fume hoods when not in use, turning off personal computers when not in use, reducing the use of screen savers on personal computers, and adjusting temperature set points in the winter and the summer months

- Employee Benefits
  - Move new employees hired effective 1/1/2010 from a defined benefit health care plan to a defined contribution plan upon retirement
  - Increases in co-payments for specialist visits, ambulance services and prescription drugs for Medicare-eligible retirees
  - Increases in retiree contributions for the Penn State Medicare plan
  - Changes being planned for active employees to include wellness initiatives, increased co-payments and the implementation of deductibles

- College of Earth and Mineral Sciences
  - Mineral Economics program closure

- Smeal College of Business Administration
  - Merger of Business Logistics, Management Science, and IS programs into Supply Chain Management Department

- Summer Session
  - Adjustment to the college reimbursement formula for summer instruction

- Harrisburg Centers
  - State Data Center – closed Capital Office
  - Eastgate Center – reduction in program funds

- Faculty Senate Office
  - Discontinued staff position

- Office of Undergraduate Education
  - Administrative streamlining
  - Consolidating of teaching and learning activities into the Schreyer Institute

- Office of Planning and Institutional Assessment
  - Discontinued funding for Quality Expo
  - Staffing changes

- Office of Global Programs
  - Reorganization focusing on support for core activities.

- Philadelphia Outreach Center
  - Reduced rental expenses

- Mail Services
  - Route Changes

Efficiency Improvements and Cost Avoidance

- Procurement Services
  - Expanded electronic procurement initiatives
  - Reverse auctions
  - Copier management program
  - Print management program
  - Bundling computer equipment purchases for multiple units
  - Competitive bidding for telecommunications equipment
  - Travel services – improved pricing on airfare, hotels and car rentals

- Physical Plant
  - Instituting an Enterprise Utility Management System which improves the overall operation of 52 of our largest utility consuming buildings
  - ESCO program to create utility and energy savings by replacing older, inefficient equipment with newer environmentally friendly and energy efficient lighting, controls, etc.
  - Continuing program of re-commissioning of buildings to ensure that systems are operating efficiently
  - Building weatherization projects
  - Improved procedures for procurement of coal, natural gas and electricity
  - Changes in steam plant shutdown procedures and steam trap management
  - Design/build delivery process improvements
  - Implemented owner-controlled insurance program for capital projects

- Other
  - Increase less than 40 hours per-week and less than 12-month employment opportunities where appropriate
  - Outside vendor to operate chemical stock rooms in Science