

University of California Regents' Meeting
Update on Los Alamos National Laboratory
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Bruce B. Darling
Senior Vice President, University Affairs
and
Interim Vice President, Laboratory Management

Mr. Chairman, we last briefed the full Board of Regents at the most recent meeting of the Board on January 15 and 16. Today I would like to review the actions we have taken during the intervening two and a half months to address the procurement, property management, business and audit problems at Los Alamos National Laboratory.

To date, 18 Laboratory senior managers and employees have been terminated, removed from management positions and/or reassigned to new positions. These include the Lab Director, the Principal Deputy Director, the Chief Financial Officer, the Security Director and Deputy Director, and the Audit Director. We have terminated each of the employees involved in theft or misuse of government funds and property, and we have referred their cases to law enforcement officials for prosecution. In addition, the University rehired Mr. Walp and Mr. Doran on January 17 and they have assisted the University in identifying additional areas that deserve our attention.

At the same time, senior University officials took on direct, personal responsibility for managing Los Alamos business functions. They have been working closely with Admiral Nanos and the Lab's Associate Director for Administration - Rich Marquez - in implementing systemic change at Los Alamos. They are joined by thousands of honest and hard-working Los Alamos employees who are working diligently to bring about a change in the culture of the Lab.

UNIVERSITY MANAGEMENT OF LOS ALAMOS AUDIT OFFICE

- University Auditor Patrick Reed is now directly managing the Audit Office. In that capacity, he has already taken a number of significant steps:
- He has strengthened the independence of the audit function by having the auditor report directly to him.
- He rescinded the so-called "loyalty oath" prior to its mention in the Department of Energy Inspector General's Special Inquiry on Los Alamos operations.
- He has commenced peer reviews of the critical audit and assessments functions and redefined the internal audit reporting structures.
- He has developed a plan to bring current the substantial backlog of audit and investigation work utilizing existing staff, UC audit managers, and outside experts.
- He added an independent whistleblower hotline (1-800-403-4744) that improves confidentiality in order to encourage employees to report improper activities without fear of retaliation. This is intended to give employees confidence that their concerns will be

investigated fully and in a timely manner. He is also implementing recent University policies for reporting and investigating irregularities and protecting whistleblowers from retaliation.

UNIVERSITY MANAGEMENT OF LOS ALAMOS BUSINESS AND FINANCE

The Laboratory's finance and business operations are also now being managed by the University's Vice President for Financial Management, Anne Broome, who has extensive corporate finance experience. She has taken the following actions:

She organized a "red team" consisting of property, procurement and technology specialists from Lawrence Livermore National Laboratory to conduct a review of the organizational structure, business procedures and financial systems of the procurement and property functions.

She is conducting an internal risk assessment of key financial and business processes, including a "cradle-to-grave" assessment of property acquisition.

She adopted a more effective transitional organizational structure in the Business Division that enhances financial controls and business processes.

She will integrate the financial control and business process improvements with the Enterprise Resource Project the Laboratory is implementing.

She named a senior procurement officer from the University as interim head of the Procurement Office and installed a new director of the purchase card program.

EXTERNAL REVIEW OF PURCHASE CARDS AND PROCUREMENT

Meanwhile, the External Review Team - made up of two former federal Inspectors General and more than a dozen forensic accountants from PricewaterhouseCoopers - has expanded its recently completed review of the Lab's purchase card system to include all other procurement practices at the Laboratory, including Just-in-Time contracting, blanket purchase agreements, and local vendor agreements. As soon as the expanded work is done, we will report the results to the Regents and to the public and we will immediately address any deficiencies identified by the External Review Team. In the meantime, we have reduced the number of Local Vendor Agreements from 35 to 27, set new restrictions on their use, reviewed each agreement to determine its value to the Lab, and we are developing additional controls to strengthen these agreements.

With regard to the purchase card program, the External Review Team has reviewed 170,000 separate transactions totaling \$120 million over a period of 45 months. Its final report has been validated by the University Auditor who has concluded that there were \$3,000 in fraudulent purchases. However, approximately \$320,000 in costs were questioned as to their allowability under the DOE contract. These costs include questionable purchases, purchases that were not approved by a supervisor, purchases disputed with the vendor, and some purchases that cannot be documented because records were lost in the 2000 Cerro Grande Fire. The full amount will be reimbursed to the Department of Energy.

In addition, the Lab adopted the University's purchase card program in June 2002.

We reduced the number of purchase cards used by the Lab's 8,500 employees from 1,100 to 561.

All card-holders, and their approving officials, have received training in purchase card policies and procedures.

We decreased card-holder spending limits and now require approval of each transaction by a supervisor.

We imposed sanctions that involve revocation of cards for inappropriate use.

EXTERNAL REVIEW OF KEY BUSINESS PROCESSES

The University has also retained Ernst & Young to conduct a comprehensive review and validation of the Laboratory's key financial processes; to review systems integration and controls; to assess the business organization and recommend the optimal organizational structure; to evaluate core competencies of the business organization personnel; and to recommend required employee skill sets. A team of over 30 Ernst & Young consultants has been at Los Alamos for several weeks now and is expected to report back to us next month.

PROPERTY INVENTORY

Property management is another high priority. To that end, we are in the midst of a comprehensive property inventory - the first since 1998. As you can imagine, at a facility like Los Alamos, which covers 43 square miles and includes some 2,000 buildings and \$943 million in controlled property inventory, a wall-to-wall inventory is a massive but important and necessary undertaking. We have also conducted a survey of all Laboratory delivery sites, known as "drop points," in order to assess vulnerabilities in security and institute secure delivery of Lab property to Lab employees. Our external consultants will recommend additional property management controls that we will be instituting.

INTERIM OVERSIGHT BOARD

On a more strategic level, the Interim Oversight Board appointed by President Atkinson to guide me and Admiral Nanos has met nearly every other week since its appointment in order to sustain these changes. Its membership includes three members of the Board of Regents, Richard Blum, Peter Preuss and Gerald Parsky; UC San Diego Chancellor Robert Dynes; and Sidney D. Drell, a Stanford University professor emeritus and a noted arms control advisor.

Our meetings have reviewed business, security, project management, scientific and weapons program management and related issues. On his own initiative, and with the full support of the Oversight Board, Admiral Nanos has initiated numerous changes at the Lab including:

Director level reviews of all scientific and national security programs to ensure that the Lab is meeting its obligations to the nation.

Reviews of all building projects to improve their likelihood of completion within the desired time schedule and budget.

Enhanced nuclear facilities stewardship, including meeting with the Department of Energy to resolve longstanding issues at the Lab.

Defining the roles of group leaders, the individuals responsible for integrating decisions involving both science and business, in order to strengthen their role and provide them with the tools to fulfill their responsibilities.

Opening up regular communication with Lab employees, the community and elected officials.

UNIVERSITY GOVERNANCE AND OVERSIGHT

At the same time, we are working on a larger revamping of the University's governance structure for the three national laboratories it operates for the federal government.

External Oversight. We are examining various national laboratory management models for elements that we can draw upon to improve our own oversight: DOE's Sandia National Laboratories, Argonne National Laboratory, Oak Ridge National Laboratory, and Brookhaven National Laboratory; DOD's Draper Laboratory; and NASA's Jet Propulsion Laboratory. Our goal is stronger oversight by people with expertise in science and weapons, technology businesses, and corporate governance who will hold the Labs and the University accountable.

For the new governance board, we are currently developing a list of candidates with experience relevant to national security laboratories. We are developing a charter and initial definition of roles and responsibilities for this oversight structure and its relationship to the UC Board of Regents, to the University President and Vice President for Laboratory Management, and to the Laboratory Directors. We will include a list of expectations for Laboratory Directors in creating and maintaining a culture of accountability at the Laboratories.

Internal Oversight. To ensure that the University remains fully engaged in oversight, not just at Los Alamos but also at the other two Laboratories, we are designing an improved internal

University oversight structure. It will integrate a broader array of University management expertise - business and finance, audit, legal counsel, and human resources - into the oversight of the Laboratories, create a strong support function and staff for the external oversight body, integrate external expertise into the University's oversight, and create our own clear set of expectations and culture of accountability.

CONGRESSIONAL HEARINGS AND PUBLIC SUPPORT

As we have carried out these management changes and laid plans for the future, we have also participated in investigations of Los Alamos by the General Accounting Office, the Department of Energy Inspector General, the Congressional Investigations and Oversight Subcommittee, and by the California Legislature's Select Committee on Oversight of the UC-managed National Labs.

I testified in Washington on February 26 and March 12, and in Sacramento on March 11. The Sacramento hearing also included testimony from President Atkinson, Chancellor Dynes and the three Lab Directors. We expect to testify at additional hearings in Sacramento and Washington in the next few months.

We have received a tremendous outpouring of support from many people and organizations for our efforts and for the University's continued management of the Labs.

Employee petitions of support have been sent to Secretary Abraham with the signatures of 3,000 Livermore employees and 2,500 Los Alamos employees.

Senator Feinstein issued a statement recognizing the changes we have put in place and supporting the University's continued role in managing the Labs. Congresswomen Tauscher and Eshoo and Congressmen Radanovich and Lewis have been particularly helpful.

The Governor of New Mexico issued a strong public statement of support for continued UC management of Los Alamos and both houses of the New Mexico Legislature unanimously passed a memorial in support of the Lab and the University.

The New Mexico Legislature tabled a bill that would have imposed a \$70 million per year tax on the Lab following a visit that Admiral Nanos and I made to the Governor and the Legislature in February.

Resolutions and letters from New Mexico chambers of commerce, labor unions, the Mayor of Livermore, retirees, city councils, Pueblos and Community Colleges have been sent to Secretary Abraham.

President Atkinson, Admiral Nanos, Livermore Director Anastasio and I have made numerous trips to Washington to meet with members of the California and New Mexico delegations and with Secretary Abraham and his leadership team at the Department of Energy. We will be back in Washington next week for further discussions with the Department of Energy and our elected officials.

This month there will likely be an audit report from the General Accounting Office and five audit reports from the Department of Energy Inspector General. These may well affect the Secretary's decision.

We are also examining ways we might partner with businesses to further improve the management of Los Alamos.

Mr. Chairman, I would be pleased to answer your questions. But before doing so, I want to comment that this has been a fascinating assignment, and I would like to express my appreciation to the many people who have selflessly devoted untold hours of their personal time to bring about the changes I have outlined today: Regents, Chancellors, the Directors of the Los Alamos, Livermore and Berkeley Labs, Los Alamos and Livermore employees, and many individuals in the Office of the President. However, we still of a lot of work to do and the outcome of the April 30th review is still uncertain.