



## Accessible Version

March 24, 2016

The Honorable David Vitter  
Chairman  
The Honorable Jeanne Shaheen  
Ranking Member  
Committee on Small Business and Entrepreneurship  
United States Senate

The Honorable Steve Chabot  
Chairman  
The Honorable Nydia Velázquez  
Ranking Member  
Committee on Small Business  
House of Representatives

### HUBZone Program: Actions Taken on February 2015 GAO Recommendations

Firms in the Historically Underutilized Business Zone (HUBZone) program of the Small Business Administration (SBA) had almost \$6.6 billion in obligations on active federal contracts for calendar year 2015.<sup>1</sup> As of December 31, 2015, there were about 16,500 HUBZones and 4,600 firms in the program. Congress established the HUBZone program to stimulate economic development in economically distressed communities. The program provides federal contracting preferences to small businesses located in HUBZone areas that also employ residents of the areas.<sup>2</sup> The contracting preferences that a certified HUBZone firm (one that meets program requirements) can receive include limited competition awards such as sole-source and set-aside contracts. An eligible HUBZone firm can also receive an award through open and full competition should its price exceed by not more than 10 percent the price of the otherwise lowest offeror (other than another small business concern). Federal agencies are responsible for trying to meet an annual statutory goal for awarding contracts to HUBZone firms (3 percent of all prime contracts and subcontracts).

We and SBA's Office of Inspector General (OIG) previously reported on the need for SBA to strengthen its internal controls and its fraud prevention to ensure only eligible firms participate in the HUBZone program.<sup>3</sup> We identified a number of internal control-related deficiencies in the

<sup>1</sup>The \$6.6 billion represents prime contracts awarded directly by a procuring agency to the bidder or offeror (prime contractor).

<sup>2</sup>HUBZone Act of 1997, Pub. L. No. 105-135, Title VI, 111 Stat. 2592, 2627-36 (1997).

<sup>3</sup>GAO, *Small Business Contracting: Opportunities Exist to Further Improve HUBZone Oversight*, [GAO-15-234](#), (Washington, D.C.: Feb. 12, 2015); *Small Business Administration: Undercover Tests Show HUBZone Program Remains Vulnerable to Fraud and Abuse*, [GAO-10-920T](#) (Washington, D.C.: July 28, 2010); *Small Business Administration: Undercover Tests Show HUBZone Program Remains Vulnerable to Fraud and Abuse*, [GAO-10-759](#) (Washington, D.C.: June 25, 2010); *HUBZone Program: Fraud and Abuse Identified in Four Metropolitan Areas*, [GAO-09-440](#)

program. For example, we identified problems with the mechanisms that SBA used to certify and monitor HUBZone firms and that SBA had not followed its policy of recertifying firms every 3 years (a certified firm can participate in the program as long as it remains eligible and is recertified).<sup>4</sup> Most recently, our February 2015 report found that SBA had implemented a number of actions to address previously identified problems but had missed some opportunities to strengthen its oversight of the HUBZone program.<sup>5</sup>

The National Defense Authorization Act for Fiscal Year 2016 includes a provision for GAO to assess SBA oversight of the HUBZone program, including SBA's process to approve or deny participation in the program and actions taken by SBA to prevent fraud, waste, and abuse.<sup>6</sup> This report addresses the actions that SBA has taken in response to the two open recommendations we made in February 2015 regarding weaknesses in its oversight of the HUBZone program.

To update information on the status of the program and recommendations from our 2015 report, we reviewed SBA written responses and documents that reflect process changes the agency made, and interviewed SBA staff. We also used data from the Federal Procurement Data System-Next Generation to analyze the dollar amount of federal contracts obligated to HUBZone firms in calendar year 2015. Based on our prior review of related documentation and interviews with knowledgeable officials, we deemed the information obtained from this data source to be sufficiently reliable for the purposes of this report.

We conducted this performance audit from December 2015 to March 2016 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

## Results in Brief

As of March 8, 2016, SBA has taken some actions to address but had not fully implemented the two recommendations we made in February 2015. Previously, we found that SBA relied on website updates and broadcast e-mails to inform firms about program changes such as area redesignations (loss of HUBZone status). But not all HUBZone firms may have signed up to

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(Washington, D.C.: Mar. 25, 2009); *HUBZone Program: Fraud and Abuse Identified in Four Metropolitan Areas*, [GAO-09-519T](#) (Washington, D.C.: Mar. 25, 2009); *Small Business Administration: Status of Efforts to Address Previous Recommendations on the HUBZone Program*, [GAO-09-532T](#) (Washington, D.C.: Mar. 25, 2009); *HUBZone Program: SBA's Control Weaknesses Exposed the Government to Fraud and Abuse*, [GAO-08-964T](#) (Washington, D.C.: July 17, 2008); *Small Business Administration: Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results*, [GAO-08-975T](#) (Washington, D.C.: July 17, 2008); and *Small Business Administration: Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results*, [GAO-08-643](#) (Washington, D.C.: June 17, 2008). Also see Small Business Administration, Office of Inspector General, *Opportunities Exist to Further Improve Quality and Timeliness of HUBZone Certifications*, 14-03 (Washington, D.C.: Nov. 19, 2013); and *HUBZone Program Examination and Recertification Processes*, 6-23 (Washington, D.C.: May 23, 2006).

<sup>4</sup>For example, see [GAO-08-643](#).

<sup>5</sup>[GAO-15-234](#).

<sup>6</sup>Pub. L. 114-92, sec. 866(d). The provision directed us to report no later than 120 days after the date of enactment of this act to the Senate Small Business and Entrepreneurship and House Small Business Committees.

receive the e-mails. As a result, we recommended that SBA take steps to inform all firms about such changes. SBA officials said they now communicate such information in approval letters for newly certified firms and add newly certified firms to the e-mail distribution list. However, SBA had not taken steps to help ensure that all previously certified firms are added to the e-mail distribution list. To better ensure that *all* certified firms potentially affected by such changes receive information about the changes or are made aware in a timely fashion of any effects on their program eligibility, SBA must take steps to ensure that previously certified firms are notified as well. In the February 2015 report, we also found that as of September 2014 SBA had a 1-year backlog for recertifying firms and generally relied on firms' attestation of continued eligibility. We recommended that SBA conduct an assessment of the recertification process and implement additional controls, such as developing guidance for requesting and verifying firm information and ensuring it had sufficient staff dedicated to recertifications to prevent recurring backlogs. In response, SBA changed its processes so that firms are alerted on an ongoing basis when they are due for recertification. In January 2016 SBA officials told us they had not issued guidance on requesting supporting documents during recertification because any potential risk of fraud would be mitigated by their policy of conducting site visits of firms. However, based on data that SBA provided, SBA only visited a fraction of certified firms in fiscal years 2013–2015. For example, SBA conducted site visits on 10 percent and 11 percent of certified HUBZone firms in fiscal years 2013 and 2014, respectively.<sup>7</sup> Additionally, SBA's reliance on site visits would not mitigate the recertification weaknesses that were the basis for our recommendation. Developing guidance on requesting supporting documentation from firms seeking recertification would provide SBA with greater assurance that only qualified firms continue in the HUBZone program and receive preferential contracting treatment. Finally, SBA continued to have a recertification backlog stemming from the transition to the new process and data issues, as of March 2016.

## Background

The HUBZone Act of 1997 (which established the HUBZone program) identified HUBZones as (1) qualified census tracts, which are determined by area poverty rate or household income;<sup>8</sup> (2) qualified nonmetropolitan counties, which are determined by area unemployment rate or median household income; and (3) lands meeting certain criteria within the boundaries of an Indian reservation.<sup>9</sup> Congress subsequently expanded the criteria for HUBZones to add former military bases and counties in difficult development areas outside the continental United States.<sup>10</sup> To be certified to participate in the HUBZone program, a firm must meet the following criteria:<sup>11</sup>

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<sup>7</sup>SBA has established a goal of conducting site visits of 10 percent of the total number of HUBZone firms that were in the program the previous fiscal year.

<sup>8</sup>Qualified census tracts are those tracts designated by the Secretary of the Department of Housing and Urban Development for the Low-Income Housing Tax Credit program.

<sup>9</sup>HUBZone Act of 1997 (Title VI of the Small Business Reauthorization Act of 1997, Pub. L. No. 105-135).

<sup>10</sup>Difficult development areas have high construction, land, and utility costs relative to area median income. The areas are designated annually using a process that compares these costs. Consolidated Appropriations Act, 2005 Pub. L. No. 108-447, Div. K, § 152, 118 Stat. 3456-58 (2004), and Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users, Pub. L. No. 109-59, § 10203, 119 Stat. 1933-34 (2005).

<sup>11</sup>Different rules apply for Indian Tribal governments, Alaska Native Corporations, Community Development Corporations, and small agricultural cooperatives. See Title 13 of the Code of Federal Regulations, Part 126.

- when combined with its affiliates, be small by SBA size standards;<sup>12</sup>
- be at least 51 percent owned and controlled by U.S. citizens;<sup>13</sup>
- have its principal office—the location where the greatest number of employees perform their work—in a HUBZone;<sup>14</sup> and
- have at least 35 percent of its employees reside in a HUBZone.<sup>15</sup>

### Status of February 2015 Report Recommendations

As of March 8, 2016, SBA had not yet taken action to fully implement either of the two recommendations we made in February 2015.<sup>16</sup> In the February 2015 report, we found that SBA relied on website updates and broadcast e-mails to inform firms about program changes. But the combination of relatively frequent changes to HUBZone designations, SBA's generally nonspecific communications to firms as illustrated by its certification letter, and the incomplete addressee list for the broadcast e-mails have increased the possibility that not all certified firms affected by such changes receive information about the changes or are made aware in a timely fashion of any effects on their program eligibility. For example, HUBZones can lose their designations because of changes in economic conditions (such as poverty or unemployment rates). These redesignated areas remain eligible for 3 years, during which firms in those areas can continue to apply to and participate in the program and receive contracting preferences.

Consequently, we recommended that SBA

- establish a mechanism to better ensure that firms are notified of changes to HUBZone designations that may affect their participation in the program, such as ensuring that all certified firms and newly certified firms are signed up for the broadcast e-mail system or including more specific information in certification letters about how location in a redesignated area can affect their participation in the program.

In response to this recommendation, SBA improved notifications to newly certified firms but has not implemented changes to better ensure that all currently certified firms are notified of

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<sup>12</sup>The firm, with its affiliates, must meet the size standard corresponding to its primary industry classification as defined in 13 CFR Part 121. SBA's size standards vary by industry and are almost always stated as the average number of employees or average annual receipts of a business.

<sup>13</sup>Qualified HUBZone firms also can be owned and controlled by Alaska Native Corporations, Indian Tribal governments, community development corporations, and agricultural cooperatives.

<sup>14</sup>While a certified HUBZone business must have its principal office in a HUBZone area, HUBZone contracts are not limited to performance in HUBZone areas.

<sup>15</sup>SBA defines an employee as an individual employed on a full-time, part-time, or other basis, and working a minimum of 40 hours per month. This includes employees obtained from a temporary employee agency, leasing concern, or through a union agreement or co-employed pursuant to a professional employer organization agreement.

<sup>16</sup>[GAO-15-234](#).

program changes that could affect their continued eligibility in the program.<sup>17</sup> According to SBA officials, SBA changed its data system to allow application reviewers to indicate if the address for the firm's principal office and addresses of some of its employees were in redesignated areas. If such a firm is approved, SBA adds language to the approval letter that explains that a redesignation can affect the firm's future eligibility (because of requirements relating to principle office location and employee residency) and the date on which the area's redesignated status will expire. SBA officials emphasized that certified firms have the primary responsibility for keeping themselves informed about the program so that they can remain eligible. While SBA also has started adding all newly certified firms (on a quarterly basis) to the distribution list for its broadcast e-mail, it has not taken steps to help ensure that all currently certified firms receive the e-mail. As a result, not all certified firms affected by changes to HUBZone designations may receive information about the changes or be made aware in a timely way of any effects on their program eligibility.

We also found a number of weaknesses with SBA's HUBZone recertification processes in the February 2015 report, including that SBA had a backlog of recertifications. According to SBA officials, because of limitations with the program's computer system and resource constraints, SBA manually identified firms due for recertification twice a year, delaying notifications to firms. SBA also did not require firms seeking recertification to submit any information to verify their continued eligibility, and did not provide guidance on when staff should request or verify documentation for recertification. Previously, SBA officials told us that they did not believe they needed to request supporting documentation from recertifying firms because all firms in the program at that time had undergone a full document review (at initial application or through the review SBA completed of its legacy portfolio in fiscal year 2012).<sup>18</sup>

As a result, we recommended that SBA

- conduct an assessment of the recertification process and implement additional controls, such as developing criteria and guidance on using a risk-based approach to requesting and verifying firm information, allowing firms to initiate the recertification process, and ensuring that sufficient staff will be dedicated to the effort so that a significant backlog in recertifications does not recur.

In response to this recommendation, SBA officials told us that they began automating the process to notify firms they were due for recertification. According to the officials, since September 2015 notification e-mails have been sent daily (compared with the former cycle of two times a year). Each firm due for recertification within the next 30 days would receive the notice. SBA sends a second e-mail to firms that have not responded within 45 days of the first notification. However, SBA still has a recertification backlog stemming from the transition to the new process. According to SBA officials, SBA stopped manual recertifications from January

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<sup>17</sup>On April 8, 2015, SBA Associate Administrator John Shoraka sent a letter to Congressional oversight committees pursuant to the requirements of 31 U.S.C. 720 to provide a "Statement of Action" in response to GAO recommendations. In this letter, Associate Administrator Shoraka stated, "SBA has completed an evaluation of existing resources and, no later than July 2015, SBA will implement an enhanced mechanism to better inform all certified firms and newly certified firms of HUBZone designation changes and explain how a redesignation can affect their participation in the HUBZone Program." From his statement, it appears that SBA understood our recommendation to include both new and existing firms.

<sup>18</sup>Legacy portfolio refers to those firms that received initial certifications before the fiscal year 2009 policy of full document review (for initial certifications) went into effect. According to agency officials, SBA conducted a full documentation review of the legacy portfolio firms to confirm that the firms complied with the program's eligibility requirements.

through September 2015 to implement the process changes (the agency wanted to diminish data entry errors during the transition). Because of the stop, 660 firms will be notified about 1 year after the time frame for recertification. SBA plans to send recertification notices to these firms between February 2016 and June 2016. Additionally, according to the officials, during the transition process SBA identified 239 records that had data issues that resulted in the firms not being recertified in the appropriate time frame. Consequently, SBA will continue to have a backlog of recertifications until at least the fourth quarter of fiscal year 2016.

According to SBA officials, SBA has not issued additional controls, such as requesting supporting documents during recertification as we suggested, because the officials believe that any potential risk of fraud would be mitigated by site visits to firms. Additionally, the officials cited resource limitations, such as SBA's reliance on a data system that does not currently meets its business processes, for not making changes. According to the officials, SBA conducted more than 500 site visits in each fiscal year from 2013 through 2015 and 81 percent, 88 percent, and 87 percent of the firms passed the visits, respectively. However, based on data that SBA provided, the agency only visited a fraction of certified firms in fiscal years 2013–2015.<sup>19</sup> For example, SBA conducted site visits on 10 percent and 11 percent of certified HUBZone firms in fiscal years 2013 and 2014, respectively. According to the officials, requiring supporting documentation as part of a firm's recertification would slow processing of initial applications and would be resource intensive. SBA's reliance on site visits alone would not mitigate the recertification weaknesses that were the basis for our recommendation. In recognition of SBA's resource constraints, we noted in our 2015 report that SBA could apply a risk-based approach to its recertification process to review and verify information from firms that appear to pose the most risk to the program. As a result of not fully implementing our recommendation, SBA lacks reasonable assurance that only qualified firms are allowed to continue in the HUBZone program and receive preferential contracting treatment. As we noted in 2015, the characteristics of firms and the status of HUBZone areas—the bases for program eligibility—often can change, and need to be monitored. For example, the size of a firm and the residency location of its employees can change in 3 years. The lack of risk-based criteria and guidance for staff to request and verify firm information during the recertification process increases the risk to the program.

### Agency Comments and Our Evaluation

We provided a draft of this report to the Small Business Administration for comment. In its written comments, which are reproduced in enclosure I, SBA disagreed with our conclusions about the actions it has taken in response to our February 2015 recommendations. In response to our conclusion that SBA has not implemented our recommendation that it establish a mechanism to better ensure that firms are notified of changes to HUBZone designations that may affect their participation in the program, SBA stated that its inclusion of specific information (about how location in a redesignated area can affect a firm's participation) in certification letters satisfied our recommendation on notifying firms. We maintain that SBA has not fully addressed the recommendation, which is intended to better ensure that all affected firms—not just those newly certified—are notified about how changes to HUBZone designations may affect their participation. SBA also provided information about tools it continues to provide to firms that proactively seek information, such as the offer of "Office Hours" call-in service.

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<sup>19</sup>As noted previously, SBA has set a goal of conducting site visits to 10 percent of firms that were in the program the previous fiscal year.

SBA also provided information about actions it has taken in response to our recommendation to assess its recertification process, implement additional controls (such as criteria for requesting and verifying firm information), allow firms to initiate recertification, and ensure that a significant backlog in recertifications does not recur. SBA stated that its recent automation of the recertification process will eliminate the recertification backlog by June 2016. But SBA also stated that its existing resources were insufficient to support collection and analysis of firm documentation during recertification and that it would not be cost-effective to allow firms to upload documentation directly into SBA's database. SBA noted that it planned to replace its existing data system in the next 24 months and that investing in additional functionality for the existing system would not be worthwhile. SBA stated that it has reasonable assurance (through its existing monitoring processes) that only qualified firms benefit from the HUBZone contracting preferences. In our February 2015 report, we noted that monitoring processes can take resource constraints into account and consequently recommended that SBA incorporate a risk-based approach for requesting supporting documentation. (SBA would review and verify information from firms that appeared to pose the most risk to the program.) Such an approach could help leverage SBA's resources, provide a more efficient approach to supplement the site visits SBA already conducts, and lessen the risk of fraud in the program.

We will continue to evaluate actions SBA takes to implement our recommendations. SBA also provided technical comments that we incorporated as appropriate.

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We are sending copies of this report to the appropriate congressional committees, the Administrator of the Small Business Administration, and other interested parties. In addition, the report will be available at no charge on the GAO website at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at (202) 512-8678 or [shearw@gao.gov](mailto:shearw@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report include Harry Medina (Assistant Director), Daniel Newman (Analyst-in-Charge), Pamela Davidson, John McGrail, and Barbara Roesmann.



William B. Shear  
Director  
Financial Markets and  
Community Investment  
Enclosure



## Enclosure: Comments from the Small Business Administration



U.S. SMALL BUSINESS ADMINISTRATION  
WASHINGTON, D.C. 20416

March 8, 2016

Mr. William B. Shear  
Director  
Financial Markets and Community Investment  
U.S. Government Accountability Office  
Washington, DC 20548

Dear Mr. Shear:

Thank you for providing the U.S. Small Business Administration (SBA) with a copy of the Government Accountability Office (GAO) report titled "HUBZone Program: Actions Taken on February 2015 GAO Recommendations." In this report, GAO addresses the actions that SBA has taken in response to the two open recommendations it made in February 2015 in which it recommended that SBA should: (1) establish a mechanism to better ensure firms are notified of changes that could affect their participation in the program; and (2) assess the recertification process and implement additional controls, such as criteria and guidance for a risk-based approach to requesting and verifying information during recertification.

SBA does not agree with GAO's conclusions about the actions taken on the recommendations of the February 2015 GAO report.

### **GAO's recommendation #1**

Establish a mechanism to better ensure that firms are notified of changes to HUBZone designations that may affect their participation in the program, such as ensuring that all certified firms and newly certified firms are signed up for the broadcast e-mail system **or** including more specific information in certification letters about how location in a redesignated area can affect their participation in the program.

### **SBA's response**

SBA understood that both sub-recommendations were not necessary. As a result, it selected the second option: "including more specific information in certification letters about how location in a redesignated area can affect their participation in the program."

The HUBZone News (i.e., the broadcast e-mail system) is a voluntary, free subscription that the HUBZone office has offered to interested parties (e.g., applicants, certified firms, acquisition community, etc.) since 2012. Subscribers receive a modest number of emails—less than six per year—from the HUBZone program through HUBZone News. However, our data indicates that only 19.1% of the HUBZone News emails delivered by the HUBZone program are opened by subscribers. This suggests that if SBA were to implement blanket distribution of emails to the existing portfolio (roughly 4,600 firms) and to newly certified firms, SBA could expect that less than 900 firms would open the emails.



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It should be understood that the current voluntary subscription is just one element in the variety of communication channels SBA uses to educate certified firms and the public about the HUBZone geographical designations. For example, the HUBZone Program offers “Office Hours” every Tuesdays and Thursdays from 2-3pm ET for firms and the public to call in with questions about geographical designations, applications process, and other general questions about the HUBZone regulatory requirements. The actions SBA has taken over the years are intended to provide the tools necessary for certified HUBZone firms to maintain compliance. For instance, in FY 2015, 87% of firms site-visited demonstrated that they were operating out of their HUBZone principal office of record. The SBA’s low rate of non-compliance findings related to geographical changes attests to the success of this multi-pronged approach.

SBA modified the HUBZone Certification Tracking System (HCTS) to include a mechanism for insertion of language into the certification letter which alerts the firm that the specific address of its principal office and/or the specific addresses of some of its employees are in redesignated areas, and the consequences. These cost-effective changes SBA has made to HCTS provide clear, targeted communication of how expiration of redesignated status can affect firms’ eligibility and participation in the program.

This change was the latest in a series of continuing efforts to further educate certified firms and the public regarding the dynamics of HUBZone geographical designations and the imperative of proactively managing regulatory and eligibility compliance. For example, SBA regularly updates its HUBZone website including updates to geographical designations. The HUBZone website also includes a mini-primer about HUBZone designations (see <https://www.sba.gov/content/hubzone-maps> and <https://www.sba.gov/content/understanding-hubzone-program#additional>). In this regard, we note that the map landing page, in particular, has the best performance metrics of all of the pages in the HUBZone website. It has the most views, highest average time on the page, and the lowest bounce rate. These indicators strongly suggest that users are engaging with the information in the page.

Further, SBA updates the HUBZone certification letter to reflect statutory, regulatory, and policy changes, and includes in it a listing of the firm’s responsibilities to maintain eligibility. Among these responsibilities are:

- Checking SBA’s HUBZone mapping pages to determine whether changes in HUBZone area designations affect, or will affect the firm’s eligibility (<http://www.sba.gov/content/hubzone-maps>); and
- Signing up to receive HUBZone News Updates via email.

### GAO recommendation #2

GAO recommended that SBA conduct an assessment of the current recertification process and implement additional controls to reduce the risk that firms that no longer meet program eligibility criteria receive HUBZone contracts, such as developing criteria and guidance on using a risk-based approach to requesting and verifying firm information during the recertification process, allowing firms to initiate the recertification process, and ensuring that there is sufficient staff dedicated to the effort so that a significant backlog in recertifications does not recur.

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### **SBA's response**

After conducting a cost-benefit analysis, SBA elected to enhance HCTS to automate the manual recertification process that had been in place since 2010. The manual procedure was labor intensive, engendered data entry errors, and contributed to delays in recertification actions, which were deployed in batches. The approach that SBA elected in automating the process through HCTS allows firms to initiate the recertification process. It is also designed to eliminate recertifications backlogs.

The FY 2015 recertifications that remain outstanding result from SBA's deployment of this enhanced functionality in September 2015. The automated process requires the firm to attest compliance in writing, with the understanding that any intentional or negligent misrepresentation of the information contained in its affirmation may result in criminal, civil, or administrative sanctions.

It should be noted that SBA discontinued the manual recertification process in January 2015, to mitigate data entry errors as it deployed the enhanced recertification module. SBA allocated approximately 1,000 hours, at cost of approximately \$100,000 to cleanse the data in preparation for the September 2015 deployment of the automated recertification functionality within HCTS.

SBA discovered that during the first 20 weeks of production, the new system missed records of a number of firms that were to be recertified. Since discovery of the problem, which derived from the aging HCTS technology and data anomalies in old records, SBA has corrected the system. The data in the missed records are being fixed; and by June 2016, SBA expects to complete the outstanding 899 firms that were due for recertification in 2015.

It should be understood that while firms missed in fiscal 2015 are now being processed, firms due for recertification in 2016 are being notified in accordance with the automated process to maintain the recertification timeliness and abide by existing regulations. The automated recertification system is now operating properly.

The SBA's existing resources are insufficient to support collection and analysis of corroborative documentation as part of the recertification process and it would not be cost-effective to allow the firm to upload the documentation directly into HCTS. HCTS is a 15 year old web application that was built for self-certification. Within the next 24 months, HCTS will be replaced with state of the art technology. At this time, investing on additional functionality for HCTS would not be worthwhile. Therefore, manual processes would have to be implemented to manage and analyze this documentation. SBA estimates that it would have to allocate approximately 4,000 hours to this effort, at a minimum cost of \$168,000. In addition, this labor-intensive process would adversely impact available resources allocated to processing of initial applications, resulting in reduced total production, and increased processing time.

The SBA has reasonable assurance that only qualified firms are allowed to benefit from the HUBZone contracting preferences. The SBA exercises its statutory and regulatory authority in monitoring compliance of its portfolio through risk-based review and investigation of firms when it cannot verify eligibility, or when it determines that the concerns are no longer eligible, and thereby mitigates fraud, waste, and abuse.

For example, every year, SBA searches the Federal Procurement Data System and assembles a list of firms that have received HUBZone contract awards in the previous fiscal year. Using that information, SBA identifies firms to receive site visits representing at least 10% of its existing portfolio. At a minimum, firms to receive site visits include: those that have received HUBZone contract awards in the

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previous fiscal year, but have not been site-visited previously; and those that have received HUBZone contracts in excess of \$180,000 during the previous fiscal year, whether or not they have been site visited previously.

Accordingly, firms that have received HUBZone contracts represent a significant percentage of the site visits. Notably, in FY 2015, 87% of firms site-visited demonstrated that they were operating out of their HUBZone principal office of record.

It should be noted that to submit an offer on a HUBZone contract, the firm, together with its affiliates, must be small under the size standard corresponding to the NAICS code assigned to the contract. Further, the firm must be in compliance with all HUBZone requirements both at time of initial offer, and at time of award in order to be eligible for a HUBZone contract.

Importantly, award of a HUBZone contract may be protested by an offeror, the contracting officer, or the SBA. In 2014, the HUBZone program launched a protest webpage to educate certified HUBZone firms and the acquisition community about this significant regulatory provision, which materially strengthens SBA's efforts to mitigate of fraud, waste, and abuse. When SBA receives a protest in connection to a HUBZone contract alleging that the firm does not meet the HUBZone principal office requirement, it conducts site visits for all the locations from which the firm is allegedly operating.

Also, it should be recognized that the characteristics of the majority of the firms in the HUBZone portfolio do not necessarily align well with the profile of successful small business competitors in the Federal contracting arena, at least at the outset. For example, for firms in the HUBZone portfolio, median gross revenue is about \$429,410, median number of employees is 5, and median years in business is 8. However, for HUBZone certified firms that have won contracts in the top small business NAICS codes, median gross revenue is about \$2,799,972, median number of employees is 15, and median years in business is 11. This suggests that overall risk of award of HUBZone contracts to ineligible firms is comparatively modest. That notwithstanding, SBA's objective is to drive risk to the lowest possible level, given available resources, through forceful application and continuing refinement of eligibility monitoring policies, techniques, and tools.

As earlier noted, to sustain and enhance the integrity of the HUBZone portfolio and mitigate fraud, waste, and abuse, the certification and continuing eligibility letters are periodically revised, particularly to clarify and strengthen understanding of compliance requirements. These notices remind firms of their responsibilities as certified HUBZone concerns. Specifically, these notices include the following:

- A statement that any concern found to misrepresent its small business status may be subject to a range of civil or criminal penalties and/or suspension or debarment from federal contracting;
- An explanation of the regulatory requirement to inform the HUBZone Program of any material changes to the concern that may affect its continued eligibility;
- A reminder of the importance of remaining in compliance at all times, and staying updated on program changes;
- A reminder to periodically visit the HUBZone website (<http://www.sba.gov/hubzone>) to keep up-to-date with the program requirements and geographical designations;
- A reminder to check SBA's HUBZone mapping pages to determine whether changes in HUBZone area designations impact or will impact the firm's eligibility (<http://www.sba.gov/content/hubzone-maps>); and
- A reminder to sign up to receive HUBZone News Updates via email.

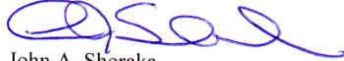
## Enclosure

Mr. William B. Shear  
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Finally, SBA recognizes the importance of communication and human engagement in maintaining program compliance. For this reason, since 2012, the HUBZone program has offered eligibility assistance on Tuesdays and Thursdays from 2-3pm ET via a toll free number available on the HUBZone website. Each year, approximately 1,339 firms participate in these sessions. Questions from callers drive the discussion, and HUBZone staff facilitate the discussion by providing answers and explaining relevant initial and continuing eligibility requirements and responsibilities. This format offers the opportunity for firms to better understand how to maintain compliance with the HUBZone program requirements, including the continuing eligibility implications of changes in HUBZone geographical designations.

Thank you for the opportunity to comment on this report.

Sincerely,



John A. Shoraka  
Associate Administrator  
Office of Government Contracting and Business Development

Accessible Text for Enclosure: Comments from the Small Business Administration

U.S. SMALL BUSINESS ADMINISTRATION

WASHINGTON, D.C. 20416

March 8, 2016

Mr. William B. Shear

Director

Financial Markets and Community Investment

U.S. Government Accountability Office

Washington, DC 20548

Dear Mr. Shear:

Thank you for providing the U.S. Small Business Administration (SBA) with a copy of the Government Accountability Office (GAO) report titled "HUBZone Program: Actions Taken on February 2015 GAO Recommendations." In this report, GAO addresses the actions that SBA has taken in response to the two open recommendations it made in February 2015 in which it recommended that SBA should: (1) establish a mechanism to better ensure firms are notified of changes that could affect their participation in the program; and (2) assess the recertification process and implement additional controls, such as criteria and guidance for a risk-based approach to requesting and verifying information during recertification.

SBA does not agree with GAO's conclusions about the actions taken on the recommendations of the February 2015 GAO report.

GAO's recommendation #1

Establish a mechanism to better ensure that firms are notified of changes to HUBZone designations that may affect their participation in the program, such as ensuring that all certified firms and newly certified firms are signed up for the broadcast e-mail system or including more specific information in certification letters about how location in a redesignated area can affect their participation in the program.

SBA's response



SBA understood that both sub-recommendations were not necessary. As a result, it selected the second option: "including more specific information in certification letters about how location in a redesignated area can affect their participation in the program."

The HUBZone News (i.e., the broadcast e-mail system) is a voluntary, free subscription that the HUBZone office has offered to interested parties (e.g., applicants, certified firms, acquisition community, etc.) since 2012. Subscribers receive a modest number of emails-less than six per year-from the HUBZone program through HUBZone News. However, our data indicates that only 19.1% of the HUBZone News emails delivered by the HUBZone program are opened by subscribers. This suggests that if SBA were to implement blanket distribution of emails to the existing portfolio (roughly 4,600 firms) and to newly certified firms, SBA could expect that less than 900 firms would open the emails.

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It should be understood that the current voluntary subscription is just one element in the variety of communication channels SBA uses to educate certified firms and the public about the HUBZone geographical designations. For example, the HUBZone Program offers "Office Hours" every Tuesdays and Thursdays from 2-3pm ET for firms and the public to call in with questions about geographical designations, applications process, and other general questions about the HUBZone regulatory requirements. The actions SBA has taken over the years are intended to provide the tools necessary for certified HUBZone firms to maintain compliance. For instance, in FY 2015, 87% of firms site-visited demonstrated that they were operating out of their HUBZone principal office of record. The SBA's low rate of non-compliance findings related to geographical changes attests to the success of this multi- pronged approach.

SBA modified the HUBZone Certification Tracking System (HCTS) to include a mechanism for insertion of language into the certification letter which alerts the firm that the specific address of its principal office and/or the specific addresses of some of its employees are in redesignated areas, and the consequences. These cost-effective changes SBA has made to HCTS provide clear, targeted communication of how expiration of redesignated status can affect firms' eligibility and participation in the program.

This change was the latest in a series of continuing efforts to further educate certified firms and the public regarding the dynamics of HUBZone geographical designations and the imperative of proactively managing regulatory and eligibility compliance. For example, SBA regularly updates its HUBZone website including updates to geographical designations. The HUBZone website

also includes a mini- primer about HUBZone designations (see <https://www.sba.gov/content/hubzone-maps> and <https://www.sba.gov/content/understanding-hubzone-program#additional>). In this regard, we note that the map landing page, in particular, has the best performance metrics of all of the pages in the HUBZone website. It has the most views, highest average time on the page, and the lowest bounce rate. These indicators strongly suggest that users are engaging with the information in the page.

Further, SBA updates the HUBZone certification letter to reflect statutory, regulatory, and policy changes, and includes in it a listing of the firm's responsibilities to maintain eligibility. Among these responsibilities are:

- Checking SBA's HUBZone mapping pages to determine whether changes in HUBZone area designations affect, or will affect the firm's eligibility (<http://www.sba.gov/content/hubzone-maps>); and
- Signing up to receive HUBZone News Updates via email.

#### GAO recommendation #2

GAO recommended that SBA conduct an assessment of the current recertification process and implement additional controls to reduce the risk that firms that no longer meet program eligibility criteria receive HUBZone contracts, such as developing criteria and guidance on using a risk-based approach to requesting and verifying firm information during the recertification process, allowing firms to initiate the recertification process, and ensuring that there is sufficient staff dedicated to the effort so that a significant backlog in recertifications does not recur.

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##### SBA's response

After conducting a cost-benefit analysis, SBA elected to enhance HCTS to automate the manual recertification process that had been in place since 2010. The manual procedure was labor intensive, engendered data entry errors and contributed to delays in recertification actions, which were deployed in batches. The approach that SBA elected in automating the process through HCTS allows firms to initiate the recertification process. It is also designed to eliminate recertifications backlogs.

The FY 2015 recertifications that remain outstanding result from SBA's deployment of this enhanced functionality in September 2015. The automated process requires the firm to attest compliance in writing, with the understanding that an intentional or negligent misrepresentation



of the information contained in its affirmation may result in criminal civil or administrative sanctions.

It should be noted that BA discontinued the manual recertification process in January 2015, to mitigate data entry errors as it deployed the enhanced recertification module. SBA allocated approximately 1,000 hours at cost of approximately \$100,000 to clean e the data in preparation for the September 2015 deployment of the automated recertification functionality within HCTS.

SBA discovered that during the first 20 weeks of production, the new system missed record of a number of firms that were to be recertified. Since discovery of the problem which derived from the aging HCTS technology and data anomalies in old records, SBA has corrected the system. The data in the missed records are being fixed; and by June 2016, SBA expects to complete the outstanding 899 firms that were due for recertification in 2015.

It should be understood that while firms missed in fiscal 2015 are now being processed, firms due for recertification in 2016 are being notified in accordance with the automated process to maintain the recertification timeliness and abide by existing regulations. The automated recertification system is now operating properly.

The SBA's existing resources are insufficient to support collection and analysis of corroborative documentation as part of the recertification process and it would not be cost-effective to allow the firm to upload the documentation directly into HCTS. HCTS is a 15 year old web application that was built for self-certification. Within the next 24 months, HCTS will be replaced with state of the art technology. At this time, investing on additional functionality for HCTS would not be worthwhile. Therefore manual processes would have to be implemented to manage and analyze this documentation. SBA estimates that it would have to allocate approximately 4,000 hours to this effort, at a minimum cost of \$168,000. In addition, this labor-intensive process would adversely impact available resources allocated to processing of initial applications, resulting in reduced total production, and increased processing time.

The SBA has reasonable assurance that only qualified firms are allowed to benefit from the HUBZone contracting preferences. The SBA exercises its statutory and regulatory authority in monitoring compliance of its portfolio through risk-based review and investigation of firms when it cannot verify eligibility, or when it determines that the concerns are no longer eligible, and thereby mitigates fraud, waste, and abuse.

For example, every year, SBA searches the Federal Procurement Data System and assembles a list of firms that have received HUBZone contract awards in the previous fiscal year. Using

that information, SBA identifies firms to receive site visits representing at least 10% of its existing portfolio. At a minimum, firms to receive site visits include: those that have received HUBZone contract awards in the

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previous fiscal year, but have not been site-visited previously ; and those that have received HUBZone contracts in excess of \$180,000 during the previous fiscal year, whether or not they have been site visited previously.

Accordingly, firms that have received HUBZone contracts represent a significant percentage of the site visits. Notably, in FY 2015, 87% of firms site-visited demonstrated that they were operating out of their HUBZone principal office of record.

It should be noted that to submit an offer on a HUBZone contract, the firm, together with its affiliates, must be small under the size standard corresponding to the NAICS code assigned to the contract. Further, the firm must be in compliance with all HUBZone requirements both at time of initial offer, and at time of award in order to be eligible for a HUBZone contract.

Importantly, award of a HUBZone contract may be protested by an offeror the contracting officer or the SBA. In 2014, the HUBZone program launched a protest webpage to educate certified HUBZone firm and the acquisition community about this significant regulatory provision, which materially strengthen SBA's efforts to mitigate of fraud, waste, and abuse. When SBA receives a protest in connection to a HUBZone contract alleging that the firm does not meet the HUBZone principal office requirement, it conducts site visits for all the locations from which the firm is allegedly operating.

Also, it should be recognized that the characteristics of the majority of the firms in the HUBZone portfolio do not necessarily align well with the profile of successful small business competitors in the Federal contracting arena, at least at the outset. For example, for firms in the HUBZone portfolio, median gross revenue is about \$429,410, median number of employees is 5, and median years in business is 8. However, for HUBZone certified firms that have won contracts in the top small business NAICS codes, median gross revenue is about \$2,799,972, median number of employees is 15, and median years in business is 11. This suggests that overall risk is of award of HUBZone contacts to ineligible firms is comparatively modest. That notwithstanding, SBA's objective is to drive risk to the lowest possible level, given available resources , through forceful application and continuing refinement of eligibility monitoring policies, techniques, and tools.

As earlier noted, to sustain and enhance the integrity of the HUBZone portfolio and mitigate fraud, waste, and abuse, the certification and continuing eligibility letters are periodically revised, particularly to clarify and strengthen understanding of compliance requirements. These notices remind firms of their responsibilities as certified HUBZone concerns. Specifically, these notices include the following:

- A statement that any concern found to misrepresent its small business status may be subject to a range of civil or criminal penalties and/or suspension or debarment from federal contracting;
- An explanation of the regulatory requirement to inform the HUBZone Program of any material changes to the concern that may affect its continued eligibility;
- A reminder of the importance of remaining in compliance at all times, and staying updated on program changes;
- A reminder to periodically visit the HUBZone website (<http://www.sba.gov/hubzone>) to keep up- to-date with the program requirements and geographical designations;
- A reminder to check SBA's HUBZone mapping pages to determine whether changes in HUBZone area designations impact or will impact the firm's eligibility
- ([http://www.sba.gov/content/hubzone -maps](http://www.sba.gov/content/hubzone-maps)); and
- A reminder to sign up to receive HUBZone News Updates via email.

## Page 5

Finally, SBA recognizes the importance of communication and human engagement in maintaining program compliance. For this reason, since 2012, the HUBZone program has offered eligibility assistance on Tuesdays and Thursdays from 2-3pm ET via a toll free number available on the HUBZone website. Each year, approximately 1,339 firms participate in these sessions. Questions from callers drive the discussion, and HUBZone staff facilitate the discussion by providing answers and explaining relevant initial and continuing eligibility requirements and responsibilities. This format offers the opportunity for firms to better understand how to maintain compliance with the HUBZone program requirements, including the continuing eligibility implications of changes in HUBZone geographical designations.

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Office of Government Contracting and Business Development

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