

**GAO**

Testimony

Before the Committee on Small Business,  
House of Representatives

---

For Release on Delivery  
Expected at 2:00 p.m. EDT  
Wednesday, March 25, 2009

**SMALL BUSINESS  
ADMINISTRATION**

**Status of Efforts to Address  
Previous Recommendations  
on the HUBZone Program**

Statement of William B. Shear, Director  
Financial Markets and Community Investment



**GAO**

Accountability \* Integrity \* Reliability

---

---

Madam Chairwoman and Members of the Committee:

I am pleased to be here today to discuss the Small Business Administration's (SBA) Historically Underutilized Business Zone (HUBZone) program. Created in 1997, the HUBZone program provides federal contracting assistance to small businesses located in economically distressed communities, or HUBZone areas, with the intent of stimulating economic development in those areas. In fiscal year 2007, federal agencies awarded contracts valued at about \$8 billion to HUBZone firms. Firms that participate in the program must be located in a HUBZone and employ residents of HUBZones to facilitate the goal of bringing capital and employment opportunities to distressed areas.

My statement today is based on work we performed to update the status of recommendations we made in our June 2008 report on the HUBZone program and reiterated in a July 2008 testimony.<sup>1</sup> These recommendations called for SBA to improve its controls over the HUBZone program and assess the program's effectiveness. Specifically, in my testimony, I will discuss SBA's progress in (1) ensuring that the HUBZone map is accurate; (2) developing and implementing guidance to ensure that participating firms are eligible; (3) eliminating the backlog of recertifications; (4) formalizing and adhering to time frames for decertifying ineligible firms; and (5) developing measures and implementing plans to assess the effectiveness of the program.

To determine SBA's progress in implementing our recommendations, we obtained and reviewed related agency documentation. We also conducted random queries of its Web-based HUBZone map to assess its accuracy. Finally, we interviewed SBA program officials and contractors to determine the status of plans to improve controls over the program and assess its effectiveness. We conducted this performance audit from January 2009 through March 2009 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

---

<sup>1</sup>GAO, *Small Business Administration: Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results*, [GAO-08-643](#) (Washington, D.C.: Jun. 17, 2008) and GAO, *Small Business Administration: Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results*, [GAO-08-975T](#) (Washington, D.C.: Jul. 17, 2008). Also see GAO, *HUBZone Program: SBA's Control Weaknesses Expose the Government to Fraud and Abuse*, [GAO-08-964T](#) (Washington, D.C.: Jul. 17, 2008).

---

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.

At the time of the July 2008 testimony and in subsequent correspondence we received from SBA, we observed that the agency did not recognize the commitment required to address the HUBZone program's deficiencies and implement our recommendations. SBA officials told us that they recognize the commitment required to implement our recommendations. Consistent with this recognition, SBA is now working with a contractor to re-engineer its HUBZone program.

In summary, SBA has initiated some steps to address the HUBZone program's deficiencies and implement our recommendations. Specifically,

- In our last report we found that SBA's HUBZone map was inaccurate and we recommended that the agency fix the inaccuracies and ensure that the map remains accurate. SBA, through its mapping contractor, updated its HUBZone map in September 2008. However, SBA does not have a process in place to ensure that the map remains accurate. Agency officials stated that a contractor is conducting business process re-engineering that will include a focus on its mapping processes. However, the re-engineering efforts are in the early stages.
- In our June 2008 report, we stated that SBA's mechanisms for certifying and monitoring firms provided limited assurance that only eligible firms participated in the program. We recommended that SBA develop and implement guidance to more routinely and consistently obtain supporting documentation and conduct more frequent site visits to ensure that firms are eligible. SBA has made limited progress in ensuring that participating firms are eligible for the HUBZone program. SBA issued a guide for analysts to use when reviewing applications to ensure that they consistently request supporting documentation. Further, since July 2008, SBA has requested supporting documentation from each new applicant. While SBA has not conducted more frequent site visits to verify the information it receives from firms, SBA officials stated that they do plan to conduct site visits of all HUBZone firms that received a contract in fiscal year 2007 during fiscal year 2009. As of March 2009, SBA conducted 7 site visits of those firms.
- Our June 2008 report stated that SBA had not followed its policy of recertifying firms (that is, the process through which SBA can monitor firms' continued eligibility) every three years and as a result there was a backlog of more than 4,600 firms that had went unmonitored for more

---

than three years. We recommended that the agency eliminate the backlog and take the necessary steps to ensure recertifications are completed in a more timely fashion. In September 2008, SBA eliminated the backlog of recertifications by hiring additional staff but has yet to implement necessary procedures to ensure that future recertifications are completed in a timely fashion. SBA officials stated that the ongoing business process re-engineering will include an assessment of the recertification process.

- In our last report we also found that SBA lacked a formal policy on time frames for decertifying firms (that is, removing ineligible firms from the list of certified firms) and that many firms were not decertified within its informal goal of 60 days. We recommended that SBA formalize its 60-day goal and adhere to it. The agency has formalized a specific time frame for decertifying firms, but it is not clear whether staff are adhering to the policy. In December 2008, SBA issued a procedural notice that formalized a 60-day time frame for processing firms for decertification. Because SBA formalized the time frame recently, we were unable to verify whether staff were adhering to it.
- In June 2008 we also found that SBA had not implemented plans to assess the effectiveness of the HUBZone program and we recommended that SBA develop performance measures and implement plans to assess its effectiveness. SBA has not begun to assess the effectiveness of the HUBZone program. In August 2008, SBA issued a notice of methodology in the Federal Register for measuring the impact of the HUBZone program. However, the proposed methodology was not well developed. For example, it did not incorporate expert input or a previous study conducted by SBA's Office of Advocacy. We do not believe that this effort was a useful process to address our recommendation.

---

## Background

The purpose of the HUBZone program, which was established by the HUBZone Act of 1997, is to stimulate economic development, through increased employment and capital investment, by providing federal contracting preferences to small businesses in economically distressed communities or HUBZone areas.<sup>2</sup> The types of areas in which HUBZones may be located are defined by law and consist of census tracts, nonmetropolitan counties, Indian reservations, redesignated areas (that is, census tracts or nonmetropolitan counties that no longer meet the criteria

---

<sup>2</sup>HUBZone Act of 1997, Pub L. No. 105-135, Title VI, Section 602(a), 111 Stat. 2592, 2627 (1997).

---

but remain eligible until after the release of the 2010 decennial census data), and base closure areas.<sup>3</sup>

To be certified to participate in the HUBZone program, a firm must meet the following four criteria:

- must be small by SBA size standards;<sup>4</sup>
- must be at least 51 percent owned and controlled by U.S. citizens;<sup>5</sup>
- principal office—the location where the greatest number of employees perform their work—must be located in a HUBZone; and
- at least 35 percent of the full-time (or full-time equivalent) employees must reside in a HUBZone.

There are more than 14,000 HUBZone areas, and as of January 2009, 9,300 certified firms participated in the HUBZone program. More than 4,200 HUBZone firms obtained approximately \$8.1 billion in federal contracts in fiscal year 2007. The annual federal contracting goal for HUBZone small businesses is 3 percent of all prime contract awards—contracts that are awarded directly by an agency.

---

<sup>3</sup>See [GAO-08-643](#) for a definition of each type of area.

<sup>4</sup>SBA's size standards are almost always stated either as the average employment or average annual receipts of a business concern and vary by industry.

<sup>5</sup>Qualified HUBZone firms also can be owned and controlled by Alaskan Native Corporations, Indian tribal governments, community development corporations, and agricultural cooperatives.

---

## SBA Updated Its HUBZone Map but Has Not Implemented Procedures to Ensure That It Remains Accurate

SBA relies on its map to publicize HUBZone areas and to determine, in part, whether firms are eligible for the program. Our June 2008 report found problems with SBA's HUBZone map. First, the map included 50 metropolitan counties as difficult development areas that did not meet this or any other criterion for inclusion as a HUBZone area.<sup>6</sup> As a result of these errors, from October 2006 through March 2008, federal agencies obligated about \$5 million through HUBZone set-aside contracts to 12 firms located in these ineligible areas. In addition, we found that the HUBZone map had not been updated since August 2006.<sup>7</sup> Our analysis of 2007 Bureau of Labor Statistics unemployment data indicated that 27 additional nonmetropolitan counties should have been identified on the map, allowing qualified firms in these areas to participate in the program. Because firms are not likely to receive information on the HUBZone status of areas from other sources, firms in the 27 areas would have believed from the map that they were ineligible to participate in the program and could not benefit from contracting incentives that certification provides.

In our June 2008 report, we recommended that SBA take immediate steps to correct and update the map and implement procedures to ensure that it is updated with the most recently available data on a more frequent basis. In response to our recommendation, SBA stated that, through a contract, the map was updated in September 2008. However, SBA has not implemented procedures to ensure that the map remains accurate. SBA officials stated it is currently re-engineering its internal processes, which include its mapping efforts, and plans to develop a competitive procurement that will include test plans and technical support for future map updates. Because SBA is in the early stages of both efforts, the map may not remain accurate. Therefore, if the map is not regularly updated, ineligible small businesses may be able to participate in the program, while eligible businesses may not be able to participate.

---

<sup>6</sup>Because the boundaries of qualified HUBZone areas can overlap, some geographical areas qualify for multiple designations.

<sup>7</sup>SBA officials told us that, in September 2006, SBA began the process of having its contractor update the map but as of June 2008 the update had not occurred.

---

## SBA Has Made Limited Progress in Ensuring the Eligibility of Firms

In June 2008, we reported that the policies and procedures upon which SBA relies to certify firms provided limited assurance that only eligible firms participated in the HUBZone program. Specifically, we found that, for certification and recertification, firms self-reported information on their applications. Rather than providing specific guidance or criteria for when HUBZone program staff should request supporting documentation, SBA's policy allowed the staff to determine what circumstances warranted a request for supporting documentation. Internal control standards for federal agencies require that agencies collect and maintain documentation and verify information to support their programs; however, we found that SBA requested documentation or conducted site visits of firms to validate the self-reported data in limited instances. Our analysis of the 125 applications submitted in September 2007 showed that SBA requested supporting documentation for 36 percent of the applications and conducted one site visit. As a follow-on to our previous fraud investigation, we also identified cases of fraud and abuse in the program and examined actions SBA has taken to establish an effective fraud prevention system; we are publicly reporting the results of this investigation today in a separate publication.<sup>8</sup>

To improve its ability to ensure that only eligible firms participate in the program, we recommended in our June 2008 report that SBA develop and implement guidance to more routinely and consistently obtain supporting documentation upon application and conduct more frequent site visits, as appropriate, to ensure that firms applying for certification are eligible. Subsequent to our report and testimony, SBA issued a desktop guide for analysts to use when they review applications. This guide provides examples of the types of documents to request and when to request them. In addition, since July 2008, SBA officials stated that they have been consistently collecting supporting documentation from each new applicant. However, the agency has not conducted more frequent site visits to verify the information firms submit. SBA officials stated that they do plan to conduct site visits of all HUBZone firms that received a contract in fiscal year 2007 during fiscal year 2009. As of March 2009, SBA conducted 7 site visits of those firms. Because of SBA's limited progress, ineligible firms may still be able to participate in the HUBZone program and receive federal contracts based on their HUBZone certification.

---

<sup>8</sup>GAO, *HUBZone Program: Fraud and Abuse Identified in Four Metropolitan Areas*, GAO-09-440 (Washington, D.C.: Mar. 25, 2009).

---

## SBA Eliminated Its Backlog of Recertifications but Has Not Established a Process or Procedures to Prevent Future Backlogs

In our June 2008 report, we noted that SBA did not follow its own policy of recertifying all firms every 3 years.<sup>9</sup> We found that SBA failed to recertify 4,655 of the 11,370 firms (more than 40 percent) that had been in the program for more than 3 years.<sup>10</sup> Of the 4,655 firms that should have been recertified, 689 had been in the program for more than 6 years. According to HUBZone program officials, the agency lacked sufficient staff to complete the recertifications. As a result of the backlog, the periods during which some firms went unmonitored and reviewed for eligibility were longer than SBA policy allowed, increasing the risk that ineligible firms were participating in the program.

We recommended that SBA establish a specific time frame for eliminating the backlog of recertifications and take the necessary steps to ensure that recertifications were completed in a more timely fashion in the future. In response to our recommendation, SBA temporarily obtained additional staff for the HUBZone program and eliminated the backlog by September 30, 2008. However, SBA has not implemented processes or procedures to ensure that future recertifications will be completed in a more timely fashion. SBA officials stated that its ongoing business process re-engineering includes an assessment of the recertification process. However, as of March 2009, SBA has made limited progress in this effort. As a result, there is still an increased risk that ineligible firms may continue to participate in the program.

---

## SBA Has Formalized a Specific Time frame for Decertifying Firms

Our July 2008 report also noted that SBA did not have a policy that included specific time frames for processing decertifications—the determinations subsequent to recertification reviews or examinations that firms are no longer eligible to participate in the HUBZone program. We found that although SBA did not have written guidance for the decertification time frame, the HUBZone program office had negotiated an informal (unwritten) goal of 60 days with the SBA Inspector General in 2006. From fiscal years 2004 through 2007, SBA failed to resolve proposed decertifications within its goal of 60 days for more than 3,200 firms. While SBA's timeliness had improved, in 2007 more than 400 (or about 33 percent) of decertifications were not resolved in a timely manner. As a

---

<sup>9</sup>SBA officials generally limited their recertification reviews to the information provided by firms but can request documentation or conduct site visits.

<sup>10</sup>These are results of GAO analysis of data from the HUBZone Certification Tracking System (as of Jan. 22, 2008).



---

consequence of generally not meeting its 60-day goal, lags in the processing of decertifications increased the risk of ineligible firms participating in the program.

In our report, we recommended that SBA formalize and adhere to a specific time frame for processing firms proposed for decertification. In response, SBA issued a procedural notice in December 2008 that formalized the 60-day time frame for processing decertifications. Because SBA recently formalized this time frame, we were unable to verify whether SBA staff are adhering to it.

---

## SBA Has Not Developed Measures or Implemented Plans to Assess the Effectiveness of the HUBZone Program

In June 2008, we reported that SBA had taken limited steps to assess the effectiveness of the HUBZone program. We found that SBA's three performance measures for the HUBZone program were not directly linked to the program's mission of stimulating economic development and creating jobs in economically distressed communities.<sup>11</sup> The Office of Management and Budget also noted in its 2005 Program Assessment Rating Tool (PART) that SBA needed to develop baseline measures for some of its HUBZone performance measures and encouraged SBA to focus on more outcome-oriented measures that better evaluate the results of the program.<sup>12</sup> In addition, the PART assessment documented plans that SBA had to conduct an analysis of the economic impact of the HUBZone program on a community-by-community basis using data from the 2000 and 2010 decennial census. However, SBA officials indicated that the agency lacked the resources necessary to develop baseline measures or to assess the results of the program.

In our report, we recommended that SBA further develop measures and implement plans to assess the effectiveness of the HUBZone program. In addition, in May 2008, after the completion of the audit work for our June

---

<sup>11</sup>According to SBA's fiscal year 2007 Annual Performance Report, the three performance measures for the HUBZone program were: (1) the number of small businesses assisted (which SBA defines as the number of applications approved and the number of recertifications processed), (2) the annual value of federal contracts awarded to HUBZone firms, and (3) the number of program examinations completed. These measures provide some data on program activity and measure contract dollars awarded to HUBZone firms.

<sup>12</sup>OMB's PART evaluation rates programs on four critical elements—program purpose and design, strategic planning, program management, and program results/accountability. The answers to questions in each of the four sections result in numeric scores for each section from 0 to 100 (100 being the best). These scores are then combined to achieve an overall qualitative rating of Effective, Moderately Effective, Adequate, or Ineffective.

---

2008 report, SBA's Office of Advocacy (Advocacy) issued a report assessing the economic impacts of the HUBZone program.<sup>13</sup> In our view, the Advocacy's report could provide, in part, a foundation for further assessments. In August 2008, in response to our recommendation, SBA published a Notice of Methodology in the Federal Register for measuring the economic impact of the HUBZone program.<sup>14</sup> Rather than conducting a comprehensive effort that considered relevant literature, input from experts in economics and performance measurement, and the methodological contributions of the Advocacy's evaluation, SBA officials planned to rely on public comments to refine the planned methodology. Two comment letters were submitted. Based on our review, we do not believe this effort was a sound process for developing measures to assess the effectiveness of the program. During subsequent discussions we held with agency staff about this issue, they stated that they have initiated a new effort to address this issue. However, because the agency has not evaluated the HUBZone program's benefits, SBA continues to lack key information that could help it better manage the program and inform the Congress of its results.

---

Madam Chairwoman, this concludes my prepared statement. I would be happy to answer any questions at this time.

---

## Contacts and Acknowledgments

For further information on this testimony, please contact William B. Shear at (202) 512-8678 or [shearw@gao.gov](mailto:shearw@gao.gov). Individuals making key contributions to this testimony included Paige Smith (Assistant Director), Triana Bash, Tania Calhoun, Julia Kennon, and Terence Lam.

---

<sup>13</sup>H. Beale and N. Deas, *The HUBZone Program Report* (Washington, D.C.: May 2008). SBA's Office of Advocacy is independent of the SBA Administrator.

<sup>14</sup>See Notice of Methodology for Measuring the Economic Impact of the HUBZone Program, 73 Fed. Reg. 46698 (Aug. 11, 2008).

---

---

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.

---

## GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

---

## Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site ([www.gao.gov](http://www.gao.gov)). Each weekday afternoon, GAO posts on its Web site newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to [www.gao.gov](http://www.gao.gov) and select "E-mail Updates."

---

## Order by Phone

The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's Web site, <http://www.gao.gov/ordering.htm>.

Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.

Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.

---

## To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: [www.gao.gov/fraudnet/fraudnet.htm](http://www.gao.gov/fraudnet/fraudnet.htm)

E-mail: [fraudnet@gao.gov](mailto:fraudnet@gao.gov)

Automated answering system: (800) 424-5454 or (202) 512-7470

---

## Congressional Relations

Ralph Dawn, Managing Director, [dawnr@gao.gov](mailto:dawnr@gao.gov), (202) 512-4400  
U.S. Government Accountability Office, 441 G Street NW, Room 7125  
Washington, DC 20548

---

## Public Affairs

Chuck Young, Managing Director, [youngc1@gao.gov](mailto:youngc1@gao.gov), (202) 512-4800  
U.S. Government Accountability Office, 441 G Street NW, Room 7149  
Washington, DC 20548

