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FULL COMMITTEE HEARING ON OVERSIGHT OF THE SMALL BUSINESS ADMINISTRATION AND ITS PROGRAMS

HEARING

BEFORE THE

COMMITTEE ON SMALL BUSINESS
UNITED STATES
HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

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FULL COMMITTEE HEARING ON OVERSIGHT OF THE SMALL BUSINESS ADMINISTRATION AND ITS PROGRAMS

Wednesday, March 25, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
Washington, DC.

The Committee met, pursuant to call, at 2:18 p.m., in Room 2360, Rayburn House Office Building, Hon. Nydia M. Vela AE1zquez [Chair of the Committee] presiding.

Present: Representatives Velázquez, Dahlkemper, Altmire, Clarke, Bright, Halvorson, Graves, Bartlett, Luetkemeyer, Thompson, and Coffman.

Chairwoman VELÁZQUEZ. I call this hearing of the Small Business Committee to order.

As Supreme Court Justice Brandeis famously said, Sunshine is the best disinfectant. To make sure oversight is a priority, the House has adopted Rule 11 which requires hearings on waste, fraud, abuse and mismanagement of programs under the committee's jurisdiction.

Accountability is critical to the legislative process, and it is something that our committee has consistently worked to promote. In the last 2 years alone, we have held several oversight hearings on issues ranging from the Katrina disaster assistance to fraud in contracting. That is a track record we are going to continue in the new Congress, starting with today's review of GAO's HUBZone investigation.

When first introduced, the HUBZone program promised to create opportunities for small businesses in low-income communities. It was designed to do this by helping entrepreneurs access the Federal marketplace. In theory, the benefits will be twofold; HUBZones will not only bolster the small business community, but will also breathe new life into struggling neighborhoods.

However, the program has been undermined by chronic underfunding, inherent program flaws and sloppy management. Instead of being incubators for growth and development, HUBZones have become breeding grounds for fraud and abuse. This afternoon's hearing will focus on a new GAO report on the HUBZone program, the findings of which are nothing short of appalling.

Unfortunately, HUBZone fraud is nothing new. Last Congress concerns on the part of both this committee and the business community prompted a General Accounting Office audit, an investigation. What GAO found was that the majority of the HUBZone busi-

nesses it reviewed in the D.C. area were ineligible and yet somehow these companies managed to collect over $100 million in Federal contracts. Those are funds that should have gone to deserving small businesses.

During last year's hearing on the matter, it quickly became clear that the HUBZone program was not only dysfunctional, it was riddled with fraud. Apologists claim these incidents were isolated. They argued that most HUBZone businesses played by the rules and said the program shouldn't be blamed for a few bad apples. To see if this was, in fact, the case, we requested a broader investigation.

The review which was carried out in four different regions across the country found that HUBZone abuse is not unique to Washington; rather, it is systemic. Today we will hear from GAO that the majority of the reviewed businesses were not even HUBZone eligible, and yet they received $30 million from the program.

Eight months after our first HUBZone hearing, SBA still has no control over the initiative. As a result, tens of millions of dollars in HUBZone contracts have gone to unqualified businesses. That includes $27 million that went to businesses GAO has already identified as ineligible in its report of July. Because SBA failed to act, those companies continued to receive contracts that were never rightfully theirs.

Abuse of a Federal program is never a good thing. Today, in light of the billions of stimulus dollars about to enter the Federal marketplace, we need to be more vigilant than ever. It is critical that small businesses have a level playing field and that taxpayer money gets the most bang for the buck. As important as it is to provide expanded opportunities to entrepreneurs, we just cannot allow a program so vitally flawed to continue.

It is time for SBA to make a decision, either overhaul the program or scrap it completely. This committee is no longer going to tolerate the excuse, ″We are working on it,″ while hardworking small businesses who have played by the rules are being cheated out of opportunities.

I would like to thank all of the witnesses in advance for their testimony.

And, with that, I yield to Ranking Member Graves for his opening statement.

Mr. GRAVES. Good afternoon, and thank you for participating in this hearing—oversight hearing of the Small Business Administration's programs. And as always, Madam Chair, I appreciate your holding this important hearing.

One of the primary goals of the Small Business Act was to ensure that small businesses receive a fair portion of contracts offered by the Federal Government. This is important because small businesses have lower overhead; they can provide goods and services to the Federal Government as efficiently, if not more so, than larger competitors. In addition, providing small businesses with their fair share of Federal contracting opportunities will hasten the economic recovery. However, time and again, the government fails to reach its contracting goals.

The government continues to bundle contracts that only large businesses can obtain, and we find that various contracting programs open themselves up to abuse and the possibility of fraud.

We need to focus efforts on improving the government contracting process. This includes preventing inappropriate contract bundling and eliminating the potential for fraud and abuse, including the HUBZone program.

As we all know, the HUBZone program was created to stimulate the economies of economically depressed areas by awarding qualified HUBZone participants with Federal contracts. However, recent investigations by the Government Accountability Office demonstrate that the program is susceptible to abuse and the possibility of widespread fraud. The studies are alarming and the SBA's response has been inadequate.

What is worse is that contracts given to firms ineligible for the program undermine the ability for legitimate HUBZone firms to win contracts. In turn, this diminishes the effectiveness of the program and revitalizing the economically depressed areas.

I look forward to hearing the testimony today from our witnesses. I want to learn a whole lot more about the progress they have made in addressing these problems; and if I don't feel like enough is being done, I can assure you that I will take a much more aggressive approach to righting this ship.

Again, I want to thank you, Madam Chair, for holding this hearing and I look forward to working with you and other Members of Congress, the GAO and the SBA to rid the HUBZone program of the abuse.

Chairwoman VELÁZQUEZ. Thank you, Mr. Graves.

Chairwoman VELÁZQUEZ. And I welcome the first witness. Mr. Darryl Hairston. He is the Acting Administrator of the Small Business Administration. He has served the Agency over the past 30 years in a variety of senior executive positions.

The SBA was created in 1953 as an independent agency of the Federal Government to aid, counsel, assist and address small business concerns.

Welcome.

STATEMENT OF DARRYL HAIRSTON, ACTING ADMINISTRATOR, U.S. SMALL BUSINESS ADMINISTRATION

Mr. HAIRSTON. Thank you, Chairwoman Velázquez, Ranking Member Graves and other distinguished members of the committee. I appreciate the opportunity to testify today in connection with the committee's hearing on waste, fraud and abuse in government programs.

As a Federal agency with an $88 billion loan portfolio, the principles of stewardship, transparency and accountability are essential to the integrity of the programs and the operations of the Small Business Administration. With the recent passage of the American Recovery and Reinvestment Act, as well as the fiscal year 2009 Omnibus Appropriations Act, Federal agencies will be held accountable not only for developing effective and efficient strategies for implementing the new statutory provisions, but also for the prudent stewardship of taxpayer dollars used for funding the programs authorized under these acts.

The SBA takes its ongoing responsibility to guard against and to prevent waste, fraud and abuse in its programs very seriously. Ensuring the proper controls are in place is crucial to the Agency's ability to implement and administer its programs in an environment that inhibits fraud, waste and abuse.

Madam Chairwoman, our management team recognizes that there is always a need for improvement in the way we conduct our business and the way we intend to address properly the recommendations contained in the GAO report released today. I am pleased to tell the committee that our commitment to better serving small businesses and aspiring entrepreneurs via our HUBZone program remains strong. We are continuing our thorough review and testing evaluation of all aspects of the program.

Where applicable, we have established new internal operating procedures. These revised controls, as well as the establishment of new ones, I believe provide that level of accountability and transparency that Americans expect of their government and which all of us here at SBA are committed to achieving.

All of us at SBA recognize the important oversight role provided by the Office of the Inspector General and the Government Accountability Office in identifying waste, fraud and abuse in government programs. I want to assure you and the members of the committee that we are working diligently to implement recommendations contained in the GAO and IG reports that identified waste, fraud and abuse in SBA programs.

Let me briefly provide you with a summary of important actions taken today. With respect to SBA's HUBZone program, the GAO issued a report in June entitled Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results. The report identified potential waste, fraud and abuse by identifying firms participating in the HUBZone program that may not have met program eligibility requirements.

Over the last 8 months since the report was issued, SBA has developed new procedures for evaluating all applications, re-certifications and program examinations. SBA is collecting supporting documentation from all firms that seek HUBZone certification or wish to maintain their HUBZone status.

While these procedures have impacted our processing times, we believe they are helping to reduce incorrectly certified firms. For example, from July 2008 to March 2009 only 22 percent of the applications submitted were certified while 77 percent were withdrawn or declined. During the same period a year ago, 66 percent of the applications submitted were certified while 33 percent were withdrawn or declined.

SBA is also in the process of reviewing its current program regulations to determine whether changes can be made to further strengthen its certification procedures to help mitigate waste, fraud and abuse as well as reduce accidental mistakes. In addition, if the HUBZone program office believes it has sufficient evidence that any firm willfully attempted to misrepresent its HUBZone status, the program will forward those firms to the SBA's suspension and debarment official and to the IG, as appropriate.

Regarding the issue of keeping the HUBZone maps current, SBA has developed a specific timetable and procedure to ensure that

HUBZone maps remain current. The SBA's HUBZone maps were last updated on September 13. The SBA intends to update the maps again by April as a result of new data it has received.

On July 17, SBA testified that it was beginning a process of reviewing possible suspension and debarment of 10 firms originally identified by the GAO report entitled SBA's Control Weaknesses Expose the Government to Fraud and Abuse. GAO originally referred 10 firms to SBA's IG. In September, SBA's IG forwarded the files to the HUBZone program office so that they could begin its examination process. Investigations of these 10 firms revealed that at least three of the firms that GAO believed to be ineligible for the program were, in fact, eligible; of the remaining seven firms, only three are still in the program and are currently undergoing program examinations for possible decertification.

All firms noted by the GAO have been investigated and examined by the SBA or are currently being investigated and examined, keeping in mind that there are due process considerations for firms under examination. The firms that have been referred to SBA suspension and debarment officials are also being investigated by that office.

Upon receipt of the GAO's files of its most recent investigation, SBA will take appropriate enforcement action on the firms we find to violate HUBZone program requirements. These enforcement actions will include, where applicable, removal, decertification from the program and coordination with SBA's Inspector General and the SBA's suspension and debarment official.

Chairwoman Velázquez and other distinguished members of this committee, thank you again for your opportunity to testify today in connection with the committee's hearing on waste, fraud and abuse in government programs. I am happy to answer any questions you may have.

Chairwoman VELÁZQUEZ. Thank you, Mr. Hairston.

[The statement of Mr. Hairston is included in the appendix at page 32.]

Chairwoman VELÁZQUEZ. Our next witness, Mr. Bill Shear, is the Director of the GAO's Office of Financial Markets and Community Investment. The Financial Markets and Community Investment team works to improve effectiveness of regulatory oversight in financial and housing markets. It also oversees the management of community development programs.

Welcome, sir.

STATEMENT OF WILLIAM B. SHEAR, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. SHEAR. Thank you. Madam Chairwoman, Representative Graves, and members of the committee, it is a pleasure to be here today to discuss our work on the HUBZone program. My statement today is based on work we performed to update the recommendations we made in our June 2008 report and reiterated in our July 2008 testimony before this committee.

SBA has recently initiated some steps as part of a reengineering effort to address the HUBZone program's deficiencies and imple-

ment our recommendations. I will summarize these steps for each recommendation we made in our June report.

First, SBA's HUBZone map used to determine firms eligibility was inaccurate, and we recommended that the Agency fix the inadequacies and ensure that the map remains accurate. SBA updated its map in September 2008; however, SBA does not have a process to ensure that the map remains accurate.

Second, we stated that SBA's mechanisms for certifying and monitoring firms provided limited assurance that only eligible firms are participating 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 issued a guide for analysts to use when reviewing applications. And since July 2008 SBA has requested supporting documentation from each new applicant. However, SBA has not conducted more frequent site visits to verify the information received from firms. As of March 2009, SBA has conducted seven site visits this fiscal year.

Third, SBA has not followed its policy of recertifying firms every 3 years. As a result, there was a backlog of more than 4,600 firms that had went unmonitored for more than 3 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 used additional staff to eliminate the backlog of recertifications, but it has yet to implement necessary procedures to ensure that future recertifications are completed in a timely fashion.

Fourth, we found that SBA lacked a formal policy and time frames for decertifying firms. And many firms were not decertified within the informal goal of 60 days. We recommended that SBA formalize its 60-day goal and adhere to it.

In December 2008, SBA issued a procedural notice that formalized a 60-day time frame for processing firms for decertification. We do not yet know whether staff are adhering to this policy.

Finally, we also found that SBA had not implemented plans to assess the effectiveness of the HUBZone program, and we recommended that the Agency develop performance measures and implement plans to assess its effectiveness.

In August 2008, SBA issued a notice of methodology in the Federal Register for measuring the impact of the program. The methodology was not well developed, and we do not believe that the effort was a useful process to address our recommendation.

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.

It is a pleasure to present our work before this committee. I would be glad to answer any questions.

Chairwoman VELÁZQUEZ. Thank you, Mr. Shear.

[The statement of Mr. Shear is included in the appendix at page 39.]

Chairwoman VELÁZQUEZ. Our next witness is Mr. Greg Kutz. He is the Managing Director of Forensic Audits and Special Investiga-

tions at GAO. The FSI unit investigates waste, fraud and abuse related to government programs and taxpayers' dollars. FSI has investigated abuses of Hurricane Katrina relief dollars, border security, and overtime and minimum wage complaints among other topics.

Welcome.

STATEMENT OF GREGORY KUTZ, MANAGING DIRECTOR, FORENSICS AUDITS & SPECIAL INVESTIGATIONS, U.S. GOVERNMENT ACCOUNTABILITY OFFICE

Mr. KUTZ. Madam Chairwoman, members of the committee, thank you for the opportunity to discuss the HUBZone program.

Last year I testified that this program was highly vulnerable to fraud and abuse, citing 10 cases here in the Washington, D.C., area. My testimony today has two parts. First, I will discuss our investigation of cases outside of the D.C. area, and second, I will discuss SBA's actions to address fraud and abuse.

First, we identified 19 additional cases of HUBZone fraud in Alabama, California and Texas. These firms received $30 million of HUBZone contracts. In all 19 cases, these firms recently made false statements regarding their program eligibility.

The following three cases give you a flavor for the types of fraud that we identified. First, one Alabama contractor listed their principal office as being in a HUBZone, which, as you know, is a key program requirement. However, as shown on the monitor, this office was actually a residential trailer reported to SBA as being ″Suite No. 19.″ The person actually living in this trailer had no apparent relationship to this company. The real principal office for this company was 90 miles away and not in a HUBZone.

Second, a Texas HUBZone firm was being used as a front for large companies. This services firm was required to perform at least 50 percent of the work using HUBZone employees. However, our work showed that between 71 and 89 percent of the work was actually being subcontracted out. The owner told us that HUBZone firms like hers are used by large companies as contracting vehicles.

And third, only 5 of 38, or 13 percent, of a California company's employees lived in a HUBZone. This firm falsely represented that it met the requirement that 35 percent of its employees live in a HUBZone.

I can't project these 19 cases to all HUBZone firms. However, these 19 cases, along with the 10 from my testimony last year, clearly show that the potential for fraud in this program is substantial. As of January 2009, there were 9,300 firms listed as being eligible for this program. It is not hard to imagine that hundreds or perhaps thousands of these firms are not eligible for this program.

Moving on to my second point. SBA does not have an effective fraud prevention program. The good news is that SBA recognizes this and is taking steps to implement an effective program. The bad news is that they are closer to the beginning than the end of this process. An effective fraud prevention program includes prevention, monitoring and investigations with consequences. Prevention is clearly the most important element of the program. SBA has recognized this and, as was mentioned by the other witness, has

an interim process in place to screen applications. However, this process was not adequately field tested and, thus, has had some unintended consequences.

Due at least in part to the lack of staffing, this process has resulted in a backlog of about 800 applications as of January 2009. I would describe this as a growing pain of moving from what was in essence a self-certification process to what hopefully will be an effective fraud prevention program.

In addition to the recommendations we made last year, we are making four new recommendations in a report we are releasing today. One of the key recommendations is for SBA to use unannounced site visits. As we have developed our 29 fraud cases over the last year, it is clear that for site visits, the element of surprise is critical.

For example, in the case I just described, our surprise visit revealed that no company employees actually worked in trailer No. 19. The picture on the monitor shows the row of mailboxes outside of this trailer as they appeared during our site visit. The next picture on the monitor shows the shiny new mailbox that appeared with the company name on it shortly after our surprise visit. According to the United States Postal Service, this mailbox is not a deliverable address.

This case clearly shows the kind of deception that owners will use and the value of a surprise site visit.

In conclusion, as was mentioned, it appears that fraud and abuse in this program exists across the country. The victims of this fraud include the American taxpayer, legitimate HUBZone firms, and the communities that were supposed to benefit from this program.

Perhaps the most troubling fraud scheme is the use of HUBZone firms as a front to funnel money to large companies.

Madam Chairwoman, I want to commend you and the committee for taking steps today to clean up this program.

That ends my statement. I look forward to your questions

Chairwoman VELÁZQUEZ. Thank you Mr. Kutz.

[The statement of Mr. Kutz is included in the appendix at page 51.]

Chairman VELÁZQUEZ. I would like to start by asking my first question to Mr. Hairston.

Mr. Hairston, at the last hearing I asked whether the level of fraud warranted the suspension of the HUBZone program. Administrator Carranza's answer at the time was ″no″ and that steps will be taken to eliminate fraud.

Today, we have found out that several companies identified last year are still in the program and have since then received $25 million in new HUBZone set-aside contracts. Added to this, the fraud in the program now appears national in scope.

I am going to ask this question to you, and I am going to ask this question again. Will you make a commitment to suspend the HUBZone program until fraud controls are in place and all companies with a HUBZone contract can be verified?

Mr. HAIRSTON. Madam Chairwoman I don't have the authority to make the decision to suspend the HUBZone program. What I can do today is to commit to you that we will take the proper steps to

make sure that we have the proper risk management framework in place to mitigate fraud, waste and abuse in the program.

But the decision to suspend the program is one that would be a decision that would certainly—

Chairwoman VELÁZQUEZ. That is enough. That is enough, Mr. Hairston.

Mr. Shear, the SBA testified in July that they will take several steps to fix the problems with the HUBZone program as identified by the GAO. As this chart shows, very little has been accomplished. Why is that?

Mr. SHEAR. I would say that the Agency did not recognize the commitment that was necessary to address these very serious deficiencies and to implement our recommendations.

Chairwoman VELÁZQUEZ. Mr. Kutz, during last July's hearing, SBA testified that its goal was to perform site visits on 5 percent of the HUBZone programs, firms. Today, we hear that the SBA is performing 1.8 site visits per month and has done only 7 this year. That is less than a quarter of 1 percent of the 10,000 firms in the program.

Is that a sufficient deterrent to fraud?

Mr. KUTZ. No.

Chairwoman VELÁZQUEZ. Administrator Hairston, why is the SBA doing less than what the Agency promised back in July?

Mr. HAIRSTON. Well, I am not clear on what the Agency promised at that time. But I can tell you that the office is working aggressively to put in place new procedures—

Chairwoman VELÁZQUEZ. Did you review—excuse me one second.

I guess that if I was you sitting at the chair, and I know that I have to come and testify before this committee, I would review the congressional records of last year in July when this issue was discussed in the hearing, whether the administrator made a commitment to this committee and then you will assess whether or not steps have been taken to make the corrections.

Mr. HAIRSTON. Well, I did, in fact, review the record, and I don't recall seeing anything regarding—specifically regarding a commitment on site visits. And she very well may have made that commitment, but I am saying I did not actually see it myself.

But I do know that they have undertaken aggressive procedures. They have implemented—they are undergoing right now a business process—reengineering process where they are looking at all of the elements of the program and they are establishing the necessary corrections, the necessary improvements to mitigate the fraud and abuse in the program.

We take this very seriously. We take the notion of prudent stewardship over the program very seriously, and we are approaching this matter very seriously

Chairwoman VELÁZQUEZ. Mr. Kutz, what type of site visits should SBA be performing and how often?

Mr. KUTZ. They should perform site visits, first of all, in the application process, at least on a risk basis, if you will. And they should be unannounced; they should not tell them they are coming. If we had told the company with the shiny new mailbox we were coming, the mailbox would have been there before we showed up, rather than after we showed up.

If you show up on a surprise basis, mail is stuffed under the door, you talk to the neighbors, no one has been here in months. That is what you get with the unannounced site visits. If you tell them you are coming, then you have a problem.

In the program examination, I think you have the same situation. Once they get in the program, again on a risk basis, unannounced, randomly you should be actually going out and checking what is really going on.

Chairwoman VELÁZQUEZ. Of the HUBZone businesses that you spoke to, it seems many were not worried about meeting eligibility requirements.

The silver mailbox you alluded to is symptomatic of a cavalier attitude. Do you think these businesses' attitudes reflect an awareness that punishment by SBA is a remote, if nonexistent, possibility?

Mr. KUTZ. No, I don't think they think that there is a serious enforcement at this point. Some of them admitted to us what they did. They are not going to say they committed fraud, but effectively they did.

I think—if you let me read a few examples for you, I think you will see the pattern here. One of our cases admitted to bidding and accepting large HUBZone contracts, the firm couldn't perform without significant subcontracting.

Another one admitted subcontracting the majority of their work to other firms or individuals. This was a services firm.

Another one admitted noncompliance with the principal office requirement. Another one admitted they listed the principal office for proposal writing and nobody actually worked in the office except one person. And another one admitted that they kept a listed principal office only to meet the HUBZone requirement.

And so I think you see the kind of attitude out there. I don't think they think they will ever get caught; and if they get caught, as we have seen, there is no serious punishment.

Chairwoman VELÁZQUEZ. Based on your investigations, can you provide this committee with an estimate of the number or percentage of fraudulent firms operating in the HUBZone nationwide?

Mr. KUTZ. Only with the ones we have looked at. We have only really looked at the principal office and 35 percent residency requirements. Of the ones we have looked at, again, they were based upon data mining and certain characteristics of certain cities, such as Washington, San Diego and San Antonio, that it was over 50 percent of the ones we looked at.

The 50 percent subcontractor requirement, we weren't looking for that, but it actually popped out with several of the cases we had where it was very clear that the work was being done not by a HUBZone company, but by large, in many cases multinational, firms that were doing well over half the work.

Chairwoman VELÁZQUEZ. I am going to recognize Mr. Graves. And then we will come to a second round where we will continue to pose questions.

Mr. GRAVES. Thank you, Madam Chair.

Mr. Hairston, last summer I contacted the SBA, and it was to inquire about the status of a petition, a protest that was filed by a

constituent of mine, and it was regarding a HUBZone contract; and I have yet to hear back from the SBA. That was last summer.

I was just curious how long it typically takes to investigate a HUBZone firm when a protest has been made. And I would like for you all to get back with me on that.

Mr. HAIRSTON. Typically, a protest should be handled within a very short period of time, within a matter of several days. Generally, a protest procedure takes place in about 7 days, so you should have received a response.

There is no defense for you not receiving a response regarding a protest or at least an acknowledgement of the outcome of the examination of the protest.

Mr. GRAVES. Well, it was last summer. I actually followed up with the—after the constituent made the protest. And like I say, it is not them necessarily that hasn't heard, because they haven't either; but I was a little surprised that I haven't heard from the SBA on it. That was a little alarming, particularly given, you know, some of the things that I have heard.

Another question is, you know, is there any evidence that suggests that the HUBZone program is meeting its objectives of economic development?

Mr. HAIRSTON. From the metrics—from the metrics that we are actually maintaining, it would appear that there are, in fact, some jobs being created as a consequence of the program and that some legitimate HUBZone firms are, in fact, receiving contracting activity.

When we look at the contracting activity for 2008, our records show that there were approximately $10.4 billion of awards that were labeled HUBZone. Of that amount, it was only 12 percent that were actually awarded through the HUBZone vehicle, which was about $1.8 billion.

The remaining awards were actually agencies' multiple counting of awards where awards may have gone either on a competitive basis or awards may have gone through the Section 8(a) program. But based on those awards they were counting them—because the firm was both an 8(a) firm or a HUBZone firm, they were, in fact, counting them in both categories. So the main indicator we have right now is job creation.

We recognize that we need much better metrics. And we are, in fact, in the process of developing much better metrics to determine, to be able to better report on whether the firms and the program are actually accomplishing the intent of the statute.

Mr. GRAVES. Mr. Shear, I would ask you the same question.

Mr. SHEAR. There are metrics to measure the benefits of the program. The performance measures used are things such as applications processed, examinations performed. So let me take the first one, applications processed.

You can see with what we observe here, it is especially of concern because it is saying, every application that gets through the gate is something that adds to the metric. The effort to try to develop metrics--it really wasn't a useful process; and the Agency is basically starting over.

They stated that they have hired an economist to work on developing metrics, and we have encouraged them to reach out to us and to others. And we told them that should happen soon.

Mr. GRAVES. Last question. In last summer's GAO report, it is suggested that the HUBZone maps were inaccurate; and I would ask what steps have been taken to improve this and how regularly are they updated?

Mr. HAIRSTON. We are actually working right now to put a contract in place to ensure that the maps are updated on a regular basis. We update the maps once we receive information from the various agencies that provide information to us that impact the maps.

Those agencies include the Department of Housing and Urban Development, the Department of Defense, the Department of Interior, the Office of Management and Budget, and several other agencies that provide information that actually have an impact on designating HUBZones. And we are putting a vehicle in place to make certain that as that information flows in, those maps will be updated.

And we just recently received information from the Department of Housing and Urban Development and OMB; and as a consequence of that, we will be updating the maps again in April.

Mr. GRAVES. Okay.

Well, I would appreciate it if you have whoever on your staff handles the inquiries, at least from congressional offices, and you get back with me on last year's—

Mr. HAIRSTON. I can assure you, I will follow up on that one.

Chairwoman VELÁZQUEZ. Mr. Bright.

Mr. BRIGHT. It is really not a question, just amazement at what I am hearing here today. And I don't know how to resolve the problem. I am a new Member, by the way, for the people here giving us testimony.

But we are experiencing tremendous waste in our government, fraud and abuse today. And to me, this is a prime example of what we need to do as a Small Business Committee to alleviate this and not a year down the road. We need to do it ASAP.

So I appreciate your testimony today. And Mr. Hairston, I appreciate your testimony, but I think you are the one that we are all looking at today to hear what you are going to do immediately before we take some type of drastic vote up here to alleviate or to reduce or to seriously curtail this program.

So I just ask you—I mean, what is your take on what I have heard here? And you really don't have to say anything else. I am astounded. I feel very much like I felt the other day when I heard these tremendous bonuses being given out to the AIG people.

So, Mr. Hairston, what can you say to give me a little comfort today that you are doing whatever you possibly can to alleviate this fraud and misuse and abuse of taxpayers' dollars out there?

You know, the small businesses make up 70 to 80 percent of our jobs out there. Sometimes we get focused on the huge corporate projects out there, and we lose focus on our small business.

But SBA could be the stabilizing factor for our economy; and for me to hear this, I am floored, I am astonished, I am very dis-

appointed. It is another, I guess, burden that we have to see on taxpayers out there, that we have got to put a stop to.

So, Mr. Hairston, I would like to hear what you feel—as a result of letting me, as a new Member of this Congress and this committee, how can you appease and satisfy me that we should not today take a vote to terminate this program right away?

Mr. HAIRSTON. Well, as I indicated before, we take this matter very seriously.

Mr. BRIGHT. You should. I hope you would.

Mr. HAIRSTON. We don't disagree with the majority of the findings of the GAO report. We recognize that there is a lack of a real risk management structure around that program.

But we also recognize that it is something that we can't put all the fixes in place overnight. But we know it is necessary that we take aggressive steps and that we do it in an urgent manner to put the proper risk management framework in place.

Mr. BRIGHT. Let me interrupt you and just ask you—I mean, this has been going on for a year at least, I can see. I am not hearing from these gentlemen over here that you have taken any drastic action to curtail this abuse and this waste.

Mr. HAIRSTON. Well, we have actually taken some steps. We have taken some preliminary steps; but we don't want to rush into trying to fix a problem and actually waste more resources and more time not appropriately fixing the problem.

Chairwoman VELÁZQUEZ. Would the gentleman yield?

Mr. BRIGHT. Yes, I will.

Chairwoman VELÁZQUEZ. Wasn't it recommended that onsite visits is a quite effective tool for deterrence? How many visits have you conducted in fiscal year 2009? Out of 10,000 firms, how many?

Mr. HAIRSTON. I think the number that was stated earlier was seven, and that is the number that was reported to me also.

Chairwoman VELÁZQUEZ. Seven.

Mr. HAIRSTON. And that is one of the courses of action that are being planned, that we will be conducting more onsite visits.

Chairwoman VELÁZQUEZ. Thank you for yielding.

Mr. BRIGHT. Are you attempting in any form or fashion at looking at criminal prosecution or even civil fraud against these agencies who are taking the money?

Mr. HAIRSTON. Well, in the cases that we are reviewing where we find that that seems to be an appropriate step, we are following the proper course. We are referring those cases to our Office of Inspector General.

Mr. BRIGHT. Have you any number to give us today of people you have done that to?

Mr. HAIRSTON. Actually, I think we have—I am not certain how many, in fact, were referred to the Office of the Inspector General.

I think all of the cases have been reviewed by the Office of the Inspector General. I know we have referred seven for a potential debarment, suspension and debarment through the normal suspension and debarment process.

Mr. KUTZ. Congressman, I think they got declinations on all 10 from U.S. attorneys. So they are not going to get prosecutions; they are looking at civil. And, of course, only four of these so far have been decertified by SBA.

Mr. BRIGHT. Wow. Thank you.

Mr. HAIRSTON. And I think of three we found to be eligible.

Mr. BRIGHT. I will close with the last few moments I have here and say this: Something needs to be done. It needs to be done right away. This is another case of waste, fraud and abuse that needs to be terminated ASAP.

And, Madam Chairman, I will yield back the remainder of my time. But I am very, very concerned about what I have heard here in the last 30 minutes.

Chairwoman VELÁZQUEZ. Using your time, Mr. Bright, if you will yield before—I would like to ask Mr. Kutz, how many people have been referred for prosecution from GAO as a result of an investigation?

Mr. KUTZ. Well, we sent the 10 last year to the IG and they got a declaration.

Chairwoman VELÁZQUEZ. How many have been initiated independently from that investigation by SBA?

Mr. KUTZ. From suspension and debarment, none, we understand.

Chairwoman VELÁZQUEZ. Thank you.

Ms. Clarke.

Ms. CLARKE. Thank you very much, Madam Chairwoman.

Chairwoman VELÁZQUEZ. Oh, I am sorry. I am sorry.

I am sorry, Mr. Bartlett.

Mr. BARTLETT. I think the gentleman to my right was here before I was.

Chairwoman VELÁZQUEZ. Mr. Thompson.

Mr. THOMPSON. Thank you, Madam Chairman. And thank you, Ranking Member Graves, for holding this important hearing today in terms of oversight of the SBA and its programs.

You know, we have been tasked with ensuring that the small businesses of America, our national economic engine, receive a fair portion of Federal procurement programs in order to purchase goods and services and keep government and military in day-to-day operations. Certainly now, more than ever, during this time of fiscal constraints, we as a committee need to be vigilant of the taxpayers' dollars that fuel the SBA procurement programs.

With that said, we must be equally concerned with the proper oversight that is in place with the additional stimulus funds that are leaving the Treasury. And also we need to make sure that these funds are used in a way that will benefit the small business operators and are done in a timely manner.

We need to ensure the small businesses are actually recipients of the funding designated for small businesses. I am alarmed, as my colleagues have indicated, to learn that the SBA does not check to make sure that a business actually qualifies for status as a HUBZone firm. In turn, this keeps contract officers from having the tools to verify the contractors' status.

The HUBZone program was designated to provide Federal contracting opportunities for qualified small businesses located in distressed areas; and the last thing our government agencies need to be doing is further assisting the misappropriation of funds that are designated for these distressed areas and creating further impediments to the true intent and mission of the HUBZones.

With that said, Mr. Hairston, several questions to start with. Why only 1.8 visits per month? Why only 7? What were the barriers? What was the decision-making that—when this was obviously a recommendation that had come from this committee previously?

Mr. HAIRSTON. It is just a matter of implementing the process and identifying the resources to complete the task.

Mr. THOMPSON. What resources were missing to—

Mr. HAIRSTON. Well, what we are doing is, we are—as a plan of action, we are engaging our field staff to help us to actually conduct field visits.

The review process of the application actually takes place in our headquarters location here in Washington, D.C. And obviously most of these firms are located out among the States where our field offices are located. And using our field staff to actually go out and conduct site visits for us.

And you will see an increase in those site visits, a substantial increase.

Mr. THOMPSON. Does the SBA contact contracting officers and agencies when questionable behavior in the HUBZone program is reported, so that the contracting officers can take appropriate action?

Mr. HAIRSTON. We would only contact a contracting officer if—in the event there was—in fact, there was a formal action taken. If the firm were to be debarred or suspended, then the contracting community would be put on notice. Conversely, if a contracting officer were to become aware of some fraudulent activity, particularly with respect to the failure to comply with the 50 percent subcontracting limitation requirement, then we would expect that they would contact us to notify us that a firm was not, in fact, complying with that particular requirement. And we would certainly hope that they would do that.

Mr. THOMPSON. Madam Chairwoman, I will yield back my time at this point

Chairwoman VELÁZQUEZ. Thank you.

Ms. Clarke.

Ms. CLARKE. Thank you very much, Madam Chairwoman and Ranking Member Graves. Thank you for holding this oversight hearing on the HUBZone program.

In the last Congress you had a similar hearing that discovered many problems with this program. And I applaud your vigilance of this critical issue.

As we are all aware, the HUBZone program encourages small businesses to locate in and hire from the Nation's most distressed communities. And it is hard to get firms to locate in distressed areas with low incomes and high unemployment. The HUBZone program offers an incentive to make it worthwhile to take a chance on rejuvenating a distressed area.

If properly implemented, the program has the possibility to create thousands of new jobs in the locations needing jobs the most. This is extremely important during these tough economic times.

So once again, I commend you, Madam Chair, for holding this hearing today to see how we can prevent future fraud, waste and

abuse in a program that can be beneficial not only to my district, but many other districts across this Nation.

Mr. Hairston, this first question is for you. Since the SBA has failed to recertify more than 40 percent of the firms that have been in the program for more than 3 years, according to last year's GAO report, the SBA noted that the HUBZone program had obtained additional staff and that the pending backlog of recertifications would be completed by September 30, 2008.

Can you let this committee know today how you intend to prevent future recertification backlogs and make sure that it happens in a timely manner? And do you have any assessment process in place to identify any future backlogs?

Mr. HAIRSTON. In fact that is a process that is under way now as part of our business process reengineering. We recognize now that it is going to take us longer to process applications than we were processing them before.

We were trying to process applications within a 30-day time frame; and we recognize that that just opens us up to too many possibilities of abuse of the program, that we will have to spend more time in terms of the certification process.

And, again, with the recertification process, that will become a priority of the program that recertifications are absolutely necessary; and it will have to establish guidelines and time frames to make sure that they are done and that they are done appropriately. We expect to have that process completed by the end of this fiscal year. And hopefully we will have that framework in place sooner rather than later so that we can move forward in a prudent manner and with respect to the oversight of the program.

Ms. CLARKE. So you don't really have a concrete time frame in place as of yet?

Mr. HAIRSTON. At this point, we are actually working with a contractor; and we plan to work with GAO and we plan to work with our Inspector General to make sure that we are putting the proper procedures in place. We are hoping to do that as quickly as we possibly can. We don't have a time frame at this point to say when it will actually be completed.

Ms. CLARKE. Would you get back to this committee as soon as you sort of have a good sense of that? Because, of course, you know that a recertification is very important to many of these companies that are trying to do right by our communities. And it could be quite interruptive for them if unanticipated delays pop up. So I hope that you will get back to us on that.

Ms. CLARKE. I would also like to touch upon the 8(a) program. In your written testimony you stated that the Office of Business Development created an online tutorial to ensure that potential applicants understood and understand the 8(a) participation requirements. But according to Mr. Shear's GAO report, released in November of 2008, he recommended that for 8(a) applicants to fully understand their realistic expectations, there needs to be an education requirement such as a seminar or an assessment tool.

Do you intend to take further steps to ensure that firms applying for the program understand the 8(a) program requirements and have realistic expectations for participation, as the report suggested?

Mr. HAIRSTON. Those education seminars are conducted routinely throughout the country by our district offices. That is an ongoing process.

Ms. CLARKE. So you are not relying solely on these online tutorials?

Mr. HAIRSTON. No.

Ms. CLARKE. Thank you very much, Madam Chair. I yield back the balance of my time

Chairwoman VELÁZQUEZ. Thank you.

And we are going to be in recess until the end of this set of votes. We have three votes.

[Recess.][3:36 p.m.]

Chairwoman VELÁZQUEZ. The Committee is called back to order.

Mr. Bartlett.

Mr. BARTLETT. Thank you very much.

I am pleased you are going to have a second round of questions and comments, because I want to participate further than just this one brief 5 minutes.

Clearly, there is inadequate supervision of this program and inadequate punishment when bad guys sin. We need to have a punishment that will discourage—there is a $500 fine for riding in the HOV. Not very many people ride in the HOV, because there is a huge punishment for that. We need to have a harsh punishment for this. We are not going to do it, but if you hung the first person who did it, nobody else would ever do it, would they? And we need to have a punishment that just discourages people from doing it.

These aren't stupid people. These are opportunists that are taking advantage of the system, and we not to encourage them not to do that.

I am very familiar with the HUBZone program because the first HUBZone contract ever was in my district. It was Garrett Container in Garrett County. Don Morin runs it, a great young entrepreneur; and they provide a lot of very good jobs there doing very important work for the government.

But there is another one of my companies that I want to talk about which I think is exemplary of what HUBZones ought to do, and this is Sycamore Associates. A great name. Who is the Bible character that went up a sycamore tree and came down a Christian? Went up there a heathen and came down a Christian.

So he is a very ethical person. He started in a little HUBZone in Frederick. It wasn't big enough. He had to grow. So he moved out to Garrett County.

I have three counties in Appalachia, 14 percent unemployment when I came to office. Really Appalachia. And great business out there. His people out there get three times the average salary out there, and he pays his people out there two-thirds as much as he pays them—they do contract work for NSA. NSA is very, very fond of them.

He pays his people out there two-thirds as much as he pays them in Howard County when they live near NSA. So he can now hire three people out there to do the same work that two people are doing in Howard County because it is just a whole lot cheaper place to use.

So this is exemplary of what HUBZones ought to do, and I am really angry that these people are abusing the system. Because every one of these cheaters takes money away from a great company like Sycamore Associates and Kurt Heckman who runs that company that are providing really good jobs and really uplifting the area.

All of Garrett County is a HUBZone because they have, as I said, 14 percent unemployment when I came to office and very low salaries. His people make at least three times the average salary. So this is doing exactly what HUBZones are supposed to do.

Does SBA not adequately manage just because you don't have the resources?

Mr. HAIRSTON. Well, let me say, first and foremost, that I agree with you wholeheartedly that we should be about eradicating that bad element from the program. We wholeheartedly agree that a lack of enforcement leads to further abuse. We are approaching that issue from that perspective, and I hope everyone understands that we recognize the types of steps that need to be taken.

Mr. BARTLETT. But you are not taking them because you just don't have the resources?

Mr. HAIRSTON. I was going to finish. I was going to say we recognize what needs to be done, and we know the type of proper oversight and the types of things we need to put in place. But we also recognize—and that is why we are going through this planning process—that it is going to add a substantial burden in terms of cost to how we conduct oversight over this program and the costs associated with doing that.

Mr. BARTLETT. So it is partly our fault because we didn't give you the money to grow your staff so that you could have the—

Now, my understanding is that the initial surveillance of this program is supposed to be self-policing. I know one small businessperson who is sitting in the audience who has done a really great job of self-policing. He understood that that is what was expected. Nobody knows better who the cheater is than the good guy who lost because the winner was a cheater. And we expected that they would come forward as self-policing. That costs the taxpayer nothing. But I don't think we did a very good job of telling the HUBZone community that that is what we expected, did we?

Mr. HAIRSTON. I am not certain that it works very well in this environment. We find that, while self-policing has worked in other programs that allow for self-certifications of a sort, we have found that, more recently, firms are afraid of offending contract officials by filing protests.

Mr. BARTLETT. See, that is our fault. We need to tell them that they are going to be applauded for filing a protest when it is a legitimate protest, not going to be punished for it. We just didn't properly advertise that.

We have got to do one of two things. Either the community know that we really expect self-policing and they are not going to be punished for it, they are going to be rewarded for it. We have to give you enough money so you can police the program, right?

Mr. HAIRSTON. Yes, sir.

Mr. BARTLETT. Thank you very much, Madam Chairman.

Chairwoman VELÁZQUEZ. Mrs. Dahlkemper.

Mrs. DAHLKEMPER. Thank you, Madam Chair, and I want to thank you for bringing this really important hearing before us today.

As Mr. Bright said earlier, I am a new Member of Congress, and I have never been in elected office before. I am out there in the private sector running my business and knowing that not everybody plays by the rules. But in my business, we do. And thinking that the government, whether it is Federal, State or local, is there protecting my interest, both as a businessperson and as a citizen, to make sure that those who are not playing by the rules are somehow punished for this and that our taxpayer dollars are not being used fraudulently, as obviously they are.

I have so many questions here, but I am sure my outrage is felt by many others, including those businesses who are doing the right thing and who are using this program for the right reasons who may end up losing that privilege to use this program because of those people who have been cheating.

I guess my question, Mr. Kutz and Mr. Shear, do you have any idea how much money of the taxpayer dollars has been lost since we had the first hearing?

Mr. KUTZ. There is at least $25 million that was awarded to some of the 10 contractors we identified last July, including one of the most egregious cases that got a $23 million award subsequent to the July, 2008, hearing. So I would consider that to be additional fraud by those same companies.

Mrs. DAHLKEMPER. And what percentage—I know you have kind of talked about this before, but you have only touched a few companies and the percentage of fraud that you think might be going on within this company.

Mr. KUTZ. I don't know that. I mean, we did not necessarily randomly sample. We actually picked certain areas that were vulnerable to the principal office and the 35 percent rule, although we weren't looking for the other thing about the subcontracting. So 50 plus percent of what we looked at so far. I don't believe that is the likely majority of the companies are not eligible.

However, it appears that there has been no real oversight for quite some time. And I think we have an admitted self-certification process for the first X number of years of this program; and they are trying to move from self-certification now to actually putting a program in place, which is why you have difficulty going from advocacy to enforcement.

Mrs. DAHLKEMPER. I think that number would be very interesting, but it would probably be so scary I am not so sure we want to know, but sitting here listening, I just wonder what that figure is, what that figure is over the course of this program and how much money of the taxpayer dollars has been fraudulently taken from us.

I guess my concern, Mr. Hairston, as we go forward here—first of all, it has really become clear that the SBA did not do their due diligence from the last hearing to today. As we go forward, we also are looking at a fair amount of money going out from the recovery package to the SBA. And, obviously, as a new Member who voted for that package, who believes in that package, I am very, very con-

cerned about your ability—your agency's ability to monitor that money. Can you give me any reassurance about that?

Mr. HAIRSTON. Well, I think we are, in fact, doing our due diligence now as we go forward. We have done our due diligence on the cases that have been referred. We fully intend to aggressively do our due diligence on the cases that are being referred by the report that is released today.

We expect that we will be meeting with the GAO and our IG and our general counsel within the next week or so to get the names of those companies so that we can start that process; and, going forward, we will continue to implement procedures to further mitigate risk in the program.

As I said before, we recognize that there is a huge risk here. We also recognize that putting the proper protocols in place to address that will be an additional cost burden for this program, and we need to plan how we need to do that and what those resources really are.

Mrs. DAHLKEMPER. What kind of transparency are you going to have for us, for the American public?

Mr. HAIRSTON. Transparency for the American public in terms of—

Mrs. DAHLKEMPER. I would like to see transparency in this program. Certainly as we go forward in terms of the recovery package. But I would like to see some transparency so that we can—

Mr. HAIRSTON. That is something we can certainly consider in this process, how we can be very transparent and how we go about conducting ourselves in this matter.

Mrs. DAHLKEMPER. I yield back. Thank you.

Chairwoman VELÁZQUEZ. Mr. Bartlett, do you still have some questions?

Mr. BARTLETT. After you, Madam Chair. You wanted a second round.

Chairwoman VELÁZQUEZ. I do. Yes. Thank you.

Mr. Kutz—oh, sorry. Mrs. Halvorson.

Mrs. HALVORSON. I know I am sitting way over here in my seat. But thank you, Madam Chairman. I do have a couple of questions.

But, first of all, I would like to follow up on what Congressman Bartlett's question was; and this is for Mr. Shear and Mr. Kutz. Do you believe that the SBA has the staff levels and the funding that is going to be required to implement some of the reforms that have been suggested? Because as I hear and I work with a lot of the different committees, I am hearing the same things over: We need help. We don't have enough funding. We are doing what we can.

What is going on? And what is it that you suggest? And do we have enough staffing levels to do what we need to have done?

Mr. KUTZ. I would say—I will let Mr. Shear add, too—it is not just people. I think it is better processes and better use of technology. It is a combination of all three factors.

I have met with SBA officials in January for over an hour, with their consultants, to give them kind of a brain dump of the kinds of things they should consider. But the kind of processes we have talked about here, the random, unannounced site visits; and they are still not doing those. And that is something they should be able

to do fairly quickly. We did 36 of those as part of this investigation ourselves with several people. So we did 36 ourselves.

The technology issue is, do they have the kind of tools technology-wise to do some of the actual kinds of preliminary work that you would do before you actually go out and do a site visit or to help you with your risk assessment?

So our recommendations to them include all three elements of that.

Chairwoman VELÁZQUEZ. Would the gentlelady yield for a second?

Mrs. HALVORSON. Yes.

Chairwoman VELÁZQUEZ. I understand that the SBA program was shut down, was closed; and you moved 12 people from that program to the HUBZone. Have you seen this—this happened last September.

Mr. HAIRSTON. Yes, I believe so.

Chairwoman VELÁZQUEZ. Did you see any progress regarding on-site visits or an acceleration of processes?

Mr. KUTZ. I can't answer on the program examination side. Apparently, they have made progress on program examinations.

But, on site visits, if they have only done seven this fiscal year, we did 36 for our investigation. So I don't think seven is enough. And I don't know how many people they have at this point. But if they have seven people, they should be able to do more than one a month, for example.

Chairwoman VELÁZQUEZ. Mr. Hairston, I will give you more time, but I just cannot allow for this to go and not being able to ask you, what will it take? This is taxpayer's money. So with much less manpower, they have conducted many more visits. Yet you put 12 people added to the program and still—what is the problem?

Mr. HAIRSTON. I would assume, first and foremost, that, from a manpower standpoint and from the standpoint of the prioritization of their resources, that is their job. That is what they do. That is what they are in business to do, is to go out and do that type of forensic investigation.

From our perspective, I don't know that the HUBZone office set its priorities to support that type of an activity. That is something that needs to be looked at, and that is something that needs to be corrected.

Chairwoman VELÁZQUEZ. But aren't you concerned that this Committee and the administration, that we are going to put pressure to close down this program?

Mr. HAIRSTON. Obviously, I am concerned. I am concerned about the program.

Chairwoman VELÁZQUEZ. For the record, let me read to you from the congressional hearing that we conducted last September. You came here. I asked you specifically about Ms. Carranza's, the former Administrator, commitment to do on-site visits. And you said, well, I am not aware that she made such a commitment. So let me read to you what she said to this Committee:

In response to the findings of the GAO forensic investigation, which we learned about last week, I have taken many steps to require site visits for those HUBZone firms that have received HUBZone contracts.

I yield back. Thank you.

Mrs. HALVORSON. Thank you, Madam Chairman. And just to reiterate—and I appreciate the conversation. I represent a district that probably could all use the HUBZone funding, low income, high poverty rate, high unemployment. Parts of my district have 14 percent unemployment rates, and I would hate to see that people that don't qualify get this kind of funding when we don't even have people in these towns that probably know even how to apply for this. So I am going to work hard, my staff and I, to help them.

And I just don't want to see that there are people who are abusing the system. And what I found in my short amount of time in this body and 12 years prior in Illinois was I think we have enough laws, we have enough programs, but we don't have enough funding and staff to enforce what we have. This is our life, and I would hope that you would take it seriously as we go back to do what it is that we all agreed to do. Because the people are not benefiting. The wrong people are.

So I would help wherever I can. I offer myself and my staff to make sure that whatever it is we are doing that we do in the right way. Because the people that live in my district in Illinois are suffering because they are not getting this kind of funding, and they are the ones that truly should. Because in some parts of my district, they don't even have blacktop roads. They have gravel and sand and propane. They don't even have natural gas. So I would really get frustrated if I knew that people in the wrong places were getting this kind of funding.

I yield back. Thank you.

Chairwoman VELÁZQUEZ. Mr. Kutz, last year GAO's fraud investigators created four phantom companies, including two with mailboxes as a principal office and a third with a Starbucks as the principal office. Are these four companies still listed as eligible HUBZone firms?

Mr. KUTZ. As of 8:00 a.m. this morning, yes.

Chairwoman VELÁZQUEZ. Administrator Hairston, why was the SBA unable to even find the phony HUBZone firm at a Starbucks? Why weren't you able to?

Mr. HAIRSTON. Well, I am sure if, in fact, those firms are in the system now, that there is a process ongoing to remove them. There is a decertification process. I would hope that that process is under way. I can get that information back to you.

Mr. KUTZ. But they are not being decertified. No. I mean, we would have gotten notice. We haven't heard anything from SBA at this point.

Chairwoman VELÁZQUEZ. Isn't this firm the same one that was found to be ineligible last July?

Mr. KUTZ. No. Those are our four fake firms that we are talking about versus the one that actually got $23 million in new contracts. Our bogus firms are still in the system. Although we haven't competed for contracts, we are not willing to go that far with it at this point.

Mr. HAIRSTON. Yeah. And I would agree that they should not be there.

Chairwoman VELÁZQUEZ. Really? Ten cases were brought to your attention last year. Only two have been officially removed from the

program, and none have been debarred today. I have read your testimony and your explanation for this. Given the seriousness of the violations, why did the SBA not choose to suspend these companies during the debarment process?

Mr. HAIRSTON. Because we don't have the authority under our regulations to suspend prior to a formal action. Differing from our 8-A program, under the regulations in our section—

Chairwoman VELÁZQUEZ. Is that correct?

Mr. KUTZ. No, that is not correct. You can suspend a company before there is a prosecution, an indictment, if you have sufficient evidence.

Chairwoman VELÁZQUEZ. And do you believe that there is sufficient evidence?

Mr. HAIRSTON. I would actually disagree with that. I would disagree with that, and our counsel would disagree with that. We don't have the authority. It is not specific in our regulations that we could actually suspend prior to a formal determination.

We can do that in the 8-A program. We have specific requirements under our regulations in the 8-A program that allow us to do that, to preclude a firm from receiving benefits for which it is not eligible.

Chairwoman VELÁZQUEZ. I want your counsel to put that in writing for the record and send it to this Committee.

Mr. KUTZ. Madam Chair, I am talking about suspensions, not debarments. Debarments require a much longer process, but suspensions can be done without as much evidence. I mean, there is enough evidence in this case to decertify. Our position would be that they could be suspended.

Mr. HAIRSTON. We rely on our counsel who says that—

Chairwoman VELÁZQUEZ. That they cannot be suspended?

Mr. HAIRSTON. That there is an evidentiary procedure and standard that has to be met and that there is a due process afforded in that process. That is why I was explaining the difference between the authority we have under our 8-A program that differs from the authority we have under our HUBZone program. But we will provide you what you are asking for.

[The information is included in the appendix at page 101.]

Chairwoman VELÁZQUEZ. Mr. Kutz, why do you believe that there have been so few referrals for either suspension or debarment?

Mr. KUTZ. As I mentioned before, because I think before you had more of a self-certification process. So, hopefully, if they are putting more stringent front-end controls in place, they will identify more cases that actually they would refer to the IG and that they would consider for suspension and debarment. So, hopefully, if you move from an environment of self-certification to one where you have got effective controls in place, you will come up with more examples.

I would just say for the record, too, here—and I think Mr. Bartlett mentioned it, too, I think you have to make some examples of people. And if you don't make some examples of some people here, you are not going to have any change.

So here we are nearly a year later from our hearing last July, and we have little or nothing that has happened to the 10 cases before. And I would say some of those were egregious fraud cases

that again I would say for the record could have been suspended by now. We are talking about 6 or 8 months after the last hearing. The fact that nothing has been done with some of those companies and they are still getting government contracts as HUBZone companies is not a good sign.

Chairwoman VELÁZQUEZ. Any comments to that?

Mr. HAIRSTON. Out of the 10 cases that were referred, I think I indicated that we found three of those firms to be eligible. Two of the firms were decertified.

Chairwoman VELÁZQUEZ. What about the other seven?

Mr. HAIRSTON. I am explaining that. Two of the firms were decertified, two of the firms withdrew from the program, and three are actually still under investigation. And seven have been referred for suspension and debarment.

Chairwoman VELÁZQUEZ. Mr. Kutz, did you get any information regarding the three firms that SBA claimed are eligible?

Mr. KUTZ. No. We have asked for information. The three cases were three cases, I believe, that they failed the 35 percent, not the principal office requirement. At the time we looked at them, we determined, based upon payroll records that we received, that they did not meet the 35 percent. SBA has represented that they now do or at some point when they do the investigation they did. We asked for support for all three of those cases about 2 months ago, and we have not received it yet.

Chairwoman VELÁZQUEZ. Why is that?

Mr. HAIRSTON. I will find out. I don't know the answer to that. I wasn't aware that that request had been made, but I will find out why they haven't gotten the information.

Chairwoman VELÁZQUEZ. Mr. Graves.

Mr. Bartlett.

Mr. BARTLETT. Thank you very much.

Is the only punishment here debarment?

Mr. HAIRSTON. Actually, suspension and debarment

Mr. BARTLETT. That is the only punishment?

Mr. HAIRSTON. No. Actually, the only other punishment would be decertification and then referral for some type of criminal prosecution.

Mr. BARTLETT. Has that ever happened?

Mr. HAIRSTON. Not that I am aware of.

Mr. BARTLETT. This reminds me of the illegal immigrants and the border. If all you do is get sent home, why not try again tomorrow? By and by, you will be successful.

If the only thing you do is debar them, that is not punishment enough. Is it our fault that you don't have harsh enough punishment to dissuade these people?

Mr. HAIRSTON. No, I think there were cases that were referred for criminals, but they were denied.

Mr. BARTLETT. What is the maximum punishment that could be meted out to these people? Can GAO tell us?

Mr. KUTZ. Well, certainly. These people all made false statements. Title 18, Section 1001. If you can get a U.S. attorney to take a case, you could prosecute a case in that particular situation. Now, the U.S. Attorney declined the case that Mr. Hairston is talking about here.

Mr. BARTLETT. They have bigger fish to fry?

Mr. KUTZ. Apparently.

Mr. BARTLETT. We have got to do something.

Mr. KUTZ. That is something the Committee could decide to do, is work with some U.S. attorneys to see if they could get a few poster-children cases to go through the criminal system. And that is something—maybe you should consider that.

Mr. BARTLETT. If we had a few of those, it would stop this thing. This is such a valuable program.

I just want to note again my personal experience with that. The first one in the country was Garrett Container out in Garrett County, 14 percent unemployment. And then they have a lot of people working there doing a really good job and they make shipping containers for our military. They are doing a doubly good job supporting the military and supporting the economy there.

And then when Sycamore Associates went out there, wow, that really was revolutionary. Because they have a number of people there making three times the mean average salary there. But they are paying them only two-thirds as much as they would need to pay them if they were—

By the way, they give them a choice. They have a job for them in Howard County for $100,000 or a job for them for 65 or $70,000 in Garrett County. They take the job in Garrett County because, the truth is, you will live better in Garrett County with $65,000 than you will in Howard County for $100,000.

So we are saving—now NSA can have three analysts where before they could only have two analysts. So this is really, really good for my district, for Garrett County, because they are paying them three times as much as the average person who works there.

Look at all of the people down the line that are better off because of that, all of the industries that serve them, the service station, the cleaners, the drugstore, the restaurant they go to and so forth. All of that. And we are really saving the taxpayer a lot of money because—and GSA is very fond of this because now they get three employees where before they could only support two employees.

So this is a great example of what these HUBZone companies ought to be doing; and I am just incensed, Madam Chairman, that we have these cheaters out there.

And I know one of our small businesspeople who is here in the audience who has been very successful in protesting. He knew that is what he was supposed to do. And he had one person that was awarded the contract. He had absolutely no capability. All he had was a townhouse. And, obviously, you protest that. He couldn't have possibly performed on it, but he was awarded the contract anyhow by this government Agency.

So our small businessperson protested that, and the protest was upheld. Then there was a second one, and he protested that, and that was upheld. So the system does work, but these small businesspeople don't know that that is what they are supposed to do.

So we now have all these egregious cheaters out there, and we need to do a couple of things. Either we need to let the community know that they are supposed to self-police, or we need to give you enough resources so you can police them. And we sure as heck

ought to have a punishment that fits the crime so that they are dissuaded from do—and we have done none of that.

Madam Chairman, almost a year ago we sat here. And here we are today, and it sounds like Groundhog Day all over again. It is the same kind of thing that we were hearing a year ago.

We need to give you more money, we need to tell the community they need to self-police, and we really need to have an adequate punishment. We need to have a few examples out there so you won't do it.

Any argument that we need to do those things?

Mr. KUTZ. No. Again, I think—as you said, I believe that if you have some examples out there of serious punishment that that will send a message.

Mr. BARTLETT. Yeah, some jail time.

Mr. KUTZ. Yes.

Mr. BARTLETT. That gets around very quickly, doesn't it?

Well, the people who are now offenders, they knew that there wasn't going to be much—it needs to be people that come in and offend from now on. You can't really—it is ex post facto, and it is unconstitutional. And the general knowledge was that there wasn't going to be any serious punishment for this. So a huge gain possible, so why not do it? We need to make that very nonproductive for them, don't we?

Thank you very much. Thank you, Madam Chairman.

Chairwoman VELÁZQUEZ. Mr. Graves.

Mr. GRAVES. How often does a business have to recertify if they are in a HUBZone?

Mr. HAIRSTON. Every 3 years.

Mr. GRAVES. Can't you just withhold certification, too, if they turn out to be fraudulent?

Mr. HAIRSTON. During the recertification process? Yeah, they can—

Mr. GRAVES. But you would have to actually go check and see if they are the real deal?

Mr. HAIRSTON. We are supposed to, yes.

Mr. KUTZ. Congressman, can I also add to that? In addition to recertifying for a HUBZone, they also recertify certain key facts on line annually. So when I mentioned in my opening statement that many of these companies—all 19 have made recent false statements. They all certified that they were HUBZone-eligible during periods that we determined that they were not. Not the SBA, but as part of our on-line overall contracting certification program.

Chairwoman VELÁZQUEZ. Mr. Bartlett, I just would like to remind the Committee that we passed the HUBZone reform through the House with overwhelming support. So we are just not here waiting for SBA to do what they are not doing. Let me state—

Mr. BARTLETT. Madam Chair, did we give them the resources? Giving them the responsibility without the resources—

Chairwoman VELÁZQUEZ. Well, the Committee passed the budget, and we are providing the resources. Yes.

Mr. BARTLETT. They are telling us they don't have the resources.

Chairwoman VELÁZQUEZ. No, no. In the budget that we passed here and that the Committee reported out—but, don't forget, for

the last 8 years, yes, their budget has been cut by almost 40 percent. We are trying to restore some of the money.

Mr. BARTLETT. We can't fault them for what is our fault, if we gave them the responsibility and not the resources.

Chairwoman VELÁZQUEZ. Well, it is a new day in Washington.

Mr. Hairston, let me just say this. I am extremely, extremely disappointed for the lack of progress. And my message to SBA is clear. You have a decision to make, whether or not you are committed to this program. And then the Committee has a decision to make regarding the future of the program.

With that, let me ask unanimous consent that members will have 5 days to submit a statement and supporting materials for the record.

Without objection, so ordered.

This hearing is now adjourned.

[Whereupon, at 4:06 p.m., the Committee was adjourned.]

NYDIA M. VELAZQUEZ, NEW YORK
CHAIRWOMAN

SAM GRAVES, MISSOURI
RANKING MEMBER

Congress of the United States
U.S. House of Representatives
Committee on Small Business

2361 Rayburn House Office Building
Washington, DC 20515-6315

STATEMENT
Of the Honorable Nydia M. Velazquez, Chairwoman
United States House of Representatives, Committee on Small Business
Full Committee Hearing on: *"Studies of SBA Contracting Programs by GAO"*
Wednesday, March 25, 2009

As Supreme Court Justice Louis D. Brandeis famously said, "sunshine is the best disinfectant." To make sure oversight is a priority, the House has adopted rule 11, which requires quarterly hearings on waste, fraud, abuse and mismanagement of programs under the committee's jurisdiction. Accountability is critical to the legislative process, and it is something that our committee has consistently worked to promote. In the last two years alone, we have held several oversight hearings on issues ranging from Katrina disaster assistance to fraud in contracting. That is a track record we are going to continue in the new Congress, starting with today's review of GAO's HUBZone investigation.

When first introduced, the HUBZone program promised to create opportunities for small businesses in low-income communities. It was designed to do this by helping entrepreneurs access the federal marketplace. In theory, the benefits would be twofold-- HUBZones would not only bolster the small business community, but would also breathe new life into struggling neighborhoods. However, the program has been undermined by chronic under-funding, inherent program flaws and sloppy management. Instead of being incubators for growth and development, HUBZones have become breeding grounds for fraud and abuse.

This afternoon's hearing will focus on a new GAO report on the HUBZone program, the findings of which are nothing short of appalling.

Unfortunately, HUBZone fraud is nothing new. Last Congress, concerns on the part of both this committee and the business community prompted a GAO audit and investigation. What GAO found was that the majority of the HUBZone businesses it reviewed in the DC area were ineligible. And yet somehow, these companies managed to collect over $100 million in federal contracts. Those are funds that should have gone to deserving small businesses.

During last year's hearing on the matter, it quickly became clear that the HUBZone program was not only dysfunctional-- it was riddled with fraud. Apologists claimed these incidents were isolated. They argued that most HUBZone businesses

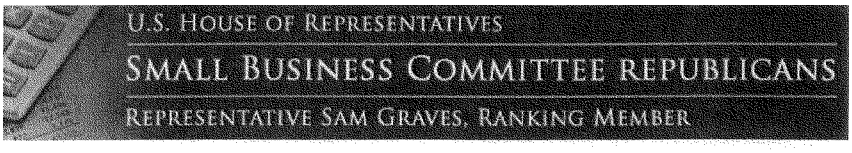
played by the rules, and said the program shouldn't be blamed for a few bad apples. To see if this was in fact the case, we requested a broader investigation.

The review, which was carried out in four different regions across the country, found that HUBZone abuse is *not* unique to Washington. Rather, it is systemic. Today, we will hear from GAO that the majority of the reviewed businesses were not even HUBZone eligible. And yet they received $30 million from the program.

Eight months after our first HUBZone hearing, SBA still has no control over the initiative. As a result, tens of millions of dollars in HUBZone contracts have gone to unqualified businesses. That includes $27 million that went to businesses GAO had *already* identified as ineligible in its July report. Because SBA failed to act, those companies continued to receive contracts that were never rightfully theirs.

Abuse of a federal program is never a good thing. Today-- in light of the billions of stimulus dollars about to enter the federal marketplace-- we need to be more vigilant than ever. It is critical that small businesses have a level playing field, and that tax payers get the most bang for their buck.

As important as it is to provide expanded opportunities to entrepreneurs, we just can't allow a program so fatally flawed to continue. It's time for SBA to make a decision--either overhaul the program, or scrap it completely. This committee is no longer going to tolerate the excuse "we're working on it," while hardworking small business who have played by the rules are being cheated out of opportunities.



Opening Statement for Hearing on
Small Business Administration's HUBZone Program
Sam Graves
Ranking Member
Committee on Small Business
United States House of Representatives
Washington, DC
March 25, 2009

Good afternoon, and thank you for participating in the Committee's *Oversight Hearing of the Small Business Administration and its Programs.* I would like to thank Chairwoman Velázquez for holding this important hearing. My comments will focus on government contracting and the Historically Underutilized Business Zone, or HUBZone program.

One of the primary goals of the Small Business Act is to ensure that small businesses receive a fair portion of contracts offered by the federal government. This is important because small businesses have lower overhead and can provide goods and services to the federal government as efficiently, if not more so, than larger competitors. In addition, providing small businesses with their fair share of federal contracting opportunities will hasten economic recovery. However, time and again the government fails to reach its contracting goals, the government continues to bundle contracts that only large businesses can obtain, and we find that various contracting programs open themselves to abuse and the possibility of fraud.

We need to focus efforts on improving the government contracting process. This includes preventing inappropriate contract bundling and eliminating the potential for fraud and abuse, including in the HUBZone program.

As we all know, the HUBZones program was created to stimulate the economies of economically depressed areas by awarding qualified HUBZone participants with federal

contracts. However, recent investigations by the Government Accountability Office demonstrate that the program is susceptible to abuse and the possibility of widespread fraud. The studies are alarming and the SBA's response has been inadequate. What is worse is that contracts given to firms ineligible for the program undermine the ability of legitimate HUBZone firms to win contracts. In turn, this diminishes the effectiveness of the program in revitalizing economically depressed areas.

I look forward to hearing the testimony of our witnesses today and learning about the progress they have made in addressing these problems. If enough is not being done I can ensure you that I will take a more aggressive approach to righting this ship.

Again, I thank the Chairwoman for holding this hearing and look forward to working with her and all members of Congress, the GAO and the SBA to rid the HUBZone program of abuse.

Testimony of
Darryl Hairston
Acting Administrator
U.S. Small Business Administration

Before the
U.S. House of Representatives Committee on Small Business
March 25, 2009

Chairwoman Velazquez and other distinguished Members of this Committee, I appreciate the opportunity to submit this written statement in connection with the Committee's hearing on waste, fraud, and abuse in Government programs.

As a federal credit agency with an $88 billion loan portfolio, the principles of stewardship, transparency and accountability are essential to the integrity of the programs and operations of the U.S. Small Business Administration (SBA). With the recent passage of the American Recovery and Reinvestment Act (Recovery Act), as well as the FY 2009 Omnibus Appropriations Act, Federal agencies will be held accountable not only for developing effective and efficient strategies for implementing the new statutory provisions but also for the prudent stewardship of taxpayer dollars used for funding the programs authorized under these acts. The SBA takes its on-going responsibility to guard against and to prevent waste, fraud and abuse in its programs very seriously. Ensuring that proper controls are in place is crucial to the Agency's ability to implement and administer its programs in an environment that inhibits fraud, waste and abuse.

Maintaining Integrity and Accountability in our Programs

The SBA believes that maintaining the integrity and accountability in all programs and operations is critical for good government. We believe that our Agency demonstrates responsible stewardship over assets and resources by providing high-quality, responsible leadership; by effectively delivering services to customers; and by maximizing desired program outcomes. The Agency has developed and implemented management, administrative and financial system controls that reasonably ensure that: programs and operations achieve intended results efficiently and effectively; resources are used in accordance with the mission of the Agency; programs and resources are protected from waste, fraud, and mismanagement; program and operations activities are in compliance with laws and regulations; and reliable, complete, and timely data are maintained and used for decision-making at all levels.

American Recovery and Reinvestment Act of 2009

The Administration is committed to investing Recovery Act dollars with an unprecedented level of transparency and accountability so Americans know where their tax dollars are going and how they are being spent. The guidance issued by the Office of Management and Budget (OMB) on February 18, 2009 contains critical action steps that Federal

agencies must take immediately to meet these objectives and to implement the Act effectively. The guidance addresses Federal agency requirements to provide spending and performance data to the "Recovery.gov" website. In addition, the guidance establishes requirements for various aspects of Recovery Act planning and implementation. These requirements are intended to meet the following crucial accountability objectives:

- Funds are awarded and distributed in a prompt, fair, and reasonable manner;
- The recipients and uses of all funds are transparent to the public, and the public benefits of these funds are reported clearly, accurately, and in a timely manner;
- Funds are used for authorized purposes and instances of fraud, waste, error, and abuse are mitigated;
- Projects funded under the Recovery Act avoid unnecessary delays and cost overruns; and
- Program goals are achieved, including specific program outcomes and improved results on broader economic indicators.

The SBA has initiated steps to comply with OMB's guidance by establishing a risk management team. This team will develop appropriate risk management plans that include risk assessment and risk mitigation strategies that are designed to effectively implement the various provisions of the act while at the same time providing the American taxpayer with the unprecedented level of transparency and accountability that the Administration is committed to. Periodic testing and validation of these plans will be key components of our strategy to monitor our performance and to reduce the potential for fraud, waste, or mismanagement.

FMFIA

The SBA's management is responsible for establishing and maintaining effective internal control and financial management systems that meet the objectives of the Federal Managers Financial Integrity Act of 1982 (FMFIA). FMFIA requires federal agencies to conduct an annual assessment of internal control and report the results to the President. The most recent assessment indicated that there were no material weaknesses in the design and operation of the Agency's internal controls. Nonetheless, SBA continues to strengthen the internal control over its programs and operations.

During FY 2008, the SBA conducted its third annual assessment of internal control over financial reporting to comply with the Office of Management and Budget's (OMB) revised Circular No. A-123 Appendix A, Internal Control Over Financial Reporting, which is similar to that imposed on publicly traded companies by the *Public Company Accounting Reform and Investor Protection Act of 2002 (the "Sarbanes-Oxley Act").* The Senior Assessment Team (SAT), chaired by the Chief Financial Officer (CFO) and composed of SBA managers from the major programs and support offices, directed this effort. The SAT reviewed the key business processes impacting financial operations and the financial statements and no material weaknesses were identified.

Audits and Investigations

All of us at SBA recognize the important oversight role provided by the Office of Inspector General (OIG) and the Government Accountability Office (GAO) in identifying waste, fraud and abuse in government programs. I want to assure you and members of the Committee that we are working diligently to implement recommendations contained in GAO reports and OIG audits that identified waste, fraud and abuse in SBA programs. Let me briefly provide you with a summary of important actions taken to date.

HUBZone

The GAO report entitled *Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results* that was issued in June of 2008 identified potential waste, fraud and abuse by identifying firms participating in the HUBZone program that may not have met the program's eligibility requirements. In response, the SBA has changed the criteria for selecting firms for program examinations to only those that received HUBZone contracts within a particular FY to target examination resources to firms mostly likely to be incorrectly receiving awards, changed the internal certification process, and is in the process of completing a business process reengineering (BPR) program to improve the program and decrease potential waste, fraud and abuse.

Over the last 8 months since the report was issued, SBA has developed new procedures for evaluating all applications, recertifications, and program examinations. As a result of these new procedures, SBA has conducted an average of 1.8 unannounced site visits per month.

SBA is collecting supporting documentation from all firms that seek HUBZone certification or wish to maintain their HUBZone status. While these procedures have impacted our processing times, we believe they are helping to reduce incorrectly certified firms. For example, from July 2008 to March 2009, only 22% of the applications submitted were certified while 77% were withdrawn or declined. During the same period a year ago (July 2007 to March 2008), 66% of the applications submitted were certified while 33% were withdrawn or declined.

SBA is also in the process of reviewing its current program regulations to determine whether changes can be made to further strengthen certification procedures to help mitigate fraud and abuse, as well as reducing accidental mistakes. In addition, if the HUBZone program office believes it has sufficient evidence that any firm willfully attempted to misrepresent its HUBZone status, the program office will forward those firms to SBA's Suspension and Debarment Official (SDO) and to the OIG.

Regarding specific timetables and procedures to ensure that the HUBZone maps remain current, the HUBZone program office completed a comprehensive scope of work and it is working with the acquisition office to complete a solicitation package to study and update current maps. The SBA's HUBZone maps were last updated on September 13, 2008. The SBA intends to update the maps again by April as a result of new data received from the

U.S. Department of Housing and Urban Development and the Office of Management and Budget.

On July 17, 2008, SBA testified that it was beginning the process of reviewing possible suspension and debarment of the 10 firms originally identified by GAO in the report titled *SBA's Control Weaknesses Exposed the Government to Fraud and Abuse*. GAO originally referred the 10 firms to SBA's OIG. In September 2008, SBA's OIG forwarded the files to the HUBZone program office so that it could begin its examination process. Investigation of these ten firms revealed that at least three of the firms that GAO initially believed to be ineligible for the program were in fact eligible HUBZone firms. Of the remaining seven firms, only three are still in the HUBZone program and are currently undergoing program examinations for possible decertification action. All firms noted by the GAO have been investigated and examined by the SBA or are currently being investigated and examined by the SBA. There are due process considerations for the firms being investigated and before any action can be taken the SBA must complete the program examinations already underway, propose the firms for decertification if appropriate, and allow them an opportunity to respond. 13 C.F.R. § 126.503.

The firms that have been referred to the SBA's Suspension and Debarment Official are also being investigated by that office, some in conjunction with the HUBZone program office. Firms being investigated for possible suspension and debarment must also be afforded due process by this office as well. Without a criminal indictment, conviction or a civil judgment, the SBA must also meet an evidentiary standard by providing the firm with due process before reaching a debarment/suspension decision. While the information provided to SBA by the GAO showed areas for concern, the information provided did not meet the usual evidentiary standard applied by SBA. Consequently, while rules allow for debarment without the need for either a civil or criminal proceeding, SBA determined that acting without a prior finding of cause required a more in-depth and thorough review by the SBA's Suspension and Debarment Official in order to meet the due process and evidentiary requirements established in regulations. The SBA's Suspension and Debarment Official has requested specific, detailed information from these business concerns to assist with a determination on how next to proceed

As soon as the HUBZone office receives the GAO's files of its most recent investigation, SBA will take appropriate enforcement actions on the firms we find to violate HUBZone program requirements. These enforcement actions will include, where applicable, removal or decertification from the program, and coordination with SBA's OIG and SBA's Suspension and Debarment Official.

Finally, the HUBZone program office embarked on a "Business Process Re-engineering" (BPR) to address the items delineated in the GAO audit report, as well as to tackle the findings from the GAO's Forensic Audit investigation. The BPR goal is to improve the operations and effectiveness of the program. This initiative involves the detailed examination of the current state of operations, articulation of recommendations to improve the program, and the development of a roadmap for improved operations within fiscal constraints. This roadmap will be completed this fiscal year.

8(a) Program

In response to the GAO report on our 8(a) Program released in November 2008, the Office of Business Development has taken several critical actions to increase oversight of 8(a) participants.

- The Office of Business Development issued guidance, in the form of an SBA Information Notice on November 18, 2008. This Notice reminded SBA staff that it is each District Office's responsibility, in conjunction with conducting an Annual Review, to identify whether any changes have been made by the 8(a) BD Program Participant to management agreements or other corporate documents that may affect the Participant's continued eligibility.

- The Office of Business Development conducted training sessions on July 15, 16 and 17th in Dallas, Texas for every Business Development Specialist that had an ANC firm in his or her portfolio. The Office of Business Development conducted comprehensive training regarding the specialized rules pertaining to firms owned and controlled by tribes, ANCs, and NHOs. SBA's Office of Inspector General and Office of General Counsel provided valuable insight in the training.

- In addition, the Office of Business Development is conducting on-going training in all aspects of the 8(a) Program for Business Development field staff in an effort to ensure compliance with governing 8(a) Program regulations.

- The Office of Business Development developed an online web-based tutorial linked to the 8(a) application package in an effort to ensure that potential applicants understand the requirements of the 8(a) Program. Prior to applying for the 8(a) Program, each firm is urged to take an on-line training and self-evaluation course which is accessible from SBA's web site.

- The Office of Field Operations, in collaboration with the Office of Business Development, and the Office of Human Capital Management, has convened a task force to review and assess the training needs for Business Development Specialists.

- A draft Plan for individualized business development assistance to 8(a) firms has been developed and will be placed in the agency's clearance process by the end of March 2009.

Lender Oversight

Prior OIG Audit Reports and other reviews identified substantial problems with the Agency's oversight of lenders. This raised considerable concerns about potential waste, fraud and abuse in the agency's loan programs. As a result of OIG reports and the Agency's concerns in this area, the Agency established the Office of Lender Oversight in 1999. It was reorganized in 2007 and renamed the Office of Credit Risk Management (OCRM).

The OCRM is charged with oversight of our lending partners and with the analysis of SBA's loan programs. This includes developing procedures to analyze and monitor the risk management profile of SBA's loan portfolio and its lenders.

The office conducts a continuous, risk based, off-site analysis of our lending partners through our Loan/Lender Monitoring System. Lending partners may access their risk and portfolio performance information through our Lender Portal. In addition, the office performs strategic on-site reviews of our lending partners' activities including the performance of their SBA lending operations and compliance with program rules and regulations. The Office of Credit Risk Management also assesses the quality of the overall SBA loan portfolio. Through this analysis it identifies and analyzes trends. As a result of this trend analysis and assessment of other analytical risk indicators, we are able to better understand lender and portfolio performance.

Oversight of our lending partners and analysis of SBA's loan programs are some of the Agency's most important functions. The activities of the Office of Credit Risk Management not only help protect the interest of the American taxpayer, but also enable our lending partners to better understand how best to fulfill the requirements of the lending programs in a way that is mutually beneficial.

One of the components of the on-site risk-based reviews is to review a sample of loans for compliance with lender and SBA policies, procedures, and documentation requirements. However, reviewers are also asked to note any instances of potentially suspicious activity at either the lender or loan level. Any instances of potentially suspicious activity are referred to OIG. Also, as part of the on-site review, reviewers question the lender about actions the lender is taking to prevent fraud. While the nature of the reviews is such that not all fraud may be detected (since only a sample of loans is reviewed and as fraud detection is more the expertise and purview of the OIG), the review process may be able to assist in detecting systemic fraud across a lender's portfolio. The on-site reviews are performed on lenders holding almost 85% of all guarantee dollars. Any material deficiencies that may affect the guarantee of any of the loans sampled during the review are noted in SBA's system. In the event that loan is subsequently purchased by SBA, the deficiencies are noted and reviewed to determine whether a guaranty repair or denial should occur.

Credit Elsewhere

Regarding our Credit Elsewhere Policy – This recently completed audit had only one recommendation – that SBA issue more detailed guidance to lenders to ensure documented lender compliance with credit elsewhere. SBA agreed with the recommendation. We were very pleased to see that GAO in its audit report recognized that OCRM's oversight efforts are making a difference, and that they are helping lenders to understand and comply with SBA's policies.

SBIC Program

An OIG audit report identified concerns that the SBIC liquidation program was not always performing liquidation in a prompt and effective manner. As a result, the SBIC program revised its SOPs and internal control system to include better metrics on liquidation. In response to this action, the OIG management challenge on this area last year reflected all yellow and green ratings.

The Financial Statement Audit

In January 2004, the financial statement auditor issued a disclaimer on SBA's FY 2003 financial statement, and subsequent audits identified material weaknesses with the financial statements for succeeding years. The OIG management challenge for FY 04 reflected substantial problems that needed to be corrected. The weaknesses with the financial statement raised serious concerns about waste and abuse in SBA programs. During the following four years, the Agency made substantial efforts to improve its financial reporting system and made such progress that the OIG actually eliminated the management challenge for financial reporting in its management challenge report for FY 08.

Madam Chairwoman, our management team recognizes that there is always a need for improvement in the way we conduct our business. As I have outlined for you, we are not only working diligently to implement recommendations contained in Government Accountability Office and Inspector General reports but we are also constantly testing, evaluating and revising our internal operating procedures in order to better serve small businesses and aspiring entrepreneurs throughout our country. The controls that we currently have in place as well as the establishment of new ones will, we believe, provide that level of accountability and transparency that Americans expect of their government and which all of us here in SBA are committed to achieving.

Chairwoman Velazquez and other distinguished Members of this Committee, thank you again for the opportunity to submit this written statement in connection with the Committee's hearing on waste, fraud, and abuse in Government programs. I am happy to answer any questions you may have.

United States Government Accountability Office

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-09-532T

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.[1] 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

[1]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.[2] 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

[2]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.[3]

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

- must be small by SBA size standards;[4]
- must be at least 51 percent owned and controlled by U.S. citizens;[5]
- 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.

[3]See GAO-08-643 for a definition of each type of area.

[4]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.

[5]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.[6] 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.[7] 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.

[6]Because the boundaries of qualified HUBZone areas can overlap, some geographical areas qualify for multiple designations.

[7]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.[8]

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.

[8]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.[9] 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.[10] 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

[9]SBA officials generally limited their recertification reviews to the information provided by firms but can request documentation or conduct site visits.

[10]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.[11] 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.[12] 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

[11]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.

[12]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.[13] 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.[14] 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. Individuals making key contributions to this testimony included Paige Smith (Assistant Director), Triana Bash, Tania Calhoun, Julia Kennon, and Terence Lam.

[13]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.

[14]***See*** Notice of Methodology for Measuring the Economic Impact of the HUBZone Program, 73 Fed. Reg. 46698 (Aug. 11, 2008).

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HUBZONE PROGRAM

Fraud and Abuse Identified in Four Metropolitan Areas

Statement of Gregory D. Kutz, Managing Director
Forensic Audits and Special Investigations

GAO-09-519T

Madam Chairwoman and Members of the Committee:

Thank you for the opportunity to discuss the results of our investigation of 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 in economically distressed communities, or HUBZone areas, with the intent of stimulating economic development in those areas. On July 17, 2008, we testified before this committee that SBA's lack of controls over the HUBZone program exposed the government to fraud and abuse[1] and that SBA's mechanisms to certify and monitor HUBZone firms provide limited assurance that only eligible firms participate in the program.[2] In our testimony, we identified 10 firms from the Washington, D.C., metropolitan area that were participating in the HUBZone program even though they clearly did not meet eligibility requirements. Of the 10 firms, 6 did not meet both principal office and employee residency requirements while 4 met the principal office requirement but significantly failed the employee residency requirement.[3] We reported in our July 2008 testimony that federal agencies had obligated a total of nearly $26 million in HUBZone contract obligations to these 10 firms since 2006.

After the hearing, you requested that we perform a follow-on investigation. We describe the results of this investigation and further background about the HUBZone program in a companion report that is being made public today.[4] This testimony will summarize our overall findings. Specifically, this testimony will address (1) whether cases of fraud and abuse in the program exist outside of the Washington, D.C., metro area; (2) what actions, if any, SBA has taken to establish an effective fraud prevention system for the HUBZone program; and (3) what actions, if any, SBA has

[1] GAO, *HUBZone Program: SBA's Control Weaknesses Exposed the Government to Fraud and Abuse*, GAO-08-964T (Washington, D.C.: July 17, 2008).

[2] GAO, *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).

[3] Firms that participate in the program generally must meet certain requirements, including (1) at least 35 percent of its employees must live in a HUBZone, (2) the principal office (i.e., the location where the greatest number of qualifying employees perform their work) must be located in a HUBZone, and (3) once a firm receives a HUBZone contract, the firm is required to abide by certain subcontracting limitations.

[4] GAO, *HUBZone Program: Fraud and Abuse Identified in Four Metropolitan Areas*, GAO-09-440 (Washington, D.C.: Mar. 25, 2009).

taken on the 10 firms that we found misrepresented their HUBZone status in July 2008.

To meet these objectives, we identified and investigated selected HUBZone firms based on certain criteria, such as magnitude of HUBZone contracts and firm location. We also interviewed SBA officials and reviewed SBA data. A more detailed discussion of our scope and methodology is provided in our separate report. We conducted our investigation from September 2008 through March 2009 in accordance with quality standards for investigations as set forth by the President's Council on Integrity and Efficiency.

In summary, we found the following:

- Fraud and abuse in the HUBZone program extends beyond the Washington, D.C., area. We identified 19 firms in Texas, Alabama, and California participating in the HUBZone program that clearly do not meet program requirements (i.e., principal office location or percentage of employees in HUBZone and subcontracting limitations). In fiscal years 2006 and 2007, federal agencies obligated nearly $30 million to these 19 firms for performance as the prime contractor on HUBZone contracts and a total of $187 million on all federal contracts.

- Although SBA has initiated steps to strengthen its internal controls as a result of our 2008 testimonies and report, substantial work remains for incorporating a fraud prevention system that includes effective fraud controls consisting of (1) front-end controls at the application stage, (2) fraud detection and monitoring of firms already in the program, and (3) the aggressive pursuit and prosecution of individuals committing fraud.

- SBA has taken some enforcement steps on the 10 firms previously identified by GAO that knowingly did not meet HUBZone program requirements. However, as of February 2009, according to SBA's Dynamic Small Business Web site, 7 of the 10 firms that we investigated were still HUBZone certified. SBA's failure to promptly remove firms from the HUBZone program and examine some of the most egregious cases from our testimony has resulted in an additional $7.2 million in HUBZone obligations and about $25 million in HUBZone contracts to these firms.

Selected Case Studies of Fraud and Abuse Outside the Washington, D.C., Metro Area

HUBZone program fraud and abuse continues to be problematic for the federal government. We identified 19 firms in Texas, Alabama, and California participating in the HUBZone program even though they clearly do not meet program requirements (i.e., principal office location or percentage of employees residing in the HUBZone and subcontracting limitations).[5] Although we cannot conclude whether this is a systemic problem based on these cases, the issue of misrepresentation clearly extends beyond the Washington, D.C., metropolitan area where we conducted our initial investigation. In fiscal years 2006 and 2007, federal agencies had obligated nearly $30 million to these 19 firms for performance as the prime contractor on federal HUBZone contracts.[6]

HUBZone regulations also place restrictions on the amount of work that can be subcontracted to non-HUBZone firms. Specifically, HUBZone regulations generally require a firm to expend at least 50 percent of the personnel costs of a contract on its own employees. As part of our investigative work, we found examples of service firms that subcontracted most HUBZone contract work to other non-HUBZone firms and thus did not meet this program requirement. When a firm subcontracts the majority of its work to other non-HUBZone firms, it is undermining the HUBZone program's stated purpose of stimulating development in economically distressed areas, as well as evading eligibility requirements for principal office and 35 percent residency requirement.

Examples of firms that did not meet HUBZone requirements included the following:

- An environmental consulting firm located in Fort Worth, Texas, that violated HUBZone program requirements because it did not expend at least 50 percent of personnel costs on its own employees or use personnel from other HUBZone firms.[7] From fiscal year 2006 through fiscal year 2007, the Department of the Army obligated more than $2.3 million in HUBZone contracts to this firm. At the time of our investigation, company documents showed that the company was subcontracting from 71 to 89 percent of its total contract obligations to other non-HUBZone firms—in

[5] These 19 firms had principal offices in or near four metropolitan areas: Dallas, Texas; Huntsville, Alabama; San Antonio, Texas; and San Diego, California.

[6] These 19 firms received a total of $187 million in federal obligations in fiscal years 2006 and 2007.

[7] See 13 C.F.R. § 126.700.

some cases, large firms. The principal admitted that her firm was not meeting the subcontracting performance requirement of HUBZone regulations. Further, the principal stated that the firm made bids on HUBZone contracts knowing that the company would have to subcontract work to other firms after the award. The principal added that other large firms use HUBZone firms in this manner, referring to these HUBZone firms as "contract vehicles."

- A ground maintenance services company located in Jacksonville, Alabama, failed to meet both principal office and 35 percent residency requirements. From fiscal year 2006 through fiscal year 2007, this firm received more than $900,000 in HUBZone set-aside obligations. However, our investigation found that the purported principal office was in fact a residential trailer occupied by someone not associated with the company. The company had represented its office as located in "suite 19," when in reality, the address was associated with trailer 19 in a residential trailer park. The two employees of the firm—a father and a son—lived in non-HUBZone areas that are located about 90 miles from the trailer park. This firm also subcontracted most of its HUBZone work to non-HUBZone firms.

- An information technology firm in Huntsville, Alabama, failed to meet both principal office and 35 percent residency requirements. From fiscal year 2006 through fiscal year 2007, federal agencies obligated over $5 million in HUBZone awards to this firm, consisting mainly of two HUBZone set-aside contracts. Based on our review of payroll records and written correspondence that we received from the firm, we determined that only 18 of 116 of the firm's employees (16 percent) who were employed in December 2007 lived in HUBZone-designated areas. In addition, our investigation found that no employees were located at the location listed as a principal office. The firm's president acknowledged that he "had recently become aware" that he was not in compliance with HUBZone requirements and was taking "corrective actions." However, the firm continued to represent itself as a HUBZone firm even after this acknowledgment.

According to HUBZone regulations, persons or firms are subject to criminal penalties for knowingly making false statements or misrepresentations in connection with the HUBZone program, including failure to correct "continuing representations" that are no longer true. During the application process, applicants are not only reminded of the program eligibility requirements, but are required to agree to the statement that anyone failing to correct "continuing representations" shall be subject to fines, imprisonment, and penalties. Further, the Federal Acquisition Regulation (FAR) requires all prospective contractors to update the

government's Online Representations and Certifications Application, which includes a statement certifying whether the firm is currently a HUBZone firm and that there have been "no material changes in ownership and control, principal office, or HUBZone employee percentage since it was certified by the SBA." Of the 19 firms that did not meet HUBZone eligibility requirements, we found that all of them continued to represent themselves as eligible HUBZone interests to SBA. Because the 19 case examples clearly are not eligible, we consider each firm's continued representation indicative of fraud, abuse, or both related to this program.

SBA Has Not Incorporated Effective Fraud Controls

Our June 2008 report[8] and July 2008 testimony clearly showed that SBA did not have effective internal controls related to the HUBZone program. In response to our findings and recommendations, SBA initiated a process of reengineering the HUBZone program. SBA officials stated that this process is intended to make improvements to the program that are necessary for making the program more effective while also minimizing fraud and abuse. To that end, SBA has hired business consultants and reached out to GAO in an attempt to identify control weaknesses in the HUBZone program and to strengthen its fraud prevention controls. As of the end of our fieldwork, SBA did not have in place the key elements of an effective fraud prevention system.[9] A well-designed fraud prevention system (which can also be used to prevent waste and abuse) should consist of three crucial elements: (1) up-front preventive controls, (2) detection and monitoring, and (3) investigations and prosecutions. For the HUBZone program this would mean (1) front-end controls at the application stage, (2) fraud detection and monitoring of firms already in the program, and (3) decertification from the program of ineligible firms and the aggressive pursuit and prosecution of individuals committing fraud.

[8] GAO, *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).

[9] Internal controls comprise the plans, methods, and procedures used to meet missions, goals, and objectives and also serve as the first line of defense in safeguarding assets and preventing and detecting errors and fraud. Fraud prevention, on the other hand, requires a system of rules, which, in aggregate, minimize the likelihood of fraud occurring while maximizing the possibility of detecting any fraudulent activity that may transpire.

Preventive controls. We have previously reported that fraud prevention is the most efficient and effective means to minimize fraud, waste, and abuse.[10] Thus, controls that prevent fraudulent firms and individuals from entering the program in the first place are the most important element in an effective fraud prevention program. SBA officials stated that as part of their interim process they are now requesting from all firms that apply to the HUBZone program documentation that demonstrates their eligibility. While requiring additional documentation has some value as a deterrent, the most effective preventive controls involve the verification of information, such as verifying a principal office location through an unannounced site visit. Moreover, SBA did not adequately field-test its interim process for processing applications. If it had done so, SBA would have known that it did not have the resources to effectively carry out its review of applications in a timely manner. As a result, SBA had a backlog of about 800 HUBZone applications as of January 2009. At that time, SBA officials stated that it would take about 6 months to process each HUBZone application—well over the 1 month goal set forth in SBA regulations.

Detection and monitoring. Although preventive controls are the most effective way to prevent fraud, continual monitoring is an important component in detecting and deterring fraud. We reported in June 2008 that the mechanisms SBA used to monitor HUBZone firms provided limited assurance that only eligible firms participate in the program. SBA officials stated that during this fiscal year, they will be conducting program examinations on all HUBZone firms that received contracts in fiscal year 2007 to determine whether they still meet HUBZone requirements. In addition, SBA officials stated that as of September 2008, SBA had eliminated its backlog of recertifications. Although SBA has initiated several positive steps, SBA will need to make further progress to achieve an effective fraud monitoring program, including steps to (1) verify the validity of a stated principal office during its recertification and application processes; (2) establish a streamlined and risk-based methodology for selecting firms for program examinations going forward; (3) incorporate an "element of surprise" into its program examinations, such as using random, unannounced site visits; and (4) review whether

[10] GAO, *Hurricanes Katrina and Rita Disaster Relief: Prevention is the Key to Minimizing Fraud, Waste, and Abuse in Recovery Efforts*, GAO-07-418T (Washington, D.C.: Jan. 29, 2007), and *Individual Disaster Assistance Programs: Framework for Fraud Prevention, Detection, and Prosecution*, GAO-06-954T (Washington, D.C.: July 12, 2006).

HUBZone firms are expending at least 50 percent of the personnel costs of a contract on their own personnel.

Investigation and prosecution. The final element of an effective fraud prevention system is the aggressive investigation and prosecution of individuals who commit fraud against the federal government. However, SBA currently does not have an effective process for investigating fraud and abuse within the HUBZone program. To date, other than the firms identified by our prior investigation, the SBA program office has never referred any firms for debarment and/or suspension proceedings based on findings from its program eligibility reviews. By failing to hold firms accountable, SBA has sent a message to the contracting community that there is no punishment or consequences for committing fraud or abusing the intent of the HUBZone program.

SBA Has Initiated Some Enforcement Actions against 10 HUBZone Firms Previously Investigated by GAO

SBA has taken some enforcement steps on the 10 firms that we found did not meet HUBZone program requirements as of July 2008. According to SBA, as of January 2009, 2 of the firms have been removed from the program and 2 others are in the process of being removed.[11] However, SBA's failure to examine some of the most egregious cases we previously identified[12] has resulted in an additional $7.2 million in HUBZone obligations and about $25 million in HUBZone set-aside or price preference contracts to these firms.

In the written statement for the July 2008 hearing, the Acting Administrator of SBA stated that SBA would take "immediate steps to require site visits for those HUBZone firms that have received HUBZone contracts and will be instituting suspension and debarment proceedings against firms that have intentionally misrepresented their HUBZone status." However, as of February 2009, according to SBA's Dynamic Small Business Web site, 7 of the 10 firms that we investigated were still HUBZone certified. SBA has removed 2 firms from the HUBZone program and is in the process of providing due process to 2 additional firms to

[11] As of February 2009, 7 of the 10 firms were still HUBZone certified, according to SBA's Dynamic Small Business Web site. One of the 2 firms in the process of being removed was no longer listed as HUBZone certified.

[12] GAO-08-964T.

determine whether they should be removed.[13] SBA officials stated that no action will be taken on 3 firms because SBA's program evaluations concluded that these firms met all the eligibility requirements of the HUBZone program. We attempted to verify SBA's work, but were not provided with the requested documentation to support its conclusion that the firms moved into compliance after our July 2008 testimony. SBA officials said that they have not yet performed program evaluations for 3 of the most egregious firms because they are experiencing technical problems with SBA's caseload system. As such, these 3 firms remain eligible to receive HUBZone set-aside contracts. SBA is also pursuing suspension and debarment actions for 7 of these firms, and the Department of Justice is considering civil actions in 5 of the 10 cases.

Recommendations for Executive Action

We will be referring all the cases we identified to SBA for further action. In our report, we also recommended that the Administrator of SBA expeditiously implement our June 2008 recommendations and take the following four actions:

- Consider incorporating a risk-based mechanism for conducting unannounced site visits as part of the screening and monitoring process.
- Consider incorporating policies and procedures into SBA's program examinations for evaluating if a HUBZone firm is expending at least 50 percent of the personnel costs of a contract using its own employees.
- Ensure appropriate policies and procedures are in place for the prompt reporting and referral of fraud and abuse to SBA's Office of Inspector General as well as SBA's Suspension and Debarment Official.
- Take appropriate enforcement actions on the 19 HUBZone firms we found to violate HUBZone program requirements to include, where applicable, immediate removal or decertification from the program, and coordination with SBA's Office of Inspector General as well as SBA's Suspension and Debarment Official.

In written comments on a draft of our report, SBA agreed with three of our four recommendations. SBA disagreed with our recommendation to

[13] A firm that SBA has decertified may seek certification no sooner than 1 year from the date of decertification. If the firm was decertified for failure to notify SBA of a material change affecting its eligibility, it must include with its application for certification a full explanation of why it failed to notify SBA of the material change.

consider incorporating policies and procedures into SBA's program examinations for evaluating if a HUBZone firm is complying with the performance of work requirements by expending at least 50 percent of the personnel costs of a contract on its own employees. SBA stated that although this requirement is included in SBA HUBZone regulations, it is not a criterion for HUBZone program eligibility but rather a mandatory contract term. SBA stated that contracting officers are required by the FAR to insert such clauses regarding subcontracting limitations. While we recognize that contracting officers have a responsibility for monitoring the subcontracting limitation, SBA also has this responsibility. In order to receive HUBZone certification, a firm must certify to SBA that it will abide by this performance requirement, and SBA is required by statute to establish procedures to verify such certifications. Therefore, we continue to believe that SBA should consider incorporating policies and procedures into its program examinations for evaluating if a HUBZone firm is meeting the performance of work requirements.

Madam Chairwoman, this concludes my statement. I would be pleased to answer any questions that you or other members of the committee may have at this time.

Contacts and Acknowledgments

For further information about this testimony, please contact Gregory D. Kutz at (202) 512-6722 or kutzg@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony. In addition to the individual named above, Bruce Causseaux, Senior Level Contract and Procurement Fraud Specialist; Matt Valenta, Assistant Director; Erika Axelson; Gary Bianchi; Donald Brown; Bruce Causseaux; Eric Eskew; Dennis Fauber; Craig Fischer; Robert Graves; Betsy Isom; Jason Kelly; Julia Kennon; Barbara Lewis; Olivia Lopez; Jeff McDermott; Andrew McIntosh; John Mingus; Andy O'Connell; Mary Osorno; and Chris Rodgers also provided assistance on this testimony.

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United States Government Accountability Office

GAO

Report to the Chairwoman, Committee on Small Business, House of Representatives

March 2009

HUBZONE PROGRAM

Fraud and Abuse Identified in Four Metropolitan Areas

GAO

Accountability * Integrity * Reliability

GAO-09-440

March 2009

GAO
Accountability·Integrity·Reliability

Highlights

Highlights of GAO-09-440, a report to Chairwoman, Committee on Small Business, House of Representatives

HUBZONE PROGRAM

Fraud and Abuse Identified in Four Metropolitan Areas

Why GAO Did This Study

The Small Business Administration's (SBA) Historically Underutilized Business Zone (HUBZone) program provides federal contracting assistance to small firms located in economically distressed areas, with the intent of stimulating economic development. In July 2008, GAO identified substantial vulnerabilities in SBA's application and monitoring process that demonstrated the HUBZone program is vulnerable to fraud and abuse. GAO also investigated 10 case studies of HUBZone firms in the Washington, D.C., area that misrepresented their eligibility.

GAO was asked to determine (1) whether additional cases of fraud and abuse exist outside of the Washington, D.C., area; (2) what actions, if any, SBA has taken to establish an effective fraud prevention program for the HUBZone program; and (3) what actions, if any, SBA took against the 10 case study firms in GAO's July 2008 testimony.

To meet these objectives, GAO identified selected HUBZone firms based on certain criteria, such as magnitude of HUBZone contracts and firm location. GAO also interviewed SBA officials and reviewed SBA data.

What GAO Recommends

GAO makes four recommendations to improve SBA's ability to screen, monitor, and investigate fraud and abuse within the HUBZone program. SBA agreed with three of them.

To view the full product, including the scope and methodology, click on GAO-09-440. For more information, contact Greg Kutz at (202) 512-6722 or kutzg@gao.gov

What GAO Found

GAO found that fraud and abuse in the HUBZone program extends beyond the Washington, D.C., area. GAO identified 19 firms in Texas, Alabama, and California participating in the HUBZone program that clearly do not meet program requirements (i.e., principal office location or percentage of employees in HUBZone and subcontracting limitations). For example, one Alabama firm listed its principal office as "Suite 19," but when GAO investigators performed a site visit they found the office was in fact trailer 19 in a residential trailer park. The individual living in the trailer had no relationship to the HUBZone firm. In fiscal years 2006 and 2007, federal agencies obligated nearly $30 million to these 19 firms for performance as the prime contractor on HUBZone contracts and a total of $187 million on all federal contracts. The map below illustrates the geographical locations for the cases we examined.

GAO Case Study Locations of Fraud and Abuse in the HUBZone Program

Source: GAO.

Although SBA has initiated steps in strengthening its internal controls as a result of GAO's 2008 testimonies and report, substantial work remains for incorporating a fraud prevention system that includes effective fraud controls consisting of (1) front-end controls at the application stage, (2) fraud detection and monitoring of firms already in the program, and (3) the aggressive pursuit and prosecution of individuals committing fraud. In addition, SBA did not adequately field test its interim process for processing applications. If it had done so, SBA would have known that it did not have the resources to effectively carry out its review of applications in a timely manner. As a result, SBA had a backlog of about 800 HUBZone applications as of January 2009. At that time, SBA's interim application process was taking about 6 months—well over its 1-month goal set forth in SBA regulations.

SBA has taken some enforcement steps on the 10 firms previously identified by GAO that knowingly did not meet HUBZone program requirements. However, SBA's failure to promptly remove firms from the HUBZone program and examine some of the most egregious cases from GAO's July 2008 testimony has resulted in an additional $7.2 million in HUBZone obligations and about $25 million in HUBZone contracts to these firms. For example, a construction firm from the July 2008 testimony admitted that it did not meet HUBZone requirements and was featured in several national publications by name. It has continually represented itself as HUBZone certified and has received $2 million in HUBZone obligations and a $23 million HUBZone set-aside contract since the July 2008 testimony.

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Abbreviations

CCR	Central Contractor Registration
FAR	Federal Acquisition Regulation
FPDS-NG	Federal Procurement Data System-Next Generation
HUBZone	Historically Underutilized Business Zone
ORCA	Online Representations and Certifications Application
SBA	Small Business Administration
SDO	Suspension and Debarment Official

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United States Government Accountability Office
Washington, DC 20548

March 25, 2009

The Honorable Nydia M.Velazquez
Chairwoman
Committee on Small Business
House of Representatives

Dear Madam Chairwoman:

Created in 1997, the Historically Underutilized Business Zone (HUBZone) program provides federal contracting assistance to small businesses 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. The Small Business Administration (SBA) administers the HUBZone program, one of several contracting assistance programs that the agency oversees. 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.

On July 17, 2008, we testified before this Committee that SBA's lack of controls over the HUBZone program exposed the government to fraud and abuse[1] and that SBA's mechanisms to certify and monitor HUBZone firms provide limited assurance that only eligible firms participate in the program.[2] In our testimony, we identified 10 firms from the Washington, D.C., metro area that were participating in the HUBZone program even though they clearly did not meet eligibility requirements. Of the 10 firms, 6 did not meet both principal office and employee residency requirements while 4 met the principal office requirements but significantly failed the employee residency requirement. We reported in our July 2008 testimony, that federal agencies had obligated a total of nearly $26 million in HUBZone contract obligations to these 10 firms since 2006. In addition, federal agencies obligated more than $105 million to these 10 firms for performance as the prime contractor on all federal contracts since 2006.

[1]GAO, *HUBZone Program: SBA's Control Weaknesses Exposed the Government to Fraud and Abuse*, GAO-08-964T (Washington, D.C.: July 17, 2008).

[2]GAO, *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).

Subsequent to the hearing, you requested that we perform a follow-on investigation. Specifically, you asked us to determine (1) whether cases of fraud and abuse in the program exist outside of the Washington, D.C. metropolitan area; (2) what actions, if any, SBA has taken to establish an effective fraud prevention system for the HUBZone program; and (3) what actions, if any, SBA has taken on the 10 firms that we found misrepresented their HUBZone status in July 2008.

To determine whether cases of fraud and abuse exist for firms located outside of the Washington, D.C. metropolitan area, we first obtained and analyzed a list of HUBZone firms from the SBA's Dynamic Small Business Search database as of September 2008.[3] We then obtained federal procurement data from the Federal Procurement Data System-Next Generation (FPDS-NG) for fiscal years 2006 and 2007.[4] We assessed the reliability of the data and determined that they were sufficiently reliable for the purposes of our investigation. We analyzed the data to identify (1) geographical locations that have both small fragments of HUBZone areas within a metropolitan area, and (2) high concentrations of HUBZone firms that reported obligations on HUBZone prime contracts totaling more than $250,000 during fiscal years 2006 and 2007. Using the above criteria, we selected four geographical areas for analysis: Dallas, Texas; Huntsville, Alabama; San Antonio, Texas; and San Diego, California. Within those four geographical areas, there were 36 firms that met our criteria for further investigation. The firms selected as case studies and the federal obligations associated with those firms did not include subcontracts that they may have received. Such information was not readily available. We conducted site visits for all 36 selected firms and used investigative methods — such as interviewing firm managers, analyzing firm payroll documents, and reviewing information from investigative databases — to gather information about the firms and to determine whether the firms met HUBZone requirements for principal office and 35 percent residency. We also reviewed information about each firm from the Online

[3]The Dynamic Small Business Search is part of the Central Contractor Registration (CCR) database. If a firm indicates it is a small business in CCR, its business information will be populated in SBA's database and can be accessed through the Dynamic Small Business Search.

[4]The FPDS-NG is the central repository for capturing information on federal procurement actions. Dollar amounts reported by federal agencies to FPDS-NG represent the net amount of funds obligated or deobligated as a result of procurement actions. Because we did not obtain disbursement data, we were unable to identify the actual amounts received by firms.

Representations and Certifications Application (ORCA) Web site.[5] In the course of our investigations, we found instances of HUBZone firms that did not expend at least 50 percent of the personnel costs of a contract on their own personnel. Although our review was not designed to evaluate this requirement, we did report those instances that we discovered in this report.

To determine what actions, if any, SBA has taken to reduce fraud and abuse in the program as well as the actions SBA has taken on the 10 firms that we found misrepresented their HUBZone status, we interviewed SBA officials from the Office of Inspector General, HUBZone Program Office, and the SBA General Counsel. We obtained and reviewed supporting documentation where appropriate. We also reviewed SBA's Dynamic Small Business Web site to determine the current HUBZone status of the 10 firms we identified in our July 2008 testimony.

Our work was not designed to identify all fraud and abuse in the HUBZone program or estimate its full extent for the entire population of HUBZone firms. In addition, our work was not designed to determine whether the selected firms we investigated committed fraud when originally applying for HUBZone status or receiving a HUBZone contract award, but rather if selected HUBZone firms are currently meeting HUBZone requirements. We conducted our investigation from September 2008 through March 2009 in accordance with quality standards for investigations as set forth by the President's Council on Integrity and Efficiency.

Background

The HUBZone program was established by the HUBZone Act of 1997 to stimulate economic development through increased employment and capital investment by providing federal contracting preferences to small businesses in economically distressed communities.[6] These areas, which are designated based on certain economic and census data, are known as HUBZones. As of January 2009, there were approximately 9,300 firms listed in the Central Contractor Registration database as participating in

[5]ORCA was established as part of the Business Partner Network, an element of the Integrated Acquisition Environment, which is implemented under the auspices of White House Office of Management and Budget, Office of Federal Procurement Policy, and the Chief Acquisition Officers Council. ORCA is "the primary Government repository for contractor submitted representations and certifications required for the conduct of business with the Government."

[6]HUBZone Act of 1997, Pub. L. No. 105-135, Title VI, § 602(a), 111 Stat. 2592, 2627 (1997).

the HUBZone program.[7] To ensure HUBZone areas receive the economic benefit from the program, SBA is responsible for determining whether firms meet HUBZone program requirements. To participate in the HUBZone program, small business firms generally must meet certain criteria established by the SBA, most notably: (1) the firm must be at least 51 percent owned and controlled by one or more U.S. citizens; (2) at least 35 percent of its employees must live in a HUBZone; (3) the principal office (i.e., the location where the greatest number of qualifying employees perform their work) must be located in a HUBZone; and (4) the firm must qualify as a small business under the size standard that corresponds with its primary industry classification. In addition, once a firm receives a HUBZone contract, the firm is required to abide by certain subcontracting limitations, which for most firms is to expend at least 50 percent of the personnel costs of a contract on their own employees or employees of other qualified HUBZone small business concerns.[8]

The SBA is legally responsible for ensuring that program participants meet program requirements.[9] If a HUBZone firm does not meet program requirements or fails to notify the SBA of material changes that affect the firm's HUBZone eligibility, the SBA may use a variety of enforcement tools against the firm. Depending on the severity of the infraction, SBA can (1) decertify and remove the firm from the list of qualified HUBZone firms, (2) suspend and/or debar the firm from all federal contracts, and/or (3) refer the firm to the Department of Justice for civil and/or criminal prosecution.

In July 2008, we testified that SBA's lack of controls over the HUBZone program exposed the government to fraud and abuse.[10] Specifically, we identified substantial vulnerabilities in SBA's application and monitoring process by demonstrating the ease of obtaining HUBZone certification.

[7]We previously reported that, as of February 2008, SBA had about 13,000 firms in the HUBZone program. SBA officials stated that they did not maintain data on the reason why there was a 3,700 decrease in the number of firms in the HUBZone program. According to SBA officials, a possible cause for this decrease was that SBA eliminated a backlog of its HUBZone recertifications. SBA officials said that many of these firms were removed from the HUBZone program because the firms either voluntarily withdrew or did not respond to SBA's recertification inquiry after giving them due process.

[8]There are different means of fulfilling this requirement, depending on the type of contract. 13 C.F.R. § 126.700.

[9]15 U.S.C. § 657a.

[10]GAO, *HUBZone Program: SBA's Control Weaknesses Exposed the Government to Fraud and Abuse*, GAO-08-964T (Washington, D.C.: July 17, 2008).

For example, by using fictitious employee information and fabricated documentation, we easily obtained HUBZone certification for four bogus firms. In addition, we also identified 10 firms from the Washington, D.C., metro area that were participating in the HUBZone program even though they clearly did not meet eligibility requirements.

In June 2008, we reported that the Small Business Administration needed to take additional actions to certify and monitor HUBZone firms as well as to assess the results of the HUBZone program.[11] Specifically, we found that the map SBA used to publicize qualified HUBZone areas was inaccurate. In addition, we found that the mechanisms that SBA used to certify and monitor HUBZone firms did not meet federal internal control standards and provided limited assurance that only eligible firms participated in the program. For example, SBA verified the information reported by firms on their application or during recertification—its process for monitoring firms—in limited instances and did not follow its own policy of recertifying all firms every 3 years. In the report, we made five recommendations designed to improve SBA's administration and oversight of the HUBZone program. We recommended that SBA correct and update its HUBZone map, develop and implement guidance to ensure more routine verification of application data, eliminate its backlog of recertifications, formalize and adhere to a specific time frame for decertifying ineligible firms, and further assess the effectiveness of the program. In responding to a draft of this report, SBA agreed with these recommendations and outlined steps that it plans to take to address them.

Selected Case Studies of Fraud and Abuse Outside the Washington, D.C., Metro Area

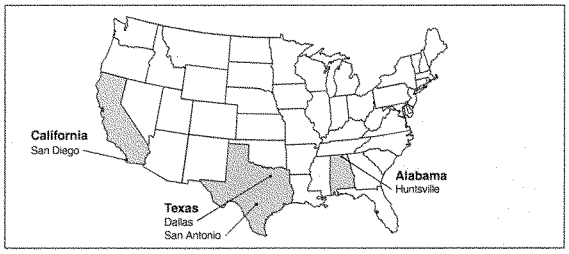
HUBZone program fraud and abuse continues to be problematic for the federal government. We identified 19 firms in the states of Texas, Alabama, and California participating in the HUBZone program even though they clearly do not meet program requirements.[12] Although we cannot conclude whether this is a systemic problem based on these cases, as shown in figure 1 below, the issue of misrepresentation clearly extends beyond the Washington, D.C., metropolitan area. In fiscal years 2006 and 2007, federal

[11]GAO, *Small Business Administration: Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results*, GAO-08-643 (Washington, D.C.: June, 2008).

[12]These firms had principal offices in or near 4 metropolitan areas: Dallas, Texas; Huntsville, Alabama; San Antonio, Texas; and San Diego, California.

agencies had obligated a total of nearly $30 million to these firms for performance as the prime contractor on federal HUBZone contracts.[13]

Figure 1: Locations of Selected HUBZone Firms That Do Not Meet Program Requirements



Source: GAO.

HUBZone regulations also place restrictions on the amount of work that can be subcontracted to non-HUBZone firms. Specifically, HUBZone regulations generally require firms to expend at least 50 percent of the personnel costs of a contract on its own employees. As part of our investigative work, we found examples of service firms that subcontracted a substantial majority of HUBZone contract work to other non-HUBZone firms and thus did not meet this program requirement. When a firm subcontracts the majority of its work to other non-HUBZone firms it is undermining the HUBZone program's stated purpose of stimulating development in the economically distressed areas, as well as evading eligibility requirements for principal office and 35 percent residency requirement.

According to HUBZone regulations, persons or firms are subject to criminal penalties for knowingly making false statements or misrepresentations in connection with the HUBZone program including failure to correct "continuing representations" that are no longer true. During the application process, applicants are not only reminded of the program eligibility requirements, but are required to agree to the statement

[13]These 19 firms received a total of $187 million in federal obligations in fiscal years 2006 and 2007.

that anyone failing to correct "continuing representations" shall be subject to fines, imprisonment, and penalties. Further, the Federal Acquisition Regulation (FAR) requires all prospective contractors to update the government's Online Representations and Certifications Application (ORCA), which includes a statement certifying whether the firm is currently a HUBZone firm and that there have been "no material changes in ownership and control, principal office, or HUBZone employee percentage since it was certified by the SBA." Of the 19 firms that did not meet HUBZone eligibility requirements, we found that all of them continued to represent themselves as eligible HUBZone interests to SBA. Because the 19 case examples clearly are not eligible, we consider each firm's continued representation indicative of fraud and/or abuse related to this program.

Table 1 highlights 10 firms that we found to be egregiously out of compliance with HUBZone program requirements. Appendix I provides details on the other 9 cases that we examined. We will be referring all 19 firms to SBA for further investigation and consideration for removal from the program.

Table 1: HUBZone Firms Making Fraudulent or Inaccurate Representations

Case	Location	Primary product or service	Fiscal Year 2006-2007 Obligations on HUBZone contracts* (reporting agencies)	Case details
1	Fort Worth, TX	Environmental Consulting	$2,310,000 (Department of the Army)	• Firm subcontracted the majority of the work to non-HUBZone firms. Although HUBZone firms are required to expend at least 50 percent of personnel costs performing HUBZone contracts, we determined that this firm has performed between 11 percent and 29 percent of the work on its various contracts to date. • Firm bid on and accepted large HUBZone set-aside contracts even though it did not have the capability to perform them without significant subcontracting. • Owner stated that HUBZone firms are being used as "contract vehicles" for large contracts.
2	Jacksonville, AL	Furniture/ Grounds Maintenance	$920,000 (Department of the Army)	• Firm did not meet principal office requirement. • Site visit to listed principal office found a residential trailer located in a trailer park. No employees were present. Utility and mail forwarding records indicate that no employees worked or lived at the listed principal office for over a year. • Firm did not meet 35 percent residency requirement because none of the employees live in a HUBZone. • Firm president admitted that his firm subcontracted the majority of work to other firms or individuals, violating the requirement to expend at least 50 percent of personnel costs using its own employees. • Firm self-certified that it met the HUBZone requirements in ORCA in February 2008.

3	Arlington, TX	General Contractor	$1,240,000
			(Department of Housing and Urban Development)
				• Firm did not meet principal office requirement.
				  • Multiple site visits to listed principal office revealed only 1 out of the firm's 33 employees were working at that location.
				  • Company provided documents confirmed that the majority of employees worked at non-HUBZone locations.
				• Firm met 35 percent residency requirement.
				• Firm self-certified that it met the HUBZone requirements in ORCA in April 2008.

Case	Location	Primary product or service	Fiscal Year 2006-2007 Obligations on HUBZone contracts[a] (reporting agencies)	Case details

4	Huntsville, AL	Information Technology	$5,020,000
			(Departments of the Army and Navy)
				• Firm did not meet principal office requirement.
				  • Site visit to listed principal office revealed no employees were working at the location.
				  • The office where the majority of employees worked was not in a HUBZone.
				  • President of firm admitted that they were not in compliance with the principal office requirement.
				• Firm did not meet 35 percent residency requirement because payroll records show that only 18 of the firm's 116 employees (16 percent) lived in a HUBZone as of December 2007.
				• Firm self-certified that it met the HUBZone requirements in ORCA in July 2008.

5	Huntsville, AL	Information Technology/ General Contractor	$2,450,000 (Department of the Army)	• Firm met principal office requirement. • Firm did not meet 35 percent residency requirement because payroll records show that only 8 of the firm's 74 employees (11 percent) lived in a HUBZone as of December 2007. • Firm self-certified that it met the HUBZone requirements in ORCA in July 2008.
6	Dallas, TX	Janitorial	$560,000 (Department of the Army and General Services Administration)	• Firm did not meet principal office requirement because multiple site visits to the listed principal office revealed firm no longer occupied this location. • Firm met 35 percent residency requirement. • Firm self-certified that it met the HUBZone requirements in ORCA in April 2008.

7	San Antonio, TX	Medical Laboratories	$250,000
			(Department of the Air Force)
				• Firm did not meet principal office requirement.
				  • Visit to the company's listed principal office revealed that the location was operated by the principal, but was a study lab operating under a different name. Company website indicates this location is a "satellite" lab.
				  • Company maintains another, larger lab that is not located in a HUBZone.
				• Firm did not meet 35 percent residency requirement because payroll records show that only 2 of the firm's 7 employees (29 percent) lived in a HUBZone as of December 2007.
				• Firm self-certified that it met the HUBZone requirements in ORCA in October 2007.

Case	Location	Primary product or service	Fiscal Year 2006-2007 Obligations on HUBZone contracts[a] (reporting agencies)	Case details

8	Birmingham, AL	Medical Services and Support	$2,220,000
			(Department of the Air Force)
				• Firm did not meet principal office requirement.
				  • Site visit to listed principal office revealed no employees were working at the location.
				  • The office where the majority of employees worked was not in a HUBZone.
				  • Manager admitted that listed principal office is only used for proposal writing and that the majority of their time is spent in an office which is not located in a HUBZone area.
				  • Manager admitted that they only keep listed principal office to meet HUBZone requirements.
				• Firm did not meet 35 percent residency requirement because payroll records show that only 1 of the firm's 11 employees (9 percent) lived in a HUBZone as of December 2007.
				• Firm self-certified that it met the HUBZone requirements in ORCA in October 2008.

9	Huntsville, AL	Military Logistics and Maintenance	$580,000 (Department of the Army)	• Firm did not meet principal office requirement because the majority of company staff worked in an office that was not located in a HUBZone. • Firm did not meet 35 percent residency requirement because payroll records show that only 13 of the firm's 53 employees (25 percent) lived in a HUBZone as of December 2007. • Firm self-certified that it met the HUBZone requirements in ORCA in July 2008.
10	San Antonio, TX	Support Services for Facility	$350,000 (Departments of the Army and Air Force)	• Firm met principal office requirement. • Firm did not meet 35 percent residency requirement because the firm's president, who was the only employee, did not live in a HUBZone. President of firm stated that the firm does not have employees to carry out its work but instead uses "leased employees." SBA's regulations state that leased employees do not count as employees for purposes of the HUBZone program.[b] • Firm does not have a current ORCA certification.

Source: GAO analysis of FPDS, ORCA, CCR and contractor data.

[a]Obligation amounts are rounded to the nearest $10,000.

[b]13 C.F.R. § 126.103.

The following is a more detailed description of fraud and abuse from 3 of the cases that we investigated.

Case Study 1: Our investigation clearly showed that this firm was being used as a front company because it was subcontracting the majority of its work to other firms. This firm is located in Fort Worth, Texas, and violated HUBZone program requirements because it did not expend at least 50 percent of personnel costs on its own employees or by using the personnel of other HUBZone firms as required by federal regulations. [14] This firm, which consists of 8 employees, has obtained millions of dollars in HUBZone contracts to provide environmental consulting services. At the time of our investigation, company documents showed that the company was subcontracting between 71 and 89 percent of its total contract obligations to other non-HUBZone firms—in some cases, large firms. The principal admitted that her firm was not meeting contract performance requirements required by HUBZone regulations. Further, the principal stated that the firm made bids on HUBZone contracts knowing that the company would have to subcontract work to other firms after the award. The principal added that other large firms use HUBZone firms in this manner, referring to these HUBZone firms as "contract vehicles."

By subcontracting the majority of its HUBZone work to non-HUBZone firms, this firm is clearly abusing its HUBZone designation and undermining the HUBZone program's stated purpose of stimulating small business development in economically distressed areas. Likewise, because the subcontracting is being conducted by non-HUBZone firms this firm is also evading eligibility requirements for principal office and the 35 percent residency requirement. This firm has been obligated over $2.3 million in HUBZone set-asides during fiscal years 2006 and 2007.

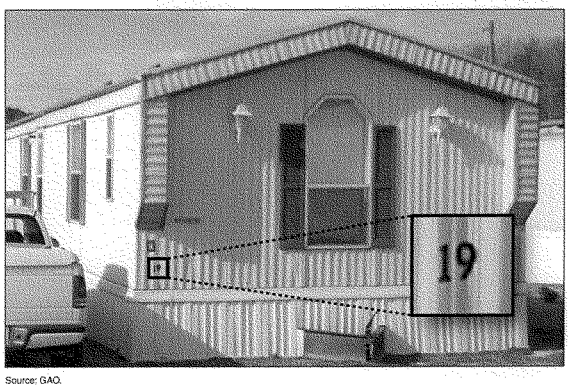
Case Study 2: Our investigation demonstrated that this firm continued to misrepresent itself as HUBZone-eligible while failing to meet HUBZone requirements.[15] This firm, which is a two-person—father and son—ground maintenance services company located in Jacksonville, Alabama, did not meet the principal office requirement, failed the 35 percent residency requirement, and served as a front company—subcontracting most of its HUBZone work to non-HUBZone firms. Our investigation found that the purported principal office was in fact a residential trailer in a trailer park.

[14]See 13 C.F.R. § 126.700.

[15]This firm attested in ORCA in February 2008 that it made "no material changes in ownership and control, principal office, or HUBZone employee percentage since it was certified by SBA."

As shown in figure 2 below, the "suite number" of the principal office provided to SBA was actually the trailer number.

Figure 2: Principal Office for Case Study 2 Firm



Source: GAO.

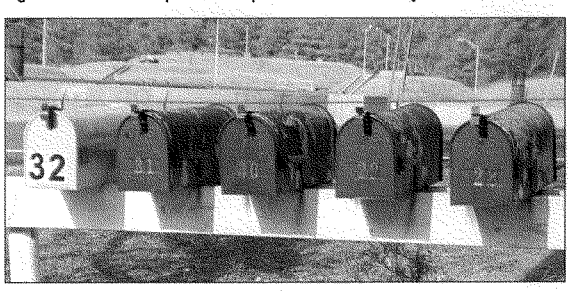
The president of the company claimed that the trailer is the principal office and that an employee lived at that trailer. However, our investigation found that the president knowingly misrepresented and concealed material facts to a GAO investigator. We found that both employees live in non-HUBZone areas that are located about 90 miles from the trailer. Additionally, we verified that the trailer is occupied by someone not associated with the company. Further, our investigation found that neither employee lived in, nor worked at, the residential trailer since August 2007.[16] Specifically, the U.S. Postal Service provided us a copy of the change of address form dated August 2007 that instructed the Postal Service to forward all mail from the trailer to another office in Birmingham, Alabama, which is not located in a HUBZone area. In addition, we obtained utility bill information that indicated that the last

[16]We were unable to verify if this trailer was ever used as the firm's principal office.

utility bill was paid by the firm in August 2007. According to DSBS, SBA most recently certified the firm at this address in April 2008.[17]

During the course of our investigation, this firm provided investigators with questionable documents in an attempt to make the residential trailer appear to be their actual principal office. As figure 3 shows, after our original interview with the president, we found that a new mailbox with the company name had been installed next to other mailboxes in the trailer park to give the perception that the firm resided at this trailer park.

Figure 3: Mailbox of Purported Principal Office for Case Study 2 Firm



Source: GAO.

Despite the evidence that this firm had not paid utility bills or received mail at this location for over a year, the firm president also provided us with a "rental agreement" stating that their company was renting the trailer until June 2009. The authenticity of this "rental agreement" is highly suspicious given the evidence we gathered and our confirmation that an individual not related to the company was living in the trailer.

For fiscal years 2006 and 2007, this firm received more than $900,000 in HUBZone set-aside obligations.

Case Study 4: We determined that during the period of our investigation this firm represented itself as HUBZone certified while failing to meet both

[17]HUBZone companies must re-certify with SBA every 3 years.

the 35 percent residency and principal office HUBZone eligibility requirements. This firm, which is located in Huntsville, Alabama, and provides information technology services, self-certified in ORCA in July 2008 that it was a HUBZone firm and that there had been "no material changes in ownership and control, principal office, or HUBZone employee percentage since it was certified by the SBA." The firm was certified by the SBA as a HUBZone firm in June 2002.

Based on our review of payroll records and written correspondence that we received from the firm, we determined that the firm failed the 35 percent HUBZone residency requirement. These documents indicated that only 18 of 116 (16 percent) of the firm's employees who were employed in December 2007, lived in HUBZone-designated areas. To have met the 35 percent residency requirement, the firm would have needed at least 41 employees residing in HUBZone-designated areas, thus, the firm did not meet this requirement by 23 employees.

In addition, we investigated the location that the firm purported to the SBA as its "principal office." Our investigation found that no employees were located at this office. Additional investigative work revealed that the firm's primary office was not located in a HUBZone. During the interview, the firm's president acknowledged that he "had recently become aware" that he was not in compliance with HUBZone requirements and was taking "corrective actions." However, the firm continued to represent itself as a HUBZone firm even after the firm's president acknowledged his company did not meet the program requirements.

Based on our analysis of FPDS-NG data, between fiscal years 2006 and 2007 federal agencies obligated over $5.0 million in HUBZone awards to this firm, consisting mainly of 2 HUBZone set-aside contracts by the Department of the Navy.

SBA Has Initiated Steps to Address Internal Control Deficiencies but Has Not Incorporated Effective Fraud Controls

Our June 2008 report and July 2008 testimony clearly showed that SBA did not have effective internal controls related to the HUBZone program. In response to our findings and recommendations, SBA initiated a process of reengineering the HUBZone program. SBA officials stated that this process is intended to make improvements to the program that are necessary for making the program more effective while also minimizing fraud and abuse. To that end, SBA has hired business consultants as well as reached out to GAO in an attempt to identify control weaknesses in the HUBZone program and to strengthen its fraud prevention controls.

Although SBA has initiated steps to address internal control deficiencies we identified in our June 2008 report, SBA has not yet incorporated effective controls for preventing, detecting, and investigating fraud and abuse within the HUBZone program. Internal controls comprise the plans, methods, and procedures used to meet missions, goals, and objectives and also serve as the first line of defense in safeguarding assets and preventing and detecting errors and fraud.[18] Fraud prevention, on the other hand, requires a system of rules, which, in their aggregate, minimize the likelihood of fraud occurring while maximizing the possibility of detecting any fraudulent activity that may transpire. Fraud prevention systems set forth what actions constitute fraudulent conduct and specifically spell out who in the organization handles fraud matters under varying circumstances. The potential of being caught most often persuades likely perpetrators not to commit the fraud. Because of this principle, the existence of a thorough fraud prevention system is essential to fraud prevention and detection.[19]

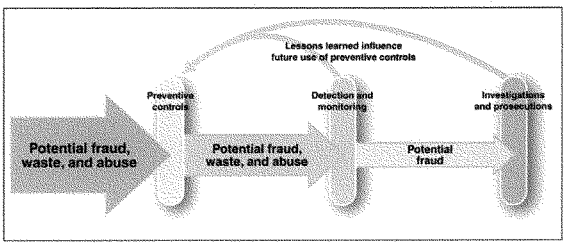
As of the end of our field work, SBA does not have in place the key elements of an effective fraud prevention system. As shown in figure 4 below, a well-designed fraud prevention system (which can also be used to prevent waste and abuse) should consist of three crucial elements: (1) upfront preventive controls, (2) detection and monitoring, and (3) investigations and prosecutions. For the HUBZone program this would mean (1) front-end controls at the application stage, (2) fraud detection and monitoring of firms already in the program, and (3) the aggressive pursuit and prosecution of individuals committing fraud. In addition, as shown in figure 4, the organization should also use "lessons learned" from

[18]GAO/AIMD-00-21.3.1 Standards for Internal Control in the Federal Government.

[19]Association of Certified Fraud Examiners, *Fraud Examiners Manual*, U.S. Edition (2007).

its detection and monitoring controls and investigation and prosecutions to design more effective preventive controls.

Figure 4: Fraud Prevention Model



Source: GAO.

We explain the three major fraud prevention elements in this model and how SBA is attempting to address them, in further detail below.

Preventive Controls

We have previously reported that fraud prevention is the most efficient and effective means to minimize fraud, waste, and abuse.[20] Thus, controls that prevent fraudulent firms and individuals from entering the program in the first place are the most important element in an effective fraud prevention program. The most crucial element of effective fraud prevention controls is a focus on substantially diminishing the opportunity for fraudulent access into the system through front-end controls. Preventive controls should be designed to include, at a minimum, a requirement for data validation, system edit controls, and fraud awareness training. Prior to implementing any new preventive controls, agencies must adequately field test the new controls to ensure they are operating as intended.

[20]GAO, *Hurricanes Katrina and Rita Disaster Relief: Prevention is the Key to Minimizing Fraud, Waste and Abuse in Recovery Efforts*, GAO-07-418T (Washington, D.C.: Jan. 29, 2007); and *Individual Disaster Assistance Programs: Framework for Fraud Prevention, Detection, and Prosecution*, GAO-06-954T (Washington, D.C.: July 12, 2006).

SBA officials stated that as part of their interim process they are now requesting, from all firms that apply to the HUBZone program, documentation that demonstrates their eligibility. SBA stated that, in the past, it only requested additional information when it encountered obvious "red flags." Although requiring additional documentation has some value as a deterrent, the most effective preventive controls involve the verification of information, such as verifying a principal office location through an unannounced site visit. If SBA verified purported principal offices by conducting unannounced site visits, such as we did for our investigation, SBA would likely find similar instances of firms attempting to defraud the HUBZone program. In addressing one of our prior recommendations, the SBA issued a Desktop Manual for processing HUBZone applications. [21] The manual provides guidance that alerts SBA staff of circumstances that warrant the need for supporting documentation. Although the Desktop Manual provides discretion to the analyst about the need to conduct a site visit, the Desktop Manual does not provide criteria when such site visits are warranted. In addition, SBA does not screen firms or individuals to ensure that they are not affiliated with prior firms that failed program eligibility reviews. As a result, an owner can change the name of a company that was removed from the HUBZone program to a new business name and be accepted back into the HUBZone program. Further, SBA did not adequately field test its interim process for processing applications. If it had done so, SBA would have known that it did not have the resources to effectively carry out its review of applications in a timely manner. As a result, SBA had a backlog of about 800 HUBZone applications as of January 2009. At that time, SBA officials stated that it would take about 6 months to process each HUBZone application—well over the 1 month goal set forth in SBA regulations.

Detection and Monitoring

Although preventive controls are the most effective way to prevent fraud, continual monitoring is an important component in detecting and deterring fraud. Monitoring and detection within a fraud prevention program involve actions such as data-mining for fraudulent and suspicious applicants and evaluating firms to provide reasonable assurance that they continue to meet program requirements. As demonstrated in our July 2008 testimony, SBA's fraud control vulnerabilities in its application process make detection and monitoring particularly important for the HUBZone

[21] We did not test the extent to which SBA personnel are following the instruction in the Desktop Manual.

program. As a result of SBA's control vulnerabilities, there are likely hundreds and possibly thousands of firms in the HUBZone program that fail to meet program requirements. Although monitoring and detection is an important component of a fraud prevention system, we reported in June 2008 that the mechanisms SBA used to monitor HUBZone firms provided limited assurance that only eligible firms participate in the program.[22] Specifically, we reported that a firm could be in the HUBZone program for years without being examined.[23] In addition, although a HUBZone firm is supposed to be recertified every 3 years, we reported that more than 40 percent of the firms in the program for over 3 years had not been recertified. To address these weaknesses, SBA officials stated that during this fiscal year, they will be conducting program examinations on all HUBZone firms that received contracts in fiscal year 2007 to determine whether they still meet HUBZone requirements. In addition, SBA officials stated that as of September 2008, SBA had eliminated their backlog of recertifications.

Although SBA has initiated several positive steps, SBA will need to make further progress to achieve an effective fraud monitoring program. For example, SBA has not found an effective and efficient way to verify the validity of a stated principal office during its recertification and application processes. In addition, SBA officials stated that although they modified their approach for conducting program examinations of HUBZone firms this fiscal year, they have not established a streamlined and risk-based methodology for selecting firms for program examinations going forward. Further, in order to determine whether firms meet eligibility requirements, SBA needs to incorporate an "element of surprise" into its program examinations such as using random, unannounced site visits to verify a stated principal office. Finally, SBA does not evaluate all HUBZone program requirements during program examinations; specifically, SBA does not review whether HUBZone firms are expending at least 50 percent of the personnel costs of a contract on their own

[22]GAO, *Small Business Administration: Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results*, GAO-08-643 (Washington, D.C.: June, 2008).

[23]Since fiscal year 2004, SBA's policy was to conduct program examinations on 5 percent of firms each year. According to SBA, a program examination involves a review of the following criteria: 1) 51 percent ownership by a U.S. citizen; 2) qualification as a small business under the size standard corresponding to primary industry classification; 3) the firm's principal office must be located in a HUBZone; and 4) at least 35 percent of the firm's employees must reside in a HUBZone.

personnel. As a result, as shown by several of our case studies, certain firms are allowed to act as "front" companies, whereby they subcontract the large majority of their work to non-HUBZone firms. This undermines the program's stated purpose of increasing employment opportunities, investment, and economic development in HUBZone areas.

Investigation and Prosecution

The final element of an effective fraud prevention system is the aggressive investigation and prosecution of individuals who commit fraud against the federal government. However, SBA currently does not have an effective process for investigating fraud and abuse within the HUBZone program. Although SBA's Desktop Manual for Processing HUBZone Applications states that an analyst may refer a HUBZone application to the Office of Inspector General or the Office of General Counsel, SBA has not established specific criteria or a process for referring firms that knowingly do not meet program requirements. To date, other than the firms identified by our prior investigation, the SBA program office has never referred any firms for debarment and/or suspension proceedings based on their findings from their program eligibility reviews. By failing to hold firms accountable, SBA has sent a message to the contracting community that there is no punishment or consequences for committing fraud or abusing the intent of the HUBZone program. However, as noted below, the SBA has started the debarment process on 7 of the 10 firms we found to have fraudulently or inaccurately misrepresented its HUBZone status in our earlier work.

SBA Has Initiated Some Enforcement Actions Against 10 HUBZone Firms Previously Investigated by GAO

SBA has taken some enforcement steps on the 10 firms that we found did not meet HUBZone program requirements as of July 2008. According to SBA, as of January 2009, two of the firms have been removed from the program and two others are in the process of being removed.[24] However, SBA's failure to examine some of the most egregious cases we previously identified[25] has resulted in an additional $7.2 million in HUBZone obligations and about $25 million in HUBZone set-aside or price preference contracts to these firms. For example, a construction firm identified in our July 2008 testimony admitted that it did not meet HUBZone requirements and was featured in several national publications by name. It has continually represented itself as HUBZone certified and has received $2 million in HUBZone obligations and a $23 million HUBZone set-aside contract since our testimony. See figure 5 for a reproduction of the continual representation this firm makes on the top banner of its Web site.

Figure 5: Reproduction of Web Site Banner for Firm SBA Has Yet to Investigate

Source: Company website.

In the written statement for the July 2008 hearing, the Acting Administrator of SBA stated that the SBA would take "immediate steps to require site visits for those HUBZone firms that have received HUBZone contracts and will be instituting suspension and debarment proceedings against firms that have intentionally misrepresented their HUBZone status." SBA has referred 7 of these firms to its General Counsel for suspension and debarment. However, as of February 2009, according to SBA's Dynamic Small Business Web site, 7 of the 10 firms that we investigated were still HUBZone certified. Table 2 highlights the 10 firms

[24]As of February 2009, 7 of the 10 firms were still HUBZone certified according to SBA's Dynamic Small Business Search. One of the two firms in the process of being removed was no longer listed as HUBZone certified.

[25]GAO, *HUBZone Program: SBA's Control Weaknesses Exposed the Government to Fraud and Abuse*, GAO-08-964T (Washington, D.C.: July 17, 2008).

that we noted at the July 2008 hearing that clearly did not meet the HUBZone program requirements, new HUBZone obligations and contracts these firms received, as well as the actions the SBA has taken against these firms as of January 2009.

Table 2: SBA Actions on 10 HUBZone Firms Previously Investigated by GAO

Previous GAO case[a]	Primary product or service	Case details	SBA compliance actions and additional contract actions through January 2009
1	Information technology (IT), engineering, logistics, technical support services, and business management services	• Multiple GAO site visits to listed principal office revealed that no employees were working at the location and the only business equipment we found was a computer and filing cabinet. • Firm maintained its actual principal office in McLean, Virginia, which is not in a HUBZone, where most of firm's qualifying employees, including the management staff, worked. • According to payroll records, only 21 percent of the firm's employees lived in a HUBZone as of December 2007.	• Firm has received nearly $3 million in HUBZone obligations since our July 2008 testimony. • SBA has not yet performed a program examination. • SBA program officials referred firm to Suspension and Debarment Official (SDO) in January 2009. • SDO submitted a notice of proposal to debar to the company in January 2009.[b]
2	General construction	• GAO site visit to the firm's listed principal office during normal business hours revealed it was one-half of a residential duplex building with no employees present. • Vice president of firm admitted to certifying the firm met HUBZone requirements even though no employees worked at their principal office location. • According to payroll records, only 12 percent of the firm's employees lived in a HUBZone as of December 2007. • Although the firm admitted to failing to meet the HUBZone requirement, as of June 2008 the firm's Web site has a large lettered statement that the firm is HUBZone-certified.	• Firm received HUBZone preference contract in September 2008 worth $23 million, which includes base and all options. • Firm has received over $2 million in HUBZone obligations since our July 2008 testimony. • SBA has not yet performed a program examination • SBA program officials referred firm to SDO in January 2009. • SDO submitted a notice of proposal to debar to the company in January 2009.

Previous GAO case[a]	Primary product or service	Case details	SBA compliance actions and additional contract actions through January 2009
3	Design and installation of fire alarm systems	• President admitted that his firm "technically" did not meet HUBZone requirements. • GAO site visit to the firm's listed principal office during normal business hours revealed that it was a virtual office. • Firm operated its actual principal office in McLean, Virginia, not in a HUBZone, where most of firm's qualifying employees, including the management staff, worked. • According to payroll records, only 8 percent of the firm's employees lived in a HUBZone area as of December 2007.	• SBA removed firm from HUBZone program in November 2008 because firm did not respond to SBA's program examination inquiry. • SBA program officials referred firm to SDO in December 2008. • SDO submitted a notice of proposal to debar to the company in January 2009.
4	Engineering and construction management services	• GAO site visit to the listed principal office during normal business hours found no employees present, the door locked, and mail stuffed under the door. • Firm operated its actual principal office in Beltsville, Maryland, which is not in a HUBZone, an indication that its daily operation is conducted out of this non-HUBZone office. • According to payroll records, only 30 percent of the firm's employees lived in a HUBZone as of December 2007.	• Firm received HUBZone set-aside contract in September 2008 worth $8,500. • SBA has not yet performed a program examination. • SBA program officials referred firm to SDO in January 2009. • SDO submitted a notice of proposal to debar to the company in January 2009.
5	IT consulting	• GAO site visit to the firm's listed principal office found the firm's president and one employee. • According to the president, between 80 to 90 full-time employees worked at a non-HUBZone location in Lanham, Maryland. A GAO site visit confirmed the existence of this location, indicating that the listed principal office does not meet HUBZone requirements. • According to payroll records, only 29 percent of the firm's employees lived in a HUBZone area as of December 2007.	• Firm received about $1.7 million in HUBZone obligations since our July 2008 testimony. • SBA completed program examination in November 2008 and notified firm that it was scheduled for removal from the HUBZone program. • SBA program officials referred firm to SDO in December 2008. • SDO submitted a notice of proposal to debar to the company in January 2009.

Previous GAO case[a]	Primary product or service	Case details	SBA compliance actions and additional contract actions through January 2009
6	Mechanical engineering	• Federal agencies obligated more than $27 million on government contracts that were not HUBZone contracts for the firm. • Multiple GAO site visits revealed no employees present at the principal office in Washington, D.C. • Firm operated from an office in Hyattsville, Maryland, not in a HUBZone, where most qualifying employees worked. • President stated that she believed SBA defined "principal office" as "where the principal" (e.g., president) worked. • President also stated that she typically worked at the principal office, but that investigators happened to find her at the non-HUBZone office location. • According to payroll records, only 4 of 78 employees (about 5 percent) lived in a HUBZone as of December 2007.	• SBA completed program examination and notified firm in November 2008 that it was scheduled for removal from the HUBZone program. • SBA program officials referred firm to SDO in January 2009. • SDO submitted a notice of proposal to debar to the company in January 2009. • SBA has still not removed firm from the HUBZone program 3 months after it found the firm was not eligible for the program.
7	Acquisition and project management	• Firm met principal office requirement. • Payroll documents indicate less than 6 percent of the firm's employees lived in a HUBZone as of December 2007. • Firm self-certified that it met the HUBZone requirements in ORCA in May 2008.	• SBA removed firm from HUBZone program in November 2008 because firm voluntarily withdrew from the program. • SBA program officials referred firm to SDO in December 2008. • SDO submitted a notice of proposal to debar to the company in January 2009.
8	Construction management	• Firm met principal office requirement. • Payroll documents showed only about 17 percent of the firm's employees lived in a HUBZone as of December 2007.	• SBA concluded firm met HUBZone program requirements based on an SBA program examination.[c]
9	IT products and services	• Firm met principal office requirement. • Payroll documents showed that the firm's only employee did not live in a HUBZone as of December 2007.	• Firm received HUBZone set-aside contract in September 2008 worth $1.8 million. • Firm has received over $20,000 in HUBZone obligations since our July 2008 testimony. • SBA concluded firm met HUBZone program requirements based on an SBA program examination.[c]

Previous GAO case[a]	Primary product or service	Case details	SBA compliance actions and additional contract actions through January 2009
10	IT and logistics management	Firm met principal office requirement. Payroll documents show only about 15 percent of the firm's employees lived in a HUBZone as of December 2007.	Firm has received over $500,000 in HUBZone obligations since our July 2008 testimony. SBA concluded firm met HUBZone program requirements based on an SBA program examination.[c]

Source: GAO analysis of SBA information.

Note: See

GAO, *HUBZone Program: SBA's Control Weaknesses Exposed the Government to Fraud and Abuse, GAO-08-964T (Washington, D.C.: July 17, 2008).*

[a]Cases are arranged in the same order as in GAO-08-964T.

[b]SBA officials stated that they are giving each company 30 days to reply to the notice of proposal to debar. Within 30 days after receipt of the notice, the contractor may submit information and argument in opposition to the proposed debarment.

[c]We maintain that the three cases SBA examined and determined to meet HUBZone program requirements were out of HUBZone compliance at the time of our review. In January 2009, we asked the SBA for documentation related to its review, but no documentation was provided to us.

As noted in the table above, as of January 2009 SBA has conducted program evaluations on 7 of the 10 firms to determine whether the firms meet the eligibility requirements for the HUBZone program. Based on these evaluations, SBA has removed 2 firms from the HUBZone program and is in the process of providing due process to 2 additional firms to determine whether they should be removed.[26] SBA officials stated that no action will be taken on 3 firms because SBA's program evaluations concluded that these firms met all the eligibility requirements of the HUBZone program. We attempted to verify SBA's work, but were not provided with the requested documentation to support their conclusion that the firms moved into compliance after our July 2008 testimony. SBA officials said they have not yet performed program evaluations for 3 of the most egregious firms because they are experiencing technical problems with SBA's caseload system. As such, these 3 firms remain eligible to receive HUBZone set-aside contracts. SBA is also pursuing suspension and debarment actions for 7 of these firms, and the Department of Justice considering civil actions on 5 of the 10 cases.

[26]A firm that SBA has decertified may seek certification no sooner than one year from the date of decertification. If the firm was decertified for failure to notify SBA of a material change affecting its eligibility, it must include with its application for certification a full explanation of why it failed to notify SBA of the material change.

Conclusions

Our work on the HUBZone program to date has shown that numerous ineligible firms have taken advantage of the opportunity to commit fraud against the federal government. The SBA has initiated steps to correct internal control deficiencies, but it still falls short in developing measures to prevent, detect, and prosecute fraud within the HUBZone program. Our work demonstrates that SBA's fraud controls lack important elements needed to screen and monitor firms which has led to HUBZone awards to firms that did not meet program requirements. For example, SBA's failure to verify principal office locations through unannounced site visits has led to firms operating their businesses from locations that are far from economically disadvantaged. In addition, a lack of oversight for monitoring all of the program requirements has allowed HUBZone firms to subcontract large portions of HUBZone work to non-HUBZone firms thereby failing to meet the program requirement that at least 50 percent of the personnel costs of a contract be expended on its own employees. Lastly, SBA's lack of enforcement within the HUBZone program has not had the effect of deterring fraudulent actors from entering or remaining in the program. Going forward, SBA must develop and incorporate effective fraud controls into its overall internal control process that will minimize fraud and abuse in the HUBZone program.

Recommendations for Executive Action

To establish an effective fraud prevention system for the HUBZone program, the Administrator of the Small Business Administration should expeditiously implement the recommendations from our June 2008 report and take the following four actions:

- Consider incorporating a risk-based mechanism for conducting unannounced site visits as part of the screening and monitoring process.
- Consider incorporating policies and procedures into SBA's program examinations for evaluating if a HUBZone firm is expending at least 50 percent of the personnel costs of a contract using its own employees.
- Ensure appropriate policies and procedures are in place for the prompt reporting and referral of fraud and abuse to SBA's Office of Inspector General as well as SBA's Suspension and Debarment Official.
- Take appropriate enforcement actions on the 19 HUBZone firms we found to violate HUBZone program requirements to include, where applicable, immediate removal or decertification from the program, and coordination with SBA's Office of Inspector General as well as SBA's Suspension and Debarment Official.

Agency Comments and Our Evaluation

We received written comments on a draft of this report from SBA's Deputy Associate Administrator of the Office of Business Development and Government Contracting. In the response, SBA agreed with three of our four recommendations. SBA stated that it is in the process of re-engineering the entire HUBZone certification and eligibility process, and SBA believes that our recommendations are useful in making necessary program changes to minimize program risk and ensure that only eligible firms received HUBZone program benefits. SBA's written comments are provided in appendix II.

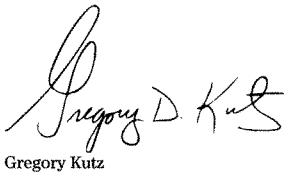
SBA disagreed with our recommendation to consider incorporating policies and procedures into SBA's program examinations for evaluating if a HUBZone firm is complying with the performance-of-work requirements by expending at least 50 percent of the personnel costs of a contract using its own employees. SBA stated that although this requirement is included in SBA HUBZone regulations, it is not a criterion for HUBZone program eligibility but rather a mandatory contract term. SBA stated that contracting officers are required by the Federal Acquisition Regulations to insert such clauses regarding subcontracting limitations. If firms submit bids that indicate that they will not meet this requirement or fail to meet this requirement during performance of the contract, the contracting officer has the authority to reject a firm's bid or terminate the contract for default. SBA stated that it will continue to work with contracting officers to ensure that this requirement is monitored.

While we recognize that contracting officers have a responsibility for monitoring the subcontracting limitation, SBA also has this responsibility. In order to receive HUBZone certification, a firm must certify to SBA that it will abide by this performance requirement, and SBA is required by statute to establish procedures to verify such certifications. In addition, verification that a firm is meeting the performance-of-work requirements is one of the subjects that SBA may review during its program examinations. Since SBA is not performing this review, it is possible that many firms may be receiving the benefits of the HUBZone program while evading the program requirements. Therefore, we continue to believe that SBA should consider incorporating policies and procedures into SBA's program examinations for evaluating if a HUBZone firm is meeting the performance-of-work requirements.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies of this report to the Administrator of the Small Business Administration and other interested

parties. The report will also be available at no charge on GAO's Web site at www.gao.gov. If you or your staff have any questions about this report, please contact me at (202) 512-6722 or kutzg@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 contributed to this report are listed in appendix III.

Sincerely yours,



Gregory Kutz
Managing Director, Forensic Audits and Special Investigations

Appendix I: Additional Case Studies of HUBZone Firms That Did Not Meet Program Eligibility Requirements

This appendix presents summary information on 9 of 19 firms that clearly did not meet the program eligibility requirements of the HUBZone program. Table 3 shows the remaining case studies that we investigated. As with the 10 cases discussed in the body of this report, these 9 firms continued to represent themselves as eligible HUBZone interests to SBA. Because these 9 case examples clearly are not eligible, we consider each firm's continued representation indicative of fraud and/or abuse related to this program.

Table 3: HUBZone Firms Making Fraudulent or Inaccurate Representations

Case	Location	Primary product or service	Fiscal Year 2006-2007 Obligations on HUBZone contracts[a] (reporting agencies)	Case details
11	San Antonio, TX	Construction	$2,770,000 (Department of the Air Force)	• Firm met principal office requirement. • Firm did not meet 35 percent residency requirement because payroll records show that only 6 of the firm's 31 employees (19 percent) lived in a HUBZone as of December 2007. • Firm self-certified that it met the HUBZone requirements in ORCA in July 2008.
12	San Diego, CA	Construction	$3,530,000 (Department of the Navy)	• Firm met principal office requirement. • Firm did not meet 35 percent residency requirement because payroll records show that only 5 of the firm's 38 employees (13 percent) lived in a HUBZone as of December 2007. • Firm self-certified that it met the HUBZone requirements in ORCA in July 2008.
13	Huntsville, AL	Engineering	$920,000 (Department of the Air Force)	• Firm met principal office requirement. • Firm did not meet 35 percent residency requirement because payroll records show that only 19 of the firm's 100 employees (19 percent) lived in a HUBZone as of December 2007. • Firm self-certified that it met the HUBZone requirements in ORCA in July 2008.
14	San Diego, CA	Engineering and Information Technology	$960,000 (Department of the Navy)	• Firm did not meet principal office requirement because the firm's principal office was not located in HUBZone area.[b] • Firm met 35 percent residency requirement. • Firm self-certified that it met the HUBZone requirements in ORCA in September 2008.

Case	Location	Primary product or service	Fiscal Year 2006-2007 Obligations on HUBZone contracts[a] (reporting agencies)	Case details
15	San Antonio, TX	Facilities Support Services/Construction	$1,840,000 (multiple agencies)	• Firm met principal office requirement. • Firm did not meet 35 percent residency requirement because payroll records show that only 8 of the firm's 76 employees (11 percent) lived in a HUBZone as of December 2007. • Firm self-certified that it met the HUBZone requirements in ORCA in May 2008.
16	San Antonio, TX	Food Service Contractors	$830,000 (Department of the Navy)	• Firm met principal office requirement. • Firm did not meet 35 percent residency requirement because payroll records show that only 62 of the firm's 239 employees (26 percent) lived in a HUBZone as of December 2007. • Firm does not have a current ORCA certification.
17	San Diego, CA	Information Technology	$2,090,000 (multiple agencies)	• Firm met principal office requirement. • Firm did not meet 35 percent residency requirement because payroll records show that only 10 of the firm's 43 employees (23 percent) lived in a HUBZone as of December 2007. • Firm self-certified that it met the HUBZone requirements in ORCA in July 2008.
18	Waco, TX	Janitorial	$440,000 (Department of Veterans Affairs)	• Firm met principal office requirement. • Firm did not meet 35 percent residency requirement because payroll records show that only 4 of the firm's 16 employees (25 percent) lived in a HUBZone as of December 2007. • Firm self-certified that it met the HUBZone requirements in ORCA in November 2008.
19	San Antonio, TX	Temporary Help Services	$350,000 (Departments of the Navy and Army)	• Firm met principal office requirement. • Firm did not meet 35 percent residency requirement because payroll records show that this firm's only employee did not live in a HUBZone as of December 2007.[c] • Firm self-certified that it met the HUBZone requirements in ORCA in July 2008.

Source: GAO analysis of FPDS, ORCA, CCR and contractor data.

[a]Net obligation amounts are rounded to the nearest $10,000.

[c]We checked this firm's principal office address using both the current HUBZone map located on SBA's Web site as well as a HUBZone map as it would have appeared in December 2007 and in both instances the firm's principal office was not located in a HUBZone area.

[c]Earlier in 2007, a total of 16 people were employed by this company, however at no time did any of the employees live in a HUBZone.

Appendix II: Comments from the Small Business Administration

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

March 13, 2009

Greg Kutz, Managing Director
Forensic Audits and Special Investigations
U. S. Government Accountability Office
Washington, DC 20548

Dear Mr. Kutz,

Thank you for allowing the U.S. Small Business Administration (SBA) the opportunity to comment on your Draft Government Accountability Office (GAO) Report Number: GAO 09-440, entitled, "HUBZone Program: Fraud and Abuse Identified in Four Metropolitan Areas."

SBA has reviewed GAO's four recommendations for executive action and is submitting the following responses:

Recommendation #1
Consider incorporating a risk-based mechanism for conducting unannounced site visits as part of the screening and monitoring process.

Response: SBA agrees with the recommendation. SBA will develop risk-based procedures for conducting site visits to ensure HUBZone program eligibility.

Recommendation #2
Consider incorporating policies and procedures into SBA's program examinations for evaluating if a HUBZone firm is expending at least 50 percent of the personnel costs of a contract using its own employees.

Response: SBA disagrees with the recommendation to revise program examination polices and procedures for evaluating if a HUBZone firm is expending at least 50 percent of the personnel cost of a contract using its own employees. Although the 50 percent requirement is included SBA HUBZone regulations, it is not a criteria for HUBZone program eligibility but rather a mandatory contract term. When awarding HUBZone set-aside contracts, HUBZone sole source contracts, or contracts with a HUBZone price evaluation preference, contracting officers are required by the Federal Acquisition Regulations to insert such clauses. If firms submit bids that indicate that they will not meet this requirement or fail to meet this requirement during performance of the contract, the contracting officer has the authority to reject a firm's bid or terminate the contract for default. SBA will continue to work with contracting officers to ensure that this requirement is monitored.

Page 2

Recommendation #3
Ensure appropriate policies and procedures are in place for the prompt reporting and referral of fraud and abuse to SBA's Office of Inspector General as well as SBA's Suspension and Debarment Official.

Response: SBA agrees with the recommendation. SBA is developing policies and standard operating procedures for prompt reporting and referral of cases of fraud and abuse to SBA's Office of Inspector General and Suspension and Debarment Official.

Recommendation #4
Take appropriate enforcement actions on the 19 HUBZone firms we found to violate HUBZone program requirements to include, where applicable, immediate removal or decertification from the program, and coordination with SBA's Office of Inspector General as well as SBA's Suspension and Debarment Official.

Response: SBA agrees with the recommendation. Once GAO provides the names of the 19 firms, the HUBZone office will confirm their ineligibility and if appropriate initiate decertification action and make referral to SBA's Office of Inspector General and SBA's Suspension and Debarment Official for action.

As indicated in the draft report, SBA is in the process of re-engineering the entire HUBZone certification and eligibility process, and we believe that the GAO's recommendations are useful in making necessary program changes to minimize program risk and ensure that only eligible firms received HUBZone program benefits. Again, thank you for the opportunity to comment. If you have any questions or require additional information, please contact Ms. Tiffani Cooper, GAO Liaison at (202) 205-6700.

Sincerely,

Calvin Jenkins
Deputy Associate Administrator
Office of Business Development and Government Contracting

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

Gregory D. Kutz, Managing Director, (202) 512-6722, kutzg@gao.gov

Staff Acknowledgments

In addition to the individual named above, Erika Axelson, Gary Bianchi, Donald Brown, Bruce Causseaux, Eric Eskew, Dennis Fauber, Craig Fischer, Robert Graves, Betsy Isom, Jason Kelly, Julia Kennon, Barbara Lewis, Olivia Lopez, Jeff McDermott, Andrew McIntosh, John Mingus, Andy O'Connell, Mary Osorno, Chris Rodgers, and Matt Valenta also provided assistance on this report.

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U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, DC 20416

March 27, 2009

Via E-mail

The Honorable Nydia M. Velázquez
Chairwoman
Committee on Small Business
U.S. House of Representatives
Washington, D.C. 20515

Subject: Authority to Suspend HUBZone Businesses Identified in GAO-08-964T

Dear Madam Chairwoman:

This is a response to a question posed during the testimony before your committee on March 25, 2009 of Darryl Hairston, Acting Administrator of the U.S. Small Business Administration (SBA). Acting Administrator Hairston was asked whether SBA has suspended any HUBZone businesses identified in GAO-08-964T, a report entitled "HUBZone Program: SBA's Control Weaknesses Exposed the Government to Fraud and Abuse" and released by the Government Accountability Office (GAO) on July 17, 2008. Acting Administrator Hairston responded that SBA did not believe it had a sufficient basis to suspend any businesses identified in the GAO's report. This opinion describes the legal basis for SBA's position.

GAO-08-964T identified 10 firms from the Washington, D.C. metro area that were participating in the HUBZone program that GAO believed did not meet the program's eligibility requirements. Specifically, GAO found that, of the 10 firms, six did not meet the program's principal office and employee residency requirements, while four met the principal office requirement but did not meet the employee residency requirement. In its report, GAO described the basis for its findings pertaining to some, but not all, of the 10 firms.

Upon receiving GAO-08-964T, SBA evaluated its legal options with regard to the 10 businesses GAO identified. One possible option was to seek government-wide suspension of the firms, pursuant to subpart 9.4 of the Federal Acquisition Regulation (FAR). If SBA were to impose a FAR suspension on a firm, that firm would be barred from receiving Federal government contracts and other Federal government assistance during the period of the suspension. If legal proceedings are not instituted, FAR suspensions are effective for 12 months after the firm is notified of its suspension, unless the agency lifts the suspension or the Department of Justice objects. Upon initiation of legal proceedings, suspensions may continue until the proceedings are completed.

At the time, SBA concluded that it did not have a sufficient evidentiary basis to impose a FAR suspension. FAR subpart 9.4 states the standard for imposing suspension

as follows,

> Suspension is a serious action to be imposed on the basis of adequate evidence, pending the completion of investigation or legal proceedings, when it has been determined that immediate action is necessary to protect the Government's interest. In assessing the adequacy of the evidence, agencies should consider how much information is available, how credible it is given the circumstances, whether or not important allegations are corroborated, and what inferences can reasonably be drawn as a result. This assessment should include an examination of basic documents such as contracts, inspection reports, and correspondence.

FAR 9.407-1(b)(1) (emphasis added). This standard for suspension is commonly referred to as the "adequate evidence" standard.

The "adequate evidence" standard is not ordinarily used in legal proceedings. Therefore, agencies and courts sometimes encounter difficulties applying the standard to specific situations where government-wide suspensions may be warranted. In the handful of reported cases interpreting the standard, the courts have compared "adequate evidence" to that which is required to find probable cause sufficient to support an arrest or search warrant. Transco Security, Inc. v. Freeman, 639 F.2d 318, 324 (6th Cir. 1981). In a seminal case, an appeals court concluded that an "adequate evidence" showing may be less than must be shown at trial, but "it must be more than uncorroborated suspicion or accusation." Horne Bros., Inc. v. Laird, 463 F.2d 1268, 1271 (D.C. Cir. 1972). The Horne Bros. court remarked that the requirement to show adequate evidence is necessary to ensure that the Government does not "simply ignore the interests of the contractor." Id. at 1272.

Outside of case law, the current FAR provision on the government-wide suspension standard imposes two additional requirements. First, the FAR requires that, in addition to meeting the evidentiary standard, the agency must determine that "immediate action is necessary to protect the government's interest." FAR 9.407-1(b)(1). Second, the FAR directs agencies to examine "basic documents," such as contracts, inspection reports, and correspondence. Accordingly, where a suspension is based on evidence other than an indictment, the suspended firm is entitled to dispute facts material to the suspension. FAR 9.407-3(b)(2). Thus, in practice, agencies usually work with the Justice Department prior to and during the suspension process to ensure that the agency does not release facts to the suspended firm that would prejudice a Federal investigation. Consequently, agencies generally impose government-wide suspensions against parties only after the Justice Department has brought formal charges in a criminal proceeding or filed a civil complaint. See FAR 9.407-2(b).

In the case of the 10 firms identified in GAO-08-946T, SBA determined that, at the time of the report's release, the agency did not have sufficient evidence to determine that the firms had violated the HUBZone program regulations. Thus, the agency could

not justify imposing government-wide suspension on the firms under the adequate evidence standard. SBA determined that, in order to take action against the firms, the agency would itself need to investigate the firms so that any action it would take would have an adequate evidentiary basis.

Since the release of GAO-08-946T, SBA has initiated its own investigations of the 10 firms and has itself compiled evidence upon which the agency can act. As noted in the most recent GAO report on the HUBZone program, GAO-09-440, SBA found that three of the 10 firms remained eligible for the HUBZone program. Evidence pertaining to these three firms' eligibility will be sent under separate cover. For the other firms, SBA is currently assessing the extent to which the firms have benefited from the HUBZone program. SBA has begun government-wide debarment action against the firms that were not found to be eligible.

Other than the government-wide suspension authority held by all executive agencies, SBA does not have existing authority to take immediate action to prevent HUBZone firms from benefiting from the program. Based on the conclusions of GAO's reports, SBA is currently considering amending its HUBZone program regulations to provide the agency with regulatory authority to suspend firms from receiving HUBZone program benefits. This process would be separate from, and presumably would not be constrained by the requirements of, government-wide suspension. SBA currently has similar regulatory authority to suspend participants in SBA's 8(a) Business Development (BD) program from receiving the benefits of that program. However, such authority does not exist within the HUBZone program.

In the context of the 8(a) BD program, SBA may suspend a firm from receiving further 8(a) BD program assistance after the issuance of a proposed letter to terminate the firm from the 8(a) BD program. If SBA suspends a firm from the 8(a) BD program using the regulatory suspension provided for in SBA's rules, the firm is immediately prohibited from receiving any further 8(a) BD program assistance pending the outcome of the termination proceeding, but the suspension does not have government-wide effect. SBA generally seeks regulatory suspension of 8(a) firms rather than government-wide suspension under the FAR because it is faster and easier to institute. In addition, Government-wide suspension has been called a "blacklist" because imposing Government-wide suspension on a contractor may have lasting effect on the contractor's prospects for receiving government contracts well after the suspension has been lifted. See Transco Sec., Inc., 639 F.2d at 321. This is the case even if the agency later determines that the suspension action was unwarranted. On the other hand, SBA's regulatory suspension does not have the same enduring consequences. Indeed, under SBA's rules, if SBA ultimately determines that termination of the suspended firm from the 8(a) BD program is not appropriate, SBA will add the length of the suspension to the end of the firm's nine-year 8(a) BD program term.

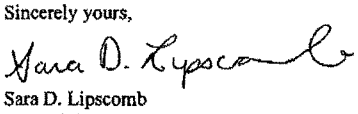
In the HUBZone program, if SBA were to implement rules providing the agency with authority to impose regulatory suspension, SBA would be able to suspend

HUBZone firms suspected of violating the HUBZone program regulations while SBA conducts a full program examination of the firm's eligibility.

In this regard, I have scheduled a meeting on Monday, March 30, 2009 with the head of the HUBZone program to give these investigations and the implementation of regulatory suspension authority the program's highest priority. My staff and I will work closely with the HUBZone program to ensure that these investigations are completed in accordance with the law and the agency's regulations. We also will move quickly to amend the program's regulations so that, if and when similar situations arise, the agency can act without delay to protect the government's interests.

I greatly appreciate this opportunity to respond to your concerns. If you have any questions concerning these matters, please contact me directly.

Sincerely yours,



Sara D. Lipscomb
General Counsel

cc: Darryl Hairston, Acting Administrator
Guy Torres, Director, Office of HUBZone

United States Government Accountability Office
Washington, DC 20548

April 17, 2009

The Honorable Nydia M. Velazquez
Chairwoman
Committee on Small Business
House of Representatives

Dear Madam Chairwoman:

This is in response to a letter submitted to you by the Small Business Administration (SBA) regarding the issue of whether SBA could suspend the firms identified in GAO's report on fraud and abuse in the HUBZone program (GAO-08-964T). Your staff forwarded the letter and invited me to respond. I wanted to take this opportunity to clarify some of the issues SBA raised in its letter, as well as to notify you of the actions taken by GAO after the release of our report last July.

In its letter, SBA stated that it did not have adequate evidence to suspend the ten firms that GAO identified as being ineligible for the HUBZone program but having received HUBZone contracts. Therefore, according to SBA, it could not suspend the firms until after it had completed its own investigation. However, as SBA noted, the "adequate evidence" standard for suspension is a low threshold, roughly equivalent to the probable cause standard necessary to issue a warrant.

GAO cooperated fully in providing timely access to its evidence of the firms' false certifications to SBA. Shortly after the release of my testimony last July, my staff met with officials from the SBA Office of Inspector General (SBA-OIG) to provide the names of the firms described in the report (which itself contained details describing the failure of each firm to meet HUBZone requirements), transmit copies of our interview write-ups with the firms and additional documentation, and offer access to our workpapers for the purposes of corrective action. It is my understanding that the SBA-OIG shared this information with the HUBZone program officials at SBA in July of 2008.

This information was gathered and the report was written according to the quality standards for investigations as set forth by the President's Council on Integrity and Efficiency. These professional standards are used by Inspectors General across the federal government to conduct investigations. Certainly, the information gathered according to these standards and shared with SBA is sufficient to meet the low threshold of adequate evidence. Indeed, in three cases, SBA issued debarment notices based solely on the evidence that GAO gathered and reported.

In its letter, SBA stated that we reported in our most recent report, (GAO-09-440), that SBA found that 3 of the 10 firms remained eligible for the HUBZone program. In fact, we reported that our findings disagreed with this SBA conclusion because these three firms failed to meet one of the eligibility criteria; however, SBA did not provide us documentation to support its conclusion for the firms.

In its letter, SBA also raised concern that suspension may not have been appropriate in the cases identified by GAO because suspension requires a determination that "immediate action is necessary to protect the government's interest." However, as stated in our subsequent HUBZone report (GAO-09-440), SBA's failure to promptly remove firms from the HUBZone program and examine some of the most egregious cases has resulted in an additional $7.2 million in HUBZone obligations and about $25 million in new HUBZone contracts given to firms that we reported in July of 2008 were ineligible for the HUBZone program and that had made false certifications to SBA. Had SBA appropriately taken immediate action in these cases it could have protected the important governmental interest of preventing contract awards to ineligible firms that misrepresented themselves to SBA.

Finally, SBA stated that it intends to amend the program's regulations so that, if and when similar situations arise, the agency can act without delay to protect the government's interests. Until this authority becomes available for the HUBZone program, we believe that it is imperative to use existing authorities as expeditiously as possible when adequate evidence is available of fraudulent or abusive practices that exploit federal programs and resources.

In a letter dated March 27, 2009, we submitted the names of the 19 ineligible firms to SBA identified in that report and also held a meeting on April 2, 2009, to provide additional information that was not included in the referral letter. We plan to provide the supporting documentation to SBA shortly and are always available to SBA officials to provide any information that is necessary to take corrective action. We hope that SBA will utilize this information to take prompt action to ensure that these firms do not receive any further procurement benefits to which they are not entitled.

Sincerely yours,

Gregory D. Kutz
Managing Director
Forensic Audits and Special Investigations

Committee's Statement in Response to SBA's Letter about SBA's Authority to Suspend HUBZone Program Participants.

During this Committee's hearing on waste, fraud and abuse in SBA programs, the Acting Administrator of SBA contended that the agency lacked authority to immediately suspend HUBZone program participants even where evidence of fraud was uncovered during a General Accountability Office (GAO) investigation. SBA concluded that such evidence was insufficient and required verification. Thereafter, SBA waited months before proceeding to seek suspension and debarment in specific cases. In the interval, millions of dollars in additional contract obligations and awards were made to the subject companies to the detriment of the Government and other legitimate HUBZone participants.

GAO subsequently testified that SBA could have taken immediate action that would have protected the government from the continuing fraud. SBA asserted that its counsel disagreed and that in the HUBZone program, unlike the 8(a) program for example, SBA could not immediately preclude a HUBZone participant from receiving benefits even if they were not eligible. At that point in the hearing the Chair requested SBA to have its counsel put that opinion in writing and submit it for the record. GAO was invited to comment for the record about SBA's submission. Both letters are attached.

The SBA letter concerning its authority to suspend participants in the HUBZone program fails to explain why it could not take immediate action. The letter acknowledges SBA has ample authority for such a suspension under existing Federal Acquisition Regulations (FAR). In addition, SBA had sufficient evidence produced by the GAO investigation to meet the "adequate evidence" threshold and therefore could have begun immediate suspension of the companies to protect the Government's interest. Even if it were conceded that SBA did not have adequate evidence to impose a FAR suspension, and that is not the case here, then it is equally troubling that, after evaluating its legal options, it took SBA four to six months to pursue other remedies. The delay allowed more damage to the Government and legitimate HUBZone participants.

Finally, in its letter, the SBA promises to look into promulgating regulations patterned after provisions in the 8(a) program that allow for immediate action when evidence is uncovered through other sources. While this Committee has no objection to such action, we believe the SBA had ample tools and adequate evidence to proceed with suspension under the FAR procedures or under existing Small Business Act authority and regulations. SBA could also have started decertification immediately under other existing rules and removed any of the 10 from the program that did not have adequate answers within 30 calendar days. With such tools available to it, SBA should not now use the regulation promulgation process to postpone diligent actions against firms identified by GAO.

Self-Policing within HUBZone Program

The design of the HUBZone Program includes a "self-policing" mechanism. This is the same design that has successfully been used for many years in the small business set-aside program. This "self-policing" mechanism is based on the concept that a firm's competitors will be able to determine if their competition is a legitimate HUBZone firm. Also, using this mechanism is a very cost effective use of Government funds.

Any HUBZone firm that loses a HUBZone competition to another HUBZone firm can protest the HUBZone status of the apparent winner by filing a HUBZone protest. The details of how to file a HUBZone protest are addressed in the SBA HUBZone Regulations at 13 CFR 126.800.

In a recent real example of a HUBZone protest, one of the losing HUBZone firms had reason to suspect that the announced winner was not in compliance with the HUBZone requirement that at least 35% of a HUBZone firm's employees live in a HUBZone. The protester had collected sufficient data to suggest to the SBA that the winner was not in compliance with the "35% rule."

The protest was reviewed by the SBA. The SBA required the protested HUBZone firm to provide payroll data to determine how many employees worked at the selected HUBZone firm. Also, in adjudicating the protest, the SBA required the selected HUBZone firm to show proof of residency of each HUBZone resident employee. This normally entails submitting a photocopy of the employee's driver's license or other solid proof of where an employee lives (such as a residential lease if an employee does not have a driver's license).

As it turned out, only 19 of 64 (29.6%) employees of the selected HUBZone firm lived in a HUBZone. Based on this, the SBA notified the contracting officer that the firm was not eligible to receive the contract. Then, the contracting officer awarded the contract to the next highest qualified firm on the bidder's ranking list. Also, the SBA proceeded to de-certify the protested firm and removed their name from the list of certified/qualified HUBZone firms. In certain cases, the SBA HUBZone Office may refer the violation to the SBA Inspector General for their review.

This is just one of a thousand examples of how the self-policing mechanism has worked over the years to help ensure that only qualified HUBZone firms are awarded HUBZone contracts.

In another example, a contracting officer had reason to doubt that the selected HUBZone firm was in compliance with the 35% rule. In this instance, the contracting officer filed a HUBZone protest against the winning firm with the SBA. The SBA required the winning firm to show detailed payroll records to determine the number of employees in the firm. Also, the firm had to produce proof of residency for every HUBZone resident employed by the selected firm. In this real case, the firm had 14 HUBZone residents out of 34 employees for a total of 41.1%. The SBA notified the contracting officer that the protested firm was, in fact, compliant with the HUBZone 35% regulation and the contracting officer then made the award of the contract to the protested HUBZone firm.

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