

**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

SECOND SESSION

HEARING HELD

JULY 28, 2010



Small Business Committee Document Number 111-076
Available via the GPO Website: <http://www.access.gpo.gov/congress/house>

U.S. GOVERNMENT PRINTING OFFICE

57-521 PDF

WASHINGTON : 2010

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

Wednesday, July 28, 2010

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

The Committee met, pursuant to call, at 1:00 p.m., in Room 2360 Rayburn House Office Building, Hon. Nydia Velázquez [chairwoman of the Committee] presiding.

Present: Representatives Velázquez, Moore, Dahlkemper, Schrader, Nye, Critz, Bean, Altmire, Bright, Graves, Luetkemeyer.

Chairwoman VELÁZQUEZ. Good afternoon. This hearing is now called to order. House Resolution 40, which was passed at the beginning of this Congress, amended Clause 2(n) of House Rule XI by requiring that committees undertake intensive and regular examination of executive branch activities. Such actions are necessary to not only safeguard taxpayer dollars, but to also improve the operations of federal agencies.

This Committee has taken this role very seriously. We have exceeded the quarterly requirement and held ten hearings on the Small Business Administration and its programs. This has included four GAO investigations, all of which were requested by this Committee.

With 3,500 employees, 84 district and regional offices, and a broad range of programs, congressional oversight is essential to the operation of the SBA. This ensures that resources are directed more efficiently and effectively to small businesses.

We have examined every area of the agency, including its access to capital, entrepreneurial development, and contracting initiatives. The Committee has convened hearings on the agency's lending programs and how they are meeting the needs of small firms in today's economy. In addition, we worked with the GAO to oversee the disaster program so that businesses are better able to secure the funds they need to rebuild after a catastrophe.

A main focus of the Committee's oversight work has been the agency's procurement programs. With large businesses receiving small business contracts and fraud regularly being uncovered, it is critical that the Committee examine these programs. We will continue our investigations until the agency fully resolves these issues.

Finally, the Committee has held hearings about the agency's entrepreneurial development and innovation programs. This has included testimony from a wide range of experts that allowed us to

consider how the agency's resources can be improved without unnecessarily increasing taxpayer expense.

Today's hearing continues the Committee's strong commitment to thorough oversight. Doing so provides a basis for not only taxpayer savings, but also the long-term modernization of the agency. This is critical because small businesses are counting on the SBA, its staff, and its programs more than at any other time in the past decade.

The agency has risen to the task before and I know— with all of the resources it has at its disposal—that it will again. And I would like to take this opportunity to applaud your efforts to hold the free fall of small business lending. By doing so, we will allow entrepreneurs to do what they do best, create the ideas and the jobs that our economy needs to move forward.

I want to take also this opportunity to thank the witnesses for your presence here this afternoon. And I now recognize Ranking Member Graves for his opening statement.

Mr. GRAVES. Thank you, Madam Chair, and thank you for holding this important hearing today regarding the oversight of the Small Business Administration and its programs and I look forward to hearing from the Administrator and the GAO on some very important issues concerning the management of the agency and particularly its inability to root out fraud and abuse in the government contract programs.

Since I've been on this Committee, the challenges facing the agency have never been resolved, nor do they seem to change. When I first joined the Committee, the SBA's contracting databases were riddled with inaccuracies and today their same contracting databases remain full of errors concerning the eligibility of firms for the agency's government contracting programs. Even before I was elected to Congress, there were problems with the loan management accounting system and here it is a decade later and those problems still exist.

Five years ago, there was an obvious lack of coordination in responding to disasters. And today, there appears to be an absence of coordination between SBA and BP concerning the compensation to victims of the oil spill in the Gulf. Quite frankly, the litany of problems facing the SBA does not involve rocket science.

The SBA does not seem to take an aggressive approach to fixing the problems identified by Congress, by the GAO, and the Inspector General. Instead, it spends scarce resources studying these problems. For example, the agency issued a contract that examined, among other things, what value-added benefits the agency will obtain from moving to a new loan management accounting system. The SBA doesn't need any more studies. It needs action. And if it is incapable of taking necessary corrective action, then it might be time to examine whether a complete overhaul of the SBA is needed to separate its regulatory functions from its mission to promote small businesses.

Congress cannot tolerate and the taxpayer can ill afford the status quo at the SBA.

Again, I want to thank you, Madam Chair, for holding this important hearing and I look forward to the recommendations from

the witnesses of actions that the agency is going to take to move in the right direction. I appreciate it.

Chairwoman VELÁZQUEZ. And it is my pleasure to welcome the Honorable Karen Mills who was sworn in April 6, 2009 as the twenty-third Administrator of the U.S. Small Business Administration. The SBA helps small business owners and entrepreneurs secure financing, technical assistance, training, and fill our contracts. Welcome.

**STATEMENT OF THE HONORABLE KAREN MILLS,
ADMINISTRATOR, U.S. SMALL BUSINESS ADMINISTRATION**

Ms. MILLS. Thank you very much Chairwoman Velázquez, Ranking Member Graves, Members of the Committee. It's an honor to be with you again. Thank you for working closely with us to improve oversight and reduce risk, while removing fraud, waste, and abuse.

The SBA has a three-pronged risk-management framework for our contracting and business development programs: upfront certification, robust monitoring, and pursuing and removing ineligible firms.

HUBZone is a great example.

First, we have reengineered our certification process, requiring more stringent documentation. We now require a statement under penalty of perjury that both applicants and renewing firms are eligible.

Second, we dramatically increased monitoring: from less than 100 site visits in 2008, to over 800 in 2009, to more than 1,000 slated for this year.

Third, we're removing ineligible firms. For example, we investigated the 29 firms the GAO identified. After reviewing the facts, 16 were decertified, 8 voluntarily decertified, and 5, in fact, remained eligible for HUBZone.

We're also pursuing HUBZone fraud cases with the Department of Justice and the Inspector General, and we continue to suspend and debar firms suspected of fraud. In fact, just yesterday we suspended four more firms and two individuals.

An environment of integrity across all of our contracting programs is crucial.

The President included more funds in SBA's proposed budget exactly for this purpose. He also created an Interagency Task Force, led by OMB, SBA and Commerce. We'll soon provide formal recommendations, including some that will help equip our agency partners with tools they need to help in the shared mission of reducing fraud, waste and abuse. At the same time, we're committed to working more closely with Congress to make sure small businesses can continue to grow and create the jobs we need now.

Two examples: This Administration supports parity, or equal treatment, through small business contracting and business development programs: 8(a), HUBZone, service-disabled veterans, and women-owned. But a recent court decision interpreted the law to give a preference to HUBZone. Without clarity on this issue, billions of dollars could be redirected away from programs like 8(a), which help thousands of minority-owned small businesses.

Already, we fear that the current confusion is causing a chilling effect in small business contracting.

We support bipartisan legislation co-sponsored by 12 Members of this Committee to provide a fix for this problem at this crucial time.

Second, there's still a credit gap. Too many good small businesses still can't find access to capital. The increased guarantee and reduced fees from the Recovery Act have put more than \$30 billion in the hands of small businesses at a cost of only about \$680 million. Taxpayers got a big bang for the buck, but we ran out of funds two months ago. As a result, SBA lending has plummeted down 60 percent.

Yesterday, I was at a service-disabled-veteran and minority-owned small business in Jacksonville. Andy Harold got a Recovery Act loan to support a contract for electronics work on a simulator that trains our troops whose vehicles get flipped over on the battlefield. He hired 10 people because of that loan.

Now is not the time to pull back. We need to continue helping firm's like Andy's that create jobs and so much more. Overall, we will continue to be vigilant in reducing fraud, waste, and abuse in all of our programs. To do that, we are committed to transparency and a strong, ongoing partnership with GAO, our IG, and this Committee.

I welcome any questions and comments about our efforts in any of the areas I've mentioned today. Thank you.

[The statement of Ms. Mills is included in the appendix.]

Chairwoman VELÁZQUEZ. Thank you. It's now my pleasure to welcome back Mr. Gregory Kutz. He's the Managing Director of Forensic Audits and Special Investigations at GAO. FSAI Unit investigates waste, fraud, and abuse related to government programs and taxpayers' dollars. FSAI 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 AND SPECIAL INVESTIGATIONS, U.S.
GENERAL ACCOUNTABILITY OFFICE**

Mr. KUTZ. Madam Chairwoman and Members of the Committee, thank you for the opportunity to discuss the HUBZone program. Today's testimony highlights the results of our most recent investigation.

My testimony has two parts. First, I will discuss the results of our undercover testing, and second, I will discuss the actions SBA has taken against the 29 firms identified in our past investigations.

First, the HUBZone program remains vulnerable to fraud and abuse. Specifically, SBA's validation controls failed as three of our four bogus firms were certified. As you know, to qualify for this program, a firm's principal office must be located in a HUBZone. Our past investigations show that fraud and abuse related to the principal office were a significant problem.

The monitor shows a picture of the address of our first bogus company, Crocket and Associates. You may recognize the site of our

principal office. This is the Alamo in San Antonio. Madam Chairwoman, we thought that SBA would catch this one. In fact, at your hearing in June of 2008 on HUBZone, SBA represented that they were going to be using Internet searches to validate the principal office.

The next picture on the monitor shows what a Google search using the address from our bogus company shows. These links lead you to the next picture on the monitor which as you can see again is the Alamo. It took us seven months and the submission of numerous counterfeit documents to be certified for this bogus company. However, these pictures clearly show that a one or two minute Internet search would have at least raised suspicions about the validity of this application.

For our second application, we used the address of a rental storage unit in Florida as our principal office. The certification of this company took about 14 months.

For our third application, we used a city hall in Texas as our principal office. The certification of this firm took seven months.

We decided to abandon our fourth application, but only after SBA lost the documentation that we submitted several times.

To go to my second point, SBA has taken action on some of the 29 firms identified in our first two investigations. As the Administrator said, 16 were decertified, 8 voluntarily withdrew from the program, and 5 were determined to be in compliance with the program. For those five, we continue to believe at the time we looked at them that they were not in compliance.

Since our March 2009 report, 17 of these firms have received \$66 million of new government contracts. Of the 29 companies before yesterday, and there's been more suspensions, only 1 was currently suspended and proposed for debarment, which brings me to the importance again of the consequences for fraud and abuse. And I'm going to use Case Study 2 from our current report to make that point.

In my June 2008 testimony, we determined that this construction firm fraudulently received \$4 million of HUBZone contracts. Madam Chairwoman, this firm also fraudulently received \$48 million of 8(a) set-aside contracts. Because this firm was not suspended or debarred in 2008, they received \$10 million of new stimulus contracts. We understand that in March of this year, this firm was suspended and proposed for debarment.

In addition, the SBA IG has taken some of the 29 cases to U.S. Attorneys. We understand that in certain instances, U.S. Attorneys are declining these cases because they believe there is no loss to the government. We believe when a firm fraudulently receives one of these contracts that the entire amount of that contract is fraud and the victims are not only the taxpayers, but the legitimate HUBZone firms.

In conclusion, our work continues to show that SBA is not very good at fraud prevention and enforcement. We understand it's very difficult to be an advocate for small business and at the same time to be the enforcer. However, to be an effective advocate you need to have an effective fraud prevention system and make examples of the bad actors.

I believe that fraud and abuse in small business programs such as HUBZone, 8(a) and service-disabled-veteran contracting is widespread. I encourage this Committee to continue making oversight of program integrity a priority.

Madam Chairman, that ends my statement and I look forward to your questions.

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

Chairwoman VELÁZQUEZ. Thank you. Mr. Kutz, Crocket and Associates at the Alamo; what are you going to try next, Franklin and Sons at Independence Hall?

Could you please outline for the Committee what type of sophisticated method GAO employed to bypass all of the SBA's new security controls?

Mr. KUTZ. As we do in all of our testing, we use publicly-available hardware, software, and materials. In this particular case, we set up websites for these companies. We had computers, email, and we stole the address, as you see, effectively. We used addresses of companies or the Alamo in the one case to really test this. So I would say it was not a highly-sophisticated operation, basic software and computers, emails, and back-up phone numbers.

Chairwoman VELAZQUEZ. Administrator Mills, SBA has come before this Committee several times in the past years and said that there is either no problem or it's been fixed. Let me take a minute to read to you some of the SBA responses over the years.

On March 25, 2009, Acting Administrator Darrel Hairston testified that "SBA has undertaken aggressive procedures. They are undergoing right now business process reengineering where they are looking at all of the elements of the program and they're establishing the necessary corrections."

Administrator Mills, on July 29, 2009, you testified that "we have tightened it up. We require more documentation already, but we are also going to do a business process reengineering of it. We did the extra 600 visits."

Administrator Mills, on November 18, 2009, testified, "We actually have changed our certification process. We now ask for extensive documentation and are working through how to make sure we get the right documentation up front."

And finally, Administrator Mills, on April 20, 2010, "we're working to ensure that only legitimate, eligible firms are benefiting from the HUBZone program."

So as you can see, there is a web of double talk here. SBA comes before the Committee and says that they're doing one thing, but GAO is finding that you're doing another. So what are you going to do differently this time to make sure that we are not having the same conversation three months from now?

Ms. MILLS. Well, thank you, Madam Chair, for raising this issue because these are shared goals. We agree with the GAO and with this Committee that it's very difficult to have integrity in the program when firms that are ineligible are getting into it.

So we perceive this as a process of continuous improvement. This has been a program that, as you point out, has had many of these issues over time. As I described, we have developed a three-pronged approach. The four firms that the GAO just described real-

ly fall into the first category which is the issue is certification. Why can a firm which is not an eligible firm get into the program? And that is something that we have, as I described earlier, created a new set of criteria that had not existed before where we are asking our companies to submit extensive documentation. And we actually, I think, distributed to the Committee in our report to Congress, exactly what that documentation includes.

I can talk about some of it, if it's of interest. But we are taking that specific documentation now in a much more rigorous oversight process.

We have not yet seen the GAO report with the details of how this got through the process. But what—

Chairwoman VELÁZQUEZ. How do you think that Crocket— what is the name—and Associates at the Alamo.

Ms. MILLS. Exactly. We're going to find out. And we're going to find the facts.

Chairwoman VELÁZQUEZ. Last time you said you would be using Google Earth, right? You said do an Internet search and that you will use any kind of tools to validate HUBZone addresses.

Ms. MILLS. Right.

Chairwoman VELÁZQUEZ. Here, you have this one, not only for— so last time you said this is just so simple, do you know how many firms are participating in the HUBZone program right now? Nine thousand. How much will it take to Google the address of—30 seconds. So it will take at least 77.5 hours of man hours to determine whether or not those are bogus addresses.

Ms. MILLS. In fact, we are currently using tools such as Google Earth to find out the addresses and principal locations of the workers who are reported to be in the HUBZone.

One of the suggestions, I believe, that Mr. Kutz may suggest is that we use Google Maps to Google these addresses. And in fact, we've already discussed this recommendation given these preliminary findings.

Chairwoman VELÁZQUEZ. Okay. I'm going to switch to another topic and that is the oil spill.

Recently, Kenneth Feinberg testified before our Committee—and another time I understand that he and the SBA have now talked.

Now, I understand that that has changed. And my question concerns how SBA treats BP claim payments for those seeking disaster loans? To this point, it is important that the SBA recognize BP claims payment as income, not as compensation for losses. Are you taking steps to ensure that this will happen?

Ms. MILLS. Thank you for your interest and your help with the BP claims process coordinating with the SBA. In fact, as you and I talked, we did make contact right after that hearing with Ken Feinberg. He called in return to my phone call. We had several conversations and meetings and consultations because what the people in the Gulf need is a BP claims process that works.

We are currently in the Gulf in 27 locations. We have 178 people, but we believe and we are giving—we are doing two things. We're giving economic injury disaster loans and we are deferring existing disaster loans because sometimes that's all a small business needs is to defer it.

Chairwoman VELÁZQUEZ. I hear all that, but I would like for you to answer my question and that is if SBA is going to recognize BP claims payment as income, not as compensation for losses, and are you taking steps to ensure that this will happen?

Ms. MILLS. Well, that's actually a very good question and I'm going to get back to you on whether we are. Because at the moment, the primary focus is to have people get their first claim from BP. So in our actual claim places, we are helping people fill out BP paperwork, referring them to the proper BP claims place, because it's better for them to get their proper compensation.

Chairwoman VELÁZQUEZ. I would like to share with you that the chair of the Senate Committee agreed with me that BP claims payment should be considered income and not as compensation for losses.

Administrator Mills, in 2003, Diamond Ventures brought a lawsuit against the SBA alleging racial discrimination in the SBIC program. Earlier this year, a federal judge denied SBA's motion for a summary judgment and subsequently ordered mediation in this case.

I understand that the court-ordered mediation recently came to a close without a settlement. Why haven't you been able to resolve this issue?

Ms. MILLS. I will get back to you on that issue and we'll see why.

Chairwoman VELÁZQUEZ. Well, I just want to make clear that your own statistics, SBA's own statistics show that less than four percent of all SBIC investment dollars went to minority-owned firms and less than 1.5 percent went to women-owned business.

And at the time of Diamond's lawsuit, there were only a handful of minority investment firms in the program. So I hope that you're paying attention to that, because I don't think that it needs for someone to bring a lawsuit for you to realize that this disparity is taking place among SBIC companies.

Ms. MILLS. Thank you. We agree. I'll look at it, too.

Chairwoman VELÁZQUEZ. Mr. Kutz. In your opinion, are the enforcement mechanisms implemented by SBA to punish those that violate eligibility standards for the HUBZone sufficient?

Mr. KUTZ. I would say no. I think we're better off than we were two years ago, because as you've heard, 24 of the 29 firms we looked at are no longer in the program. We validated that they're no longer in the system. They're not in the system. They cannot get HUBZone contracts. And it sounds like there's been additional suspension. So—but are we where we need to be? No. I believe more quick, aggressive action. I think the example I used in my opening statement of the firm that committed 8(a) fraud also and they received \$10 million of stimulus contracts, it's still never too late. They still get suspended. It's never too late to make it right, protect the government, but it should have been done earlier.

So I think it's still, on a scale of 1 to 10, maybe a 3 is where we are at this point.

Chairwoman VELÁZQUEZ. Administrator Mills, what kind of message do you think this sends to individuals looking to game the system that only 1 out of 29 with exception of the 4 that you just mentioned that happened yesterday maybe because we were having this hearing today?

Ms. MILLS. Madam Chair, you're exactly right. If we don't punish the bad actors, people will not be deterred. So we have, as our third prong, made a concerted change in terms of going after bad actors.

So to that extent we actually have a whole series of tools that we're employing: suspension, debarment, collaboration with the Inspector General, civil fraud actions with the Department of Justice, and false claims actions with the Department of Justice.

In addition, now when you sign the HUBZone contract, it's under penalty of perjury and it has to be notarized. So all of these activities should give us more basis to do what you so rightly urge us to do which is to go after bad actors.

Chairwoman VELÁZQUEZ. Mr. Kutz, you have been working at the HUBZone program for a number of years now. Why is this program so vulnerable to fraud?

Mr. KUTZ. I think it's a combination of the inherent nature of maintaining the 35 percent, perhaps. In some areas like Washington, where you've got slivers of HUBZone locations and those places it's difficult to perhaps police and look over. So it's the inherent nature and in addition to that just some of the lack of fraud prevention controls and consequences in the past.

I mean most companies look at this and say, hey, if I cheat, I get to keep the contract. If I get caught, I might get decertified. Chances of going to jail are zero and I might not get suspended or debarred.

Now that's changing here, hopefully. And I appreciate the oversight here and the efforts SBA is making. So we need to move more aggressively to get where we need to be.

Chairwoman VELÁZQUEZ. Okay. Mr. Graves.

Mr. GRAVES. Thank you, Madam Chair. How important do you think it is, Mr. Kutz, as far as how important a role is the possibility of punishment play in a good anti-fraud program? And we've kind of danced around that, but a strong punishment program has to be—it has to be out there.

Mr. KUTZ. I think it's enormous. I mean if you look across the government, we look at programs across the government, those programs that there are no consequences and no one is ever held accountable through prosecution or in suspension debarment, those are the ones that are most vulnerable to something happening. So I believe it's critical.

Mr. GRAVES. What steps would you take to ensure that only qualified applicants, I mean beyond what some of the things we've already talked about?

Mr. KUTZ. I think that the Internet searches we're talking about as the Chairwoman said, if you did it for all several thousand, that's an achievable thing. They take several minutes. It may not catch everything, but certain obvious indicators would come out.

And I'm a proponent of at least unannounced site visits to these locations. I think that's a good practice. Our experience is when you show up unannounced, you get a very different view than when you tell them you're coming. So those are my two primary prevention techniques here.

Mr. GRAVES. And you may have already answered this, but given your background, how would you rate the SBA's aggressiveness in suspending federal debarment?

Mr. KUTZ. I think it was at zero before we started this and I think it's moved towards two and today it may be three—suspended firms and two more individuals, maybe three. But it's not quite where we need to be.

Mr. GRAVES. It's a long ways where we need to be.

Chairwoman VELÁZQUEZ. Mr. Critz?

Mr. CRITZ. I just have one question. Thank you, Madam Chair. You know, we talk about that it's been a while since we—or since your audit showed that there were problems and I'm just curious to hear from the Administrator, how aggressively you are addressing these issues.

Is this a training issue? Is it that the staff that exists don't have the training that they need to follow through on this? And I'm just curious to hear what the plan is going forward.

Ms. MILLS. Thank you. I think Mr. Critz spoke earlier and we have aggressively added staff to the HUBZone oversight function. And we have re-engineered it.

So he is correct, that we were starting at a place that was about zero, that there was not firm action against bad actors and there was no plan or program for how we went after oversight on this program and getting rid of fraud, waste, and abuse.

And in fact, there was not even a statement that we would not tolerate fraud, waste and abuse. Now we have a position and specific actions that have been implemented. On the front end, we did the certifications. In the middle end, we increased the site visits. There were seven in the six months before I came. There will be a thousand this year, the majority of which will be unannounced.

In the back end, we're working very hard, making progress on going after the bad actors. And once again, we're using a lot of tools in the tool kit, including going after them with the Department of Justice on multiple fronts.

Chairwoman VELÁZQUEZ. Mr. Critz, will you yield for a second?

How many of the 29 firms that were ineligible continue to receive federal contracts?

Ms. MILLS. This is one of the most troubling findings of the GAO. And we have not—

Chairwoman VELÁZQUEZ. Mr. Kutz, do you know?

Mr. KUTZ. Seventeen.

Chairwoman VELÁZQUEZ. Seventeen.

Ms. MILLS. Seventeen. Thank you.

Chairwoman VELÁZQUEZ. Do you know the total amount of money?

Mr. KUTZ. The total amount is \$200 million. The amount of new contracts is \$66 million since your last hearing in 2009 on HUBZone.

Chairwoman VELÁZQUEZ. Thank you. Thank you for yielding.

Mr. CRITZ. I appreciate your answer and I'm from a school of thought that there's benchmarks, there's goals, there's timing.

I would like to hear an answer from both of you as to is this something that you feel that the staffing level that you have or the plan for staffing, the training level that you have and the plan for training that this is something that will be resolved within six months that you'll be at some artificial number, 95 percent assurance that HUBZone, 8(a), and small business or the veteran classi-

fications will be running at a level that you feel comfortable that you're really catching all the bad actors?

Ms. MILLS. At this time, we are making significant progress in each of the pieces. But as I said, it's really in the continuous improvement. And we think that we've got now a good partnership with the GAO. We have a lot of ways that people have in the past been able to come into this program that have been ineligible. We've blocked up some of the holes. We've got some more work to do. And this involved a complete reengineering of our department and the addition of enormous resources. In the President's budget, there are additional resources for us which will be very valuable.

Mr. KUTZ. I would say there's progress, certainly. There's a long ways to go, but when you consider where we were two years ago when the first hearing was held, I think that what they've done and the oversight you've done here have made a difference.

With respect to people, it's interesting. It's two pieces to it. It's not only the number of people, it's the type of people and I think you know we've seen SBA has been in traditionally more of an advocacy organization than enforcement. That's a difficult transition. And I mentioned that in my opening statement.

I think the Ranking Member mentioned the same thing. That's an important aspect to make sure that they have the right people doing this.

Mr. CRITZ. I appreciate your answer and from my perspective, I'm looking at the numbers that \$680 million worth of investment yield \$30 billion worth of loans or activity economically. And certainly, these kind of backwards movements, it's hard to measure what the true impact is, but I appreciate your testimony and I yield back.

Chairwoman VELÁZQUEZ. Mr. Luetkemeyer.

Mr. LUETKEMEYER. Thank you, Madam Chair.

Ms. Mills and Mr. Kutz, as I've sat here over the last year and a half and watched this play out, are there any tools that you need? You mentioned tools a minute ago to be able to do your job.

Are there any additional tools or things that you need that we can help you with that you see right now?

Ms. MILLS. To be honest with you, this oversight is actually extremely helpful. And we see this as a partnership. It's difficult to make progress, but we have changed the view I think now in partnership, that this is a valid concern, that we do do oversight and that we don't tolerate fraud, waste, and abuse and that we have to have integrity in the programs.

We are trying to use our resources as effectively as possible. We do appreciate the help that many have given us in terms of going after bad actors.

Mr. LUETKEMEYER. Okay. Do you need anything else? Have you got what you need?

Ms. MILLS. Yes, I think we would very much like to have the budget—

Mr. LUETKEMEYER. I apologize for cutting you off. I've just got five minutes.

Mr. Kutz?

Mr. KUTZ. Two things. There may be some software or other law enforcement-type tools they don't have access to what we have, in

some cases other law enforcement that they could use. But I think the big one here is getting the Department of Justice and U.S. Attorneys interested in taking these cases. Because if you don't get U.S. Attorneys interested in taking the cases, you're going to get a declination as I mentioned in my opening statement.

So this Committee perhaps could work with the Department of Justice and SBA and the whole IG investigative community to try to make at least a couple examples a year of these firms and maybe each program, 8(a), service-disabled-veterans, HUBZone, etcetera. Because if the U.S. Attorney won't take the case, you're out of luck. If they say this isn't interesting, there's no loss to the government by these frauds, then they're not going to do anything. And you won't get any prosecutions.

Mr. LUETKEMEYER. That is always a problem with law. We can make all the laws here in the world, all the great laws, but if there's no enforcement of them we've just wasted our time and wasted a lot of trees. So think enforcement is a key provision here.

The next question of you, Mr. Kutz, are you working with SBA with recommendations regularly in your oversight to explain to them what you see, where weaknesses are, what your recommendations are, instead of playing a game of gotcha?

Mr. KUTZ. Right. After the undercover, under our protocols, we have to first of all brief the requestor, which is the Chairwoman. And then we brief the Agency on what we've done. And we've provided past recommendations.

I don't know if we've had any new recommendations. Just some of the things like using the Internet tools. I think the Administrator said they've staffed up to 20 people. I don't know how well-trained they are, but the training and type of backgrounds they have are important. And so we're always available.

And two years ago, or a year and a half ago, I sat down for an hour, an hour and a half with their consultant and kind of did a brain dump of everything we could think of that they could do. So we have and will always be available to help them.

Mr. LUETKEMEYER. Ms. Mills, with regards to that, can you give me a percentage of the stuff they've given you that you've implemented at this point?

Ms. MILLS. Well, in the past recommendations, particularly on 8(a) they gave us 12 distinct recommendations. They were really excellent. They were like a roadmap. And we've done all 12.

We're in the process of doing the last five, but we've accepted all 12 and we've implemented the majority.

Mr. LUETKEMEYER. Okay, Mr. Kutz, with regards to other programs that SBA has implemented, how much oversight—how much investigation have you done in those and are there problems in other areas?

Mr. KUTZ. 8(a) definitely. We issued a report to the Chairwoman on that and we found 14 firms with \$325 million of fraud and as she mentioned, there's been some recommendations and certainly progress. The one that's probably the most troubling, I think Representative Nye and I had a field hearing I attended on service-disabled veteran-owned small business and that's a joint effort with SBA and VA. That's very troubling. We continue to get dozens and

dozens of allegations of fraud in that program. I believe that there is significant fraud still.

Mr. LUETKEMEYER. One of the problems that I see is the fact that you—I've served in the private sector and I've also served in the public sector.

In the public sector, you're dealing with lifetime bureaucrats. And it's difficult with their mindset to sometimes change which is what you're trying to do, to change them to become a different type of organization, to look at things in a different light. This is the way they've done it for the lifetime. They've been there 20 to 30 years. You're not going to tell me anything different. I'm going to outlast you, because you're going to be gone with the next administration. All I've got to do is bide my time and we'll deal with the next Administrator. That's a problem.

And I think in fairness to you, Ms. Mills, I think that the inherent problem with bureaucracy and trying to change their attitudes is a difficult thing. And I admire—I certainly understand your task, although obviously we've got to do it. We've got to change it because obviously we've got some problems here that we've been looking at for a long, long time.

With that, I yield back, Madam Chair.

Chairwoman VELÁZQUEZ. Thank you. Ms. Bean.

Ms. BEAN. Thank you, Madam Chairwoman. And thank you to both of our witnesses for your testimony here today.

A couple questions for Administrator Mills. Welcome back. My first question is just in follow up to what's going on relative to contracts being awarded to some of those who shouldn't have been eligible in the first place, you talked about a new certification process. Are you in the process of creating a new decertification process to once and for all take that those bad actors out?

Ms. MILLS. Well, many of those have been decertified. I think our decertification process at this point works. The question is getting to it quickly. And then making sure that those who are decertified don't get back in the system and that they come out of the system. And that's the place. We're looking forward to working with GAO on exactly what happened in these cases and then fixing.

Ms. BEAN. My next question is relative to Recovery Act provisions. I think you painted a striking picture of how important it is to providing many small businesses that you speak to and that we speak to in our districts in terms of small business lending in the secondary market.

The recent decline in loan approvals is very disconcerting, having followed the success that you had had in increasing it so drastically in helping address the credit gap.

I guess my question is what do you think we need to be doing further? I have a lot of small business forums in my district with businesses and I hear from many who shared successes from the Recovery Act loans that they've received through the 7(a) or 504 programs. And then I'm also hearing from others who may not have even applied to SBA, but just have access to capital issues which is so critical.

Obviously, we've passed a number of initiatives through the House. We're waiting for the Senate to act and I would assume you'd want to see not only an extension of the Recovery Act provi-

sions that just expired in May and have led to this downfall in lending, but the small business lending fund, maybe the 504, to address the commercial real estate markets.

What other things would you like to see us act on or the Administration act on in support of access to capital improving to address that gap?

Ms. MILLS. First of all, I want to thank this Committee and the House for passing the extensions several times actually, for the Recovery Act. We believe that we've been very effective putting the \$30 billion in. We are very, very, very concerned about the drop off that occurred when the authority and the money ran out. We're down 60 percent. We're hearing from small businesses and all over the country that the freeze is back on.

We have over 600 in the Recovery Act queue, so as soon as that passes, we can fund them. And this bill is on the floor of the Senate at this moment and we are very, very hopeful. The Administration, the President is very clear in urging the Senate to pass this bill.

Ms. BEAN. We're glad to see them to closure which is always a big feat over there. And I know we're helpful that that happens because there is such leverage potential to take that \$30 billion and put essentially \$300 billion of lending out into the small business community.

My last question for you is regarding the recent recovery report card that showed that 32 percent of the Recovery Act federal contracts went to small businesses. And I commend your efforts and the Administration's on improving the level of contracts that are awarded to small businesses.

To what would you attribute that relatively high increase and what could we learn from it that we could apply to other federal contracting efforts?

Ms. MILLS. Well, first, in the Recovery Act there actually weren't goals, the Vice President announced that he was going to consider that all the small business goals did exist. And we beat them all. And we did that by a joint effort with the Department of Commerce where we conducted over 300 match-making events to make sure small businesses and minority-owned businesses and woman-owned businesses got access to Recovery Act contracts.

The lessons there were so strong that the President has asked us to form a task force, and we have, to implement, not just to study, but to implement the best practices from that Recovery Act success to make our numbers in our entire program. And we are in the process of doing that.

Ms. BEAN. Thank you very much, and I yield back.

Chairwoman VELAZQUEZ. Mr. Bright.

Mr. BRIGHT. Yes, ma'am. Thank you, Madam Chairman. Let me thank the witnesses first for being here today and giving us the testimony.

Administrator Mills, like every member of this Committee, I am a strong supporter of American small businesses and I believe Congress and the SBA should do everything in their power to support businesses across the nation.

Hearings like this provide us with an opportunity to evaluate how that process is working. Ask questions and share any concerns we may have.

And I am disappointed to have to say this, but I have serious concerns about the SBA's ability to carry out some of its most basic responsibilities.

Far too often I hear complaints from small businesses in my district that are having difficulty working with the SBA. When the situation calls for it, my office has made efforts to help these businesses navigate the red tape individuals encounter any time they deal with the Federal Government.

Most of the time we find ourselves sharing the frustration felt by my constituents. This is particularly troubling because the SBA, like every other agency, has a constitutional or a congressional affairs staff that helps answer Members' inquiries. If a Member can't get the attention of the SBA, I can only imagine how hard it is for an average business owner to get answers.

While this has been my experience on a number of complaints that have been shared with my office, let me remind you of a specific case that has concerned me, one that I brought to your attention the last time we spoke which was about a month ago.

Last year, the Defense Department awarded a contract to build MI-17 helicopter simulators to a business in Pennsylvania. In November 2009, a company in my district filed a protest that the company that won the bid didn't qualify under the SBA guidelines.

I wrote you a month later asking that the SBA conduct a fair and rigorous review of that protest. Unfortunately, that didn't happen. SBA ruled that this company met SBA requirements in February of this year. But when it was sent back by your own office of Appeals and Hearings in May, the Judge in that case found numerous errors in the determination. He wrote a scathing report and remanded the decision back to SBA to do it over again.

So nearly nine months later, we find ourselves right back at square one with no review of that evaluation. Now I know the Judge in this case can't make the determination himself, nor do I want him to try.

What I do expect, however, is that the SBA should be able to conduct a fair and rigorous review and get it done in a timely fashion. Instead, my letters on this issue have been returned with non-answers and my staff has been given the runaround when they ask for information.

What should have been done months ago remains in SBA limbo with no assurances from anyone from your office that this would be done and done soon.

Let me be clear. I can accept this when businesses in my district don't win a contract. It happens and that's okay. That's not the point of my discussion or my comments today. What I cannot accept is a series of errors and potentially allow a business to win a contract that they are ineligible to receive and I say potentially because the sad fact is we're still waiting on SBA to settle the matter over nine months later. That's entirely too long. The contract will be completed by the time the review has been completed by your office.

So Chairperson, Madam Chairman, I'm sorry to have to spend my time focusing on such a specific issue, but I remain concerned about the case that I believe is my responsibility to raise the issue

in whatever venue necessary so that we can get this matter righted.

So Madam Administrator Mills, I have one question for you and one question only. Can I get your commitment today, to direct your folks and your office to take this issue more seriously and try to come to a conclusion as quickly as possible so we can right a significant wrong out there?

Ms. MILLS. Yes, absolutely. You have my commitment. And we apologize for this distress that you described.

Mr. BRIGHT. Thank you. I yield back the remainder of my time.

Chairwoman VELÁZQUEZ. Mr. Schrader.

Mr. SCHRADER. Thank you, Madam Chair. I have a question for Administrator Mills.

You've obviously made huge strides in what you've done I think since coming to the office, previous administration, seven site visits, you're up over a thousand, and I think you deserve some congratulations for that.

These are tough questions, but we're trying to help you do a little bit better going forward. But I appreciate your leadership and taking the GAO's counsel to heart.

The question I guess I have is some basic stuff here. Mr. Kutz talked about the Internet search to come up with some pretty obvious—that the Alamo is not exactly the place where a new business starts up. And yet at the same time, your organization, some of your staff members, it was taking like 7 to 14 months to certify these folks. Why the 7 to 14 months versus a few minutes on the Internet?

Ms. MILLS. Well, thank you very much for your support. We do think we're making progress.

This is a very tough task and we are getting after it aggressively and getting some achievements because we have some great people working on it. Specifically, we created a quite rigorous front-end requirements on HUBZone which had not existed. Appendix Table 1 of our report describes it. I'd love to read it, but I won't.

That created a backlog, because when we switched to a much more rigorous up-front progress, it created a lengthy delay in getting all the applications through until we re-engineered the process and began to process more applications. We have gone over that bump and are pushing, making great process in reducing the time, but it was unacceptably long.

We also brought on new staff, trained new staff. Re-engineered the process. Greatly enhanced the amount of documentation that was required so we had to then take it seriously and go over it. We're now going to also add and continue to refine that set so that we find the thing that will help us be able to get out the bad actors.

Mr. SCHRADER. I just hope that there will be some prioritization of obvious things that you would do first, you know, for maximum value of minimal amount of effort or expenditure of human resources and capital.

I would take Mr. Critz' suggestions to heart. Develop some performance metrics. I mean that helps you, when you come before us show the fact that perhaps you have made substantial progress and

you do have a target date for 95 percent compliance as opposed to the other.

If we've got 29 firms with \$66 million in new federal contracts, it probably shouldn't have them or that's 29 out of how many contracts? I mean, unfortunately we're talking probably billions and billions of dollars here.

The other, I guess, concern I have is the one where the documents are actually lost. Mr. Kutz talked about four firms and one firm, they had to stop pursuing their investigation because the documents are lost. Isn't that sort of unacceptable?

Ms. MILLS. Yes. We are going to look into that when we get the full report.

Mr. SCHRADER. Would it be advisable to maybe reduce the overall funding for this program down to something where you guys can kind of match your resources on the enforcement side to the contracting resources on the other side to show yourselves to advantage?

Ms. MILLS. I'm not sure I understand the question.

Mr. SCHRADER. Well, I'm concerned that we've got a lot of money going out the door, but we don't have the personnel in place obviously to make sure that we're getting adequate bang for the buck if you will.

Ms. MILLS. We have a goal to meet of three percent of the contracts. The only cost is in the oversight and the interactions with the agencies to make sure there's access.

Mr. SCHRADER. I'm just suggesting that we want to balance our resources within the agency. It takes a while to change the culture of the agency and perhaps less money for the HUBZone program. We have the Supreme Court decision to deal with. We've got obvious fraud and abuse that's going on. So I'm just a little concerned.

Ms. MILLS. Just to clarify, there is no money, funding for the HUBZone program except for in the oversight and promotion of the program.

Mr. SCHRADER. Well, then I'm even more concerned a little bit. Thank you. I yield back.

Chairwoman VELÁZQUEZ. Ms. Dahlkemper.

Ms. DAHLKEMPER. Thank you, Madam Chair. Thank you to the witnesses.

Ms. Mills, I wanted to ask you about a different subject, a women-owned small business contracting program. I know you've been a champion for the implementation of this program and that the proposed rules for this program were put out earlier this year, but where do we stand now on putting out the final rule and finally implementing this program?

Ms. MILLS. As I have mentioned before here, this is one of the things that we feel very proud of. A rule that came about in the year 2000 had never been implemented for women's contracting. We were able to get this rule out for public comment. We received a thousand public comments that closed on May 3rd. We have dealt with each and every one of them. Some were extremely helpful and valuable to rewrite the rules, based on the input. And that rule is going through final clearance.

We expect to have this program operational by the end of the year.

Ms. DAHLKEMPER. That's great. That's obviously great news for many women in my district who have talked to me and I know some have talked to you about this very important program.

As we're looking at some of these other programs and the fraud that we've seen in these programs, what kind of mechanisms are being put in place to ensure that fraud that we've seen these other programs don't occur in this small business program?

Ms. MILLS. We're taking the same three-pronged approach. In the women's rule, it's likely to be both self-certification and external certification. So we need to make sure that we have a process to make sure that only the qualified people get in.

Then in the middle, we will have oversight which will be program exams, some unannounced. And in the final part, we will have the same kind of emphasis on enforcement that we're trying to bring at an accelerated level to all of the programs.

Ms. DAHLKEMPER. So this three-pronged approach you're bringing to every program that's coming out of SBA at this point?

Ms. MILLS. That's correct.

Ms. DAHLKEMPER. Mr. Kutz, can you comment on if you think this is all adequate as we bring out another new program?

Mr. KUTZ. I did look at the report that they put out yesterday. I just got it yesterday. And they did talk about something similar to what we call the fraud prevention model where you've got the prevention, the monitoring and the enforcement involved. And if they do some of the things they're talking about that's certainly a large step in the right direction.

Ms. DAHLKEMPER. Thank you very much. I yield back, Madam Chair.

Chairwoman VELÁZQUEZ. Mr. Nye.

Mr. NYE. Thank you, Madam Chair.

Mr. Kutz, you mentioned in an earlier answer to a question that you had taken part in a field hearing that I held in my district in Virginia earlier this year in May. That field hearing was a follow-up on a full Committee hearing that Chairwoman Velázquez held last November here where we discussed a GAO report on fraud in the service-disabled-veteran small business program.

You mentioned again in your answer earlier today that you felt that that was still a problem area and I agree with you on that.

I wanted to ask you just a couple of quick follow-up questions to establish kind of a baseline of where we started back in November and where we are today.

The report came out in November, at least in one of the particular cases, you told us about a firm that was ineligible, you had discovered, because it didn't perform any of the actual work and it subcontracted 100 percent of the job to a Denmark-based firm that had reported over \$12 billion in 2008 revenues, so clearly not a small business.

After the report came out, that firm's partner admitted the contract award was improper and they would withdraw as soon as another contractor was found. Can you tell us, if you know, if any action had been taken against that particular firm in that case?

Mr. KUTZ. As of today, they have not been suspended or debarred, although I know that the SBA IG, the VA IG, and the FBI are involved in a criminal investigation and that one is such

a clear case. If we don't get debarment and prosecution for that one, we may as well give up.

Mr. NYE. I appreciate that answer. What about the other nine cases that you mentioned in your—that you had found fraud in the report that you released last November? Have any of those companies involved in suspension or debarment to your knowledge?

Mr. KUTZ. None as of today. I do believe there are on-going criminal investigations on several. There is even a Grand Jury involved I believe on one. So there is some hope that we'll get one of these first prosecutions hopefully here, but again, there's nothing imminent that I'm aware of.

Mr. NYE. Can you tell us about those ten companies if any of them have received additional contracts subsequent to the report that you issued back in November of 2009?

Mr. KUTZ. Right, and my data is a little bit old, but they've got \$5 million of service-disabled sole source and set-aside. They've got \$10 million of other contracts and they've got millions of dollars of stimulus contracts. Just those.

Mr. NYE. Okay. So thank you for helping us establish what is to my mind a bleak picture of what's going on in the service-disabled-veteran business program.

You came to my district in May where you gave us an update on, and some of these figures, we talked to some local businesses, service-disabled business owners about their impressions of the program and what they thought about it.

We've talked a lot today about penalties and how important it is to have consequences when firms commit fraud in order to deter other firms from doing exactly the same thing and continuing to create the same kind of problems that we've already seen revealed.

I held a hearing of my Subcommittee here on July 15th where we visited with folks from the SBA, but also from a lot of the agencies that had specifically been involved in doing the contracting of those ten cases that we talked about in your report that had been found to be fraudulent.

And to be honest, I was very disappointed to hear the responses from the agencies in terms of what action they have taken since the nine months have passed since they knew about these particular cases of fraud.

Administrator Mills, I wanted to ask you, you had Associate Administrator Joe Jordan with us at that hearing and he mentioned that out of those cases that we discussed, only one of them has been referred to the Inspector General of the SBA for suspension or debarment. And it was decided at the end of the day not to pursue a debarment or any penalty whatsoever as far as we could tell.

What I wanted to ask you is can you comment on why none of those cases have gone on to the penalty phase where we have been able to see at least a suspension that we can show our other veteran firms that we're taking action on these things?

Ms. MILLS. Well, first, I want to thank you for your leadership in this area. This is a shared goal, because as you said, if we don't have the enforcement action, people won't believe there's a real consequence to misbehaving.

And, as I understand it, there are nine firms still being investigated by the IG. And we hope that there will be action taken as

you said. There seems to be—we're trying every tool in the tool kit. We're trying to bring new ones in and we're trying to find a way to do things more quickly for consequences.

And we appreciate your continued focus.

Mr. NYE. One quick follow-up and I note that my time is getting short, but Associate Administrator Jordan mentioned that the SBA and the VA have formed a task force on these particular types of fraud issues. Can you talk about exactly what it is that you foresee that task force doing and how far along they've gotten in their work?

Ms. MILLS. I'm happy to tell you about the overall task force. The President has asked myself and General Shinseki to form a task force on small business veteran activities.

We have loans, small business veteran loans. We have government contracting and we also have entrepreneurial development and counseling programs.

And the task force will deal with all of the—specifically in this area, we're working very hard with them on their computer systems to identify small business, small businesses that are owned by service-disabled veterans. Who is a service-disabled veterans is something they work in their computer systems. And on any other specifics, I'm happy to have Mr. Jordan come back to you.

Mr. NYE. I would appreciate and as I told the folks that were participating in my hearing, we intend to continually follow up on this issue.

It's been nine months since the first report came out. My feeling is that having talked to a lot of folks representing many different executive agencies, there's a big focus on process here, task forces and committees and other things.

But at the end of the day the folks that pay the bills, the taxpayers, want to see some results here, and I think we owe it to them to show them results. And results mean consequences on the businesses and so while I appreciate the fact that we're making progress in the sense of setting up procedures, we need to get to the consequence phase in some way that we can report openly and honestly to the taxpayers that we've pursued fraud and we've rooted it out.

There's a reason why I have written a bill that provides for criminal penalties for those who would defraud this program because I think it's important that they see a real result when they try to defraud our veterans and our taxpayers and we're counting on you and the other agencies to show us some results from your work as well. Thank you very much.

Chairwoman VELÁZQUEZ. Mr. Moore.

Mr. MOORE. Thank you, Madam Chair. Ms. Mills, I want to ask a question concerning the question of pass-through fraud which can occur in the federal contracting process.

As I understand it, a pass-through is an arrangement where a large corporation sets up a shell company known as a pass through to obtain federal contracts which are to be set aside for small businesses.

Each year since 2006, the SBA's Inspector General has listed pass throughs as the top challenge facing your agency. To combat this problem, some in Congress have suggested passing legislation

which would direct the SBA to more specifically define pass throughs and would permit the Agency to penalize pass throughs with defined prison terms.

Do you agree that some legislation is necessary to combat this type of fraud. If so, what would you like to see? If not, what other measures are currently being taken or should be taken in the future to combat pass through fraud?

Ms. MILLS. The issue of a big business masquerading as a small business with a shell corporation or something else is highly problematic for us. We agree with you, that we want to go after this. I believe, but I'll get you the details that the 8(a) regulation reform that went out for public comment and is going to be final does help address that issue and we're happy to get you those details and see if you have further suggestions.

Mr. MOORE. I would like to see those details because obviously if the law is not being complied with as a former prosecutor, I want to see that happen. Thank you very much and Madam Chair, I yield back my time.

Chairwoman VELÁZQUEZ. Thank you.

Mr. KUTZ. Can I mention one more thing about that, Madam Chairwoman?

Chairwoman VELÁZQUEZ. Sure.

Mr. KUTZ. The issue of having this—the numbers you get on these goaling requirements and stuff, those pass throughs help misstate those numbers. In other words, if you are given a number, Congressman Nye and I talked about, there was a pass through to a company in Denmark with \$12 billion of revenue. That was scored a service-disabled-veteran-owned small business contract in the reports that you get.

So the other impact of the pass through, is that you're getting misleading information on how much money is actually going to small businesses, that's an important point. I just want to make sure that you all understand.

Chairwoman VELÁZQUEZ. Mr. Graves.

Mr. GRAVES. Thanks, Madam Chair. Administrator Mills, the data concerning firms that are found to be ineligible for all the special contracting programs, is it being submitted to the new federal warranty performance and integrity information system?

Ms. MILLS. If I could get back to you on the answer to that, because I'm not familiar with the specific system that you just mentioned.

Mr. GRAVES. All right, if you could do that this week, it would be great.

Chairwoman VELÁZQUEZ. I do have some more questions.

Ms. Mill, GAO has recommended that SBA conduct unannounced site visits on HUBZone applicants such as the one at 30 Alamo Plaza, right?

What percentage of companies do you currently visit, unannounced and in person and how do you decide which firms to visit?

Ms. MILLS. This year, we're going to visit a thousand firms.

Chairwoman VELÁZQUEZ. You are?

Ms. MILLS. We have visited so far 711 and by Fiscal Year end one thousand. My understanding is that the majority of those are unannounced.

I don't know—

Chairwoman VELÁZQUEZ. Can you corroborate that information for the Committee?

Ms. MILLS. And we'll find out how we decide.

Chairwoman VELÁZQUEZ. Mr. Kutz, can you explain to the Committee and the SBA why unannounced visits are different from announced visits and what the value-added for such unannounced visits?

Mr. KUTZ. The element of surprise is always important.

Our unannounced visits have revealed things like mail stuck under the door and the neighbor saying no one has been there for six months. You would not get that with an announced visit.

We had one where we did an unannounced visit and I showed this at one of your hearings where the next time we showed up they had actually nailed in a shiny new mailbox, I don't know if you recall that, where the next time we came they made it appear as if they were there.

So that's one of the issues that SBA is waiting six or nine months to go after the companies we identified. By then, they may have doctored it up and made it look like it is a qualified firm. So yes, it's very, very important.

Chairwoman VELÁZQUEZ. SBA has previously indicated that they do not have the resources to perform site visits for all the applications that they receive.

In your opinion, what kind of resources will SBA need to perform this site visit?

Mr. KUTZ. I think that they've moved toward 20. That's the report I read yesterday said, from single digits when what first started this, so that's a large step. You can do a lot with 20 people. My unit only has 55 people and we do investigations across the government. I think with leveraging technology, the Internet searches, other vehicles they've got, whether that means they can do 10 percent or 50 percent site visits I don't know that, but again, the threat that there is a site visit of these firms, either entering the program or they're in the program is an important element of a control system.

Chairwoman VELÁZQUEZ. The ten percent that SBA is doing right now, do you think that is adequate?

Mr. KUTZ. It depends. If it's done on a risk basis and is done appropriately, it's better than what we had before. I would say, again, I believe, they're doing it mostly—my understanding is for people who have already gotten contracts. It's just as important to do it for people who haven't gotten them yet. Because as we've seen here, once someone has fraudulently gotten a contract, very little has been done in the past. So I think it should be done on both and ideally more than ten percent would be better.

Chairwoman VELÁZQUEZ. Mr. Kutz, in your last report, you mentioned that the three parts of a good fraud prevention program are prevention, monitoring, investigation with consequences.

How does this concept apply to the HUBZone program with respect to prevention, monitoring investigations and prosecution?

Mr. KUTZ. We've talked about several of the prevention methods with respect to the unannounced site visits. One of the other things I would mention is they're asking for lots of documents now. The

one thing we didn't see is validation of those documents. In other words, we sent in utility bills which is one of the things they get for support, for example, as to whether or not someone is in a HUBZone. You can doctor those up in about a minute or two. But maybe randomly calling the utility company and saying yeah, does this company actually live there or work there, the site visit.

So the front end is the site visits, the Internet research and other document reviews. The monitoring is what I think they call the recertifications and it's important. We're looking at moving from every three years to every year to do those. That would certainly be more effective.

And the investigations serve not only as a consequence for people, but actually it's a prevention also. When people know there's a chance of getting caught, there's a better chance they're not going to try. So I think we've touched on many of the things.

The key thing we hadn't talked about until your question here was the validation of documents. They should do some independent validation of documents in some instances.

Chairwoman VELÁZQUEZ. And have you made those recommendations?

Mr. KUTZ. I don't know if we've done the validation of documents. I have to go back and look at our recommendations. But the other ones I think are part of all of our recommendations.

Chairwoman VELÁZQUEZ. Mr. Altmire?

Mr. ALTMIRE. Thank you, Madam Chair. Mr. Kutz, GAO found in one case that a firm continued to benefit from another SBA program even though it had misrepresented its HUBZone eligibility and had been decertified. When GAO did further investigation on this company, it was discovered that the firm had also misrepresented its status in the 8(a) program as well.

So my question is how could this happen and when SBA finds that a firm is ineligible for one program, do they cross check with another? What's the process?

Mr. KUTZ. It doesn't appear that they did in this particular case until they got our 8(a) report and they found it was with the same firm we had found in the HUBZone program. So I have to ask the Administrator. I don't think in that case they did. That is a good practice. We have definitely suggested to that to them in our corrective action briefings, not just 8(a) but all their other programs. Because again, if people are inclined to commit fraud, they're not going to do it in just one area. We found that with tax cheats and a lot of other types of places. You don't just do it once. You typically are a repeat offender.

Administrator Mills, do you want to comment on that?

Ms. MILLS. In fact, I don't know if it was a specific recommendation that you have, but it's something that has been discussed and we're looking at the computer compatibility because it's quite obvious that you'd want to do this.

Mr. ALTMIRE. How about sort of the opposite scenario, hypothetically, when one firm that does business with the SBA qualifies legitimately in one program, but misrepresents itself in another program, what are the consequences to that? What's being done to prevent that? What happens in the program that they're legitimately qualifying for? So far, we haven't seen anything as a con-

sequence. I don't know if going forward they're looking at doing that.

Ms. MILLS. I think that's a good question and one of the issues is coming down to the facts which is in what way did they get disqualified? Is it a foot fault or is it a fraud?

Mr. ALTMIRE. Right. And for Administrator Mills, as you know, in the 2008 report, GAO recommended that SBA formalize a specific time frame for decertifying HUBZones. As indicated in the previous reports, SBA had an informal time frame for decertification of 60 days.

I was wondering, has a formal time frame been implemented yet and if so, what is that time frame?

Ms. MILLS. I'm happy to get back to you about that.

Mr. ALTMIRE. Okay, thank you. Do you know what's being done at SBA to ensure that those contractors that are in the process of being decertified are not receiving HUBZone contracts while that's taking place, while they're in the process of decertification, that they're not still qualifying for HUBZone contracts?

Ms. MILLS. Our process is that we turn them over for investigation. There is a fact finding and as we know, sometimes we have found that, in fact, they were put up for decertification, but they are eligible. And so we do presume that they're innocent until we find the facts and then we go after them.

Mr. ALTMIRE. My final question for Administrator Mills, GAO has found that five of the firms that had been decertified were still continuing to claim on their websites that they were HUBZone certified. What does the SBA do to prevent this type of misrepresentation?

Ms. MILLS. Well, we would not necessarily know what's on their website. But we do believe that in some areas, for instance, service-disabled veterans, we are now requiring them to take themselves off the Federal Register. If they don't take themselves off, we take them off.

Mr. ALTMIRE. Mr. Kutz?

Mr. KUTZ. We'd be happy to make sure—if they don't know who those ones are that still have HUBZones up, we will let you know that, so maybe you can send them a little email message.

Ms. MILLS. I'd be happy to do that.

Mr. ALTMIRE. So how does that work? Is there someone that searches to make sure that those people that have been decertified have not continued to claim or is it something that would have to be brought to your attention?

Mr. KUTZ. That's something we did as part of our investigation. We wanted to see once they were decertified if they still held themselves out as being HUBZone firms.

Mr. ALTMIRE. Is that something that will be done going forward?

Mr. KUTZ. We wouldn't do that. That would be something SBA could consider certainly.

Mr. ALTMIRE. Maybe give that some consideration. Thank you both for your testimony.

Chairwoman VELÁZQUEZ. Thank you. Mr. Kutz, this is my last question for you today. If you were put in charge of the HUBZone program tomorrow, what is the one thing that you would change in an effort to prevent fraud, waste, and abuse?

Mr. KUTZ. Well, normally I would talk about—and we do fraud across the government. I always talk about the front end. But in this particular case, I would probably look at the back end and really make an effort to get some poster children prosecuted, debarred, so that the message is out there to people that hey, if you do something wrong here, we're going to be serious about it. Don't even think about it. You might get caught. And if you get caught, something serious will happen.

So usually I would say the front end, but given where we are today, I would say the back end.

Chairwoman VELÁZQUEZ. Administrator Mills, after hearing and listening to all the questions and comments made, I want to ask you and I would like a yes or no answer, do you believe that the HUBZone program has sufficient internal controls to prevent fraud?

Ms. MILLS. This is—I know you want a yes or no answer, but of course, the answer is it's process. We're better than we were, but we're not good enough yet. We're making progress. We need to make more.

Chairwoman VELÁZQUEZ. So you're not there yet?

Ms. MILLS. Not there yet.

Chairwoman VELÁZQUEZ. Well, I hope that three months from now we will not come back and hear or find that four bogus companies are still on the certification list or getting contracts. This is serious business because in the process, not only taxpayers are losing, but those legitimate small businesses who today are suffering and they're playing by the rules. So it is up to you to have an oversight process in place, internal controls, to make it happen.

So with that, I want to thank all of you for being here today and I ask unanimous consent that Members will have five days to submit a statement and supporting materials for the record. Without objection, so ordered. This hearing is now adjourned.

[Whereupon, at 2:23 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 20515-4315

STATEMENT

Of the Honorable Nydia M. Velázquez, Chairwoman
United States House of Representatives, Committee on Small Business
Committee Hearing: *Oversight of the Small Business Administration and its Programs*
Wednesday, July 28, 2010

H.Res. 40, which was passed at the beginning of this Congress, amended Clause 2(n) of House Rule XI by requiring that committees undertake intensive and regular examination of executive branch activities. Such actions are necessary to not only safeguard taxpayer dollars, but to also improve the operations of federal agencies.

This Committee has taken this role very seriously. We have exceeded the quarterly requirement and held 10 hearings on the Small Business Administration and its programs. This has included 4 GAO investigations, all of which were requested by this Committee.

With 3,500 employees, 84 district and regional offices, and a broad range of programs, congressional oversight is essential to the operation of the SBA. This ensures that resources are directed more efficiently and effectively to small businesses.

We have examined every area of the agency, including its access to capital, entrepreneurial development, and contracting initiatives. The Committee has convened hearings on the agency's lending programs and how they are meeting the needs of small firms in today's economy. In addition, we worked with the GAO to oversee the disaster program so that businesses are better able to secure the funds they need to rebuild after a catastrophe.

A main focus of the Committee's oversight work has been the agency's procurement programs. With large businesses receiving small business contracts and fraud regularly being uncovered, it is critical that the Committee examine these programs. We will continue our investigations until the agency fully resolves these issues.

Finally, the Committee has held hearings about the agency's entrepreneurial development and innovation programs. This has included testimony from a wide range of experts that allowed us to consider how the agency's resources can be improved without unnecessarily increasing taxpayer expense.

Today's hearing continues the Committee's strong commitment to thorough oversight. Doing so provides a basis for not only taxpayer savings, but also the long-term modernization of the agency. This is critical because small businesses are counting on the SBA, its staff, and its programs more than at any other time in the past decade.

The agency has risen to the task before and I know – with all of the resources it has at its disposal – that it will again. By doing so, we will allow entrepreneurs to do what they do best – create the ideas and the jobs that our economy needs to move forward.



Contact: Alexandra Haynes
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Opening Statement for Hearing:
"Oversight of the Small Business Administration and its Programs"
Ranking Member Sam Graves (R-MO)
House Committee on Small Business
United States House of Representatives
Washington, D.C.
July 28, 2010

I would like to thank the Chairwoman for holding this important hearing today on Oversight of the Small Business Administration and its programs. I look forward to hearing from the Administrator and the GAO on some very important issues concerning the management of the Agency, particularly its inability to root out fraud and abuse in its government contracting programs.

Since I have been on this Committee, the challenges facing the agency are never resolved. Nor do they seem to change.

When I first joined the Committee, the SBA's contracting databases were riddled with inaccuracies. Today, those same contracting databases remain full of errors concerning the eligibility of firms for the Agency's government contracting programs. Even before I was elected to Congress, there were problems with the loan management accounting system. A decade later those problems still exist. Five years ago there was an obvious lack of coordination in responding to disasters. Today, there appears to be an absence of coordination between the SBA and BP concerning compensation to victims of the oil spill in the Gulf.

Quite frankly, the litany of problems facing the SBA does not involve rocket science. If it had, we would still be trying to launch the Gemini spacecraft and would not have landed men on the moon.

The SBA does not seem to take an aggressive approach to fixing the problems identified by Congress, the GAO, and the Inspector General. Instead, it spends scarce resources studying these problems. For example, the Agency issued a contract that examined, among other things, what value-added benefits the Agency will obtain from moving to a new loan management accounting system. The SBA does not need any more studies; it needs action. If it is incapable of taking necessary corrective action then it might be time to examine whether a complete overhaul of the SBA is needed to separate its regulatory functions from its mission to promote small businesses. Congress cannot tolerate and the taxpayer can ill afford the status quo at the SBA.

Again I thank the Chairwoman for holding this important hearing and look forward to recommendations from the witnesses of actions that the Agency will take to move it in the right direction.

I yield back.



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

TESTIMONY OF KAREN G. MILLS

ADMINISTRATOR

U.S. SMALL BUSINESS ADMINISTRATION

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES COMMITTEE ON SMALL BUSINESS

ACCOUNTABILITY UPDATE

JULY 28, 2010

Chairwoman Velazquez, Ranking Member Graves, members of the Committee: It's an honor to be with you again. Thank you for working closely with us to improve oversight and reduce risk, while removing fraud, waste, and abuse.

The SBA has a three-pronged risk-management framework for our contracting and business development programs: upfront certification, robust monitoring, and pursuing and removing ineligible firms.

HUBZone is a great example.

First, we reengineered the certification process, requiring more stringent documentation. We now require a statement under penalty of perjury that both applicants and renewing firms are eligible.

Second, we dramatically increased monitoring: from less than 100 site visits in 2008, to over 800 in 2009, to more than 1,000 slated for this year.

Third, we're removing ineligible firms. For example, we investigated the 29 firms GAO identified. After reviewing the facts, 16 were decertified, 8 voluntarily decertified, and 5, in fact, remained eligible for HUBZone.

We're also pursuing HUBZone fraud cases with the Department of Justice and the Inspector General, and we continue to suspend and debar firms suspected of fraud. In fact, just yesterday we suspended four more firms and two individuals.

An environment of integrity across all of our contracting programs is crucial.

The President included more funds¹ in SBA's proposed budget exactly for this purpose.

¹ \$2 million was requested in the President's FY2011 budget.

He also created an Interagency Task Force, led by OMB, SBA and Commerce. We'll soon provide formal recommendations, including some that will help equip our agency partners with tools they need to help in the shared mission of reducing fraud, waste and abuse.

At the same time, we're committed to working more closely with Congress to make sure small businesses can continue to grow and create the jobs we need now.

Two examples:

This Administration supports parity – or equal treatment – throughout small business contracting and business development programs: 8(a), HUBZone, service-disabled veteran, and women-owned.

But a recent court decision interpreted the law to give a preference to HUBZone. Without clarity on this issue, billions of dollars could be redirected away from programs like 8(a), which help thousands of minority-owned small businesses.

Already, we fear that the current confusion is causing a chilling effect in small business contracting.

We support bipartisan legislation co-sponsored by 12 members of this Committee to provide a fix for this problem at this crucial time.

Secondly, there's still a credit gap. Too many good small businesses still can't find access to capital.

The increased guarantee and reduced fees from the Recovery Act have put more than \$30 billion in the hands of small businesses at a cost of only about \$680 million.²

Taxpayers got a big bang for the buck, but we ran out of funds two months ago. As a result, SBA lending has plummeted 60 percent.

Yesterday, I was at a service-disabled-veteran and minority-owned small business in Jacksonville. Andy Harold got a Recovery loan to support a contract for electronics work on a simulator that trains our troops whose vehicles get flipped over on the battlefield. He hired 10 people because of that loan.

Now is not the time to pull back. We need to continue helping firm's like Andy's that create jobs and so much more.

Overall, we will continue to be vigilant in reducing fraud, waste, and abuse in all of our programs. To do that, we are committed to transparency and a strong, ongoing partnership with GAO, our IG, and this Committee.

I welcome any questions and comments about our efforts in any of the areas I've mentioned today.

² About 69,000 SBA Recovery loans have been given. Borrowers report they have created hundreds of thousands of jobs.

United States Government Accountability Office

GAO

Testimony
Before the Committee on Small Business,
House of Representatives

For Release on Delivery
Expected at 1:00 p.m. EDT
Wednesday, July 28, 2010

**SMALL BUSINESS
ADMINISTRATION**

**Undercover Tests Show
HUBZone Program Remains
Vulnerable to Fraud and
Abuse**

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



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. In fiscal year 2009, federal agencies obligated nearly \$3 billion in sole source or set-aside contracts to firms participating in the HUBZone program. Created in 1997, the program provides federal contracting assistance to small businesses located in HUBZones—economically distressed areas with low income levels or high unemployment rates. Qualified businesses in these areas are eligible to bid on federal prime contracts and subcontracts available exclusively to program participants, in addition to benefiting from other contracting preferences. The SBA must certify that a small business meets the following criteria to qualify for the program: the firm must be owned and controlled by one or more U.S. citizens; at least 35 percent of full-time employees must live in a HUBZone; and the principal office, where most qualifying employees work, must be in a HUBZone. According to the SBA's Dynamic Small Business Web site, as of July 2010, 9,300 firms were participating in the program.

Over the last 2 years, we have reported on fraud and abuse and other concerns with the HUBZone program.¹ In July 2008, we testified that the SBA's lack of an effective fraud prevention program meant its application process could not provide reasonable assurance that only eligible firms were being certified to participate in the program. Using fictitious employee and owner information and fabricated documentation, we easily obtained HUBZone certification for four bogus firms. We also identified 10 firms from the Washington, D.C., metro area that participated in the program even though they did not meet eligibility criteria. In March 2009, we reported on 19 additional HUBZone firms from Alabama, California, and Texas that were not eligible for the program.

¹ GAO, *Small Business Administration: Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results*, GAO-08-973T (Washington, D.C.: July 17, 2008). 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). GAO, *HUBZone Program: SBA's Control Weaknesses Exposed the Government to Fraud and Abuse*, GAO-08-964T (Washington, D.C.: July 17, 2008). GAO, *HUBZone Program: Fraud and Abuse Identified in Four Metropolitan Areas*, GAO-09-440 (Washington, D.C.: Mar. 25, 2009). GAO, *HUBZone Program: Fraud and Abuse Identified in Four Metropolitan Areas*, GAO-09-519T (Washington, D.C.: Mar. 25, 2009).

My statement today summarizes our most recent report, which we are releasing today, regarding the HUBZone program.² Our report and my statement responds to your request that we (1) perform additional proactive testing of the SBA's HUBZone certification process and (2) determine what actions, if any, the SBA has taken against the 29 case study firms we identified in our prior work. In conducting our work, we proactively tested SBA's application process by applying for HUBZone certification for four bogus businesses with fictitious owners and employees. For all four bogus businesses, we used publicly available resources to fabricate documents. To determine what actions, if any, the SBA has taken against the 29 case study firms, we made inquiries with SBA officials. We also analyzed data from the Federal Procurement Data System-Next Generation. We did not attempt to project the extent of fraud and abuse in the program nor systematically assess HUBZone program controls. Our work was done in accordance with quality standards for investigations as set forth by the Council of the Inspectors General on Integrity and Efficiency.

SBA's HUBZone Certification Process Remains Vulnerable to Fraud and Abuse

The SBA continues to struggle with reducing fraud risks in its HUBZone certification process, although SBA has taken steps to bolster SBA's controls. In our previous investigations, we found that many of the firms in the 29 cases fraudulently used "virtual offices" and fake business locations as their principal offices to qualify for HUBZone status. Our testing revealed that the SBA still does not adequately authenticate self-reported information—especially principal office locations—to ensure program eligibility. Specifically, the agency certified three of our four bogus firms based on fraudulent information. We used fabricated explanations, fraudulent documentation, and borrowed addresses or principal offices, including the Alamo, a public storage facility in Florida, and a city hall in Texas. The SBA lost application materials for our fourth firm on multiple occasions, forcing us to abandon our application. The SBA's failure to verify principal office locations—even through a simple Internet search—leaves the program vulnerable to firms misrepresenting their eligibility, preventing program benefits from going to intended targets.

² GAO, *Small Business Administration: Undercover Tests Show HUBZone Program Remains Vulnerable to Fraud and Abuse*, GAO-10-759 (Washington, D.C.: June 25, 2010).

As we stated in our March 2009 report, SBA began to take actions intended to strengthen the program's internal controls.³ However, we were still able to obtain certification for our bogus firms, and the certification process became considerably longer. The SBA took at least 7 months to process each of the three applications that it certified from our bogus companies. In our previous test, the SBA certified our firms in as little as 2 weeks, though this occurred with minimal requests for documentary evidence. SBA's increased processing times failed to prevent our bogus firms from becoming certified.

In response to our proactive testing, SBA officials stated that it was unreasonable to expect them to have identified our fictitious firms because of the bogus documentation that we included in our applications. For example, SBA officials stated that the submission of false affidavits would subject an applicant to prosecution. However, while the threat of prosecution is an important deterrent, it does not help to identify firms that attempt to commit fraud, as our testing shows. SBA officials also stated that competitors may identify fraudulent firms and likely protest if those firms were awarded a HUBZone contract. While competitors may identify some ineligible firms that were awarded contracts, SBA is responsible for ensuring that only eligible firms participate in the HUBZone program.

We indicated that if the SBA had conducted site visits at the addresses of the firms represented in our applications, those applications would have been identified as fraudulent. SBA officials stated that because of resource constraints, they primarily conduct site visits on certified firms that receive large prime HUBZone contracts. However, we believe that such reviews are too late in the process. We also suggested that the SBA conduct Internet searches on the addresses of applicant firms to help validate principal office locations. Such searches would have minimal impact on resources.

³ In the March 2009 report, we reported that SBA officials stated that they have begun 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.

**SBA Has Taken Some
Actions on the 29
HUBZone Firms
Previously
Investigated by GAO**

As of March 2010, the SBA has reviewed the status of all 29 firms we referred to it from our prior HUBZone investigations. Of the 29 firms, 16 were decertified by the SBA, 8 voluntarily withdrew from the HUBZone program, and 5 were found by the agency to be in compliance with program requirements and remain certified. We did not attempt to verify SBA's work. Although SBA indicated that firms sometimes come in and out of compliance while in the program, we maintain that the five firms SBA determined to meet HUBZone program requirements were out of compliance at the time of our initial review. In addition, we found that five decertified firms continued to market themselves, through their Web sites, as HUBZone certified even after the SBA removed them from the HUBZone program.

Since our March 2009 report, the 29 firms we identified have received more than \$66 million in federal obligations for new contracts. Not all of these obligations are necessarily improper, and some do not relate to HUBZone contracts. For example, one firm continued to benefit from another SBA program even though it misrepresented its eligibility for the HUBZone program and was decertified by the SBA. This firm, a construction firm that was a part of our recent investigation into fraud and abuse in the SBA's 8(a) Business Development Program,⁴ also had been 8(a) certified while in the HUBZone program.⁵ During that investigation, we found that the firm misrepresented its status as a qualified 8(a) firm because it was being controlled by individuals who did not qualify for the program. Because SBA did not promptly suspend or debar the firm, this firm received nearly \$600,000 in additional noncompetitive 8(a) contracts since our last report and nearly \$10 million in additional contracts from the federal government. According to SBA officials, the agency has recently proposed debarment for this firm and, as a result, the firm is generally ineligible for additional federal government contracts at this time.

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.

⁴ GAO, *8(a) Program: Fourteen Ineligible Firms Received \$325 Million in Sole-Source and Set-Aside Contracts*, GAO-10-425 (Washington, D.C.: March 2010).

⁵ This firm is represented as GAO case 2 in Table 1 GAO-10-759.

**Contact and Staff
Acknowledgments**

For further information regarding this testimony, please contact Greg Kutz at (202) 512-6722 or kutzg@gao.gov. In addition, contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals who made key contributions to this testimony are Andy O'Connell, Assistant Director; Matthew Valenta, Assistant Director; Lerone Reid, Analyst-In-Charge; Eric Eskew, Agent-In-Charge; Jason Kelly; Barbara Lewis; Jeff McDermott; and Timothy Walker.

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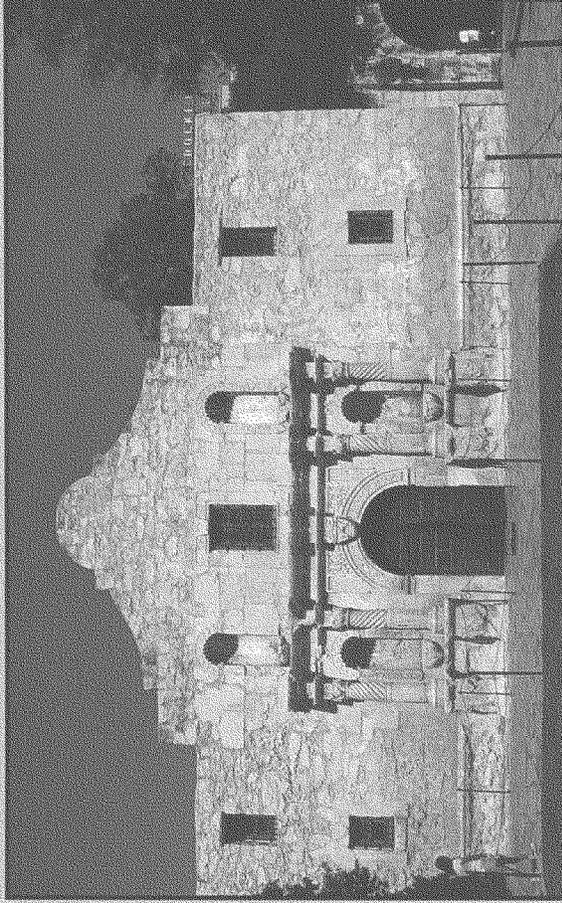


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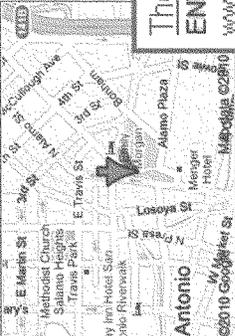
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**Statement of Yvette D. Clarke before the Small Business
Committee's Hearing on the "Oversight of the Small Business
Administration and its Programs"**

July 28, 2010

- First, I would like to thank Chairwoman Velasquez and Ranking Member Graves for holding this very important review of where the SBA stands with regards to waste, fraud, abuse or mismanagement in Government programming.
- Earlier this month I had the opportunity to sit in on a House Oversight Committee field hearing regarding Census fraud in Brooklyn. It was there that I came to appreciate how much money is wasted and how many people suffer as a result of fraud, abuse and mismanagement, especially during these tough economic times.
- Therefore, I am greatly pleased that the Chairwoman and Ranking Member have called this hearing so that we can adequately monitor, address and/or mitigate the occurrence of impropriety within these programs.
- As the Representative of a very diverse small business community, I am greatly concerned about the status of programs that address minority, veteran and women-owned businesses. The 8(a), HUBZone, service-disabled veteran, and women-owned business programs are crucial to strengthening communities like mine. If executed correctly, these programs can adequately address the urgent needs of small businesses in my district and across this nation. So when I hear of instances of fraud within these programs, I am deeply concerned.
- I have strongly advocated that Minority, veteran and women-owned businesses receive parity within the SBA, through small

business contracting and development programs. This can only be done if the integrity of the targeted programs remains secure.

- It is my hope that through this hearing my colleagues and I gain insight into ways in which we can mitigate the occurrence of fraud for existing and future programming. Small businesses in my district and across the nation heavily rely on it.
- Again, thank you Madame Speaker and I yield back the balance of my time.

United States Government Accountability Office

GAO

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

June 2010

SMALL BUSINESS ADMINISTRATION

Undercover Tests Show HUBZone Program Remains Vulnerable to Fraud and Abuse



GAO-10-759

G A O
Accountability Integrity Reliability

Highlights

Highlights of GAO-10-759, a report to the Chairwoman, Committee on Small Business, House of Representatives

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 and March 2009, GAO reported on substantial vulnerabilities to fraud and abuse in the HUBZone application and monitoring process. GAO also found 10 HUBZone firms in the Washington, D.C., area and 19 firms in four other metropolitan areas in Alabama, California, and Texas that made fraudulent or inaccurate representations to get into or remain in the HUBZone program.

Given the Committee's continued concern over fraud and abuse in the HUBZone program, GAO (1) performed additional proactive testing of SBA's HUBZone certification process, and (2) determined whether SBA has taken any actions against the 29 case study firms GAO identified in its prior work. Using publicly available resources to fabricate documents, GAO proactively tested SBA's application process by applying for HUBZone certification for four bogus businesses with fictitious owners and employees. GAO also interviewed SBA officials and reviewed SBA data about the 29 case study firms. GAO did not attempt to project the extent of fraud and abuse in the program nor systematically assess HUBZone program controls.

GAO makes no recommendations in this report.

View GAO-10-759 or key components. For more information, contact Gregory Kutz at (202) 512-6722 or kutzg@gao.gov.

June 2010

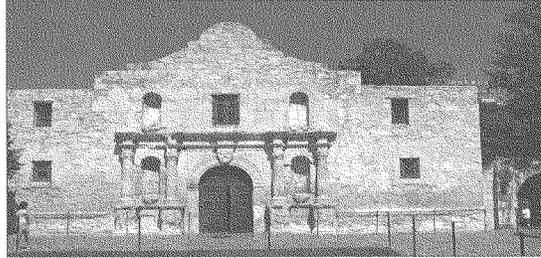
SMALL BUSINESS ADMINISTRATION

Undercover Tests Show HUBZone Program Remains Vulnerable to Fraud and Abuse

What GAO Found

The HUBZone program remains vulnerable to fraud and abuse. Using falsified documents and employee information, GAO obtained HUBZone certification for three bogus firms using the addresses of the Alamo in Texas, a public storage facility in Florida, and a city hall in Texas as principal office locations. A simple Internet search by SBA could have revealed these as phony applications. While the agency has required more documentation in its application process since GAO's July 2008 report, GAO's testing shows that SBA does not adequately authenticate self-reported information and, for these cases, did not perform site visits to validate the addresses. Further, the changes have significantly increased the time it takes SBA to process applications. Specifically, SBA took 7 or more months to process each of the bogus applications—at least 6 months longer than for GAO's previous investigations. SBA continually lost documentation for GAO's fourth application, and eventually withdrew it after GAO failed to resubmit the same materials for the fourth time. On its Web site, SBA reported that applicants are experiencing delays during the application process.

National Historic Landmark Address (The Alamo) Used by GAO as Principal Office Location for a Bogus HUBZone Firm



Source: GAO.

SBA has taken some action on most of the 29 firms that GAO previously reported did not meet HUBZone program requirements. The SBA decertified 16 firms from the HUBZone program, and another 8 firms voluntarily withdrew. While GAO maintains all 29 firms did not meet requirements at the time of its review, SBA stated that the other 5 firms were in compliance at the time of its own review and so remain certified. Since GAO's March 2009 report, 17 of the 29 companies have received more than \$66 million in federal obligations for new contracts. GAO recently reported that one firm has also defrauded the SBA 8(a) program. Because the SBA did not promptly debar the firm from federal contracts, it was able to fraudulently receive an additional \$600,000 in noncompetitive 8(a) federal contracts since GAO's last report. SBA recently proposed debarring this firm.

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Abbreviations

DOJ	Department of Justice
HUBZone	Historically Underutilized Business Zone
ISDC	Interagency Suspension and Debarment Committee
ORCA	Online Representations and Certifications Application
SBA	Small Business Administration
SDO	SBA's Suspension and Debarment Official

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United States Government Accountability Office
Washington, DC 20548

June 25, 2010

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

Dear Madam Chairwoman:

In fiscal year 2009, federal agencies obligated nearly \$3 billion in sole source or set-aside contracts to firms participating in the Historically Underutilized Business Zone (HUBZone) program, which we have shown to be vulnerable to fraud and abuse.¹ Administered by the Small Business Administration (SBA), this program is meant to spur economic growth in underdeveloped areas by helping qualified small businesses secure federal contracts. Qualified businesses located in HUBZones—economically distressed areas with low income levels or high unemployment rates—are eligible to bid on federal prime contracts and subcontracts available exclusively to program participants, in addition to benefiting from other contracting preferences. The SBA must certify that a small business meets the following criteria to qualify for the program: the firm must be owned and controlled by one or more U.S. citizens; at least 35 percent of full-time (or full-time equivalent) employees live in a HUBZone; and the principal office, where most qualifying employees work, must be in a HUBZone. According to the SBA's Dynamic Small Business Web site, as of March 2010, 9,300 firms were participating in the program.

In July 2008, we testified that the SBA's lack of an effective fraud prevention program meant its application process could not provide reasonable assurance that only eligible firms were being certified to

¹GAO, *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); 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); GAO, *HUBZone Program: SBA's Control Weaknesses Exposed the Government to Fraud and Abuse*, GAO-08-964T (Washington, D.C.: July 17, 2008); GAO, *HUBZone Program: Fraud and Abuse Identified in Four Metropolitan Areas*, GAO-09-440 (Washington, D.C.: Mar. 25, 2009); and GAO, *HUBZone Program: Fraud and Abuse Identified in Four Metropolitan Areas*, GAO-09-519T (Washington, D.C.: Mar. 25, 2009).

participate in the program. Using fictitious employee and owner information and fabricated documentation, we easily obtained HUBZone certification for four bogus firms. We also identified 10 firms from the Washington, D.C., metro area that participated in the program even though they did not meet eligibility criteria. In March 2009, we reported on 19 additional HUBZone firms from Alabama, California, and Texas that were not eligible for the program.

Because you expressed concerns about continued fraud and abuse in the program, we (1) performed additional proactive testing of the SBA's HUBZone certification process and (2) determined what actions, if any, the SBA has taken against the 29 case study firms we identified in our prior work.

To proactively test the SBA's HUBZone certification process, we created four new bogus firms and applied for HUBZone certification using false information and fabricated documents to meet the SBA's certification requirements. Our applications contained fictitious employee information and bogus principal office addresses. We used publicly available guidance provided by the SBA to create the applications. When necessary, we fabricated documents to support our applications using commercially available hardware, software, and materials. To determine what actions, if any, the SBA has taken against the 29 firms that we found misrepresented their HUBZone status, we made inquiries on our referrals with SBA officials from the HUBZone Program Office, and the SBA's Suspension and Debarment Official (SDO). To identify federal obligations received by the firms subsequent to our referral to SBA, we analyzed data from the Federal Procurement Data System-Next Generation. We also reviewed the SBA's Dynamic Small Business Web site to determine the current HUBZone status of the 29 firms. To identify firms that represented themselves as HUBZone certified, where they may possibly receive benefits from improperly being associated with the program, even after they were decertified by the SBA, we reviewed the Web sites of all 29 firms. We did not review SBA records to confirm actions on the 29 firms or the firms' actions to comply with HUBZone requirements.

Our work was not designed to systematically assess HUBZone program controls or to determine the legal sufficiency of any actions SBA took against the selected firms we referred for investigation. We conducted our investigation from October 2008 through June 2010 in accordance with quality standards for investigations as set forth by the Council of the Inspectors General on Integrity and Efficiency.

Background

The HUBZone program was established by the HUBZone Act of 1997 to stimulate economic development by providing federal contracting preferences to small businesses operating in economically distressed communities known as HUBZones. The SBA is responsible for administering the program and certifying applicant firms that meet HUBZone program requirements. To be certified, in general, firms must meet the following criteria: 1) the company must be small by SBA size standards;² 2) the company's principal office—where the greatest number of employees perform their work—must be located in a HUBZone; 3) the company must be at least 51 percent owned and controlled by U.S. citizens; and 4) at least 35 percent of the company's full-time (or full-time equivalent) employees must reside in a HUBZone.³ As of March 2010, approximately 9,300 firms were listed in the SBA's Dynamic Small Business database as participating in the HUBZone program.

A certified HUBZone firm is eligible for a variety of federal contracting benefits, such as sole source contracts and set-aside contracts.⁴ Contracting officers may award a sole source contract to a HUBZone firm if, among other things, the officer does not have a reasonable expectation that two or more qualified HUBZone firms will submit offers and the anticipated award price of the proposed contract, including options, will not exceed \$5.5 million for manufacturing contracts or \$3.5 million for all other contracts. Once a qualified firm receives a HUBZone contract, the firm is required to spend at least 50 percent of the personnel costs of the contract on its own employees.⁵ The company must also represent, as provided in the application, that it will "attempt to maintain" having 35

²The Small Business Act, as amended, defines a small business generally as one that is "independently owned and operated and that is not dominant in its field of operation."

³For service and construction firms, determination of principal office excludes employees who perform the majority of their work at job site locations to fulfill specific contract commitments.

⁴Sole source contracts involve a noncompetitive purchase or procurement process accomplished after soliciting and negotiating with only one source, thus limiting full and open competition. Set-aside contracts reserve an acquisition exclusively for participation by small business concerns.

⁵There are exceptions to the 50 percent requirement, depending on the type of contract; for example, qualified HUBZone firms may meet the 50% labor requirement by using employees of other qualified HUBZone firms. 13 C.F.R. § 126.700.

percent of its employees reside in a HUBZone during the performance of any HUBZone contract it receives.⁶

The SBA must ensure that both applicant and participant firms meet and maintain eligibility criteria at the time of application and, if they are granted certification, throughout their tenure in the program. During the application process, firms attest to the authenticity of the information that they submit to the SBA regarding their eligibility. Subsequent to certification, SBA regulations require firms to immediately notify the agency if any material changes occur that affect their eligibility, such as changes to the number of employees residing in a HUBZone or the location of the firm's principal office.⁷ Moreover, certified HUBZone firms competing for government contracts must verify in the government's Online Representations and Certifications Application (ORCA)⁸ that there have been "no material changes in ownership and control, principal office, or the percentage of employee's living in a HUBZone since it was certified by the SBA." Firms and individuals who misrepresent their eligibility during the application process or while participating in the program are subject to civil and criminal penalties; decertification from the HUBZone program; or debarment from all federal contracts.⁹

SBA's HUBZone Certification Process Remains Vulnerable to Fraud and Abuse

The SBA continues to struggle with reducing fraud risks in its HUBZone certification process despite reportedly taking steps to bolster its controls. The agency certified three of our four bogus firms based on fraudulent information, including fabricated explanations and supporting documentation. The SBA lost documentation for our fourth application on multiple occasions, forcing us to abandon our application. Our testing revealed that the SBA does not adequately authenticate self-reported

⁶15 U.S.C. § 632(p)(5)(A).

⁷13 C.F.R. §126.501.

⁸ORCA 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."

⁹If SBA determines at any time that a HUBZone Small Business Concern (SBC) is not qualified, SBA may de-certify the HUBZone SBC, remove the concern from the list, and/or seek imposition of penalties pursuant to §126.900. 13 C.F.R. §126.504.

information—especially as it pertains to information regarding whether a firm's principal office location meets program requirements. For example, for our successful firms, we used the addresses of the Alamo, a public storage facility in Florida, and a city hall in Texas as our principal office locations—locations that a simple Internet search could have revealed as ineligible for the program. While ensuring that a HUBZone applicant's principal office is legitimately located in a HUBZone is a complicated process, the SBA's failure to verify principal office locations leaves the program vulnerable to firms misrepresenting the locations of their principal offices and thus, benefits of the program not going to areas that are economically disadvantaged. Figure 1 below shows one of the acceptance letters we received.

with the owners we represented in our applications.¹⁰ However, the SBA also increased the amount of time it takes to certify firms and, by all indications, suspended the use of agency processing time guidelines as indicated by an e-mail that we received from an SBA official and information that the agency posted on its Web site.¹¹ The SBA took at least 7 months to process each of the three applications from our bogus companies that it certified. In our previous test, the SBA certified our firms in as little as 2 weeks, with minimal requests for documentary evidence. SBA's increased processing times failed to prevent our fraudulent firms from being certified.

As we indicated in our March 2009 report, the SBA initiated a process of reengineering the HUBZone program in response to our findings and recommendations. Though we did not assess the effectiveness of the actions that the SBA undertook to strengthen its internal controls, we were still able to exploit those weaknesses in order to obtain program certification for our bogus firms.

Specific details about each of our fraudulent applications are reported below.

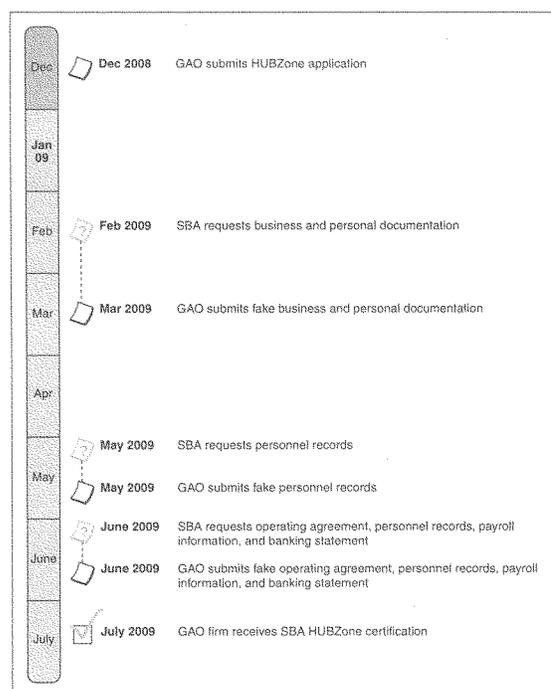
Fictitious Application 1: We received HUBZone certification about 7 months after submitting this application to the SBA. For the principal office location, we used the address of the Alamo, a National Historic Landmark in Texas. We claimed that both the firm's employees were HUBZone residents. Nearly 3 months after submission, we received an e-mail from the SBA requesting a copy of the HUBZone maps that we used to verify the residency of our employees, birth certificates, copies of tax returns for the last 3 years, corporate documents, and a copy of our firm's rental agreement and a recent utility bill. We fabricated these documents using publicly available materials and software and submitted them to the

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

¹¹According to the SBA, the increase in processing time is attributed to its efforts to implement a new, more rigorous certification process it started in late 2008 in response to our findings of fraud and abuse within the HUBZone program. The SBA also stated that this new process, which requires the review of supporting documentation to verify a firm's eligibility for the program, is significantly more labor intensive than the previous electronic-only process that we were able to successfully exploit before. The agency further noted that the HUBZone program is experiencing much heavier application volume than ever before.

SBA. The SBA then requested a copy of the firm's most recent official payroll records and sought clarification between the number of employees who worked at our firm's principal office and those who worked off site. We were also required to provide additional payroll records and corresponding banking statements with the line-by-line transactions that supported the payments that we claimed to make to our fictitious employees. After all of the requested information was provided, we were approved for HUBZone certification. Figure 2 provides a timeline highlighting the major interactions that occurred with the SBA during the processing of this application.

Figure 2: Timeline of HUBZone Application



Source: GAO analysis.

Fictitious Application 2: The SBA certified this bogus company 14 months after our investigators applied for HUBZone certification. The address we used for our principal office was the same as a rental storage

unit in Florida. We claimed the firm was a partnership that employed two individuals who both resided in a HUBZone. To substantiate our firm's principal address, the agency requested that we submit a lease, a recent utility and telephone bill, and a copy of our firm's business registration. To verify the firm's business activity and ownership, the SBA requested copies of our firm's federal business income tax returns for the last 3 years and birth certificates of the two owners, and a copy of our firm's partnership agreement. To verify employee information, the SBA requested copies of each of the HUBZone resident employees' driver's licenses or voter registration cards, a copy of our firm's quarterly unemployment tax filings, and certified copies of the firm's quarterly payroll. SBA also requested tax information and a copy of our firm's most recent payroll documents, which we fabricated and provided to the SBA. Several months thereafter, our bogus firm was granted HUBZone certification.

Fictitious Application 3: After 7 months of processing, SBA approved this bogus firm for HUBZone participation. The address of this firm's principal office was a city hall in Texas. We indicated that two of the firm's employees who worked for the bogus firm lived in a HUBZone. Several months after processing our application, the SBA requested documentary evidence of the firm's location, business activity, ownership, and employee information. After the SBA deemed the fabricated information that we submitted regarding payroll as insufficient to determine our employee information, the agency put our application on hold until we provided further documentation. We then provided SBA with a sworn statement to support information regarding payroll. SBA requested clarification about the frequency that our bogus employees worked from the principal office and granted HUBZone certification soon after.

Fictitious Application 4: After 4 months of processing, the SBA withdrew this application after we abandoned it. We abandoned this application because the SBA claimed that it did not receive supplementary documentation that we repeatedly provided. Two months after the initial submission of this application, we followed up with the SBA to inquire about its status. At the point of inquiry, SBA indicated that our application was being assigned to an analyst for processing. Two months after our inquiry, we received a request for supporting documentation that was similar to those we received in our previous applications. We provided the requested information 3 days after receiving the request. Two weeks later, we followed up to confirm receipt of our documents. The SBA indicated that it did not receive the information that we provided, so we resent the information and requested that the agency confirm receipt. Three weeks

later, after failing to receive confirmation on the receipt of our documentation, we inquired about the status of our application. Again, the agency told us that it did not receive the documentation and subsequently gave us one day to resubmit it. If not provided, the agency indicated, our application would be withdrawn. We decided to abandon the application and our application was withdrawn from the program.

**SBA Has Taken Some
Actions on the 29
HUBZone Firms
Previously
Investigated by GAO**

As of March 2010, the SBA has reviewed the status of all 29 firms we referred to it from our prior HUBZone investigations. Since our March 2009 report, these firms have received more than \$66 million in federal obligations for new contracts. Not all of these obligations are necessarily improper, and some do not relate to HUBZone contracts. Of the 29 firms, 16 were decertified by the SBA, 8 voluntarily withdrew from the HUBZone program, and 5 were found by the agency to be in compliance with program requirements and remain certified. We did not attempt to verify SBA's work. And although SBA indicated that firms sometimes come in and out of compliance while in the program, we maintain that the firms represented in the cases that the SBA reviewed and determined to meet HUBZone program requirements were out of compliance at the time of our review. In addition, we found that five decertified firms continued to market themselves, through their Web sites, as HUBZone certified even after the SBA removed them from the HUBZone program. Tables 1 and 2 below show the results of the SBA's review of the 29 firms we referred from our July 2008 testimony and March 2009 report.

Table 1: SBA Actions on 10 Firms GAO Reported as Ineligible for the HUBZone Program in July 2008

GAO case	Primary product or service	Violations found by GAO, December 2007	SBA compliance actions and additional procurement actions through March 2010	HUBZone status, March 2010
1	Information technology (IT), engineering, business management	<ul style="list-style-type: none"> Principal office not in HUBZone. Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed firm from HUBZone program in June 2009. SBA Suspension and Debarment Official is coordinating with Department of Justice (DOJ) and Interagency Suspension and Debarment Committee (ISDC) to determine whether debarment is appropriate action and, if so, whether SBA should be the lead agency. Since our March 2009 report, this firm has received \$9.4 million in federal obligations for new contracts. 	Decertified
2	Construction	<ul style="list-style-type: none"> Principal office not in HUBZone. Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed firm from HUBZone program in July 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. Since our March 2009 report, this firm has received \$9.6 million in federal obligations for new contracts. 	Decertified
3	Design and installation of fire alarm systems	<ul style="list-style-type: none"> Principal office not in HUBZone. Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed firm from HUBZone program on November 2008. SBA SDO determined that debarment was unwarranted based on the evidence of the case. Since our March 2009 report, this firm has received \$3.4 million in federal obligations for new contracts. 	Decertified
4	Engineering and construction management	<ul style="list-style-type: none"> Principal office not in HUBZone. Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed firm from HUBZone program on May 2009. SBA SDO is coordinating with DOJ and ISDC to determine whether debarment is appropriate action and, if so, whether SBA should be the lead agency. 	Decertified
5	IT consulting	<ul style="list-style-type: none"> Principal office not in HUBZone. Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and proposed removal of firm from HUBZone program. Firm voluntarily withdrew from the HUBZone program in May 2009. SBA SDO is coordinating with DOJ and ISDC to determine whether debarment is appropriate action and, if so, whether SBA should be the lead agency. Since our March 2009 report, this firm has received \$500,000 in new federal obligations. 	Voluntarily withdrew

GAO case	Primary product or service	Violations found by GAO, December 2007	SBA compliance actions and additional procurement actions through March 2010	HUBZone status, March 2010
6	Mechanical engineering	<ul style="list-style-type: none"> Principal office not in HUBZone. Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and proposed removal from HUBZone program. Firm voluntarily withdrew from the HUBZone program in March 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. Since our March 2009 report, this firm has received \$630,000 in federal obligations for new contracts. 	Voluntarily withdrew
7	Acquisition and project management	<ul style="list-style-type: none"> Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> Firm voluntarily withdrew from the HUBZone program in November 2008. SBA SDO determined that debarment was unwarranted based on the evidence of the case. Since our March 2009 report, this firm has received \$960,000 in federal obligations for new contracts. 	Voluntarily withdrew
8	Construction management	<ul style="list-style-type: none"> Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA concluded firm met HUBZone program requirements based on an SBA program examination.³ Since our March 2009 report, this firm has received \$3.3 million in federal obligations for new contracts. 	Certified
9	IT products and services	<ul style="list-style-type: none"> Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA concluded firm met HUBZone program requirements based on an SBA program examination.³ Since our March 2009 report, this firm has received \$657,000 in federal obligations for new contracts. 	Certified
10	IT and logistics management	<ul style="list-style-type: none"> Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA concluded firm met HUBZone program requirements based on an SBA program examination.⁴ Since our March 2009 report, this firm has received \$5.8 million in federal obligations for new contracts. 	Certified

Source: GAO analysis.

Note: Cases are presented in the same order as reported in GAO-08-964T.

³Although SBA indicated that some firms may come in and out of compliance while in the program, we maintain that this firm did not comply with HUBZone requirements at the time of our review.

Table 2: SBA Actions on 19 Firms GAO Reported as Ineligible for the HUBZone Program in March 2009

GAO case	Primary product or service	Violations found by GAO, March 2009	SBA compliance actions and additional procurement actions through March 2010	HUBZone status, March 2010
1	Environmental consulting	<ul style="list-style-type: none"> Less than 50% of personnel costs for own staff to perform HUBZone contracts. 	<ul style="list-style-type: none"> SBA did not take any action on firm because SBA concluded that firm met both the 35% residency and principal office requirement. SBA stated that contracting officers are required by the Federal Acquisition Regulations to insert such clauses regarding subcontracting limitations. We believe that SBA should evaluate whether HUBZone firms are meeting the performance-for-work requirements. 	Certified
2	Grounds maintenance and furniture	<ul style="list-style-type: none"> Principal office not in HUBZone. Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and proposed removal from HUBZone program. Firm voluntarily left HUBZone program in June 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. Since our March 2009 report, this firm has received \$71,000 in federal obligations for new contracts. 	Voluntarily withdrew
3	General contractor	<ul style="list-style-type: none"> Principal office not in HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and proposed removal from HUBZone program. Firm voluntarily left HUBZone program in June 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. 	Voluntarily withdrew
4	Information technology	<ul style="list-style-type: none"> Principal office not in HUBZone. Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and proposed removal from HUBZone program. Firm voluntarily left HUBZone program in July 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. Since our March 2009 report, this firm has received \$2.9 million in federal obligations for new contracts. 	Voluntarily withdrew
5	Information technology, general contracting	<ul style="list-style-type: none"> Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed the firm from HUBZone program in October 2009. SBA SDO determined that debarment was not warranted based on the evidence of the case. 	Decertified

GAO case	Primary product or service	Violations found by GAO, March 2009	SBA compliance actions and additional procurement actions through March 2010	HUBZone status, March 2010
6	Janitorial	<ul style="list-style-type: none"> Principal office not in HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed the firm from HUBZone program in June 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. 	Decertified
7	Medical laboratories	<ul style="list-style-type: none"> Principal office not in HUBZone. Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and proposed removal from HUBZone program. Firm voluntarily left HUBZone program in July 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. 	Voluntarily withdrew
8	Medical services and support	<ul style="list-style-type: none"> Principal office not in HUBZone. Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and proposed removal from HUBZone program. In July 2009, SBA SDO proposed debarment for the firm. At that time, the firm was placed on the federal Excluded Parties List System. In response to the proposed debarment, the firm provided evidence that it was presently responsible and that it was no longer necessary for the firm to be debarred. In October 2009, SBA SDO determined that debarment was unnecessary to protect the government's interests and the firm was removed from the Excluded Parties List System. SBA SDO did not believe evidence established sufficient grounds for debarment. The firm voluntarily withdrew from the HUBZone program in July 2009. 	Voluntarily withdrew
9	Military logistics and maintenance	<ul style="list-style-type: none"> Principal office not in HUBZone. Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed the firm from HUBZone program in July 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. 	Decertified
10	Facility support services	<ul style="list-style-type: none"> Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed the firm from HUBZone program in July 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. 	Decertified

GAO case	Primary product or service	Violations found by GAO, March 2009	SBA compliance actions and additional procurement actions through March 2010	HUBZone status, March 2010
11	Construction	<ul style="list-style-type: none"> Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed the firm from HUBZone program in July 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. 	Decertified
12	Construction	<ul style="list-style-type: none"> Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed the firm from HUBZone program in August 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. Since our March 2009 report, this firm has received \$8.9 million in federal obligations for new contracts. 	Decertified
13	Engineering	<ul style="list-style-type: none"> Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed the firm from HUBZone program in July 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. Since our March 2009 report, this firm has received \$4.7 million in federal obligations for new contracts. 	Decertified
14	Engineering and information technology	<ul style="list-style-type: none"> Principal office not in HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed the firm from HUBZone program in February 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. 	Decertified
15	Facilities support services/construction	<ul style="list-style-type: none"> Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed the firm from HUBZone program in August 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. Since our March 2009 report, this firm has received \$9.1 million in federal obligations for new contracts. 	Decertified

GAO case	Primary product or service	Violations found by GAO, March 2009	SBA compliance actions and additional procurement actions through March 2010	HUBZone status, March 2010
16	Food service contractors	<ul style="list-style-type: none"> Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed the firm from HUBZone program in November 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. Since our March 2009 report, this firm has received \$319,000 in federal obligations for new contracts. 	Decertified
17	Information technology	<ul style="list-style-type: none"> Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA concluded firm met HUBZone program requirements based on an SBA program examination.* Since our March 2009 report, this firm has received \$5.4 million in federal obligations for new contracts. 	Certified
18	Janitorial	<ul style="list-style-type: none"> Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed the firm from HUBZone program in August 2009. SBA SDO determined that debarment was unwarranted based on the evidence of the case. Since our March 2009 report, this firm has received \$76,000 in federal obligations for new contracts. 	Decertified
19	Temporary help services	<ul style="list-style-type: none"> Fewer than 35% of employees live in a HUBZone. 	<ul style="list-style-type: none"> SBA performed program examination and removed the firm from HUBZone program in August 2009. In May 2009, SBA SDO proposed debarment for the firm. At that time, the firm was placed on EPLS. In September 2009, SBA SDO determined that firm did not willfully misrepresent its status to obtain a HUBZone set-aside contract and because of administrative action taken by SBA, that debarment was unnecessary to protect the government's interests. The firm was removed from EPLS at that time. 	Decertified

Source: GAO analysis.

Note: Cases are presented in the same order as reported in GAO-09-440.

*Although SBA indicated that some firms sometimes come in and out of compliance while in the program, we maintain that this firm did not comply with HUBZone requirements at the time of our review.

We also found that one firm continued to benefit from another SBA program even though it misrepresented its eligibility for the HUBZone program and was decertified by the SBA. This firm, a construction firm

that was a part of our recent investigation into fraud and abuse in the SBA's 8(a) Business Development Program,¹² also had been 8(a) certified while in the HUBZone program.¹³ ¹⁴ During that investigation, we found that the firm misrepresented its status as a qualified 8(a) firm because it was being controlled by individuals who did not qualify for the program. Because the SBA did not promptly suspend or debar the firm, this firm was able to receive nearly \$600,000 in additional noncompetitive 8(a) contracts since our last report. According to SBA officials, SBA has recently proposed debarment for this firm.

Corrective Action Briefing

We briefed SBA officials on the results of our investigation on June 17, 2010. Regarding our proactive testing, SBA officials indicated that it was unreasonable to expect them to have identified our fictitious firms due to the bogus documentation that we included in our applications. For example, SBA officials stated that the submission of false affidavits would subject an applicant to prosecution. SBA officials also stated that competitors may identify fraudulent firms and likely protest if those firms were awarded a HUBZone contract. While competitors may identify some ineligible firms that were awarded contracts, it is SBA's responsibility to ensure that only eligible firms participate in the HUBZone program. We suggested that SBA conduct Internet searches on the addresses of applicant firms to help validate principal office locations. We also indicated that if SBA had conducted site visits at the addresses of the firms represented in our applications, those applications would have been identified as fraudulent. SBA officials stated that due to resource constraints, they primarily conduct site visits on certified firms that receive large prime HUBZone contracts.

Regarding our 29 referred firms, SBA officials stated that debarment has recently been proposed for an additional firm. We suggested that if SBA determines that a HUBZone firm is not eligible for the program, it should consider conducting a review of that firm's eligibility if that firm is also certified in other SBA programs. SBA agreed with our suggestion. In

¹² GAO, *8(a) Program: Fourteen Ineligible Firms Received \$325 Million in Sole-Source and Set-Aside Contracts*, GAO-10-425 (Washington, D.C.: March 2010).

¹³ The 8(a) program, also administered by the SBA, is one of the federal government's vehicles for developing small businesses that are owned by socially and economically disadvantaged individuals.

¹⁴ This firm is represented as GAO case number 2 in table two above.

addition, SBA provided technical comments which we incorporated into our report.

As arranged with your office, unless you publicly announce its contents earlier, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies of this report to the Administrator of the Small Business Administration, interested congressional committees and members, and other interested parties. In addition, this report will also be available at no charge on GAO's Web site at <http://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. Key contributors to this report were Andy O'Connell, Assistant Director; Matthew Valenta, Assistant Director; Lerone Reid, Analyst-In-Charge; Eric Eskew, Agent-In-Charge; Jason Kelly; Barbara Lewis; Jeff McDermott; and Timothy Walker.

Sincerely yours,



Gregory D. Kutz
Managing Director
Forensic Audits and Special Investigations

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