

LEARNING FROM HISTORY: IDEAS TO
STRENGTHEN AND MODERNIZE THE HUBZONE
PROGRAM

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None.	
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None.	

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THURSDAY, MARCH 2, 2017

HOUSE OF REPRESENTATIVES,
COMMITTEE ON SMALL BUSINESS,
SUBCOMMITTEE ON CONTRACTING AND WORKFORCE,
Washington, DC.

The Subcommittee met, pursuant to call, at 10:01 a.m., in Room 2360, Rayburn House Office Building, Hon. Steve Knight, [chairman of the Subcommittee] presiding.

Present: Representatives Knight, Chabot, González-Colón, Evans, and Murphy.

Chairman KNIGHT. Good morning. It has been an interesting morning already, but we are ready to go.

Welcome to the first hearing of the Subcommittee on Contracting and Workforce for the 115th Congress.

This hearing will come to order. Before we begin, I would like to take a moment to thank the returning members for their continued service and welcome our new members, particularly Ranking Member Stephanie Murphy. This Subcommittee has enjoyed a long history of bipartisanship, and I look forward to working with Ms. Murphy and all of our members as we begin this new Congress.

I would also like to sincerely thank everybody for being with us today, with a special thanks to each of our witnesses. I appreciate your willingness to take time out of your schedule and appear before this Subcommittee to share your expertise and insight.

As we approach the 20th anniversary this year, today we will examine the Small Business Administration's Historically Underutilized Business Zones, more commonly known as HUBZone Program.

When the HUBZone Program was first established, its goal was to create hope for hundreds of thousands of underemployed or unemployed who long ago thought our country had given up on them. I can think of no more important goal than bringing economic hope, independence, jobs, and businesses to neglected areas marked by high unemployment and poverty. To achieve this objective, the HUBZone Program must be run efficiently and effectively. That requires us to take a hard look backwards and learn from the past.

Over the past 20 years, the Government Accountability Office and the Small Business Administration's Office of Inspector General have conducted several audits and investigations identifying shortfalls in the program that have invited fraud and abuse. A

number of recommendations were made, and many were adopted by SBA. However, some have not.

The program was improved significantly throughout the years, but there is still room to improve. We are very fortunate to have a panel of experts with us this morning who have either studied or participated in the HUBZone Program. The testimony we hear today will provide us with a launching point from which we can further examine the intricacies of the program and determine whether adjustments are needed to ensure that the program performs as intended and benefits the small businesses and communities most in need.

Again, I want to thank each of our witnesses for taking the time to be with us today. I look forward to hearing your testimony, and now I yield to the Ranking Member Murphy for her opening statement.

Mrs. MURPHY. Thank you, Mr. Chairman. I look forward to working with you and the rest of our colleagues to craft bipartisan legislation that will help our small businesses succeed and our economy grow.

Each year the Federal Government procures more than 400 billion in goods and services from businesses around the country through the vehicle of government contracts. Recognizing the benefit that these contracts bring to our local communities in terms of economic development and job creation, Congress created a small business contracting program in 1997 aimed directly at helping underserved regions with low employment and high poverty.

The Historically Underutilized Business Zone Program, or HUBZone Program, provides Federal assistance to firms located in economically distressed areas by lowering barriers to entry into the Federal marketplace for these firms. Ideally this would not only provide an incentive for selling goods and services to the government, but it would also create jobs and bring revenue to these struggling areas.

However, since its implementation, the HUBZone Program has not quite filled its potential. From ensuring that only certified businesses enter the program and maintain their eligibility, to informing businesses of their HUBZone status in a timely manner, to even being able to present evidence that the program is meeting its mission, SBA has lagged behind in meeting these basic tasks.

In fact, at one point in time oversight of the certification process was so poor that the GAO investigators were able to certify fake businesses that they created where the principal office locations were in ineligible locations, including the Alamo landmark in Texas and a Starbucks down the street from the White House. Additionally the SBA Office of Inspector General found three firms that were certified under the reengineered certification process that did not meet all of the program eligibility criteria.

In addition, for many years the program's portfolio consisted of businesses that were eligible only because of a grandfathering clause. Once this expired and other areas lost their HUBZone designation, close to 6,000 businesses were decertified. While GAO's most recent report shows that there have been improvements in the certification process, these improvements are not far enough along to ensure that the businesses are adhering to the program's

requirements. The recertification process has for the most part become a self-certification with little outreach or follow-up from SBA.

I look forward to hearing from our witnesses today about ways in which the program can be improved to provide sufficient oversight for initial certification, recertification, and business development.

Additionally SBA's outreach efforts have been unsuccessful in getting new businesses to enter the program. Nearly 90 percent of the HUBZone areas still do not have a business participating in the program. This low participation rate has resulted in the failure to meet the 3 percent prime and 3 percent subcontracting goals.

The dollars and actions awarded through this program have continually decreased since fiscal year 2008 with only 71,000 actions worth \$6.4 billion, or 1.82 percent of prime contracting dollars awarded to these firms in fiscal year 2015. Even then the program was vastly underutilized since only 25 percent of these actions were awarded through a HUBZone set-aside or a sole source contract.

I know that last year the full committee held a hearing on HUBZones that shed light on the inadequacies of the program and made clear that reforms are necessary to get the program on track. Today's hearing will provide the background and ideas needed to guide the committee as we draft legislation to address these deficiencies.

I thank the witnesses for being here and look forward to gaining more insight as to how we can make the HUBZone Program more effective in meeting its mission. Thank you, and I yield back.

Chairman KNIGHT. Thank you very much. I would like to now introduce our witnesses, and I think what we will do is we will introduce all four, and then we will start and go down.

Our first witness today is Mr. William Shear, Director of the Financial Markets and Community Investment Team at the Government Accountability Office. That is an acronym. Mr. Shear is a familiar face, appearing before the Small Business Committee on a number of occasions, most recently at our September 7th full committee hearing last year. GAO has issued several reports on the HUBZone Program. We welcome Mr. Shear back today to discuss the themes GAO has identified in its body of work.

Our second witness today is Mr. Hannibal "Mike" Ware. Mr. Ware serves as an acting inspector general for the U.S. Small Business Administration Office of the Inspector General. The OIG is responsible for independent oversight of SBA's programs and operations. Mr. Ware has served as the SBA Director Deputy Inspector General since last April. Prior to joining SBA OIG, Mr. Ware served for 26 years for the Department of Interior OIG, most recently as the Deputy Assistant Inspector General For Management. Similar to GAO, the SBA OIG has also conducted several reviews of the HUBZone Program. We look forward to hearing Mr. Ware's testimony on that body of work.

Our third witness is Ms. Shirley Bailey. Ms. Bailey is testifying today in her capacity as board chair of the HUBZone Contractors National Council. The HUBZone Council is a nonprofit trade association providing information and support for HUBZone-certified and other small businesses, prime contractors, professionals, agencies, and organizations interested in the HUBZone Program. Ms.

Bailey has been deeply involved in the HUBZone Program for many years, both in her service as HUBZone Council board member, and in her personal experience as a small business owner. Ms. Bailey is the co-owner, Executive Vice President, and Chief Operating Officer of GCC Technologies, LLC, a successful HUBZone-certified small business located in Garrett County, Maryland. We are pleased to welcome Ms. Bailey before the committee today.

I would like to now yield to the ranking member to introduce our fourth witness.

Mrs. MURPHY. Thank you, Chairman Knight. It is my pleasure to introduce Dr. Mansoor Mollaghasemi. She is the founder of Atria Technologies, LLC, a small business located in my district in Orlando and one of 17 firms in Central Florida that are HUBZone certified. Atria Technologies provides professional services in engineering, program management, and technology and system integration to government agencies and prime contractors. She is also the founder and CEO of Productivity Apex, an engineering company that focuses on using technology to improve the productivity of public and private organizations. Additionally she is an Associate Professor in the College of Engineering at the University of Central Florida where she has been teaching and conducting research for more than 25 years.

And, Chairman Knight, if you will allow me just a moment of personal privilege, I should note that Orlando has just been recognized by the American City Business Journal as the twelfth best metro area in the country for small business vitality, and I know entrepreneurs like Dr. Mollaghasemi helped Orlando achieve that recognition.

Thank you for joining us today, and we look forward to hearing your testimony.

Chairman KNIGHT. Thank you, Ms. Murphy.

Okay. If committee members have an opening statement prepared, I ask that they be submitted for the record.

I would like to take a moment to explain how the lights work. You will each have 5 minutes. It will go yellow, and then it will go red. If it goes red, I will give you a little time, but just kind of be aware that it is going red, and we will get through this.

Five minutes is a pretty good time, and we will start off with Mr. Shear, and the floor is yours, sir.

STATEMENTS OF WILLIAM B. SHEAR, DIRECTOR, FINANCIAL MARKETS AND COMMUNITY INVESTMENT, UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE, WASHINGTON, D.C.; HANNIBAL "MIKE" WARE, ACTING INSPECTOR GENERAL, UNITED STATES SMALL BUSINESS ADMINISTRATION, WASHINGTON, D.C.; SHIRLEY BAILEY, CO-OWNER-EXECUTIVE VICE PRESIDENT AND CHIEF OPERATING OFFICER GCC TECHNOLOGIES, LLC, OAKLAND MD, TESTIFYING ON BEHALF OF THE HUBZONE CONTRACTORS NATIONAL COUNCIL; AND MANSOOREH MOLLAGHESAMI, PH.D., PRESIDENT & CEO, ATRIA TECHNOLOGIES LLC, ORLANDO, FL

STATEMENT OF WILLIAM B. SHEAR

Mr. SHEAR. Thank you.

Chairman Knight, Ranking Member Murphy, and members of the committee, I am pleased to be here today to discuss our work on the SBA's Historically Underutilized Business Zone Program.

Congress established the HUBZone Program to stimulate economic development in economically distressed communities. The program provides Federal contracting preferences to small businesses located in HUBZone-designated areas that also employ residents of the areas.

In this statement I will discuss the evolution of the HUBZone Program based on our body of work issued between June 2008 and September 2016. In addition, we met with SBA officials one week ago to discuss the status of open recommendations. Among other things, I will discuss areas of weaknesses that we have previously identified in performance audits and fraud investigations, related recommendations, and SBA's actions to address them.

While weaknesses remain, SBA has taken some steps to enhance program processes to varying extents. I will refer to the following examples. First, the certification process. In response to a recommendation in our June 2008 report based on the limited verification of the information firms reported, since 2009 SBA has required firms to provide supporting documentation for applications.

Second, susceptibility to fraud and abuse. In response to recommendations made in a series of investigations in 2008, 2009, and 2010, SBA officials told us the agency began conducting site visits to 10 percent of certified firms.

Third, recertification process. In 2015, we found that SBA had not required firms seeking recertification to submit any information to verify continued eligibility and instead simply relied on their attestations of continued eligibility. As of February 2017, SBA has not yet implemented our recommendation to reassess its recertification process and add additional controls. SBA officials told us that the agency continues to develop a technology solution to help address our recommendation.

Fourth, communications with firms about designations. In 2015, we found that SBA's communications to firms about programmatic changes, including redesignation, generally were not specific to affected firms, and thus some firms might not have been informed they would lose eligibility. SBA revised its letters to newly certified firms, and as of February 2017, SBA was implementing additional steps to ensure that all currently certified firms would be notified of changes that could affect their program eligibility. For this recommendation as well, SBA officials told us that the agency continued to develop a technology solution to help address our recommendation. We will continue to monitor SBA's implementation of this activity.

Finally, in our 2008 and 2015 reports, we presented statistics on economic conditions in HUBZone qualified and redesignated HUBZone Census tracts, and in nonmetropolitan areas. And in this statement we have updated statistics on economic conditions. We continue to find that economic distress has been more severe in designated HUBZone areas than in redesignated areas.

Chairman Knight and Ranking Member Murphy, this concludes my prepared statement. I would be happy to answer any questions.

Chairman KNIGHT. Thank you very much, Mr. Shear. We will go on to Mr. Ware.

STATEMENT OF HANNIBAL “MIKE” WARE

Mr. WARE. Chairman Knight, Ranking Member Murphy, and distinguished members of the subcommittee, thank you for the opportunity to be here today and for your continued support of the Office of Inspector General.

As Acting Inspector General, I am proud to represent the dedicated men and women of my office. As an independent office, OIG conducts and supervises reviews and investigations relating to SBA programs and supporting operations. Today I am happy to discuss the work we have done to combat fraud, waste, and abuse in SBA’s HUBZone Program.

Before I discuss our oversight of the HUBZone Program, I want to provide the subcommittee with a bit of context to illustrate how the risks within the HUBZone Program factor into our top management challenges. Our independent reviews, along with an ongoing dialogue with SBA program officials and external oversight entities such as GAO, guide the identification of these challenges facing SBA. Pertinent to today’s hearing, we have identified weaknesses in small business contracting programs and inaccurate procurement data as a top management challenge.

Our work in overseeing the HUBZone Program continues to substantiate this challenge. We issued two reports in recent years specific to the HUBZone Program, one in November 2013 and one in September of 2014. Those scopes and methodologies differed. In both reviews, our findings called into question the accuracy of Goaling reporting as it pertains to the governmentwide Federal contract and Goaling results. We also found SBA had certified firms that did not meet all of the eligibility criteria, and ineligible firms had received contract awards.

For the HUBZone Program, these findings indicate there may be distortions in the governmentwide Goaling results, and the intended economic benefits of the program are not realized when ineligible businesses receive HUBZone preferential contract awards. SBA has taken corrective action to close the five recommendations that were associated with those reports.

In terms of substantiating the management challenge of weaknesses in Small Business contracting programs, we also are aware of work published by GAO which we factor into our oversight planning purposes to ensure we are not duplicating efforts. We intend to initiate a new review in the HUBZone Program in 2018.

On a more granular level, our office continues to receive complaints on the hotline involving allegations of wrongdoing in the HUBZone Program. In fiscal year 2016, we received over a thousand complaints, with 18 being pertinent to the HUBZone Program. These allegations and other leads developed directly by our investigations division are thoroughly reviewed and processed for action by appropriate offices within and external to OIG, which can include criminal investigation.

Since fiscal year 2014, our office has opened 13 investigations involving the HUBZone Program, resulting in 13 indictments or in-

formations, 12 convictions or guilty pleas, about \$12 million in dollar accomplishments, and \$35 million of cost avoidances.

In the course of our mission, we also promote suspensions, debarments, and similar administrative enforcement actions. Last year, for example, we sent 75 suspension and debarment referrals to the SBA. Seven involved the HUBZone Program. The year before that we sent six that involved the HUBZone Program. And in 2014, we referred 50 matters with two involved in the HUBZone Program.

While the OIG is committed to rooting out the fraud, waste, and abuse, it cannot be overstressed that SBA's role in implementing proper controls and enforcing regulations on the front end is key to the viability of not only the HUBZone Program, but also of its Federal contracting programs. The regulatory oversight is especially important given SBA's attempting to tackle the competing interests of expanding the number of firms certified for HUBZone Program participation. Due diligence to ensure only eligible participants are certified and recertified is vital, as is the need for continued vigilance through on-site inspections.

We will continue to focus on this important Federal contracting program as well as the most critical risks facing the SBA.

Thank you for the opportunity to speak to you today. I look forward to your questions.

Chairman KNIGHT. Thank you, Mr. Ware. And we will go on to Ms. Bailey.

STATEMENT OF SHIRLEY BAILEY

Ms. BAILEY. Good morning, Chairman Knight, Ranking Member Murphy, and members of the subcommittee.

I want to thank you for the opportunity to testify on behalf of the HUBZone Contractors National Council.

My name is Shirley Bailey, President and Board Chair of the HUBZone Council, and co-owner of GCC technologies, LLC, a certified HUBZone company located in Garrett County, Maryland.

The Council strives to contribute to the economic development of disadvantaged communities by helping HUBZone certified firms maximize their success in earning Federal contracts. The underlying principal behind the HUBZone program, which was established 19 years ago, remains relevant today: to decrease unemployment and revitalize low-income and economically distressed communities by encouraging businesses to located in these HUBZone areas.

Congress in its creation of the program wrote: Creating new jobs in economically distressed areas has been the greatest challenge for many of our Nation's governors, mayors, and community leaders. The trend is for businesses to locate in areas where there are customers and a skilled workforce. Asking a business to locate in a distressed area often seems counter to its potential to be successful. But without businesses in these communities, we don't create jobs, and without sources of new jobs, we are unlikely to have a successful revitalization effort.

The question before this subcommittee is how this program can live up to its potential, and the numbers suggest that this program has room for growth. As of February 2017, there were only 6,026

certified firms, which represents a loss of over a third of the HUBZone firms since the 2010 Census. Yet these businesses have had substantial impact on their communities. An average HUBZone company is awarded over a million dollars in Federal contracts, a critical revenue threshold in business sustainability. Federal contracts awarded to HUBZone companies directly support more than 40,000 jobs every year, of which a minimum of 35 percent of these jobs are HUBZone employees.

Our written statement goes into a full history of the program, but I would like to use my time today to address the changes we believe would increase participation in the program and ultimately help the communities that would benefit. There are two themes that should guide changes to the program, business certainty and program modernization.

With respect to business certainty, we make the following recommendations. The first one is to increase or consider the increase in the redesignation period from 3 to 7 years. To determine program eligibility, SBA uses data from the decennial Census and the American Community Survey. While Census data is updated every 10 years, ACS data is updated every 5 years. For certain areas, this means minor changes in economic data can lead to a community's eligibility to change annually as they go through those evaluations.

When a track or county ceases to meet the qualifications for HUBZone status due to changes in income, unemployment, or poverty data, it becomes a redesignated area. As a redesignated area, it qualifies as a HUBZone designated area for an additional period of 3 years. To create business certainty, we recommend increasing the current 3-year redesignation period to 7, which will allow firms to make more substantial, long-term investments without the fear of losing their status before the business has had an opportunity to succeed or mitigate potential financial impacts resulting from the loss of their HUBZone status.

Two, consider supporting the capital investment of a company's principal office. Many firms make significant capital investments to locate their principal office in a HUBZone, such as signing long-term leases or buying and renovating buildings. In order to incentivize the company to stay in the distressed area even if the area loses its HUBZone designation, we recommend the principal office requirement remain fulfilled regardless of redesignation until the firm relocates or no longer meets other requirements of the program, such as the employee residency requirement or Small Business size standard. This will encourage long-term investment by providing business with certainty.

Three, simplify employee residency requirements for the smallest businesses. By changing the current residency requirement from a 35 percent threshold to 33, 1 in 3 employees would be required to reside in a HUBZone. In addition to simplifying the calculation for employers, this also helps small firms ensure that they meet the requirements after the unforeseen departure of one employee.

With respect to program modernization, we recommend the following: increased participation in the rural communities. Fewer than expected nonmetropolitan counties qualify for the HUBZone Program due to having more burdensome requirements for median

income and unemployment than metropolitan areas. While rural areas tend to have lower median income and higher unemployment, nonmetropolitan counties are not homogenous. Certain county areas may be better off due to the presence of a single employer, such as a hospital or college—this is the case that we have in Garrett County, Maryland—and cause the county to be ineligible. We recommend the nonmetropolitan county qualification levels be reexamined to account for the diversity in these areas.

In closing, let me be clear that the Council is advocating for strengthening and modernizing the program. However, it should not come at the expense of effective compliance efforts by the SBA. Fraud penalizes those companies that have gone through the proper procedures of certification and met the requirements. In order to achieve the desired rulings of an effective program, Congress should provide the funding necessary to allow for expeditious processing of applications and the required steps recommended by the GAO.

It is disingenuous to fault SBA for failing to administer the program without appropriating funds to adequately meet the directives. By working together, distressed communities can attract businesses which will create jobs and investment. To continue on the current path will result in underutilization of the program. Our goal should be to encourage businesses to locate and create jobs in these communities, and we stand ready to help.

And thank you again for your time and consideration.

Chairman KNIGHT. Thank you, Ms. Bailey. We are going to put a bookmark right here, Doctor. We have votes. Votes are called. We have about 7 and a half minutes left to vote, so I want to make sure that all the members have a chance to get down.

So we will take a recess right now, and we will reconvene with Dr. Mollaghasemi when we return.

[Recess.]

Chairman KNIGHT. We are back in, and I appreciate you all staying around.

We did have the chairman of the full committee who was here earlier, and I appreciate Chairman Chabot being here. He has been an exceptional chairman and we appreciate when he can come to our subcommittee hearing.

So when we left off, we had Ms. Bailey. I appreciate your testimony. And now we are going to go to Dr. Mollaghasemi for 5 minutes.

STATEMENT OF MANSOOREH MOLLAGHASEMI, PH.D.

Ms. MOLLAGHASEMI. Good morning. Chairman Knight, Ranking Member Murphy, and members of the subcommittee, thank you for the opportunity to testify at this hearing.

I am honored to share my experience as an entrepreneur and highlight the critical role of the program such as HUBZone in the growth of our economy. My name is Mansooreh Mollaghasemi, and I am the founder and President of Atria Technologies, an engineering company based in Orlando, Florida.

Please allow me to first provide some context on the role of small business in fostering innovation in the United States. All of today's household names like Google, Amazon, Apple, Facebook, and many

more were all small businesses, in the early years, with an incredible vision and an unmatched team, and they did not spring forward from within large organizations. But how can we infuse this innovation from small business into our Federal Government?

These SBA programs can provide a mechanism for entry, and without them, frankly these barriers are often insurmountable. To give you a firsthand account, please allow me to share my story. Right after I finished my Ph.D. in industrial engineering, I became an Assistant Professor in the Department of Industrial Engineering at the University of Central Florida. Don't get me wrong. I love teaching. I love doing research, managing my grants, and graduating graduate students and mentoring them. But there was always something missing. I wanted to solve real-world problems and apply my research to more impactful real world problems.

So years later I finally took the leap and started a business focused on using technology to improve the productivity and efficiency of private and public organizations. I remember how naive I was, thinking if I could offer a solution to a government organization, of course they are going to use me. So I started down that path, but the meetings went generally like this. I would go; I would listen to their problem; I would talk to them about our core competencies and offer a solution; We would brainstorm, and then the conversation would go something like this: We like what you do. We think it would be useful to our organization, but we have no mechanism to come to you. First time I heard that, mechanism, what is a mechanism?

So then I started researching. My research uncovered multiple things. I learned about the 8a program, more so than the HUBZone, but I knew that it existed. And I was already in a lease, that was not in a HUBZone, so I went down the path of 8a certification. Needless to say the process and its requirements were daunting, and I was advised to hire a firm to help me. So I paid, years ago, \$4,000 in consulting fees and a lot of hours of my own time, and luckily because of paying attention to details, I got certified. And another thing I should mention is that I had no visibility into the application process. I didn't even know whether it was moving from one step to another or whether I would be ultimately certified or not.

While I was able to in the meantime, while I was going through that, acquire and retain high-profile commercial clients and competitive government contracts, the 8a program really was the key that opened a lot of opportunities for me. I should mention that through one of those 8a contracts with NASA, I developed, with my team, the first ever supply chain model of earth to Mars, arguably the longest supply chain known to mankind. In another contract, we built a highly sophisticated optimization tool to help USDOT to move freight more efficiently than with internal R&D I was able to develop a commercial tool out of it.

Fast forward to 10 years later when I founded Atria Technologies. I was surprised to experience the same lack of visibility and long lead time in the application process, which was over 7 months. So there are certainly opportunities for improvement in the application and the certification process.

But let me also share with you the positives that I have observed about the HUBZone Program. Aside from providing the small business with much needed past performance and experience to compete for larger opportunities, I am not aware of any other program with such significant social impact. This program provides, as you know, distressed areas with sustainable and meaningful jobs, leading to economic development of these communities and reduction of unemployment, and as Ms. Bailey mentioned, reduced homelessness.

Personally, while I have always strived to provide mentorship to various groups, especially women, prior to owning a HUBZone company, it never dawned on me to go specifically seek out people that live in specific areas. This program forces you to do that and do something good and have a social impact in the process.

So in summary I would like to leave you with three thoughts: small business in America is an engine of innovation that is unmatched in any other economy in the world. Second, programs like HUBZone are the essential keys to bringing the benefit of this innovation to the government of the American people through Federal contract awards and spurring economic development in distressed areas. And, third, opportunities exist to streamline the application and oversight process for these programs to enable their more efficient and effective use.

It is truly an exciting time to be the leader of a small business. We are the envy the world and rightly so. The Federal programs we are discussing today are vital to enabling the bright light of small business innovation to shine on the services provided by our Federal agencies.

Thank you for your time today.

Chairman KNIGHT. Thank you very much.

We will now go into questions. I have a few of my own. We will take about 5 minutes each, and I am sure the ranking member has questions.

Quickly, Mr. Shear, we have got, according to GAO, the SBA has not implemented the procedure measures, the effectiveness of the HUBZone Program. What do you think are the most important metrics that SBA needs to start collecting and tracking? And before you answer that, I am going to take a couple of the comments that you made that it looks like the GAO has made recommendations. And one of the questions outside of this that I kind of jotted down was how do you lose eligibility, and if you do lose eligibility, what happens? Is it pulled from you, or is there some sort of enforcement mechanism? How do we go about that? I know there is three or four questions there.

Mr. SHEAR. I think the answer to your question on eligibility is what happens to businesses subject to decertification. There is a process where businesses can become decertified from the program, even though we have said—and sometimes this gets kind of confusing, and I know I have asked a lot of questions of it as we have done our work—recertification is almost like a self-certification. So we say, well, why would there be a backlog and things like that? Well, the question becomes if a firm becomes identified to be decertified, there is a process for that, but there is a decertification process, and there are firms that are decertified.

Some of the companies are being decertified that are asked to self-certify and provide documentation, and they don't do that, so some will withdraw on their own. But there is a process where there are businesses that lose their certification, and that might be a question for the HUBZone Council as well.

Going back to evaluation, I will just say generally SBA's track record of evaluating its programs, including pilot programs—HUBZone isn't one—but evaluating programs and using evaluations in their strategic planning and to inform how programs could be improved, is something that SBA comes up short on. So in terms of what we are looking for, and I know we had extensive interactions, SBA hired an economist after our 2008 report to work on an evaluation—

Chairman KNIGHT. And I will stop you right there because I have got Mr. Ware here shaking his head a little bit, and I want to kind of delve into this, because I think part of what we are going to be doing, in this subcommittee, is making sure that if a program is in place, we want it to be in place to help and to enhance opportunities.

But if there is a problem and the problem is not being looked at or not being solved, then that might be someplace that we want to take a harder look at and structure some sort of work that way.

Mr. SHEAR. And so let me finally kind of get to the issue on evaluation. Evaluations can start out as simple. It is looking in specific districts. I mean, sometimes it can just start with let's look at the HUBZone map. I have a rough HUBZone map here for your district.

Chairman KNIGHT. I have seen it.

Mr. SHEAR. And for Orlando. And you just see the way they are configured. And the question is, you look at the map and you just even start to ask questions about how does this program play out? It can involve the role of district offices.

But when we talked about evaluation here, we were talking about what is it about the HUBZone Program; how can you measure its impact on local economies? So part of it is collecting metrics other than how many firms are you certifying? It is not a matter of counting up jobs that those firms employ. It is a matter of trying to come up with some kind of benchmarks, and let's try to look at where you have HUBZone activity.

What do you see what is happening to those local economies in terms of what it is—it can be jobs. It can be looking at just improvements in economic conditions, but there are a number of metrics you could use, but the idea is whether you start at a case study level or you are using systematic, economic modeling. There are ways to assess programs like this, and this is what we were sharing with SBA at that time—

Chairman KNIGHT. Okay. And I am going to go to Mr. Ware here real quick. We talk about this at the State level, too, and I am sure that Florida and California and all of the other States have their own programs that try and enhance and try to give businesses opportunities inside a zone, whether it be an enterprise zone or a free-trade zone or something like that.

Mr. Ware, let me kind of get to the crux of this. Is there something more that the SBA should be doing? Because I am seeing

these numbers from 2006, from 2007, all the way up to 2015 and 2016, of numbers that are not alarming, but it doesn't seem like they are correcting.

Mr. WARE. Thank you. And I think that is a very good question and actually one being relatively new to SBA that I asked coming through the door as I started to review more of our work. And that question was, are we really measuring the right things to make sure that the programs are really having the type of economic impact in the communities that they are supposed to be having? And I am not sure, based on the body of work that I have seen, that that is how we are working towards answering—those are the answers that we are measuring and trying to come to. But—

Chairman KNIGHT. So, those are always going to be the questions though, and I know I am taking a little extra time here, but the metrics of how you measure a program are always the key to the program. If you can't measure if it is doing something, or if it is providing what you initially constructed, then we don't know, and that is a bad thing.

Mr. WARE. Yeah. But the agency has done quite a bit to strengthen the program and to do things, and the findings of both my office and Mr. Shear's is it generally wraps around those types of, the same type of things all the time as you saw by just going forward and reading the reports. It is basically with certification or recertification or with how we measure and report on the numbers and everything else. Although they have made a lot of strides, a lot more work still needs to be done.

Chairman KNIGHT. Very good. I am going to go to the ranking member for her questions.

Mrs. MURPHY. Thank you for all of your testimony.

My first question is for Dr. Mollaghasemi. You know, a major purpose of this hearing is for us to get a better understanding of how this program works for small businesses and within the community. Could you elaborate a little bit on what your experience with the HUBZone certification process looked like?

Ms. MOLLAGHASEMI. Sure. So the answer that I will give you, I will try not to do it too much, but when you have a data point, you tend to go to that, so I am going to compare it to the 8a certification because I have gone through both.

The application process was not bad, you know, the requirements. It wasn't as daunting as the 8a certification. I was really happy to find it online because when I was doing 8a certification, a folder like this had to be mailed, and you always worried will papers get misplaced and so forth. So I liked that part of it, the online format of it.

The problem came in when, again, you had no visibility into where it is? Am I moving in the process? And the help desk was extremely cordial every time I asked for status. While they were very quick to get back with me, this sort of form email came out that within 30 days you are going to be assigned a rep, and then within 90 to 160 days you should be certified. So, that is a very lengthy process. That is an eternity for a small business. So the visibility was not there, and it was a lengthy process.

And I have had more questions answered today than I have ever been able to ask because of all the valuable advice that is here.

And there is really no, I haven't found, other than my local SBDC office, that resource is extremely valuable, as you know, in the entrepreneurship sense. I have them on speed dial if I have a question. So that has been my experience.

But in terms of recruiting, as you know, right by UCF there is a HUBZone. I am extremely fortunate, although I am extremely small now, I am very fortunate to have one very high-tech woman engineer that occupies one of the full-time HUBZone positions. But I am able to augment the part-time 40 hour a month from the surrounding University with students, so I can mentor them and give them experience.

Mrs. MURPHY. Just as a follow-up to the recruitment piece, in your experiences, do small businesses incur additional costs when they are located in and employ workers who reside in economically distressed areas? Is it harder for you to find and recruit and train workers?

Ms. MOLLAGHASEMI. In my case no, but I suspect going forward, because I have a high-tech business, I am not going to be able to staff up full-time employees. As you know, these are high-paying jobs, and the likelihood of living in a HUBZone area is slim.

So because of the location that I am, I can hire part-time people, but remember that in a high-tech business if they are part-time students, for example, what does that do? That just increases your rates because they become overhead for the most part. So I don't foresee for a technical engineering, high-tech company that this would be fast growing without me finding other types of service contracts to be able to do, which I haven't done yet.

Mrs. MURPHY. Great. Thank you.

And then my second question for Mr. Shear, you talked extensively in your testimony about some of the status of how SBA has followed through or not on the implementation of the recommendations. Can you talk a little bit more about why you think it is that the SBA has been incomplete in their effort to evaluate the program? And also specifically you had mentioned a technology solution that was in process. Can you tell me a little bit more about that?

Mr. SHEAR. Yes. Let me start with the second first on technology. In response to recommendations we made, actually for both the 8a program and HUBZone a number of years ago, SBA embarked on a technology solution to help assist with those programs, and it was called OneTrack, and it ended in failure. It was never implemented.

And SBA generally, from our management review we did at the request of the full committee, we just observed a lot of turnover at the CIO level and an agency that is challenged in implementing technology.

So now let me bring that to the HUBZone Program. There is a recognition, and rightly so, that SBA is now developing a new technology for the HUBZone Program. So like when we spoke with them last August, it seemed to be a very vague idea, but they said, well, we will have it up and running in the spring. And we never thought that that was possible, and it wasn't. So speaking with them last week, they spoke with much more detail; they have

thought a lot more about this technology solution, and they are now more realistic about the timelines.

It should be something that businesses can use, hopefully by the end of the fiscal year, and that SBA could use for its own analysis of the program by the end of the calendar year. So we just hope that by the end of the calendar year they will have something that is actually usable.

So now let's talk about that technology. The idea is that you would have data that would be for each of the HUBZone firms where you could do queries on where are they located? Where are they generating economic activity? You can use it for data mining for looking at places where fraud might be most prevalent. So you can use it for a number of things. So they have said, well, they will use it for recertification. They will use it to notify firms because it is very difficult to do without that.

So they are proposing a technology solution, and I hope they can get it to work because then you can also have queries again for firms that end up in redesignated areas. Where are they? I was just showing, Dr.—and I am sorry, I can't pronounce your name, a map of Orlando, and you just see the way HUBZones are spread out. If you just have, if you can make informed decisions about where the activity is occurring and just try to say what is happening in the areas where the activity is occurring compared with other similarly situated places. When we spoke to the economist that was hired by SBA in 2009 to try to develop an evaluation, we shared these ideas without saying how he should do his evaluations.

But to go back to what Chairman Knight said, we actually had a mandate, a number of years ago, to evaluate the Empowerment Zone Program. And so we shared with the SBA economist how that was done, but it requires data on where activity occurs. So from a standpoint of conducting evaluations; making it easier for firms by notifying them; and by dealing with the recertification process by doing queries where you can try to identify, in a risk-based way, where might you have to go do a site visit, or where you might have to follow up and get more information from firms from the internal control standpoint—the technology solution could be useful.

And then again, where is the activity going on? What happens at this location? Are they decertified firms? Are they firms that are in redesignated areas? Are they isolated places, or are they adjacent to areas with depressed economies, just looking at the map can be useful. So it is promising if SBA can pull it off, but let me just flip to the other side.

Supposedly the district offices are the boots on the ground, and in our work, now in Puerto Rico we are including the district office in a very big way, but in the past we didn't go through what the district offices are doing. We went to business groups, and we went to chambers of commerce and local economic development entities to kind of see from their standpoint what is SBA doing to help encourage this program?

So when you don't have technology in place, it becomes more important to really have a presence in a community and have resources committed to that. And so from the lens that we have

looked at that, it doesn't seem like SBA really has a presence in those local jurisdictions.

So there is a number of ways to do some of these things that involve, people, like site visits are very expensive, that involve people in the absence of technology, but it is like neither side of that, there is not enough of that occurring on either the people or technology side.

Mrs. MURPHY. Thank you.

Chairman KNIGHT. Thank you very much.

I have to go in to get my driver's license renewed tomorrow and change the address, so I know, Doctor, what you are going through because I have looked online, and they said I come in, and it will take them 90 days to send me my driver's license. When I have to go in, to be there to take care of all this, I don't know why it would take 90 days, but that is the department of redundancy department that I am going to.

So, Ms. Bailey, I have one final question. Are you aware of any economically distressed communities that have experienced significant economic improvement due to the HUBZone Program, and does the SBA highlight these communities?

And the reason I ask this, and I will give you a little bit of a follow-up here, is because I think that some of these zones that we have talked about before that are trying to help, that are trying to give this effort in, and I agree, Mr. Shear, it has got to be easier to check and make sure that things are working, and if we are going to talk about fraud and abuse and things like that, I always say that the business has to be a partner in this, but the HUBZone has to be as easy as possible to make sure that the business can get through this.

So if we are going to ask the business to do something, then it should be a very easy process, and that is why I bring up the DMV. It should be a very easy process for me to go through a very simple step. And yet 3 months later is when the step is going to be completed. That doesn't seem very simple, even though you are asking me to come in and take care of this, and that is fine. That is not what government should be doing. Government should be the partner, and then if you are doing something wrong, we should be able to come back and say you are doing something wrong and we are going to ask you to correct it. And if you can't correct it, then we are going to ask you to leave. That is the way, in my opinion, it should work.

Ms. BAILEY. And that is true, and the question was is do we know of HUBZones that have actually shown some economic improvement as of this program? And, yes, we have ones that are going in and out, but the definition of what is that improvement? How much is that improvement?

The example of Garrett County, Maryland, we moved in to Garrett County, Maryland in 2007, and the way we ended up doing that, we were first in Allegany County. Went in, renovated a building. It got redesignated, so we had to look for another area that would have the HUBZone Program. So we looked around with Garrett County.

When we went to Garrett County, we had 14 people. We now have over 200 with over about 75 in Garrett County alone. When

we looked at that, when we first went in, there was probably only two or three of our companies in there that were HUBZones. Now we have over 11. Garrett County for the first time since the inception of this program is now redesignated. Do we consider it to be a significant improvement? Probably not, but we have gone over those thresholds that were considered to be the 80 percent, and we are now at 88, which isn't a whole lot, and then 125 versus the 140.

So we saw this improvement. But when we went into that area, we were about at 180, and probably income was probably about 60, 65 or something like that, so there has been significant improvement. But there are several organizations that did come into there, made a significant impact. These organizations are very community oriented. They focus, they have active community involvement programs, those types of things. They have connections with the commissioners, the economic development groups, the colleges. And we find that these areas that are very successful have those types of toolkits in their pocket, that they are a working unity that are all going through and trying to propel the HUBZone Program.

Garrett County puts out as the HUBZone Program as one of their major economic development tools. So looking at this, there are certain areas, we know that there are areas like in Page County, Virginia, those areas that are outside about the 200-mile radius of the D.C. they have to have a different type of mechanism to be able to pull all of these units together and be able to get these dollars into those areas. And that is what is key here.

The key is to get the dollars and the contracts being performed in these areas so you get the maximum multiplier effect. It doesn't do any good to issue a contract to a contractor who has an principal office in these areas and all the work being done in Washington, D.C.

So the more that we can concentrate on being able to do that, you are going to see a greater impact in these areas. And that is a perfect example. And I will go back, you know, using our company as an example. When we went out to Garrett County, one of our first contracts was to help the SBA in 2008 with doing the HUBZone Program. And we talked to SBA. Originally our contract was to be performed in D.C. And after months and months of conversation, we convinced them, let us do this in Garrett County. And we ultimately were able to do that, expand that contract, and be able to support them from Garrett County, Maryland.

We were subsequently able to do that with the VA verification support as well, which is still being done in Garrett County, Maryland. So it shows that this type of work can be done outside of the Washington, D.C. area, and you are going to get the biggest impact when you can do that. So the greatest thing that we can do is try to figure a way to get these contracts out to these areas. And the further out we go into the Midwest, into those areas that don't have these straight government installations right in their back door, those are the ones we can have the biggest impact on as well.

Chairman KNIGHT. Well, thank you very much. We always appreciate entrepreneurs and business owners that come in and have provided jobs and opportunities for people. That will always about

our mantra around here, that we do believe in opportunities and the ability to create. So, Ms. Murphy? Do you have any more?

Mrs. MURPHY. Just one final question. So in 2008 and 2009, we have discussed how the GAO investigators have identified 29 firms that were participating in the SBA HUBZone programs that were not in compliance with the program requirements. And then in 2013, SBA OIG found three firms that the SBA certified that were not in compliance with the eligibility criteria. And the example we talked about was the one firm who had the HUBZone in Washington, D.C., whose primary location was in a HUBZone in Washington, D.C., but its actual location was in an affluent suburb.

Mr. Ware, from your perspective, what adverse outcomes can occur when participating businesses are not in compliance, and what proactive strategies can SBA use to mitigate any negative impact.

Mr. WARE. Well on the first part—could you repeat that first question? The first question was—maybe I should have just taken the second one, but go ahead.

Mrs. MURPHY. Just from your perspective, what adverse outcomes can occur when participating businesses are not in compliance? And then what proactive strategies can the SBA use to mitigate the negative impact?

Mr. WARE. Thank you very much.

The adverse outcomes, when firms are in that should not be in, that means that a firm that could have gotten that contract did not. So definitely that is, in my opinion, the most major part, and then on top of it, all the Goaling numbers that we are so interested in for good reason, they are thrown off as well. So those are the two major reasons for it.

And in terms of proactive strategy, we have long been talking about the need to definitely leverage more of information technology resources, and piggybacking off of what Mr. Shear said, I mean, we are saying the same things.

In terms of some of their legacy systems, that system they have currently is about 17 years old. It is archaic. It is not working. Things are still stovepiped, so it causes a lot of delay and everything else. But makes the need for more boots on the ground in terms of doing a stronger review and incorporating the work of contracting officers as well because they also play a role in this in terms of raising red flags when they see it because they are the ones getting it first. And if they were kind of brought into the equation to help out in that regard, those are some of the things that could definitely strengthen it and be a proactive stance, a proactive approach instead of everything being so reactionary with us coming in after the fact with the finding.

Mrs. MURPHY. Thank you.

Chairman KNIGHT. I would like to thank all of our witnesses for coming in, and this is our first committee.

I can tell you we will have a fairly bold agenda talking about the issues that come in front of us. I think that, I am not speaking for the rest of the committee, but we do believe in opportunities. I am sure I am speaking for everyone when I say we do believe in opportunities, and we do believe that businesses should thrive. If there are opportunities that businesses can thrive and work in partner-

ship with government, then we want that partnership to be a lot clearer and a lot easier for both parties.

SBA's HUBZone Program was created to combat poverty, increase economic independence and provide stability. As we have learned today, the HUBZone Program has faced some challenges in the past. SBA has made some improvements. However, we need to continue working to ensure the program operates at the highest level to help both our small businesses and our communities most in need.

I encourage SBA to continue on this path forward collaborating with GAO and OIG to resolve any outstanding recommendations, and I believe we will be following up and seeing, because I would hate to have this panel back next year and be talking about the exact same things. That is not our goal. Our goal is always to be better and to correct deficiencies.

So I look forward to working with each and every one of you to make the HUBZone Program one that works for our small businesses and our communities.

I ask unanimous consent that members have 5 legislative days to submit statements and supporting materials for the record. Without objection, so ordered. This hearing is adjourned.

[Whereupon, at 11:53 a.m., the subcommittee was adjourned.]

A P P E N D I X



United States Government Accountability Office

Testimony

Before the Subcommittee on
Contracting and Workforce, Committee
on Small Business, House of
Representatives

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HUBZONE PROGRAM

Oversight Has Improved but Some Weaknesses Remain

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

GAO Highlights

Highlights of GAO-17-456T, a testimony before the Subcommittee on Contracting and Workforce, Committee on Small Business, House of Representatives

Why GAO Did This Study

The purpose of the HUBZone program is to stimulate economic development in economically distressed areas designated as HUBZones. SBA certifies small business firms located in HUBZones to participate in the HUBZone program—that is, determines they are eligible for federal contracting preferences under the program, such as awards of sole-source and set-aside contracts. HUBZone areas lose their designations when they no longer meet applicable criteria on economic conditions and enter a 3-year transitional period (“redesignation”) during which HUBZone firms can continue to apply to and participate in the program. HUBZone firms had almost \$6.6 billion in obligations on active federal contracts for calendar year 2015.

This testimony discusses, among other things, areas of weaknesses that GAO previously identified in reviews and fraud investigations of the program, related recommendations, and SBA’s actions to address them. This statement is based on GAO’s body of work issued between June 2008 and September 2016. GAO also met with SBA officials in February 2017 to discuss the status of open recommendations.

Since 2008, GAO has made 11 recommendations to improve the HUBZone program. SBA has implemented seven of these recommendations, not implemented two and is in the process of implementing the other two.

View GAO-17-456T. For more information, contact William B. Shear at (202) 512-8678 or shearw@gao.gov.

March 2, 2017

HUBZONE PROGRAM

Oversight Has Improved But Some Weaknesses Remain

What GAO Found

The Small Business Administration (SBA) designates economically distressed areas as Historically Underutilized Business Zones (HUBZones), based on data such as unemployment and poverty rates. Since 2008, GAO has issued several products that identified weaknesses in the HUBZone program and made recommendations to SBA to address them. While weaknesses remain, SBA has taken some steps to enhance program processes to varying extents. For example,

- **Certification process.** In 2008, GAO found that SBA performed limited verification of the information firms reported on applications. In response to GAO’s recommendation to develop and implement guidance for the certification process, SBA has taken steps to improve its processes to verify the eligibility of firms applying to the program. Since fiscal year 2009, SBA has required firms to provide supporting documentation for applications that the agency then reviews.
- **Susceptibility to fraud and abuse.** In 2008 and 2009, GAO’s investigations found 29 HUBZone firms in five metropolitan areas made fraudulent or inaccurate representations, which allowed them to get into or remain in the program. In response to GAO’s recommendations to address potential fraud, SBA increased its documentation requirements. But in 2010, GAO still was able to obtain HUBZone certification using bogus addresses. Subsequently, according to SBA officials, in fiscal year 2010 SBA began conducting site visits to 10 percent of certified firms.
- **Recertification process.** Firms wishing to remain in the program must recertify their continued eligibility to SBA every 3 years. However, in 2015, GAO found that SBA had not required firms seeking recertification to submit any information to verify continued eligibility and instead simply relied on their attestations of continued eligibility. GAO recommended that SBA reassess its recertification process and add additional controls. As of February 2017, SBA had not yet implemented this recommendation.
- **Communications with firms about designations.** GAO found in 2015 that SBA’s communications to firms about programmatic changes (including redesignation) generally were not specific to affected firms and thus some firms might not have been informed they would lose eligibility. GAO recommended that SBA establish a better notification mechanism. In response, SBA revised its letters to newly certified firms to inform them of the consequences of redesignation, and as of February 2017, SBA was implementing additional steps to ensure that all currently certified firms would be notified of changes that could affect their program eligibility.

Chairman Knight, Ranking Member Murphy, and Members of the Subcommittee:

I am pleased to be here today to discuss our work on the Small Business Administration's (SBA) Historically Underutilized Business Zone (HUBZone) program. As of October 2016, there were about 19,700 HUBZones and 4,804 certified firms participating in the program.¹ For calendar year 2015 (the most recent year that data were available), firms in the program had almost \$6.6 billion in obligations on active federal contracts directly awarded to bidders.

Congress established the HUBZone program to stimulate economic development in economically distressed communities. The program provides federal contracting preferences to small businesses located in HUBZone-designated areas that also employ residents of the areas.² The contracting preferences that a certified HUBZone firm (one that meets program eligibility requirements) can receive include limited-competition contracting awards such as sole-source and set-aside contracts. In some cases, a HUBZone-certified firm can receive an award through full and open competition.³ Federal agencies are responsible for trying to meet an annual statutory goal for awarding contracts to HUBZone firms (3 percent of the total dollar amount of all prime contracts and subcontracts subject to such goals). During fiscal year 2015, federal agencies collectively awarded 1.8 percent of eligible contracts to HUBZone-certified firms.

In this statement, I will discuss the evolution of the HUBZone program over the past decade, based on prior GAO performance audits and fraud investigations. Specifically, this testimony (1) discusses areas of weaknesses we have identified in prior reports, including fraud investigations, and SBA's actions to address them; and (2) examines 2012 and 2015 data on the economic characteristics of HUBZones.⁴ Generally, our prior work addressed SBA's efforts to better ensure that

¹According to SBA, as of February 2017 there were 19,467 HUBZone qualified census tracts, 768 qualified nonmetropolitan counties, 108 qualified base closure areas and 593 qualified Indian lands.

²HUBZone Act of 1997, Pub. L. No. 105-135, Title VI, 111 Stat. 2592, 2627-36 (1997), as amended.

³A certified firm also can receive a price evaluation preference of 10 percent in full and open competition if the apparent successful offering firm is not a small business.

⁴Census data from 2015 are the most currently available.

only eligible small businesses participate in the HUBZone program, including efforts to address fraud; how SBA communicates about HUBZone area designations to HUBZone firms; and the economic characteristics of HUBZones, including those slated to lose their designations. In preparing this statement, we relied on our body of work issued between June 2008 and September 2016.⁵ In addition, in February 2017 we met with SBA officials to discuss the status of open recommendations. As part of our fraud investigations, we created bogus firms with fictitious owners and employees and submitted applications for HUBZone certification to SBA. In addition, we selected HUBZone firms based on certain criteria, such as receipt of HUBZone contracts, and investigated them to determine whether they met key program eligibility requirements.

The work on which this statement is based was performed in accordance with generally accepted government auditing standards or quality standards for investigations as set forth by the President's Council on Integrity and Efficiency, as appropriate. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. More detailed information on the scope and methodology used can be found in each of the reports cited throughout this statement.

Background

The HUBZone Act of 1997 (which established the HUBZone program) identified HUBZones as (1) qualified census tracts, which are determined generally by area poverty rate or household income; (2) qualified nonmetropolitan counties, which are determined generally by area unemployment rate or median household income; and (3) lands meeting

⁵See GAO, *HUBZone Program: Opportunities Exist to Further Improve Program Oversight*, GAO-16-866T (Washington, D.C.: Sept. 7, 2016); *HUBZone Program: Actions Taken on February 2015 GAO Recommendations* GAO-16-423R (Washington, D.C.: Mar. 24, 2016); *Small Business Contracting: Opportunities Exist to Further Improve HUBZone Oversight*, GAO-15-234 (Washington, D.C.: Feb. 12, 2015); *Small Business Administration: Undercover Tests Show HUBZone Program Remains Vulnerable to Fraud and Abuse*, GAO-10-759 (Washington, D.C.: June 25, 2010); *HUBZone Program: Fraud and Abuse Identified in Four Metropolitan Areas*, GAO-09-440 (Washington, D.C.: Mar. 25, 2009); *HUBZone Program: SBA's Control Weaknesses Exposed the Government to Fraud and Abuse*, GAO-08-964T (Washington, D.C.: July 17, 2008); and *Small Business Administration: Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results*, GAO-08-643 (Washington, D.C.: June 17, 2008).

certain criteria within the boundaries of an Indian reservation.⁶ Congress subsequently expanded the criteria for HUBZones to add former military bases and counties in difficult development areas outside the continental United States.⁷ The number of HUBZones increased from about 8,000 in 2000 to more than 14,000 in 2006.

SBA generally updates HUBZone designations at least twice a year based on whether they meet statutory criteria (such as having certain income levels or poverty or unemployment rates). SBA generally uses data from other federal agencies to determine if areas still qualify for the HUBZone program. As a result of the updates, additional areas are designated for inclusion while other areas lose their designation. Census tracts and nonmetropolitan counties that lose their designation begin a 3-year "redesignation" period during which firms in those areas can continue to apply to and participate in the program and receive contracting preferences.⁸ For instance, about 3,400 HUBZones redesignated in 2012 lost their designations in 2015. Another approximately 2,500 census tracts and nonmetropolitan counties are scheduled to lose their designation by January 2020. After the 3 years, firms in these areas lose their certified status and the associated federal contracting award preferences.

⁶ HUBZone Act of 1997, Pub. L. No. 105-135, Title VI, 111 Stat. 2592, 2627-2636 (codified in several sections, as amended, in title 15, United States Code). By statute, qualified census tracts are generally those the Secretary of the Department of Housing and Urban Development designates for the Low-Income Housing Tax Credit program.

⁷ Difficult development areas have high construction, land, and utility costs relative to area median income, and are designated annually. Consolidated Appropriations Act, 2005 Pub. L. No. 108-447, Div. K, § 152, 118 Stat. 3456-58 (2004), and Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users, Pub. L. No. 109-59, § 10203, 119 Stat. 1933-34 (2005). In addition, Section 866 of the National Defense Authorization Act for Fiscal Year 2016 authorized Native Hawaiian Organizations to own HUBZone "small business concerns"; expanded the definition of "base closure area"; and authorized the inclusion of "qualified disaster areas" under the program. In August 2016, SBA issued a final rule to implement these changes.

⁸ A 2004 statute revised the definition of redesignated areas to permit them to remain qualified until the release date of 2010 Census data. When the data were released in October 2011, a large number of redesignated HUBZones lost their program status.

To be certified to participate in the HUBZone program, a firm must meet the following criteria:⁹

- when combined with its affiliates, be small by SBA size standards;¹⁰
- be at least 51 percent owned and controlled by U.S. citizens;¹¹
- have its principal office—the location where the greatest number of employees perform their work—in a HUBZone;¹² and
- have at least 35 percent of its employees reside in a HUBZone.¹³

SBA recertifies firms (that is, determines that firms continue to meet HUBZone eligibility requirements to participate in the program) every 3 years.

⁹Different rules apply for Indian Tribal governments, Alaska Native Corporations, Community Development Corporations, and small agricultural cooperatives. See 13 CFR Part 126.

¹⁰The firm, with its affiliates, must meet the size standard corresponding to its primary industry classification as defined in 13 CFR Part 121. SBA's size standards vary by industry and are almost always stated as the average number of employees or average annual receipts of a business.

¹¹Qualified HUBZone firms also can be owned and controlled by Alaska Native Corporations, Indian Tribal governments, community development corporations, and agricultural cooperatives.

¹²While a certified HUBZone business must have its principal office in a HUBZone area, HUBZone contracts are not limited to performance in HUBZone areas.

¹³SBA defines an employee as an individual employed on a full-time, part-time, or other basis, and working a minimum of 40 hours per month. This includes employees obtained from a temporary employee agency, leasing concern, or through a union agreement or co-employed pursuant to a professional employer organization agreement.

SBA Has Made Some Improvements in Response to Identified Weaknesses

Since 2008, GAO has reported on weaknesses in the HUBZone program and SBA's efforts to address those vulnerabilities.¹⁴ GAO made 11 recommendations intended to address identified problems associated with the program's certification and recertification processes, communication with firms, and the program's susceptibility to fraud and abuse (see app. I for a summary and status of our recommendations). The following sections discuss the weaknesses we previously identified and the program revisions and improvements SBA subsequently implemented in response to our recommendations.

Certification Process

We reported in June 2008 that, for its certification process, SBA relied on data that firms entered in the online application system and performed limited verification of the self-reported information. Although agency staff had the discretion to request additional supporting documentation, SBA did not have specific guidance or criteria for such requests. Consequently we recommended that SBA develop and implement guidance to more routinely and consistently obtain supporting documentation upon application.

In response to that recommendation, SBA revised its certification process, and since 2009 has required firms to provide documentation, which SBA officials review to determine the firms' eligibility for the HUBZone program.¹⁵ SBA then performs a full-document review on all applications as part of its initial certification process to determine firms' eligibility for the program. However, we also found in 2015 that the revised process SBA implemented resulted in delays in processing applications—81 percent of the 4,809 initial applications submitted between fiscal year 2009 and 2013 that we reviewed exceeded SBA's

¹⁴See GAO-16-866T; GAO-16-423R; GAO-15-234; *Small Business Administration: Undercover Tests Show HUBZone Program Remains Vulnerable to Fraud and Abuse*, GAO-10-920T (Washington, D.C.: July 28, 2010); GAO-10-759; GAO-09-440; *HUBZone Program: Fraud and Abuse Identified in Four Metropolitan Areas*, GAO-09-519T (Washington, D.C.: Mar. 25, 2009); *Small Business Administration: Status of Efforts to Address Previous Recommendations on the HUBZone Program*, GAO-09-532T (Washington, D.C.: Mar. 25, 2009); GAO-08-964T; *Small Business Administration: Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results*, GAO-08-975T (Washington, D.C.: July 17, 2008); and GAO-08-643.

¹⁵GAO-15-234.

processing goal of 90 days.¹⁶ Additional recommendations from our June 2008 report are discussed below.

Susceptibility to Fraud and Abuse

We previously found that SBA's challenges with its certification process made the HUBZone program vulnerable to fraud and abuse.¹⁷ For example, in July 2008 we testified that 10 HUBZone firms in the Washington, D.C., area had made fraudulent or inaccurate representations to get into or remain in the HUBZone program, and in a March 2009 report we found that another 19 firms in four other metropolitan areas had made fraudulent representations.¹⁸

We also reported in June 2010 that although SBA had increased documentation requirements for the application process, SBA still was not adequately authenticating self-reported information.¹⁹ We demonstrated this by obtaining 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.²⁰

When we revisited this issue in 2015, SBA officials told us that the agency conducted site visits on 10 percent of its portfolio of certified firms annually to help address these vulnerabilities.²¹ SBA selects the firms to receive site visits based on established criteria (such as the amount of HUBZone contract awards the firm has received) or on an as-needed basis in connection with the review of an initial certification application or after receipt of a protest.²²

¹⁶SBA began implementing its full document review during fiscal year 2009.

¹⁷For example, see GAO-10-920T, GAO-10-759, GAO-09-440, GAO-09-519T, and GAO-08-964T.

¹⁸GAO-09-440.

¹⁹GAO-10-759.

²⁰SBA continually lost documentation for our fourth application, and eventually withdrew it after we failed to resubmit the same materials for the fourth time.

²¹GAO-15-234. According to SBA officials, SBA began conducting site visits on 10 percent of firms in fiscal year 2010.

²²In general, the HUBZone protest process allows SBA, contracting officers, or any interested party to protest the qualified HUBZone status of an awardee or apparent awardee of a federal HUBZone contract.

Recertification Process	In 2008 and 2015, we identified a number of concerns with SBA's HUBZone recertification process. ²³ Generally, SBA relied on self-reported information to make its recertification decisions and had a backlog of firms waiting to be recertified. As a result, SBA lacked reasonable assurance that only qualified firms were allowed to continue in the program and receive preferential contracting treatment.
Lack of Supporting Documentation	In February 2015, we reported that SBA relied on firms' attestations of continued eligibility and generally did not request supporting documentation as part of the recertification process.²⁴ SBA only required firms to submit a notarized recertification form stating that their eligibility information was accurate. SBA officials did not believe they needed to request supporting documentation from recertifying firms because all firms in the program had undergone a full document review, either at initial application or during SBA's review of its legacy portfolio in fiscal years 2010–2012.²⁵ However, as we found, the characteristics of firms and the status of HUBZone areas—the bases for program eligibility—often can change and need to be monitored. As a result, we concluded that SBA lacked reasonable assurance that only qualified firms were allowed to continue in the HUBZone program and receive preferential contracting treatment. We recommended that SBA reassess the recertification process and implement additional controls, such as developing criteria and guidance on using a risk-based approach to requesting and verifying firm information. In March 2016, we found that SBA had not yet implemented additional controls (such as guidance for when to request supporting documents) for the recertification process because SBA officials believed that any potential risk of fraud would be mitigated by site visits to firms. The officials also cited resource limitations.²⁶ Based on data that SBA provided, the agency visited about 10 percent of certified firms each year during fiscal years 2013–2015. SBA's reliance on site visits alone would

²³See GAO-08-643 and GAO-15-234.

²⁴GAO-15-234.

²⁵According to agency officials, SBA conducted the portfolio review to verify that firms certified before SBA implemented the full document review complied with the program's eligibility requirements.

²⁶GAO-16-423R.

	not mitigate the recertification weaknesses that were the basis for our recommendation. In recognition of SBA's resource constraints, we stated in our 2015 report and reiterated in 2016 that SBA could apply a risk-based approach to its recertification process to review and verify information from firms that appear to pose the most risk to the program. We concluded that a lack of risk-based criteria and guidance for staff to request and verify firm information during the recertification process increased the risk that ineligible firms could obtain HUBZone contracts. We also reiterated that the characteristics of firms and the status of HUBZone areas—the bases for program eligibility—often can change, and needed to be monitored. As of February 2017, SBA officials told us that the agency had begun implementing a technology-based solution to address some of the ongoing challenges with the recertification process. The officials expected that the new solution would help them better assess firms and implement risk-based controls by the end of calendar year 2017.
Backlog	In 2008 and again in 2015, we found that the recertification process was backlogged—that is, firms were not being recertified within the 3-year time frame. In 2015, we reported that as of September 2014, SBA was recertifying firms that had been first certified 4 years previously. While SBA initially eliminated the backlog following our 2008 report, according to SBA officials the backlog recurred due to limitations with the program's computer system and resource constraints. Consequently, in 2015 we again recommended that SBA take steps to ensure that significant backlogs would not recur. In response to the recommendation, SBA made some changes to its recertification process. For example, instead of manually identifying firms for recertification twice a year, SBA automated the notification process, enabling notices to be sent daily to firms (to respond to and attest that they continued to meet the eligibility requirements for the program). According to SBA officials, as of February 2017 this change has not yet eliminated the backlog.
SBA's Communications with Firms about Designations	In 2008 and 2015, we reported on challenges some firms had faced or might have faced in understanding their eligibility status for the program. Generally, SBA relied on information posted on its website to communicate with interested parties about the HUBZone program.
Accuracy of HUBZone Maps	

SBA's HUBZone website includes links to the HUBZone map, which firms can use to determine if an address or a particular area is designated as a HUBZone. In our June 2008 report, we found that SBA's HUBZone map contained ineligible areas and had not been updated to include currently eligible areas.²⁷ As a result, ineligible small businesses had participated in the program, and eligible businesses had not been able to participate. Consequently, we recommended that SBA take steps to correct and update the map used to identify HUBZone areas and implement procedures to help ensure that the map would be updated with the most recently available data on a more frequent basis. In response to our recommendation, SBA subsequently contracted with its mapping vendor in 2008 to enable more frequent updating of the HUBZone map (at least annually). According to SBA officials, the accuracy of the map is checked twice after each upgrade, first by the mapping vendor and then by an SBA employee.

Notification to Firms

We subsequently reported in February 2015 that while HUBZone designations can change with some frequency, SBA's communications to firms about programmatic changes (including redesignation) generally had not been targeted or specific to firms that would be affected by the changes.²⁸ At that time SBA used a broadcast e-mail (which simultaneously sends the same message to multiple recipients) to distribute program information. In 2015, SBA's e-mail addressee list had not been updated to include firms certified since the list was created in 2013. While firms could sign up through SBA's website to receive the e-mails, not all certified firms may have done so. Consequently, we recommended that SBA establish a mechanism to better ensure that firms are notified of changes to HUBZone designations that may affect their participation in the program. This recommendation was intended to address communications to all certified firms, whether newly certified or in the program for years.

In response to our recommendation, SBA improved its notifications to newly certified firms but not to other certified firms. For example, SBA's certification letter to firms with principal offices in a redesignated area specifically states that the firm is in a redesignated area, explains the implications of the designation, and notes when the redesignated status will expire. However, we found in March 2016 that SBA had not yet

²⁷GAO-08-643.

²⁸GAO-15-234.

implemented changes to better ensure that all currently certified firms would be notified of changes that could affect their program eligibility.²⁹ It is important that all certified firms potentially affected by such changes receive information about the changes or are made aware in a timely fashion of any effects on their program eligibility.

As of February 2017, SBA had begun to improve its notifications to all firms. According to SBA officials, the agency has started sending program notices to all the firms in its portfolio. They told us that for its most recent notice in February 2017, the agency copied all the e-mail addresses in its HUBZone database and placed them in the e-mail distribution system.³⁰ According to SBA officials, SBA intends to repeat this effort with subsequent notices. We will continue to monitor SBA's implementation of this activity.

Economic Distress Has Been More Severe in Designated HUBZone Areas Than in Redesignated Areas

Our June 2008 and February 2015 reports demonstrated that economic distress (based on poverty and unemployment rate and median household income) has been more severe in designated HUBZone areas than in redesignated areas.³¹ For example, in June 2008, we found that approximately 60 percent of qualified metropolitan census tracts had a poverty rate of 30 percent or more, while approximately 4 percent of redesignated metropolitan census tracts had a poverty rate of 30 percent or more. Similarly, we found that about 46 percent of qualified nonmetropolitan counties had a poverty rate of 20 percent or more, while 21 percent of redesignated nonmetropolitan counties had a poverty rate of 20 percent or more.

In our February 2015 report, we analyzed indicators (including poverty and unemployment rate and median household income as of 2012) to

²⁹GAO-16-423R.

³⁰According to the officials, SBA sends the notices to about 19,000 e-mail addresses, including both firms and interested parties.

³¹See GAO-08-643 and GAO-15-234. As discussed in the Background, SBA updates HUBZone designations (assesses whether they still meet statutory criteria). As a result, additional areas are designated for inclusion while other areas lose their designation. Census tracts and nonmetropolitan counties that lose their designation begin a 3-year "redesignation" period during which firms in those areas can continue to apply to and participate in the program and receive contracting preferences. After the 3 years, firms in these areas lose their certified status and the associated federal contracting award preferences.

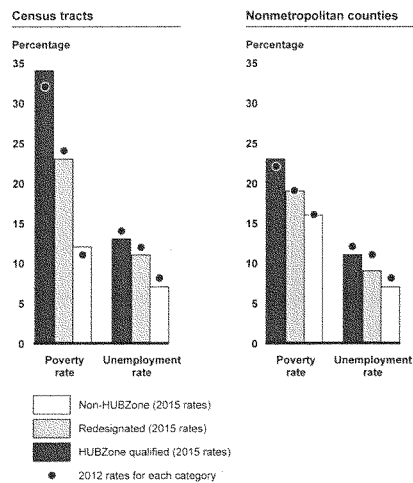
illustrate the differences in economic conditions among HUBZone areas (qualified and redesignated areas) and non-HUBZone areas (nonqualified tracts or areas). We found that indicators for redesignated areas on average fell below those of qualified areas, consistent with what we reported in June 2008. We also found that indicators for redesignated areas on average fell between those of qualified areas and nonqualified areas.

For this statement, we updated our prior analysis of the economic conditions of such areas (to include not only data as of 2012 but also as of 2015, the most current available). Based on current analysis of poverty and unemployment rate data, indicators for redesignated areas on average again fell between those of qualified and non-qualified areas (see fig. 1). For example, for census tracts in 2015

- qualified tracts had poverty and unemployment rates of 34 percent and 13 percent, respectively;
- redesignated tracts had rates of 23 percent and 11 percent, respectively; and
- nonqualified tracts had rates of 12 percent and 7 percent, respectively.

A similar pattern existed for nonmetropolitan counties. Also, while the poverty and unemployment rates for qualified and non-HUBZone nonmetropolitan counties remained relatively unchanged between 2012 and 2015, the unemployment rate decreased in redesignated counties.

Figure 1: Comparison of Unemployment and Poverty Rates, by Census Tract and Nonmetropolitan County HUBZone Eligibility Status, as of 2012 and 2015



Source: GAO analysis of Bureau of Labor Statistics and American Community Survey data. | GAO-17-456T

We also updated our analysis that included indicators for household income and housing value for qualified, redesignated, and non-HUBZone areas (by census tract). As shown in table 1, in both 2012 and 2015 qualified areas on average, had higher poverty and unemployment rates and lower median household income and housing values than either redesignated or non-HUBZone areas. On average, redesignated areas had economic indicators between those of qualified and nonqualified areas. Between 2012 and 2015 the poverty rate increased in qualified census tracts while the average median housing income and housing values decreased. In contrast, the average median household income increased for both redesignated and non-HUBZone areas during that period.

Table 1: Comparison of Selected Economic Indicators for Census Tracts (HUBZone and Non-HUBZone), 2012 and 2015

	Percentage in poverty		Unemployment rate (percentage)		Average median household income (dollars)		Average median housing value (dollars)	
	2012	2015	2012	2015	2012	2015	2012	2015
HUBZone qualified census tracts	31.5	33.9	13.9	13.3	32,200	30,518	158,701	146,197
Redesignated census tracts	23.6	23.4	12	10.6	40,383	41,494	207,738	190,611
Non-HUBZone census tracts	11	11.7	8.3	7.3	63,643	64,906	243,259	245,922

Source: GAO analysis of Bureau of Labor Statistics and American Community Survey (data). | GAO-17-456T

Note: The American Community Survey covers topics such as the social, economic, demographic, and housing characteristics of the U.S. population. The 5-year estimates from the survey represent data collected over a period of time. The primary advantage of using multiyear estimates is the increased statistical reliability of the data for less populated areas and small population subgroups. The most recent 5-year estimate covers 2011–2015.

As we have stated since our June 2008 report, while allowing continued eligibility for firms located in redesignated areas can benefit firms and communities in such areas, allowing continued eligibility could also result in diffusion—decreased targeting of areas with greatest economic distress—by lessening the competitive advantage on which small businesses may rely to thrive in economically distressed communities. Therefore, while allowing redesignated areas to remain eligible can generate economic benefits for such areas, the inclusion of such areas in the HUBZone program could limit the benefits that qualified areas with more depressed economic conditions might realize. In taking into account the potential impacts of actions that can expand or reduce the number of HUBZones and redesignated areas, our June 2008 report included a recommendation to SBA to further develop measures and implement plans to assess the effectiveness of the HUBZone program that take into account factors such as the economic characteristics of the HUBZone area. Although SBA took initial steps to develop such an assessment, the agency has not implemented our recommendation.

We plan to continue to evaluate elements of the HUBZone program. The Puerto Rico Oversight, Management, and Economic Stability Act contains a provision for us to evaluate the application and utilization of SBA contracting activities (including contracting activities relating to HUBZone firms) in Puerto Rico.³² Our work will include an analysis of the impact of SBA's June 2016 decision to remove a statutory cap on the number of

³²Pub. L. No. 114-187, § 408, 130 Stat. 549, 592 (2016).

qualified census tracts in metropolitan statistical areas in Puerto Rico (as well as nationwide).³³ According to SBA, the removal of the cap resulted nationally in 2,015 additional census tracts qualifying as HUBZones at that time.³⁴ We anticipate issuing the report in June 2017.

Chairman Knight, Ranking Member Murphy, and members of the Subcommittee, this concludes my statement. I would be pleased to respond to any questions you may have.

**GAO Contact and Staff
Acknowledgments**

If you or your staff have any questions about this testimony, please contact William B. Shear, Director, Financial Markets and Community Investment, at (202) 512-8678 or shearw@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. GAO staff who made key contributions to this testimony are Harry Medina (Assistant Director), Daniel Newman (Analyst in Charge), Pamela Davidson, John McGrail, John Mingus, and Barbara Roesmann.

³³According to SBA, before June 16, 2016, and pursuant to the Small Business Act, it applied the same definition of the term "qualified census tract" for the HUBZone program as that used by the Secretary of the Department of Housing and Urban Development for the Low-Income Housing Tax Credit program. Statutory provisions for that program define qualified census tracts as those meeting certain poverty rate or income criteria capped by the number of tracts in any metropolitan statistical area with no more than 20 percent of the total population of the statistical area. See 26 U.S.C. § 42(d)(5)(B)(ii). Because of this statutory cap, some tracts that met the poverty rate or income criteria were not constituted qualified census tracts and therefore not included in the HUBZone program. On June 16, 2016, SBA announced that "in keeping with the spirit and intent of the HUBZone program," and because SBA now believed application of the 20 percent population cap was "not consistent" with the Small Business Act, it would no longer apply the statutory cap in designating HUBZones. SBA said its decision to change the HUBZone criteria resulted in an additional 2,015 census tracts qualifying as HUBZones nationwide, including 516 in Puerto Rico. Finally, on June 30, 2016, Congress enacted the Puerto Rico Oversight, Management, and Economic Stability Act which, among other things, authorized SBA not to apply the 20 percent cap but only for HUBZone designations in Puerto Rico and only for 10 years.

³⁴In our February 2015 report, we analyzed the hypothetical impacts of lifting this cap. We estimated that as of June 2014, about 2,400 more census tracts would qualify as HUBZones if the 20 percent cap were not in place.

Appendix I: Summary and Status of Previous GAO HUBZone Recommendations

The following table summarizes the status of our recommendations from HUBZone performance audits and investigations as of February 2017.¹ We classify each recommendation as

- closed, implemented;
- partially implemented (the agency took steps to implement the recommendation but more work remains);
- open (the agency has not taken steps to implement the recommendation); or
- closed, not implemented (the agency decided not to take action to implement the recommendation).

The recommendations are listed by report.

GAO recommendations	Status
Small Business Contracting: Opportunities Exist to Further Improve HUBZone Oversight: GAO-15-234, February 12, 2015	
Establish a mechanism to better ensure that firms are notified of changes to HUBZone designations that may affect their participation in the program, such as ensuring that all certified firms and newly certified firms are signed up for the broadcast e-mail system or including more specific information in certification letters about how location in a redesignated area can affect their participation in the program	Partially implemented
Conduct an assessment of the recertification process and implement additional controls, such as developing criteria and guidance on using a risk-based approach to requesting and verifying firm information, allowing firms to initiate the recertification process, and ensuring that sufficient staff will be dedicated to the effort so that a significant backlog in recertifications does not recur.	Open
HUBZONE Program: Fraud and Abuse Identified in Four Metropolitan Areas: GAO-09-440, March 25, 2009	
Consider incorporating a risk-based mechanism for conducting unannounced site visits as part of the screening and monitoring process.	Closed-implemented
Consider incorporating policies and procedures into SBA's program examinations for evaluating if a HUBZone firm is expending at least 50 percent of the personnel costs of a contract using its own employees.	Closed - not Implemented
Ensure appropriate policies and procedures are in place for the prompt reporting and referral of fraud and abuse to SBA's Office of Inspector General as well as SBA's Suspension and Debarment Official.	Closed-implemented
Take appropriate enforcement actions on the 19 HUBZone firms we found to violate HUBZone program requirements to include, where applicable, immediate removal or decertification from the program, and coordination with SBA's Office of Inspector General as well as SBA's Suspension and Debarment Official.	Closed-implemented

¹See GAO, *HUBZone Program: SBA's Control Weaknesses Exposed the Government to Fraud and Abuse*, GAO-08-964T (Washington, D.C.: July 17, 2008), which reported the results of a fraud investigation that led to a corrective action briefing to SBA but no recommendations.

Appendix I: Summary and Status of Previous
GAO HUBZone Recommendations

GAO recommendations	Status
Small Business Administration: Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results: GAO-08-643, June 17, 2008	
Take immediate steps to correct and update the map that is used to identify HUBZone areas and implement procedures to ensure that the map is updated with the most recently available data on a more frequent basis.	Closed-implemented
Develop and implement guidance to more routinely and consistently obtain supporting documentation upon application and conduct more frequent site visits, as appropriate, to ensure that firms applying for certification are eligible.	Closed-implemented
Establish a specific time frame for eliminating the backlog of recertifications and ensure that this goal is met, using either SBA or contract staff, and take the necessary steps to ensure that recertifications are completed in a more timely fashion in the future.	Closed-implemented
Formalize and adhere to a specific time frame for processing firms proposed for decertification in the future.	Closed-implemented
Further develop measures and implement plans to assess the effectiveness of the HUBZone program that take into account factors such as (1) the economic characteristics of the HUBZone area and (2) contracts being counted under multiple socioeconomic subcategories.	Closed - not Implemented

Source: GAO | GAO-17-456T

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STATEMENT OF

**HANNIBAL "MIKE" WARE
ACTING INSPECTOR GENERAL
U.S. SMALL BUSINESS ADMINISTRATION**

BEFORE THE

**SUBCOMMITTEE ON CONTRACTING AND WORKFORCE
COMMITTEE ON SMALL BUSINESS
U.S. HOUSE OF REPRESENTATIVES**

MARCH 2, 2017

INTRODUCTION

Chairman Knight, Ranking Member Murphy, and distinguished members of the subcommittee, thank you for the opportunity to discuss our oversight of the U.S. Small Business Administration's (SBA's) Historically Underutilized Business Zones (HUBZone) program. The HUBZone program encourages economic development in historically underutilized business zones through the establishment of preferences in Federal contracting opportunities.

The Office of Inspector General (OIG) was established within SBA by statute to promote economy, efficiency, and effectiveness and to deter and detect waste, fraud, abuse, and mismanagement in the Agency's programs and operations. During fiscal year (FY) 2016, OIG achieved nearly \$145 million in monetary recoveries and savings—an almost seven-fold return on investment relative to our FY 2016 operating budget—and made 81 recommendations for improving SBA's operations and reducing fraud and unnecessary losses in the Agency's programs.

OIG'S ROLE

The stated purpose of the Inspector General Act of 1978, as amended (IG Act) is to create an independent and objective unit within specified agencies to combat fraud and abuse in the programs. To this end, my office is responsible for conducting audits and investigations of the programs and operations and undertaking other activities, such as inspections and evaluations, to promote economy, efficiency, and effectiveness in Agency programs. Importantly, as Acting Inspector General (IG), I am charged with keeping the Administrator and Congress fully and currently informed about problems and deficiencies in the Agency. The IG Act contains a variety of statutory guarantees of OIG independence, designed to ensure the objectivity of OIG work and to safeguard against efforts to compromise that objectivity or hinder OIG operations. It is these guarantees of independence that make statutory IGs unique.

The IG Act affords my office the authority to mount a multidisciplinary approach to Agency oversight. We have a broad statutory mandate to conduct audits and investigations relating to the programs and operations of the Agency and to conduct other activities for the purpose of promoting economy and efficiency in the administration of the Agency. Within this broad mandate, I am given full discretion to undertake those audits and investigations that are "necessary or desirable."

OIG audits are conducted in accordance with Federal audit standards established by the Comptroller General, and other reviews generally are conducted in accordance with standards established by the Council of the Inspectors General for Integrity and Efficiency (CIGIE). In addition, we coordinate with the Government Accountability Office (GAO) to avoid duplicating Federal audits. We also establish criteria to ensure that the non-Federal auditors (typically, certified public accountant firms) that OIG uses comply with Federal audit standards.

OIG investigations are conducted in accordance with the CIGIE Quality Standards for Investigations and Federal law. In conducting investigations, whenever the IG has reason to

believe that Federal criminal law has been violated, the IG must promptly report that evidence directly to the Department of Justice, without prior clearance by Agency officials outside OIG.

TOP MANAGEMENT CHALLENGES FACING SBA

We have aligned our resources to focus on the areas of highest risk within SBA, especially those programs with identified, systemic concerns. In accordance with the Reports Consolidation Act of 2000, OIG released its *Report on the Most Serious Management and Performance Challenges Facing the Small Business Administration in FY 2017* in October 2016 and has prepared similar reports since FY 2000. This report represents our current assessment of Agency programs and activities that pose significant risks, including those that are particularly vulnerable to fraud, waste, error, mismanagement, or inefficiencies. Its overall goal is to focus attention on significant issues in order to work with SBA managers to enhance the effectiveness of programs and operations under their purview. The report highlights the following top management challenges facing SBA:

- Challenge 1. Weaknesses in Small Business Contracting Programs and Inaccurate Procurement Data Undermine the Reliability of Contracting Goals Achievements
- Challenge 2. SBA's IT Leadership Capabilities Need Strengthening to Address Operational Risks and Challenges
- Challenge 3. SBA Needs Effective Human Capital Strategies to Carry Out its Mission Successfully and Become a High-Performing Organization
- Challenge 4. SBA Needs to Improve its Risk Management and Oversight Practices to Ensure Its Loan Programs Operate Effectively and Continue to Benefit Small Businesses
- Challenge 5. SBA Needs to Ensure that the Section 8(a) Business Development Program Identifies and Addresses the Needs of Program Participants, Only Eligible Firms Are Admitted in the Program, and Standards for Determining Economic Disadvantage Are Justifiable
- Challenge 6. SBA Can Improve Its Loan Programs by Ensuring Quality Deliverables and Reducing Improper Payments at SBA Loan Operation Centers
- Challenge 7. Disaster Assistance Must Balance Competing Priorities to Deliver Timely Assistance and Reduce Improper Payments
- Challenge 8. SBA Needs to Effectively Manage Its Acquisition Program

The management challenges are driven by SBA's current needs and are based not only on our understanding of SBA's programs and operations, but also on recent reports from other government agencies, including GAO. Accordingly, the challenges we present each year may change based on the SBA's risks, as well as the actions that it has—or has not—taken to remedy past weaknesses.

The management challenge report is an important tool that we believe assists SBA in prioritizing its efforts to improve program performance and enhance its operations. For our FY 2018 report, we will strive to achieve a shared understanding of the most pressing risks facing SBA leaders, with the goal of better informing Congress and other stakeholders. The chart below summarized the status of SBA's top management challenges:

		Color Scores				Change from Prior Year	
		Status at End of FY 2016					
	Challenge	Green	Yellow	Orange	Red	Up ↑	Down ↓
1	Small Business Contracting	1	1	2		1	
2	IT Leadership			3			
3	Human Capital		2				
4	SBA Loan Program Risk Management and Oversight		5	1			
5	8(a) Business Development Program		2		1	2	
6	Ensuring Quality Deliverables and Reducing Improper Payments at SBA Loan Operation Centers		3				
7	Disaster Loan Program		2	1			
8	Acquisition Management		4			4	
	TOTAL	1	19	7	1	7	0

 Implemented  Substantial Progress  Limited Progress  No Progress

OIG OVERSIGHT ACTIVITIES INVOLVING HUBZONE PROGRAM

Through audits and other reviews, OIG provides independent oversight of critical aspects of SBA's programs and operations to improve the Agency's efficiency and effectiveness. OIG works closely with GAO to provide oversight of SBA's programs and operations and to promote integrity and efficiency. An important aspect of this work is identifying and following up on SBA's major management and performance challenges. OIG also supports SBA's mission by detecting, investigating, and deterring fraud and other wrongdoing in the Agency's programs and operations. OIG serves as a Government-wide training resource for small business fraud and enforcement issues. These activities help to ensure that SBA employees, loan applicants, and program participants possess a high level of integrity. This is critical to properly administering SBA programs because it helps ensure that the Agency's resources are used by those who deserve and need them most.

OIG has identified weaknesses in small business contracting programs and inaccurate procurement data as a top management challenge. These weaknesses and inaccuracies undermine the reliability of contracting goal achievement reporting to Congress. The Small Business Act established a Government-wide goal that 23 percent of all prime contracts be

awarded to small businesses each FY. SBA has reported since FY 2013 that the Federal Government met or exceeded its goal of awarding 23 percent of Federal contracting dollars to small businesses. As the advocate for small business, SBA should strive to ensure that only eligible small firms obtain and perform small business awards. Further, SBA should ensure that procuring agencies accurately report contracts awarded to small businesses when representing their progress in meeting small business contracting goals. However, over the years, Congress has expressed concerns about the accuracy of the Small Business Goaling Report. These concerns have been substantiated by OIG audits and other Government studies that have shown widespread misreporting by procuring agencies, since many contract awards that were reported as having gone to small firms have actually been substantially performed by larger companies. Awards made to ineligible firms affect procurement opportunities for small businesses and damage SBA's credibility in reporting accurate small business contracting goals achievements. While some contractors may misrepresent or erroneously calculate their size, the incorrect reporting also results from errors made by Government contracting personnel, including the misapplication of small business contracting rules. Without reliable data, SBA cannot accurately measure the Federal Government's small business contracting goal achievements, which in turn weakens the ability of Congress and other Federal policy makers to determine whether the Government is maximizing contracting opportunities for small businesses.

Opportunities Exist to Further Improve Quality and Timeliness of HUBZone Certifications

In November 2013, OIG issued Audit Report 14-03, *Opportunities Exist to Further Improve Quality and Timeliness of HUBZone Certifications*. This report presents the results of the OIG's audit to determine whether SBA's HUBZone program certification process provides assurance to limit program certification to eligible firms.

OIG found that the HUBZone certification process was reengineered from self-certification to a full document review, and we found that SBA properly certified 9 of 12 firms reviewed. However, OIG identified three firms the SBA certified even when the firms did not meet all of the eligibility criteria. Ineligible firms that obtained certification distorted the small business HUBZone goaling numbers by at least \$1.3 million and possibly took contracting opportunities away from eligible firms. Additionally, certifying ineligible firms detracted from the economic benefits the program intends to promote in the disadvantaged HUBZone areas. The SBA also did not meet the required 30-calendar-day timeline for any of the 12 firms we reviewed, nor did it meet the proposed deadline of 90 days for 5 firms. For firms that are certified, the amount of time SBA takes to review the application directly inhibits opportunities to obtain Federal contracts. OIG recommended three actions directed to the Office of Government Contracting and Business Development to improve the HUBZone certification process and decrease the likelihood of ineligible firms receiving HUBZone certification. SBA officials have since implemented corrective action to close these recommendations.

Agencies Receive Goaling Credit for Firms No Longer in the 8(a) or HUBZone Programs

In September 2014, OIG issued Evaluation Report 14-18, *Agencies are Overstating Small Disadvantaged Business and HUBZone Goaling Credit by Including Contracts Performed by*

Ineligible Firms. This report presents the results of our evaluation of select Section 8(a) Business Development Program and HUBZone contract awards.

OIG identified over \$400 million in contract actions that were awarded to ineligible firms, which may have contributed to the overstatement of goaling dollars for the HUBZone and small disadvantaged preference programs in FY 2013. Besides reporting inaccurate information in Federal Procurement Data System-Next Generation (FPDS-NG), procuring agencies may have limited contracting opportunities for firms currently participating in the 8(a) or HUBZone programs.

Further, OIG found that HUBZone and 8(a) certification information is not consistently transmitted to the Dynamic Small Business Search and the System for Award Management. As a result, the affected small businesses are not getting the visibility in the Dynamic Small Business Search, especially the HUBZone firms, which may affect Federal agencies' ability to meet their HUBZone procurement goals.

Additionally, OIG also identified over \$1.5 billion dollars in contract actions for firms that were in the 8(a) or HUBZone programs at the time of contract award but were no longer in the programs in FY 2013. Specifically, SBA regulations permit procuring agencies to claim small disadvantaged business and HUBZone goaling credit on certain contract actions even after firms have left the program. In our opinion, the amount of dollars the SBA reports to Congress and the public as being performed by 8(a) and HUBZone firms in the Small Business Goaling Report is significantly influenced by the inclusion of contract actions performed by former program participants.

OIG made two recommendations to the Associate Administrator for Government Contracting and Business Development intended to strengthen controls between SBA databases on certification data of 8(a) and HUBZone firms and information reported in FPDS-NG. SBA officials have since implemented corrective action to close these recommendations.

HOTLINE, INVESTIGATIONS, SUSPENSION AND DEBARMENT REFERRALS, AND TRAINING AND OUTREACH ACTIVITIES

Hotline

OIG's Hotline receives and reviews allegations of waste, fraud, abuse, or serious mismanagement within SBA or its programs from employees, contractors, and the public. In FY 2016, the Hotline received 1,041 complaints, 18 of which pertained to the HUBZone program. For context, the Hotline received 28 HUBZone-related complaints in FY 2014 and 13 HUBZone-related complaints in FY 2015. Hotline analysts conduct a preliminary review of each allegation and may consult with OIG's Investigations Division, Audits Division, and Office of Counsel to determine the appropriate course of action. Referrals within OIG may result in corrective actions, audits, or administrative, civil, or criminal investigations. Referrals made to SBA program offices are done so for any appropriate tracking or action. Of the 18 HUBZone complaints received in FY 2016, 12 were referred to SBA program officials, 3 were referred to

outside agencies, 2 were referred to OIG's Investigations Division, and 1 was resolved by the Hotline.

Investigations

OIG aggressively investigates allegations of fraud, waste, and abuse involving SBA's programs and operations, to include the HUBZone program. In FY 2016, the SBA OIG's investigations resulted in 45 indictments or informations and 41 convictions. Since FY 2014, OIG opened 13 investigations involving the HUBZone program, resulting in 13 indictments or informations, 12 convictions or guilty pleas, \$11,891,589 in dollar accomplishments (potential investigative recoveries, fines, and asset forfeitures attributed to OIG investigations), and \$35,000,000 of cost avoidances (loans/contracts not approved or canceled as a result of OIG investigations).

In pursuing investigations involving fraud, waste, or abuse in the HUBZone program, OIG has a strong record of collaborating with GAO. Two notable examples of such efforts were initiated in 2008 and 2009, respectively:

- In testimony on July 17, 2008, GAO identified 10 firms in the Washington, DC, area participating in the HUBZone program even though they clearly did not meet the eligibility requirements. These 10 firms were investigated by OIG. All 10 cases were declined criminally by the United States Attorney's Office; however, the Department of Justice's Civil Fraud Division opened investigations on 6 firms that were alleged to be in non-compliance with the HUBZone principal office requirement, resulting in \$1.3 million in civil settlements from 4 of these companies.
- On March 25, 2009, GAO released report GAO-09-440: *HUBZONE PROGRAM - Fraud and Abuse Identified in Four Metropolitan Areas*. The four metropolitan areas identified were Dallas, TX; Huntsville, AL; San Antonio, TX; and San Diego, CA. OIG opened investigations in Texas and California in response to the findings of this report. One of the investigations resulted in a \$200,000 civil settlement.

Suspension and Debarment Referrals

OIG promotes suspensions, debarments, and similar administrative enforcement actions. These actions protect taxpayer funds from parties who are not a good risk for the Government. A typical OIG referral contains a summary of allegations, suggested administrative record (evidence supporting the case), and a draft notice of suspension or proposed debarment. Most OIG administrative referrals involve SBA's loan and contract programs. OIG ensures a suspension and debarment official reviews all appropriate allegations arising in other contexts, such as the investigation of False Claims Act qui tam cases.

In FY 2016, OIG sent 75 suspension and debarment referrals to the SBA. Included among these 75 referrals were 7 involving the HUBZone program. For context, OIG referred 74 matters to the SBA in FY 2015, with 6 of these involving the HUBZone program, and in FY 2014, OIG referred 50 matters to SBA, with 2 of these involving the HUBZone program. With the exception of the lending programs, SBA has not acted on suspension and debarment referrals

from OIG in a timely manner. As such, OIG has planned a review of SBA's suspension and debarment processes to increase transparency in this area and inform the Administrator and Congress of our findings.

Training and Outreach Activities

OIG also conducts, supervises, and participates in various training activities to counter fraud in SBA programs. Annually, OIG's training and outreach efforts include over a thousand attendees, including Government employees, lending officials, and law enforcement representatives, on topics related to fraud in Government lending and contracting programs. In FY 2016, OIG partnered with the National Science Foundation OIG to present the second annual Small Business Procurement Integrity Seminar. This seminar, which OIG offered in two locations, equipped Federal oversight personnel with the knowledge to identify, develop, and pursue small business contracting fraud cases. The course covered the major small business contracting programs and included a discussion of typical fraud schemes, program rules, and key procurement databases accentuated by multiple case studies. At the end of the session, participants took part in a hypothetical case, which allowed the application of principles taught during the day. OIG personnel also participated in the training of criminal investigators from several Federal agencies and the District of Columbia OIG. This training included information on subpoenas, civil remedies, administrative remedies, and small business procurement cases. OIG will continue to pursue these training opportunities as part of its outreach efforts.

CONCLUSION

OIG continues to focus on the most critical risks facing SBA, and weaknesses in small business contracting programs and inaccurate procurement data is among these risks. Though the Federal Government has a goal of only 3 percent of all dollars for Federal prime contracts to HUBZone-certified small business concerns, OIG will continue to focus its oversight efforts on this program to maintain its integrity and inform the Administrator and Congress of findings related to the program's operations. We are planning a review involving the HUBZone program for inclusion on our 2018 Audit Oversight Plan. As always, we will coordinate with our GAO colleagues with a view toward avoiding duplication and ensuring effective coordination and cooperation on oversight of the HUBZone program. We value our relationship with this subcommittee, and with the Committee on Small Business and Congress at large, and we look forward to working together to address identified risks and the most pressing issues facing the HUBZone program.



Written Testimony of

Shirley Bailey

On behalf of

The HUBZone Contractors National Council

Before the

House Committee on Small Business
Subcommittee on Contracting and Workforce

"Learning from History:
Ideas to Strengthen and Modernize the HUBZone Program"

March 2, 2017

Chairman Knight, Ranking Member Murphy, and Members of the Subcommittee, my name is Shirley Bailey and I appreciate the opportunity to be here today to provide testimony on the Historically Underutilized Business Zones (HUBZone) program.

The HUBZone Contractors National Council (Council) is a non-profit trade association providing information and support for companies and professionals interested in Small Business Administration's (SBA) HUBZone program. We would like to thank the Committee for their commitment to small businesses and for advancing small businesses in the federal marketplace.

The HUBZone Council has existed since January 2000, and strives to contribute to the economic development of disadvantaged communities by reducing unemployment and homelessness by strengthening, improving, and promoting the HUBZone Program and by helping HUBZone-certified companies maximize their success in earning federal contracts.

The Council's membership includes HUBZone-certified small businesses, other small businesses, prime contractors, and other organizations interested in the HUBZone Contracting Program. In addition, the HUBZone Council is an advocate as it relates to procurement and entrepreneurial policy and continues to seek needed modernization of the program from the Congress and SBA. The details of which are included.

History of the HUBZone Program

Economic development in Historically Underutilized Business Zones is particularly challenging. While assistance -including tax abatement, regulatory relief, **job training** and other incentives to attract small businesses are helpful – they are not enough. Distressed areas need sustainable jobs and a business needs customers to succeed and create jobs. Creating incentives for the federal government to be the customer, while HUBZone firms establish revenue, invest in communities and **create jobs**, is a sustainable option for firms located in the nation's poorest communities

Based on this need for jobs and economic development in distressed areas, Senator Kit Bond (R-MO) and a bipartisan coalition including the Chairman and Ranking Member of the House Small Business Committee, Rep. Jim Talent (R-MO) and Rep. John LaFalace (D-NY), and Senators John Kerry (D-MA), Olympia Snowe (R-ME), sponsored the legislation which created the Historically Underutilized Business Zone federal contracting program in 1997. The goal was to provide real economic opportunity in our nation's most blighted areas by "creat[ing] realistic opportunities for moving people off of welfare and into meaningful jobs" in "inner cities and rural counties that have low household incomes, high unemployment, and whose communities have suffered from a lack of investment."¹ The program was also established to assist in replacing lost jobs from our nation's declining manufacturing and industrial sectors.

¹ U.S. Congress, Senate Committee on Small Business, Small Business Reauthorization Act of 1997, report to accompany S. 1139, 105th Cong., 1st sess., August 19, 1997, S.Rept. 105-62 (Washington: GPO, 1997), p. 25.

In 1996, President Clinton further supported this concept and issued an Executive Order calling for “empowerment contracting”, which sought to give price evaluation credit to small business contract activities by firms in areas of great distress. The goal of the order was, “Fostering growth of Federal contractors in economically distressed communities and ensuring that those contractors become viable businesses for the long term which will promote economy and efficiency in Federal procurement and help to empower those communities²”.

The HUBZone program promotes **all of these goals**. The HUBZone Program is the only small business program that focuses Federal contracting dollars on generating jobs, increasing investment and decreasing unemployment in our nation’s most distressed areas. In fiscal year 2014, HUBZone firms reinvested \$3.5 billion back into distressed communities nationwide³.

Like other SBA set-aside programs for economically disadvantaged, service-disabled veteran-owned, and women-owned firms, there is a socio-economic utilization goal for HUBZone firms. As such, the HUBZone authorization bill, the Small Business Reauthorization Act of 1997, included a 3% prime contract goal for HUBZone firms, and increased the overall government-wide contracting goal to 23%. The HUBZone goal serves as a benchmark to determine whether agencies are appropriately utilizing the program, and is a floor, not a ceiling.

SBA finalized the regulations to implement the HUBZone program in the summer of 1998 and began accepting program applications in March 1999⁴. Early on, however, it became apparent the program needed an off-ramp. Going from federal assistance in creating jobs to losing that ability shortly thereafter did not serve the purpose of the program. Therefore, Congress passed the Small Business Reauthorization Act of 2000, to provide for a 3-year grandfathering period, or to extend participation for 3 years after an area is no longer eligible. Congress understood that many HUBZone areas rely on the designation to improve employment, and that immediate removal of the designation could hurt an area economically in such a way that it would become eligible for the program once again.

In 2005, Congress expanded the HUBZone program to incorporate areas that have undergone Base Realignment and Closure (BRAC) through the Department of Defense. Large military installations are often a community’s largest and most important employer. The loss of a base can hurt an area for decades afterwards. The incentive the HUBZone program creates for new businesses to revitalize an area is just what a BRAC area needs.

² William J. Clinton: Executive Order 13005 - Empowerment Contracting 21 May 1996
<http://www.presidency.ucsb.edu/ws/?pid=52845>

³ American Express, *The Crucial Role Small Businesses Play in Their Communities*, October 28, 2014 (reporting that small businesses returned, on average, 52% of their revenues to the local economy).

⁴ Congressional Research Service, Small Business Administration HUBZone Program, R41268, August 4, 2016

Improvements made by Congress throughout the early 2000s enabled the HUBZone program to reach a participatory high of over 14,000 firms⁵, and in fiscal year 2009 the government awarded a record 2.81% of federal contracts to HUBZone firms.

However, data from the 2010 census showed that a large number of areas had improved enough to be removed from the program. These areas contained approximately one-third, or 2,400 HUBZone businesses⁶. While exiting the program should indicate economic revitalization, our nation was experiencing the worst recession in decades. Removing thousands of small businesses from the program designed to provide economic development, during the worst recession since the great depression indicated the program was not working to satisfy the program's goals.

The removal of so many HUBZones businesses led government spending to decline for a number of years. In FY2015, the government only awarded 1.82% of contracts to HUBZone firms; almost a full percentage point below where the program was six years prior. As of February 2017, there are only 6,026 certified firms, which represents a loss of over one-third of HUBZone firms since the 2010 census⁷. The program has not fully recovered because Congress has not addressed challenges in program eligibility.

In fiscal year 2014, HUBZone firms reinvested \$3.5 billion back into distressed communities nationwide⁸. The continued analysis of HUBZone data since 2010 as well as the ongoing failure to meet the goal has increased attention of the program. As detailed below, legislation to revise the program was introduced in the last Congress.

The National Defense Authorization Act for Fiscal Year 2016 also expanded the use of HUBZones in BRAC areas by extending both the area and the length of time an area qualifies. The Act also granted eligibility to Native Hawaiian Organizations, and included qualified Presidentially declared disaster areas that were previously in the HUBZone program.

In June 2016, the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) expanded the HUBZone program in Puerto Rico, and required SBA to provide a "risk based approach" to application certification and recertification⁹.

⁵ U.S. Congress, House Committee on Small Business, Status of Efforts to Address Previous Recommendations on the HUBZone program, Statement delivered by William B. Shear available at <http://www.gao.gov/assets/130/122102.html>

⁶ SBA, FY2014 Congressional Budget Justification and FY2012 Annual Performance Report, p. 43, at <https://www.sba.gov/sites/default/files/files/1-FY%202014%20CBJ%20FY%202012%20APR.PDF>.

⁷ *ibid.*

⁸ American Express, *The Crucial Role Small Businesses Play in Their Communities*, October 28, 2014 (reporting that small businesses returned, on average, 52% of their revenues to the local economy).

⁹ Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA) P.L. 114-187 (June 2016)

Background on the Program

Benefits of the HUBZone Program

The HUBZone program has similar authorities to SBAs other set-aside programs by allowing contracting officers to utilize set-asides and sole source for HUBZone firms. Also, for full and open competition, “the price offered by a qualified HUBZone business shall be deemed as being lower than the price of another offeror if the HUBZone business price offer is not more than 10% higher than the other offer¹⁰.” The Price Evaluation Preference (PEP) is an important tool, but it is often misunderstood or misapplied by contracting officers of federal agencies. Simply put, in full and open competition, a HUBZone bid can be up to 10 percent higher than another offer, and the HUBZone offer should nevertheless be accepted. As discussed later, price-evaluation preferences accounted for only 2 percent, or \$36 million of HUBZone program contract dollars in FY2015 and its use is widely regarded as a rarity¹¹.

HUBZone Program Eligibility

To qualify for the program, companies must have a “principal office” in a HUBZone. SBA defines principal office to be the location where the greatest number of employees at any one location perform their work¹².

HUBZone areas can qualify under one of six criteria including qualified census tracts (QCTs), qualified non-metropolitan counties, difficult development areas, qualified Indian lands, military property closed under the Base Realignment and Closure (BRAC), and qualified disaster areas.

Qualified Census Tracts

Qualified census tracts are defined based on current eligibility from the U.S. Department of Housing and Urban Development (HUD) for the Low Income Housing Tax Credit (LIHTC) for the most recent year census data is available. To qualify, at least 50 % of households must have income “below 60% of the median gross income of the metropolitan statistical area (in metropolitan census tracts) or the median gross income for all non-metropolitan areas of the state (in non-metropolitan census tracts) or a poverty rate of at least 25%¹³.”

Non-Metropolitan Counties (NMC)

Qualified non-metropolitan counties can become HUBZone eligible by having median household income less than 80% of the non-metropolitan state median household income, based on Census

¹⁰ Small Business Reauthorization Act of 1997, S. 1139, 105th Cong., 1st sess., August 19, 1997 (Washington: GPO, 1997),

¹¹ Congressional Research Service, Small Business Administration HUBZone Program, R41268, August 4, 2016

¹² SBA has an exception for construction and service industries, which have exemptions based on their occasional need to assign employees at the contract location.

¹³ 13 C.F.R. §126.103 and 26 U.S.C. §42(d)(5)(B)(ii)(I).

data, or an unemployment rate not less than 140% of the average unemployment rate for the state or for the U.S., whichever is lower¹⁴. Unlike QCTs, qualified NMC designations are annually determined by SBA.

The qualified non-metropolitan county designation is the only type of HUBZone that is determined by the SBA. The formula is set in law and the data are derived from other agencies, but the designation is made by SBA.

Additional HUBZone eligible areas are Indian Country, HUD-designated difficult development areas (DDA) which are areas with high construction, land, and utility costs relative to area median gross income, Department of Defense property that has undergone BRAC, and areas that were previously HUBZones, and experienced a Presidentially declared disaster.

Employee Requirements

An additional program requirement is that a least 35% of employees must live in a HUBZone. While other SBA socio-economic programs focus on the characteristics of the owner, the HUBZone program is focused on firm employees. This requirement ensures that jobs are not just located in distressed areas, but HUBZone firms are creating jobs for those living in distressed areas, as well. This allows HUBZone firms to empower communities through sustainable jobs and an economic multiplier effect. This requirement is often the most challenging for firms to comply.

Redesignation

To improve the program, Congress passed the Small Business Reauthorization Act of 2000, to provide for a 3-year grandfathering period or to extend participation for 3 years after an area is no longer eligible. Congress believed that many HUBZone areas rely on the designation to improve employment, and that immediate removal of the designation could hurt an area economically in such a way that it would become eligible for the program once again.

HUBZone Program Impact

While there are currently only a little more than 6,000 HUBZone firms, these businesses have had substantial impact on their communities. Federal contracts awarded to HUBZone companies directly support 40,000 jobs every year¹⁵ and the average HUBZone company is awarded over \$1 million in federal contracts, a critical revenue threshold in business sustainability¹⁶.

¹⁴ 13 C.F.R. §126.103.

¹⁵ Maria Contreras-Sweet, *SBA Fiscal Year 2015 in Review*, October 2, 2015 (Stating that small businesses received \$91.7 billion dollars, supporting 550,000 jobs in the economy).

¹⁶ Small Business Dashboard, available at <http://smallbusiness.data.gov/> (Reporting that in FY 2014, HUBZone contracts totaled \$6.7 billion. The average firm received approximately \$1.3 million).

If each HUBZone qualified area had a single HUBZone business, it would generate an additional \$17 billion in economic activity and support over 100,000 jobs. This is such a large number because almost 90% of HUBZone areas do not have a single HUBZone certified company. Largely due to this underutilization, the government has never met the goal of awarding 3% of federal contracts to HUBZone firms¹⁷. Failure to meet the 3% goal resulted in over \$4 billion left on the table that economically stressed communities would have benefitted from, just last year.

Program Challenges

Program Integrity & Funding

The HUBZone program has suffered from chronic underfunding since it was first authorized in 1997. When the program was first established, it was authorized between \$5 and \$10 million to set up the program office, conduct outreach to both federal agencies and small businesses, and ensure program integrity¹⁸. However, the program has rarely received more than \$2-\$3 million in a given fiscal year though it currently costs SBA more than \$15 million to operate the program annually¹⁹. In FY2016, the program received an appropriation of \$3 million²⁰.

While SBA has supplemented program costs through the appropriations provided for general administrative expenses, it is a challenge to improve the program without the necessary support. After years of underfunding the program, SBA has experienced difficulties in building mechanisms to support audit controls that reduce waste, fraud, and abuse. While these changes will help the program, it is imperative that Congress further assist SBA with program administration.

Program Utilization

Throughout the early 2000s both SBA and federal agencies improved their utilization of HUBZone firms. Data from the 2010 census showed that approximately one-third, or 2,400 HUBZone businesses should be removed from the program²¹. While exiting the program should indicate economic revitalization, our nation was experiencing the worst recession in decades when the 2010 Census was conducted – yet thousands of small businesses were removed from the program designed to provide economic development.

By removing so many HUBZone businesses, government spending in the program has declined steadily since 2011, to 1.82% in FY2015. During the great recession, almost 2,400 firms were

¹⁷ Government Accountability Office, *Small Business Contracting: Opportunities Exist to Further Improve HUBZone Oversight*, at 37, February 2015. Available at <http://www.gao.gov/assets/670/668468.pdf>.

¹⁸ <http://www.sbc.senate.gov/republican/HTML/agencies/hubzones/hubzone24.pdf>

¹⁹ Congressional Research Service, Small Business Administration HUBZone Program, R41268, August 4, 2016

²⁰ SBA, FY2017 Congressional Budget Justification and FY2015 Annual Performance Report, p. 26, at https://www.sba.gov/sites/default/files/FY17-CBJ_FY15-APR.pdf.

²¹ SBA, FY2014 Congressional Budget Justification and FY2012 Annual Performance Report, p. 43, at <https://www.sba.gov/sites/default/files/files/1-FY%202014%20CBJ%20FY%202012%20APR.PDF>

removed from the program²².

Streamline HUBZone Program Data

Previously, economic data to determine HUBZone eligibility was primarily available through the decennial census. As a result, QCTs most often changed as new economic data became available every ten years. However, the Commerce Department is increasingly utilizing the American Community Survey (ACS) to produce housing and population data annually. In response to annual ACS data, HUD announced it would update eligible census tracts every five years. However, when comparing ACS data from the 2006-2010, the 2007-2011, and 2008-2012 surveys, they found some statistical anomalies.

In response, and to avoid making QCT designations on a single, possibly inaccurate data point, HUD announced QCT designations would be made using all three surveys (2006-2010, 2007-2011, and 2008-2012). Now to qualify for HUBZone, census tracts are required to meet the thresholds in at least two ACS surveys. Additionally, HUD is now updating eligible areas with the release of new ACS data annually.

The burden to qualify a specific HUBZone has increased substantially since the program was created. What used to be a potential change in eligibility that would most likely occur every ten years, is now an annual test. Furthermore, requiring areas to qualify under two different ACS surveys means areas that may be close the margins of eligibility are likely to be left behind.

Proposed Legislation

The Council is interested in advancing legislation seeking to make structural improvements to the HUBZone program. Last Congress, H.R. 5250, introduced by Representative Delaney, addressed the need to provide participating companies program certainty by lengthening the redesignation period from three to seven years. Increased time in the program would build the lasting economic benefit for communities that the HUBZone program provides.

Also from last Congress, S. 2838, the Small Business Transforming America's Regions Act of 2016 was passed by the Senate Small Business Committee. S. 2838 lengthened the redesignation period from three to seven years and authorized governors to annually petition SBA to designate one or more NMCs in the governor's state as a HUBZone. The legislation sought to empower governors to further invest in state economic development by seeking to make NMCs HUBZones.

HUBZone Council Recommendations to Congress

²² *ibid.*

The Council appreciates Congressional interest in making improvements to the program and would like to offer the following suggestions.

Program Certainty

HUBZone Application Improvements

To ensure compliance, SBA certifies all HUBZone companies. While Congress recently changed some of the elements of certification, SBA's timeline to process applications is far too long. This summer, SBA updated HUBZone program regulations to increase the application review period from 30 to 120 days²³. Requiring over four months to process and application is far too long.

Increase the Redesignation Period.

To determine program eligibility, SBA uses data from several sources including the decennial Census and the American Community Survey (ACS). While Census data is updated every 10 years, ACS data is updated annually. For certain areas, this means minor changes in economic data can lead a community's eligibility to change annually.

To create better program and business certainty, increasing the current three-year redesignation period to seven years will allow firms to make more substantial, long-term investments without the fear of losing their status before the business has had an opportunity to succeed.

Support Capital Investment of Principal Office

Many firms make significant capital investments to locate their principal office in a HUBZone, only to face substantial losses when the HUBZone is re-designated. To resolve this issue, the principal office requirement will remain fulfilled, regardless of redesignation, until the firm relocates or no longer meets other requirements of the program (like the employee residency requirement). This will encourage long-term investment by providing business with certainty and investment protection.

Simplify Employee Residency Requirement for Smallest Businesses

By changing the current 35% threshold to 33%, one in three employees would be required to reside in a HUBZone. In addition to simplifying the calculation for employers, this also helps small firms to ensure they meet their requirements after the unforeseen departure of one employee.

Program Modernization

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U.S. Small Business Administration, HUBZone and National Defense Authorization Act for Fiscal Year 2016 Amendments, Direct Final Rule, August 4, 2016. Available at <https://www.federalregister.gov/articles/2016/08/04/2016-18251/hubzone-and-national-defense-authorization-act-for-fiscal-year-2016-amendments>

Encourage Investment Throughout Entire Metropolitan Areas

HUD's Low-income Housing Tax Credit (LIHTC) program limits the amount of qualified census tracts in any Metropolitan Statistical Areas (MSA) to no more than 20 percent of the total population of the MSA. Because of this restriction, many disadvantaged communities have not received a HUBZone designation, because they are better off – relatively – than the surrounding area.

Limiting the number of HUBZones only serves to inhibit program growth. In Spring 2016, SBA Administratively removed the 20 percent limitation on all HUBZones and announced that an additional 2,015 census **tracts** now qualify for the program. SBA's removal of this unnecessary barrier will assist countless small businesses who are interested in participating.

Increase Participation in Non-Metropolitan Counties (NMC)

Fewer than expected NMCs qualify for the HUBZone program due to having more burdensome requirements for median income and unemployment than MSAs in metropolitan areas. While rural areas tend to have lower median income and higher unemployment, non-metropolitan counties are not homogenous. Certain county areas may be better off due to the presence of a single employer, like a college, and could cause the county to be ineligible. Therefore, the NMC qualification levels should be lessened to account for the diversity in rural areas.

Increase participation of HUBZone Program to include all Federal Agencies and grant programs to improve infrastructure and community development programs

Currently, HUBZone firms are not included in small business programs allocated to state programs for infrastructure and community development programs.

Participation in Overseas Contracts

For the first time ever, starting this year, SBA will be counting overseas contracts towards the total eligible dollars for small businesses. This change will create more opportunities for businesses at the State Department, DOD and USAID. Many overseas contracts require foreign national participation which significantly impacts firm's ability to maintain 35% since foreign nationals are currently included in 35% employee residency calculation. The Council also looks forward to working with the committee to ensure HUBZone businesses have access to these opportunities, in particular in fulfilling employee residency requirements.

Conclusion

The HUBZone program was created with the intent of moving individuals into meaningful jobs in communities that have suffered from a lack of investment. It is unlike other SBA programs in that the focus is not on the company, but the community. It is an economic development

program.

Since its inception, the program has underperformed. While Congress has addressed expansions of the program to certain places, it has been more than fifteen years since changes were made to the primary program structure. In order for the HUBZone program to reach its full potential as outlined in 1997, the program needs to be modernized. The Council listed a number of proposals in this testimony and is open to working with the Committee on other ideas.

The HUBZone Council strives to contribute to the economic development of disadvantaged communities by reducing unemployment and homelessness and by strengthening, improving, and promoting the HUBZone Program. We would like to thank the committee for their support of our efforts and the efforts of all small businesses seeking to do work for the federal government.



Testimony of

Mansoorah Mollaghasemi, Ph.D.

President, Atria Technologies, LLC

before the

**Committee on Small Business Subcommittee on Contracting
and Workforce**

on the subject of

**Learning from History: Ideas to Strengthen and Modernize
the HUBZone Program**

March 2, 2017

Chairman Knight, Ranking Member Murphy and members of the Committee on Small Business Subcommittee on Contracting and Workforce, thank you for allowing me the opportunity to testify at the hearing entitled “Learning from History: Ideas to Strengthen and Modernize the HUBZone Program.”

My name is Dr. Mansooreh Mollaghasemi and I am the Founder & President of Atria Technologies which provides professional services in engineering, program management, and technology & system integration. I’m pleased to share my experiences as an entrepreneur and small business owner in the United States, and highlight the critical role of programs such as the HUBZone program in the growth of my business—and many others like mine.

But first I would like to provide some context on the role that small businesses play in the unique innovation of American business. Google, Amazon, and Apple are all household names today with a market cap of \$1.7 Trillion. The common theme among all of them is that growth was achieved primarily in the business-to-business or business-to-consumer space in the US first, with dramatic expansion to worldwide presence shortly thereafter.

Note that these companies did not spring forward from within large corporations. They were all small businesses in their early years, staffed with employees with an unmatched fire for the achievement of an incredible vision. And succeed they did! This is American business at its core. The bottom line is that there is no other country in the world that has shown the same ability to innovate.

But what is missing from this picture? What is missing, is a commensurate infusion of this unparalleled innovation from small business into the requirements of our Federal government. The HUBZone program provides one mechanism to transfer this innovation from a small business to solve the problems faced by our Federal government.

Last year, Federal government spending reached \$1.1 trillion dollars in contracts and grants¹ with approximately 75% of that funding awarded to businesses. The lion’s share of that funding is awarded to large businesses and one key reason lies in the risk aversion of the government. Agencies generally look for three things in selecting contractors: past performance, “back reach”, and financial security/depth. To meet all three criteria, large business is almost always preferred, with “second place” going to those medium and small business that have managed to find a way to gain experience and past performance with federal contracting.

So the “catch 22” here is that the experience with federal contracts that small businesses need to demonstrate successful past performance, depth of staff with federal program track records, and the financial depth from contract wins—that ver experience, or rather the lack of it, is the major roadblock to their ability to contribute their innovative capabilities to government efforts.

¹ USA Spending. <https://www.usaspending.gov/transparency/Pages/OverviewOfAwards.aspx>. Publication date unavailable. Updated 2017. Accessed February 21, 2017.

Finding that mechanism to enable them to gain experience with federal contracting is precisely the value that these small business vehicles like the HUBZone program provide to those small businesses who seek to provide their goods and services to the Federal government. Without these programs, the barriers to entry can be insurmountable.

Why is this? Please allow me to use my own story as an example....

After receiving a Ph.D. in Industrial Engineering, I began my career as an assistant professor at the University of Central Florida. While I greatly enjoyed teaching graduate and undergraduate classes, conducting research, and mentoring and directing graduate students, I often longed for applying my research to more impactful real world problems. To that end, I finally took the leap in 2001 and started a business to focus on using technology to improve the productivity and efficiency of private and public organizations. I am extremely fortunate to have agencies like NASA and US Department of Transportations (USDOT) as well as Lockheed Martin, Disney, and Universal Studios among my clients. But the road to success has not been easy.

There are numerous challenges facing an entrepreneur, the least of which are the long hours, recruiting and retaining quality employees, and the constant pressure to make payroll.

I knew that we had services that would be of value to Federal government agencies. And I remember how naive I was at the start, thinking that if I could offer a solution to a government agency's problem, they would, of course, want to procure my small business services! But the meetings generally went along these lines: I would listen to their particular problem, present what our core competencies were and offer a solution to their problem, and have a brainstorming discussion. Then would come the response... "we like what you do... we think it would be useful to our organization... but there is no mechanism for us to procure your services."

So I began researching the various mechanisms. I learned about the HUBZone program and the 8a certification and the benefits of each problem as well as the difficulty attaining the certifications. At the time, my office was not in a HUBZone location and because I was already committed to a lease, I decided to pursue the 8a certification. The process and its requirements seemed daunting; so I hired an experienced firm and paid over \$4,000 in early 2003 to help me with the application preparation. The process was every bit as time consuming as I had been warned about but luckily paying attention to details and providing the requisite documentation helped me to get 8a certified one year later. It is worth noting that I had no visibility into the application evaluation process and no idea if my application was even moving through the process, and whether it would ultimately be accepted or denied.

While I was able to acquire and retain many high profile commercial clients and won some competitive grants, the 8a program was the key that opened the door to major opportunities for us to serve the needs of our Federal government.

- Through one of our 8a contracts with NASA, my company developed and analyzed the first every supply chain model of Earth to Mars, arguably the longest supply chain known to mankind.
- In another contract, we built a highly sophisticated optimization tools to help USDO to pilot solutions for moving freight more efficiently. With additional infusion of internal R&D funds, this tool served as the genesis for the development of a commercial tool.

As we built our past performance and developed intellectual property, additional opportunities came about that spurred our growth further.

Years later, when I decided to start Atria Technologies, I was surprised to experience the same lack of visibility and long lead time in the application process.

In 2013, I founded Atria Technologies to meet the needs of local prime contractors to fulfill HUBZone requirements. I learned that many small businesses have difficulty attaining and/or maintaining their certification. This may be due to redesignation of HUBZone areas, difficulty in meeting the 35% HUBZone employee requirement, or lack of experience in running a business, in general.

Although I already had an existing business, very few of my nearly 30 employees who were engaged in multiyear projects lived in a HUBZone. With Atria Technologies, there was an opportunity to start with a clean slate, pursue and hire full time employees that live a HUBZone, and find and mentor part time HUBZone employees who happen to be students at the university.

I acquired an office in a HUBZone location, hired my first HUBZone employee who was a student at the university and applied for HUBZone certification for Atria Technologies a few months later. While I was pleased to find the application process fully on line, the certification process was not much different from what I had experienced in 2003 while pursuing 8a certification.

During what turned out to be a full 7-month certification process, I made several inquiries into the status of the application. While the email correspondence with the HUBZone helpdesk was extremely cordial and I received a prompt response generally within a day, the helpdesk team was unable to provide a time frame for processing my application.

For any business in the 21st Century, seven months is a long time—as long as the life of many products. Please believe me when I say that for a small business, a seven-month wait for paperwork to be approved is an eternity. It is worth noting that by the time I received certification, I had already spent over \$15,000 without a single contract.

While my other business focuses on developing software tools to put in the hands of end users, Atria Technologies focuses on professional services to serve government agencies and prime contractors. Almost all federal contracts won by large companies include a small business contracting plan that includes 1 to 3% HUBZone certified small business requirement. This will provide small busi-

nesses with the much needed past performance to compete for larger opportunities while contributing to jobs and economic development in distressed areas.

Today, Atria Technologies is a subcontractor to a large Prime contractor on a multi-year Air Force contract in Systems Engineering, has 4 employees with 2 residing in a HUBZone. One of the HUBZone employees is a full time engineer and the other is a student who works 40 hours per month. The ability to hire part time HUBZone employees on a 40 hour basis is one of the regulations that I find beneficial. This not only allows the small business to meet the requirement of the program but most importantly provides an opportunity for the part time employees to gain experience, build their resume, and make additional income.

So what is the takeaway? These SBA programs are critical for enabling small businesses to take their first steps into serving the needs of our Federal government and as a result contribute to growth and economic development. Specifically, the HUBZone program helps the small business program participants earn their track records for “past performance” that enable them to stand up and compete on their own for larger opportunities while infusing further investment and jobs in distressed areas.

But as beneficial as these programs are, there are ways that they can be improved, primarily in the removal of “red tape” and barriers to entry for small business leaders. For example, it would be extremely valuable to provide visibility into the application process. Existing technology can be effectively used to streamline the approval process, and historical data can be mined to predict the time required to process applications based on their complexity. Moreover, once HUBZone certified, small business owners would greatly benefit from having a resource that can provide guidance and answer questions about the program. I have been fortunate to find such a resource at our local SBDC office whom I have contacted on several occasion to clarify rules and seek guidance.

So, in summary I would like to leave you with three thoughts:

- Small business in America is an engine of innovation that is unmatched in any other economy in the world,
- Programs like HUBZone are the essential keys to bringing the benefits of this innovation to the government of the American people through federal contract awards and spurring economic development in distressed areas,
- Opportunities exist to streamline the application and oversight process for these programs to enable their more efficient and effective use.

It is truly an exciting time to be the leader of a small business. We are the envy of the world, and rightly so. The federal programs we are discussing today are vital to enabling the bright light of small business innovation to shine on the services provided by our government agencies.

Thank you for your time today.

