United States Government Accountability Office

GAO

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

June 2008

SMALL BUSINESS ADMINISTRATION

Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results

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GAO-08-643

June 2008

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Highlights

Highlights of GAO-08-643, a report to the Chairwoman, Committee on Small Business, House of Representatives

SMALL BUSINESS ADMINISTRATION

Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results

Why GAO Did This Study

The Small Business Administration's (SBA) Historically Underutilized Business Zone (HUBZone) program provides federal contracting assistance to small firms located in economically distressed areas, with the intent of stimulating economic development. Questions have been raised about whether the program is targeting the locations and businesses that Congress intended to assist. GAO was asked to examine (1) the criteria and process that SBA uses to identify and map HUBZone areas and the economic characteristics of such areas, (2) the mechanisms SBA uses to ensure that only eligible small businesses participate in the program, and (3) the actions SBA has taken to assess the results of the program and the extent to which federal agencies have met their HUBZone contracting goals. To address these objectives, GAO analyzed statutory provisions, as well as SBA, census, and contracting data, and interviewed SBA and other federal and local officials.

What GAO Recommends

GAO recommends that the SBA Administrator take steps to ensure that only eligible firms participate in the HUBZone program and to further assess the effectiveness of the program. In responding to a draft of this report, SBA agreed with these recommendations and outlined steps that it plans to take to address them.

To view the full product, including the scope and methodology, click on GAO-08-643. For more information, contact William B. Shear at (202) 512-8678 or shearw@gao.gov.

What GAO Found

SBA relies on federal law to identify qualified HUBZone areas based on provisions such as median income in census tracts, but the map it uses to publicize HUBZone areas is inaccurate, and the economic characteristics of designated areas vary widely. To help firms determine if they are located in a HUBZone area, SBA publishes a map on its Web site. However, the map contains areas that are not eligible for the program and excludes some eligible areas. As a result, ineligible small businesses have been able to participate in the program, and eligible businesses have not been able to participate. Revisions to the statutory definition of HUBZone areas (such as allowing continued inclusion of areas that ceased to be qualified) have nearly doubled the number of areas and created areas that are less economically distressed than areas designated under the original criteria. Such an expansion could diffuse the benefits to be derived from steering businesses to economically distressed areas.

The mechanisms that SBA uses to certify and monitor firms provide limited assurance that only eligible firms participate in the program. Although internal control standards state that agencies should verify information they collect, SBA verifies the information reported by firms on their application or during recertification—its process for monitoring firms—in limited instances and does not follow its own policy of recertifying all firms every 3 years. GAO found that more than 4,600 firms that had been in the program for at least 3 years went unmonitored. Further, SBA lacks a formal policy on how quickly it needs to make a final determination on decertifying firms that may no longer be eligible for the program. Of the more than 3,600 firms proposed for decertification in fiscal years 2006 and 2007, more than 1,400 were not processed within 60 days—SBA's unwritten target. As a result of these weaknesses, there is an increased risk that ineligible firms have participated in the program and had opportunities to receive federal contracts based on their HUBZone certification.

SBA has taken limited steps to assess the effectiveness of the HUBZone program, and from 2003 to 2006 federal agencies did not meet the government-wide contracting goal for the HUBZone program. While SBA has some measures to assess the results of the HUBZone program, they are not directly linked to the program's mission, and the agency has not implemented its plans to conduct an evaluation of the program based on variables tied to the program's goals. Consequently, SBA lacks key information to manage the program and assess performance. Contracting dollars awarded to HUBZone firms increased from fiscal year 2003 to 2006, but consistently fell short of the government-wide goal of awarding 3 percent of annual contracting dollars to HUBZone firms. According to contracting officials GAO interviewed, factors such as conflicting guidance on how to consider the various small business programs when awarding contracts and a lack of HUBZone firms in certain industries may have affected the ability of federal agencies to meet their HUBZone goals.

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Abbreviations

BLS	Bureau of Labor Statistics
BRAC	Base Realignment and Closure Act
CCR	Central Contractor Registration
DHS	Department of Homeland Security
DOD	Department of Defense
DSBSS	Dynamic Small Business Source System
FAR Council	Federal Acquisition Regulation Council
FPDS-NG	Federal Procurement Data System-Next Generation
GPRA	Government Performance and Results Act
HUBZone	Historically Underutilized Business Zone
HUD	Department of Housing and Urban Development
IG	Inspector General
NAICS	North American Industry Classification System
OMB	Office of Management and Budget
OSDBU	Office of Small and Disadvantaged Business Utilization
PART	Program Assessment Rating Tool
SBA	Small Business Administration
SDB	Small Disadvantaged Business
SSA	Social Security Administration

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GAO

Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

June 17, 2008

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

Dear Madam Chairwoman:

Created in 1997, the Historically Underutilized Business Zone (HUBZone) program provides federal contracting assistance to small businesses in economically distressed communities, or HUBZone areas, with the intent of stimulating economic development in those areas. In fiscal year 2007, federal agencies awarded contracts valued at about $8 billion to HUBZone firms. The Small Business Administration (SBA) administers the HUBZone program, one of several contracting assistance programs that the agency oversees. Firms that participate in the program must be located in a HUBZone and employ residents of HUBZones to facilitate the goal of bringing capital and employment opportunities to distressed areas. There are more than 14,000 HUBZone areas, and, as of February 2008, almost 13,000 firms participated in the program. Further, to support and encourage the development of small businesses in HUBZones, Congress has set a goal for federal agencies to award 3 percent of their annual contracting dollars to qualifying firms located in HUBZones.

Questions have been raised about whether the program is targeting the locations and businesses that Congress intended to assist and the extent to which federal agencies have awarded contracts to certified HUBZone firms. Therefore, you asked us to review SBA's administration and oversight of the HUBZone program. Specifically, this report examines (1) the criteria and process that SBA uses to identify and map HUBZone areas and the economic characteristics of such areas, (2) the mechanisms that SBA uses to ensure that only eligible small businesses participate in the HUBZone program, and (3) the actions SBA has taken to assess the results of the program and the extent to which federal agencies have met their HUBZone contracting goals.

In examining the criteria that SBA uses to identify HUBZone areas, we reviewed applicable statutes, regulations, and agency documents. To assess the accuracy of SBA's map of HUBZone areas, we interviewed SBA's mapping contractor and reviewed the contractor's policies and procedures. In addition, we analyzed 2000 census data to (1) determine the economic characteristics, such as poverty and unemployment rates, of metropolitan and nonmetropolitan HUBZone areas and (2) illustrate the effect that adjusting the HUBZone area qualification criteria would have on the number of HUBZone areas. To determine how SBA ensures that only eligible small businesses participate in the HUBZone program, we reviewed policies and procedures established by SBA for certifying and monitoring HUBZone firms and internal control standards for federal agencies. We compared the actions that SBA takes to help ensure that only eligible firms participate with its policies and procedures and selected internal control standards. In examining such compliance, we analyzed data from the HUBZone Certification Tracking System (the information system used to manage the HUBZone program) to determine the extent of SBA monitoring. For example, we reviewed data on the 125 applications submitted in September 2007 to determine the extent to which SBA had requested documentation from firms to support the applications. Further, we analyzed data from the Federal Procurement Data System-Next Generation (FPDS-NG) and SBA's Dynamic Small Business Source System (DSBSS) to identify the characteristics of businesses that participated in the program.

To determine the measures that SBA has in place to assess the results of the HUBZone program, we reviewed SBA's performance reports and other agency documents. We compared the HUBZone performance measures with our guidance on the attributes of effective performance measures.[1] To determine the extent to which federal agencies have met their contracting goals, we analyzed data from FPDS-NG and SBA's reports on federal contracting dollars awarded to HUBZone firms. We also interviewed small business and contracting officials from a nongeneralizable sample of four agencies that received different ratings from SBA based on its contracting scorecard—Department of Commerce (Commerce), Department of Defense (DOD), Department of Homeland Security (DHS), and Social Security Administration (SSA)—to determine what factors affect federal agencies' ability to meet HUBZone contracting goals. In addition, we visited a nongeneralizable sample of four HUBZone areas—Lawton, Oklahoma (to represent Indian Country); Lowndes County, Georgia (a nonmetropolitan area); and Los Angeles and Long Beach, California (two metropolitan areas)—to interview stakeholders about what, if any,

[1]GAO, *Tax Administration: IRS Needs to Further Refine Its Tax Filing Season Performance Measures*, GAO-03-143 (Washington, D.C., Nov. 22, 2002).

benefits they believed the selected firms and communities received. We also interviewed SBA officials in headquarters and selected field offices, as well as SBA contractors. We assessed the reliability of the data we used and found them to be sufficiently reliable for the purposes of this report. Appendix I contains additional information on our scope and methodology.

We conducted this performance audit from August 2007 to June 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Results in Brief

SBA relies on federal law to identify qualified HUBZone areas, but the map it uses to publicize qualified HUBZone areas is inaccurate; in addition, the economic characteristics of HUBZone areas vary widely, which could diffuse the economic benefits of the program. To help firms interested in the program determine if they are located in a HUBZone area, SBA publishes a map on its Web site that serves as the primary information source about the program. However, the map contains areas that are not eligible for the program and excludes some eligible areas. Specifically, the map incorrectly includes 50 metropolitan counties as difficult development areas that do not meet this or any other criteria for inclusion in the HUBZone program. In addition, 27 nonmetropolitan counties that are eligible based on their unemployment rates were excluded because SBA has not updated its map since August 2006. As a result, ineligible small businesses participated in the program, and eligible businesses have not been able to participate. The HUBZone Act of 1997 designated three types of areas in which HUBZones could be located: qualified census tracts, nonmetropolitan counties, and Indian reservations, which qualified as economically distressed based on criteria such as low income levels and high unemployment and poverty rates. Subsequent legislation expanded the definitions of these types of areas and designated additional types of areas, such as redesignated areas (areas that no longer meet the economic criteria but remain eligible until after the release of the 2010 decennial census data). As a result, the number of qualified HUBZone areas increased from 7,895 in 1999 when the program was first implemented to 14,364 in 2006. HUBZone program officials told us that expanding the number of qualified HUBZone areas could diffuse the economic benefits of the program, and we found that types of HUBZone areas varied greatly with respect to characteristics associated with economic distress, such as poverty and unemployment rates. For example, approximately 60 percent of metropolitan-qualified census tracts (excluding the redesignated tracts) had a poverty rate of 30 percent or more; in contrast, about 4 percent of redesignated metropolitan census tracts had a poverty rate of 30 percent or more. While establishing new HUBZone areas could provide economic benefits to these new areas, it could also result in diffusion—less targeting to areas of greatest economic distress—by lessening the very competitive advantage upon which businesses may rely to thrive in economically distressed communities.

The mechanisms that SBA uses to certify and monitor HUBZone firms provide limited assurance that only eligible firms participate in the program. For certification and recertification, firms self-report information on their applications. Rather than providing specific guidance or criteria for when HUBZone program staff should request supporting documentation, SBA's policy allows the staff to determine what circumstances warrant a request for supporting documentation. Internal control standards for federal agencies require that agencies collect and maintain documentation and verify information to support their programs; however, we found that SBA requested documentation or conducted site visits of firms to validate the self-reported data in limited instances. Our analysis of the 125 applications submitted in September 2007 showed that SBA requested supporting documentation for 36 percent of the applications and conducted one site visit. While SBA's policies and procedures require program examinations—the one process that consistently includes reviews of supporting documentation—the agency conducts them on 5 percent of certified HUBZone firms each year. The recertification process offers SBA another opportunity to monitor firms, but SBA has not complied with its policy of recertifying firms every 3 years. More than 4,600 of the firms that have been in the program for at least 3 years (about 40 percent) have not been recertified. SBA officials stated that the agency lacked sufficient staff to meet the recertification goal and hired a contractor in December 2007 to help with recertification. However, SBA has not established a specific timeline to ensure that the backlog is eliminated. SBA also decertifies firms (removes them from the list of certified firms) after determining they no longer meet eligibility criteria. In fiscal years 2006 and 2007, SBA proposed decertification for more than 3,600 firms and ultimately decertified more than 2,900 ineligible firms that were participating in the program. However, SBA lacks formal guidance that would specify a time frame for processing these decertifications. Of the more than 3,600 firms proposed for decertification, more than 1,400 were not processed within SBA's informal goal of 60 days.

According to SBA officials, they plan to use their contract staff to address this problem after the recertification backlog is eliminated. As a result of a lack of controls (or limited application of controls) and weaknesses in the application and monitoring-related processes, SBA is unable to ensure that only eligible firms participate in the program and have opportunities to receive federal contracts based on their HUBZone certification.

SBA has taken limited steps to assess the effectiveness of the HUBZone program, and from 2003 to 2006, federal agencies did not meet the governmentwide contracting goal for the HUBZone program. SBA's current performance measures for the program track the number of firms certified or recertified, the annual value of contracts awarded to HUBZone firms, and the number of program examinations completed annually, but these measures are not directly linked to the program's mission of stimulating economic development in economically distressed communities. Federal agencies are required to identify results-oriented goals and measure performance toward the achievement of their goals. According to some local economic development officials in the HUBZone areas we visited, information on the program's impact could help them inform small businesses about the potential benefits. SBA has recognized the need to assess the effect of the program on communities but has not devoted resources to completing such an evaluation. Consequently, SBA lacks key information that could help it better manage and assess the results of the program. We also found that most federal agencies did not meet their HUBZone contracting goals during fiscal year 2006. While the percentage of prime contracting dollars awarded to HUBZone firms increased in each fiscal year from 2003 to 2006, the 2006 awards fell short of the governmentwide 3 percent goal by about one-third. According to contracting officials we interviewed, factors such as conflicting guidance on how to consider the various small business programs when awarding contracts and a lack of HUBZone firms in certain industries may have affected the ability of federal agencies to meet their HUBZone goals.

This report contains five recommendations designed to improve SBA's administration and oversight of the HUBZone program. We recommend that SBA correct and update its HUBZone map, develop and implement guidance to ensure more routine verification of application data, eliminate its backlog of recertifications, formalize and adhere to a specific time frame for decertifying ineligible firms, and further assess the effectiveness of the program. We provided SBA with a draft of this report for its review and comment. SBA agreed with our recommendations and outlined steps that it plans to take to address each of them. For example, the agency stated that it anticipates that the HUBZone map will be updated no later than August 29, 2008, and that it plans to develop procedures that will provide guidance on when supporting documentation and site visits will be required during certification. SBA's comments are reprinted in appendix II.

Background

The HUBZone program was established by the HUBZone Act of 1997 to stimulate economic development through increased employment and capital investment by providing federal contracting preferences to small businesses in economically distressed communities or HUBZone areas.[2] The types of areas in which HUBZones may be located are defined by law and consist of the following:

- *Qualified census tracts*. A qualified census tract has the meaning given the term by Congress for the low-income-housing tax credit program.[3] The list of qualified census tracts is maintained and updated by the Department of Housing and Urban Development (HUD). As currently defined, qualified census tracts have either 50 percent or more of their households with incomes below 60 percent of the area median gross income or have a poverty rate of at least 25 percent. The population of all census tracts that satisfy one or both of these criteria cannot exceed 20 percent of the area population. Qualified census tracts may be in metropolitan or nonmetropolitan areas. HUD designates qualified census tracts periodically as new decennial census data become available or as metropolitan area definitions change.

- *Qualified nonmetropolitan counties*. Qualified nonmetropolitan counties are those that, based on the most recent decennial census data, are not located in a metropolitan statistical area and in which

  1. the median household income is less than 80 percent of the nonmetropolitan state median household income;

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

[3]The low-income-housing tax credit program aims to increase the availability of low-income housing by providing a tax credit to owners of newly constructed or substantially rehabilitated low-income rental housing. Projects located in qualified census tracts are eligible for up to 30 percent more tax credits than identical projects not in qualified census tracts.

2. the unemployment rate is not less than 140 percent of the average unemployment rate for either the nation or the state (whichever is lower); or

3. a difficult development area is located.[4]

The definition of a difficult development area is similar to that of a qualified census tract in that it comes from the tax code's provision for the low-income-housing tax credit program. For the low-income-housing tax credit program, difficult development areas can be located in both metropolitan and nonmetropolitan counties; however, for the HUBZone program, they can only be located in nonmetropolitan counties in Alaska, Hawaii, and the U.S. territories and possessions.

- *Qualified Indian reservations*. A HUBZone-qualified Indian reservation has the same meaning as the term Indian Country as defined in another federal statute, with some exceptions. These are all lands within the limits of any Indian reservation, all dependent Indian communities within U.S. borders, and all Indian allotments. In addition, portions of the state of Oklahoma qualify because they meet the Internal Revenue Service's definition of "former Indian reservations in Oklahoma."

- *Redesignated areas*. Redesignated areas are census tracts or nonmetropolitan counties that no longer meet the economic criteria but remain eligible until after the release of the 2010 decennial census data.

- *Base closure areas*. Areas within the external boundaries of former military bases that were closed by the Base Realignment and Closure Act (BRAC) qualify for HUBZone status for a 5-year period from the date of formal closure.

In order for a firm to be certified to participate in the HUBZone program, it must meet the following criteria:

- the company must be small by SBA size standards;[5]

[4]Difficult development areas have high construction, land, and utility costs relative to area median income, and HUD designates new difficult development areas annually using a process that compares these costs.

[5]SBA's size standards are almost always stated either as the average employment or average annual receipts of a business concern and vary by industry.

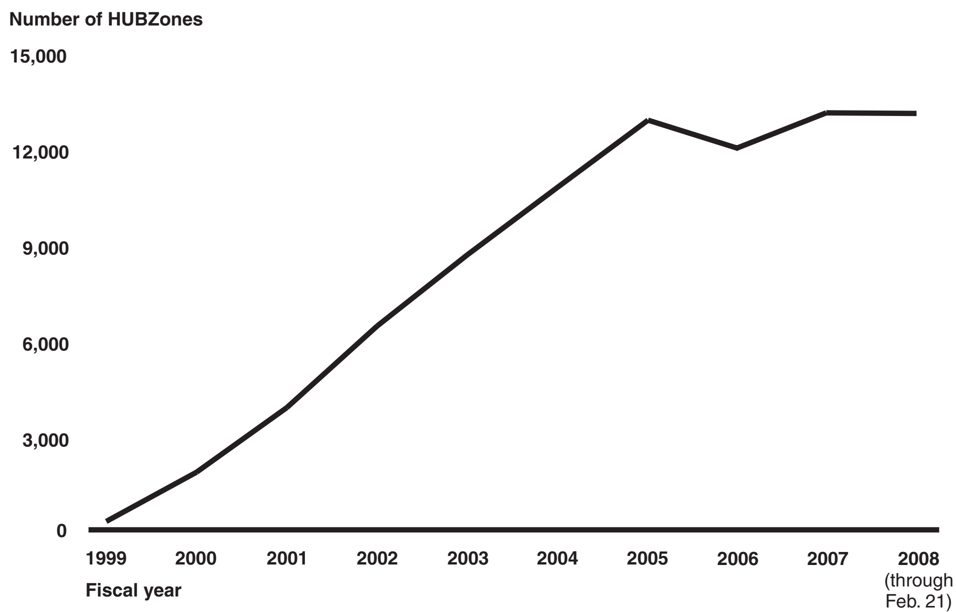
- the company must be at least 51 percent owned and controlled by U.S. citizens;[6]

- the company's principal office—the location where the greatest number of employees perform their work—must be located in a HUBZone;[7] and

- at least 35 percent of the company's full-time (or full-time equivalent) employees must reside in a HUBZone.

As of February 2008, 12,986 certified firms participated in the HUBZone program (see fig. 1). Over 4,200 HUBZone firms obtained approximately $8.1 billion in federal contracts in fiscal year 2007.

Figure 1: Number of Certified HUBZone Firms, Fiscal Years 1999-2008



Source: SBA.

[6]Qualified HUBZone firms can also be owned and controlled by Alaskan Native Corporations, Indian tribal governments, community development corporations, and agricultural cooperatives.

[7]While a small business must have its principal office in a HUBZone area, it does not have to limit its work to that HUBZone. Certified HUBZone businesses can bid on and receive federal contracts for work to be performed anywhere; that is, HUBZone contracts are not limited to HUBZone areas.

Note: The numbers for 1999 through 2007 are as of the end of the fiscal year. According to SBA officials, the number of certified firms has leveled off in recent years in part because of the maturing of the program and efforts by SBA to monitor the eligibility of HUBZone firms.

A certified HUBZone firm is eligible for federal contracting benefits, including "sole source" contracts, set-aside contracts, and a price evaluation preference. A contracting officer can award a sole source contract to a HUBZone firm if, among other things, the officer does not have a reasonable expectation that two or more qualified HUBZone firms will submit offers and the anticipated award price of the proposed contract, including options, will not exceed $5.5 million for manufacturing contracts or $3.5 million for all other contracts. If a contracting officer has a reasonable expectation that at least two qualified HUBZone firms will submit offers and an award can be made at a fair market price, the contract shall be awarded on the basis of competition restricted to qualified HUBZone firms. Contracting officers also can award a contract to a HUBZone firm through "full and open competition." In these circumstances, HUBZone firms are given a price evaluation preference of up to 10 percent if the apparent successful offering firm is not a small business. That is, the price offered by a qualified HUBZone firm shall be deemed as lower than the price offered by another firm (other than another small business) if the price is not more than 10 percent higher than the price offered by the firm with the lowest offer.

As of October 1, 2000, all federal agencies were required to meet the HUBZone program's contracting goals.[8] Currently, the annual federal contracting goal for HUBZone small businesses is 3 percent of all prime contract awards—contracts awarded directly by an agency. In the HUBZone Act of 1997, Congress increased the overall federal contracting goal for small businesses from 20 percent to 23 percent to address concerns that the HUBZone contracting requirement would reduce federal contracts for non-HUBZone small businesses. Each year, SBA issues a small business goaling report that documents each department's achievement of small business contracting goals.

SBA administers the HUBZone program, and the HUBZone program office at SBA headquarters is responsible for certifying firms, publishing a list of HUBZone-certified firms, monitoring certified firms to ensure continuing eligibility, and decertifying firms that no longer meet eligibility requirements. A HUBZone liaison at each of SBA's 68 district offices is

[8]Prior to that, a select number of agencies were subject to HUBZone goals.

responsible for conducting program examinations—investigations that verify the accuracy of information supplied by firms during the certification process, as well as current eligibility status. HUBZone liaisons also handle program marketing and outreach to the economic development and small business communities. Federal agencies are responsible for trying to meet the HUBZone contracting goal and for enforcing the contracts awarded to HUBZone firms. Each federal agency has an Office of Small and Disadvantaged Business Utilization (OSDBU), or an equivalent office, that helps the agency employ special contracting programs and monitor the agency's overall small business and special contracting goals.

In addition to the HUBZone program, SBA has other contracting assistance programs. The 8(a) program is a business development program for firms owned by citizens who are socially and economically disadvantaged. SBA provides technical assistance, such as business counseling, to these firms. While the 8(a) program offers a broad range of assistance to socially and economically disadvantaged firms, the Small Disadvantaged Business (SDB) program is intended only to convey benefits in federal procurement to disadvantaged businesses. All 8(a) firms automatically qualify for SDB certification, and federal agencies are subject to an annual SDB contracting goal of 5 percent of all federal contracting dollars. Small businesses also can be certified as service-disabled veteran-owned, and the contracting goal for these firms is 3 percent of all federal contracting dollars.

SBA Relies on Federal Law to Identify HUBZone Areas, but Its Map Is Inaccurate and the Economic Characteristics of Designated Areas Vary Widely

SBA relies on federal law to identify qualified HUBZone areas, but its HUBZone map is inaccurate and the economic characteristics of HUBZone areas vary widely. The map that SBA uses to publicize HUBZone areas contains ineligible areas and has not been updated to include eligible areas. As a result, ineligible small businesses have participated in the program, and eligible businesses have not been able to participate. A series of statutory changes has resulted in an increase in the number and types of HUBZone areas. HUBZone program officials noted that such an expansion could diffuse (or limit) the economic benefits of the program. We found that different types of HUBZone areas varied in the degree to which they could be characterized as economically distressed (as measured by indicators such as poverty and unemployment rates).

Recent Legislation Increased the Number and Types of HUBZone Areas

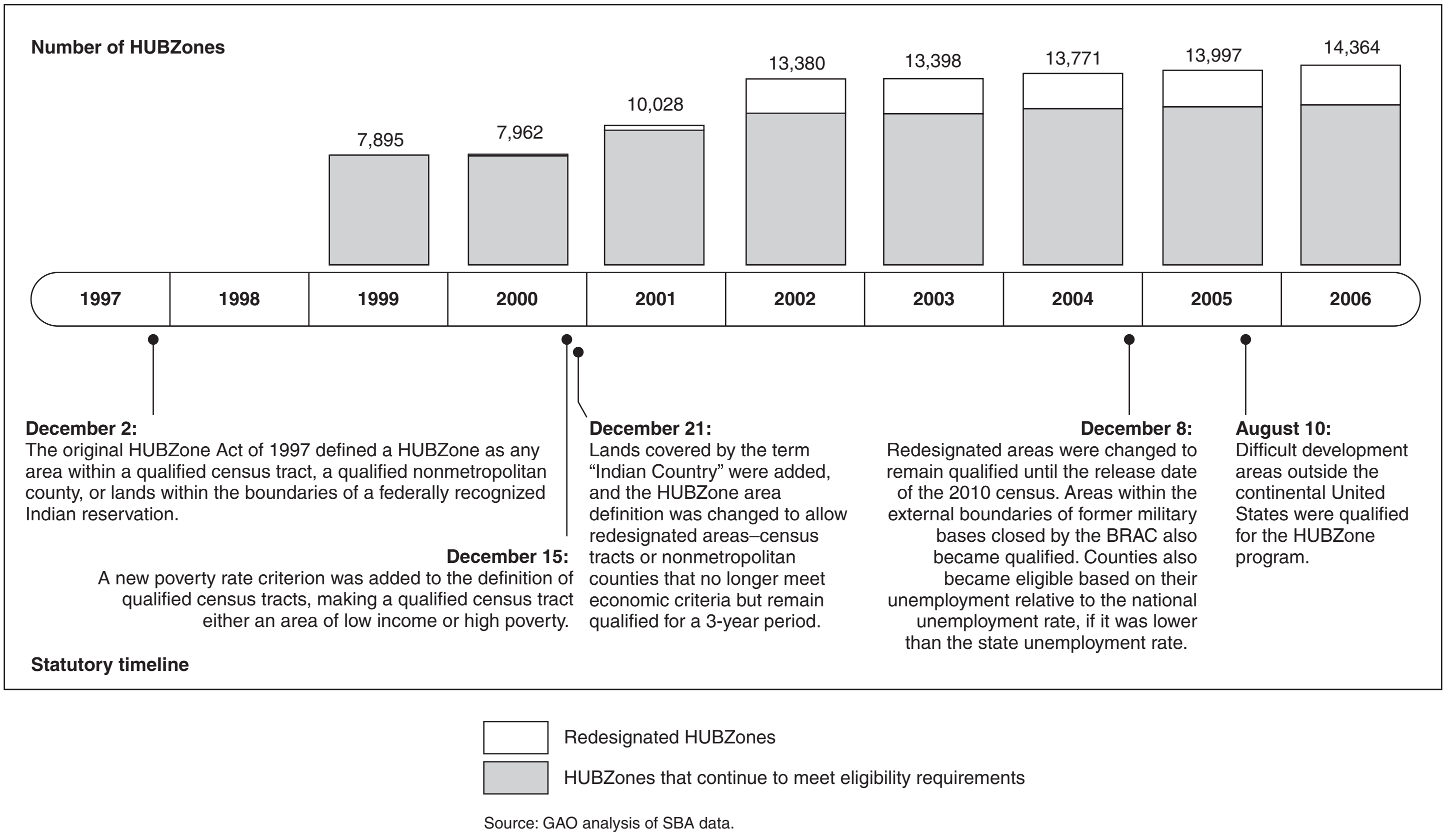
In recent years, amendments to the HUBZone Act and other statutes have increased the number and type of HUBZone areas. The original HUBZone Act of 1997 defined a HUBZone as any area within a qualified census tract, a qualified nonmetropolitan county, or lands within the boundaries of a federally recognized Indian reservation. Qualified census tracts were defined as having the meaning given the term in the tax code at the time—areas in which 50 percent or more of the households had incomes below 60 percent of the area median gross income. Qualified nonmetropolitan areas were counties with low median household income or high levels of unemployment.

However, subsequent legislation revised the definitions of the original categories and expanded the HUBZone definition to include new types of qualified areas (see fig. 2). A 2000 statute (1) defined Indian reservation to include lands covered by the Bureau of Indian Affairs' phrase Indian Country and (2) allowed all lands within the jurisdictional areas of an Oklahoma Indian tribe to be eligible for the program.[9] The 2000 statute also amended the HUBZone area definition to allow census tracts or nonmetropolitan counties that ceased to be qualified to remain qualified for a further 3-year period as "redesignated areas." Also in 2000, Congress changed the definition of a qualified census tract in the tax code by adding a poverty rate criterion; that is, a qualified census tract could be either an area of low income or high poverty.[10]

[9]HUBZones in Native America Act of 2000, Pub. L. No. 106-554, Title VI, Subtitle A, § 604, 114 Stat. 2763, 2763A-698 (2000).

[10]Pub. L. No. 106-554, § 1(a)(7) (title I, § 135(b)), 114 Stat. 2763, 2763A-613 (2000).

Figure 2: Statutory Changes to Definitions for HUBZone Areas and Effect on Number of HUBZones, 1997-2006



Source: GAO analysis of SBA data.

A 2004 statute revised the definition of redesignated areas to permit them to remain qualified until the release date of the 2010 census data.[11] In that same statute, Congress determined that areas within the external boundaries of former military bases closed by BRAC would qualify for HUBZone status for a 5-year period from the date of formal closure. In addition, Congress revised the definition of qualified nonmetropolitan counties to permit eligibility based on a county's unemployment rate relative to either the state or the national unemployment rate, whichever was lower. Finally, in 2005, Congress expanded the definition of qualified nonmetropolitan county to include "difficult development areas" in Alaska,

[11]Small Business Reauthorization and Manufacturing Assistance Act of 2004, Pub. L. No. 108-447, Div. K, ch. 3, subtitle E, § 152(c), 118 Stat. 2809, 3457 (2004).

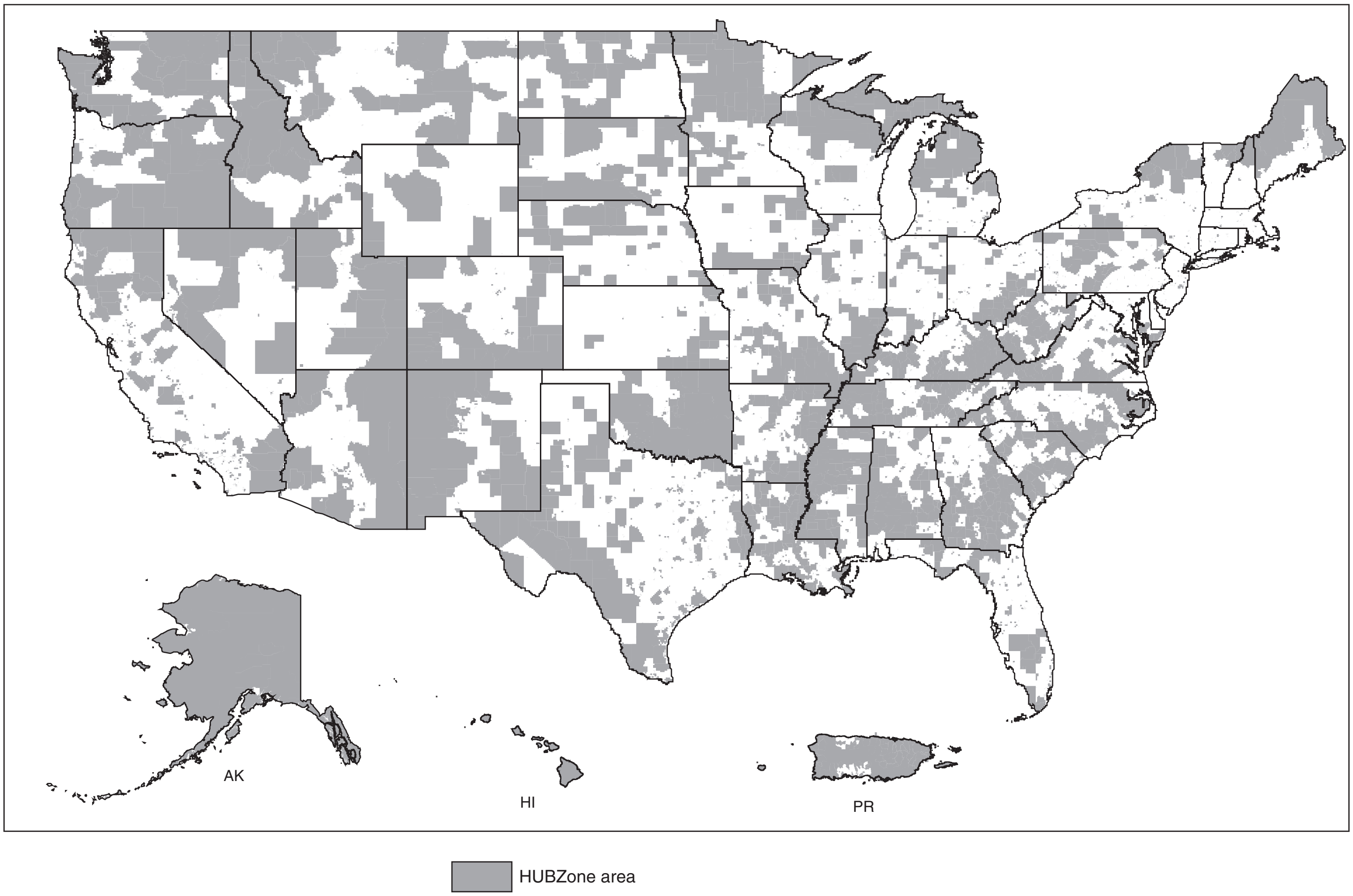
Hawaii, and the U.S. territories.[12] These areas have high construction, land, and utility costs relative to area median income.

Subsequent to the statutory changes, the number of HUBZone areas grew from 7,895 in calendar year 1999 to 14,364 in 2006. As shown in figure 2, the December 15, 2000, change to the definition of a qualified census tract—a provision of the low-income-housing tax credit program—resulted in the biggest increase in the number of qualified HUBZone areas. SBA's data show that, as of 2006, there were 12,218 qualified census tracts, 1,301 nonmetropolitan counties, 651 Indian Country areas, 82 BRAC areas, and 112 difficult development areas (see fig. 3).[13]

[12]Pub. L. No. 109-59, § 10203, 119 Stat. 1144, 1933 (2005).

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

Figure 3: Location and Extent of HUBZone Areas, 2006

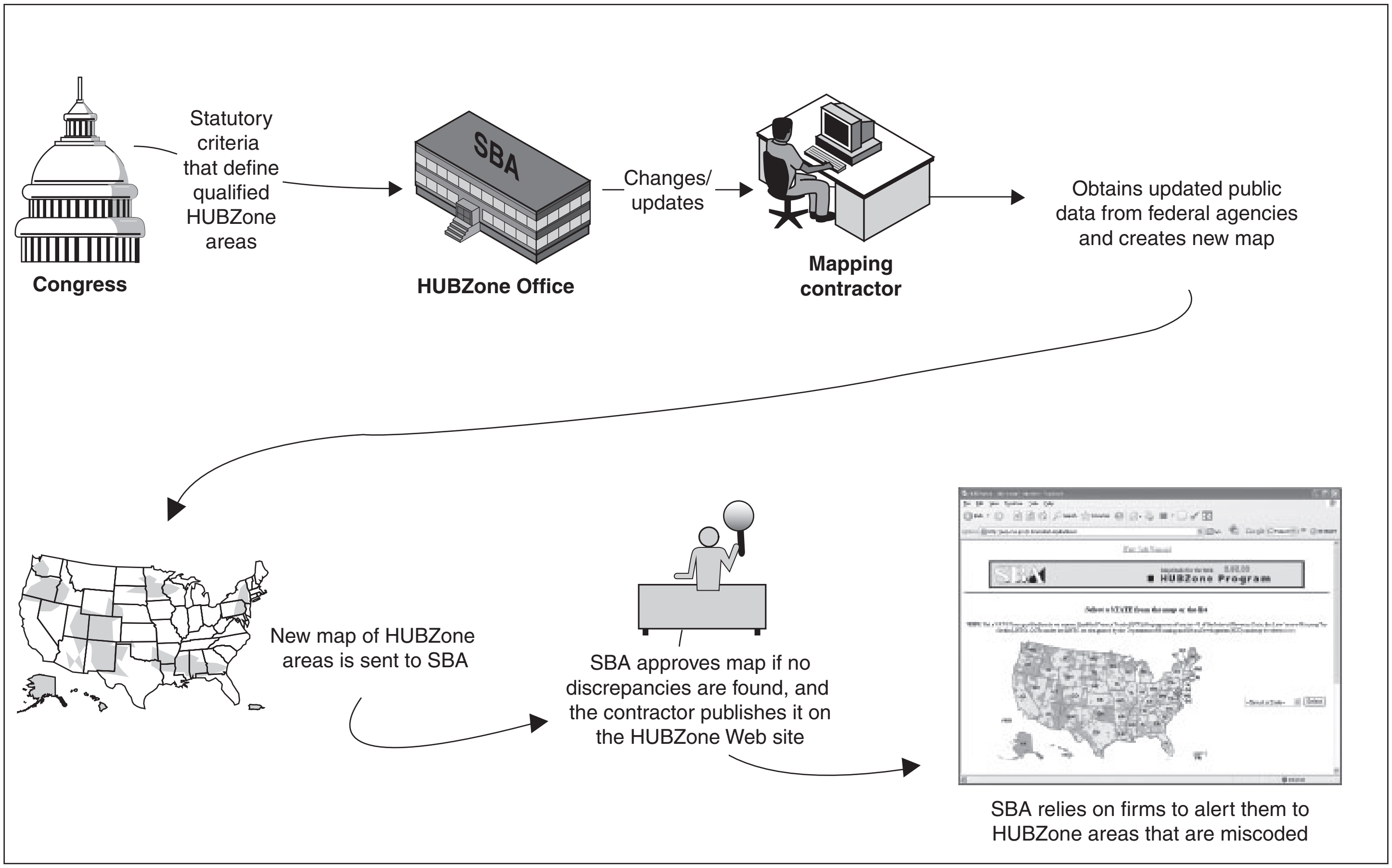


Sources: SBA (data); MapInfo (map).

SBA's Web Map Inaccurately Identifies Eligible Areas

SBA program staff employ no discretion in identifying HUBZone areas because the areas are defined by federal statute, but SBA has not always designated these areas correctly on the SBA Web map. To identify and map HUBZone areas, SBA relies on a mapping contractor and data from other executive agencies (see fig. 4). When a HUBZone designation changes or more current data become available, SBA alerts the contractor. The contractor retrieves the data from the designated federal agencies, such as HUD, the Bureau of Labor Statistics (BLS), and the Census Bureau. Most HUBZone area designation data are publicly available (and widely used by researchers and the general public), with the exception of the Indian Country designation.

Figure 4: Process Used to Map HUBZone Areas



Sources: GAO analysis of SBA documents and interviews; Art Explosion (images).

Once the changes to the HUBZone areas are mapped, the contractor sends the maps back to SBA. SBA performs a series of checks to ensure that the HUBZone areas are mapped correctly and then the contractor places the maps and associated HUBZone area information on SBA's Web site.[14]

[14]A small business can find the location of HUBZone areas using mapping software available on the HUBZone Web site. The system allows searches by address, county, city, or state and displays HUBZone areas with labels identifying the designations under which the area qualifies (for example, census tract, nonmetropolitan county, Indian Country, BRAC area, and difficult development area).

Essentially, the map is SBA's primary interface with small businesses to determine if they are located in a HUBZone and can apply for HUBZone certification. SBA officials stated that they primarily rely on firms to identify HUBZone areas that have been misidentified or incorrectly mapped. Based on client input, SBA estimated that from 1 percent to 2 percent of firms searching the map as part of the application process report miscodings. SBA's mapping contractor researches these claims each month.

During the course of our review, we identified two problems with SBA's HUBZone map. First, the map includes some areas that do not meet the statutory definition of a HUBZone area. As noted previously, counties containing difficult development areas are only eligible in their entirety for the HUBZone program if they are not located in a metropolitan statistical area. However, we found that SBA's HUBZone map includes 50 metropolitan counties as difficult development areas that do not meet this or any other criteria for inclusion as a HUBZone area. Nearly all of these incorrectly designated HUBZone areas are in Puerto Rico.[15] When we raised this issue with SBA officials, they told us they had provided a definition of difficult development areas that was consistent with the statutory language used by the agency's mapping contractor in December 2005. However, according to SBA, the mapping contactor failed to properly follow SBA's guidance when adding difficult development areas to the map in 2006. According to SBA officials, the agency is in the process of acquiring additional mapping services and will immediately re-evaluate all difficult development areas once that occurs. As a result of these errors, ineligible firms have obtained HUBZone certification and received federal contracts. As of December 2007, there were 344 certified HUBZone firms located in ineligible areas in these 50 counties. Further, from October 2006 through March 2008, federal agencies obligated about $5 million through HUBZone set-aside contracts to 12 firms located in these ineligible areas.

Second, while SBA's policy is to have its contractor update the HUBZone map as needed, the map has not been updated since August 2006.[16] Since

[15]More specifically, 47 were in Puerto Rico, 2 were in Alaska, and 1 was in Hawaii. Puerto Rico consists of 78 municipios, which are the equivalent of counties; the 47 difficult development areas on the HUBZone map cover about half of Puerto Rico.

[16]SBA officials told us that, in September 2006, SBA began the process of having the contractor update the map. However, this update never occurred.

that time, additional data such as unemployment rates from BLS have become available. According to SBA officials, the update was delayed because SBA awarded the contract for management of the HUBZone system to a new prime contractor, which is still in the process of establishing a relationship with the current mapping subcontractor. Although SBA officials told us they are working to have the contractor update the mapping system, no subcontract was in place as of May 2008.

While an analysis of the 2008 list of qualified census tracts showed that the number of tracts had not changed since the map was last updated, our analysis of 2007 BLS unemployment data indicated that 27 additional nonmetropolitan counties should have been identified on the map. Because firms are not likely to receive information on the HUBZone status of areas from other sources, firms in the 27 areas would have believed from the map that they were ineligible to participate in the program and could not benefit from contracting incentives that certification provides.

Having an out-of-date map led SBA, in one instance, to mistakenly identify a HUBZone area. When asked by a congressman to research whether Jackson County, Michigan, qualified in its entirety as a HUBZone area, an SBA official used a manual process to determine the county's eligibility because the map was out of date. The official mistakenly concluded that the county was eligible. After that determination, the congressman publicized Jackson County's status, but SBA, after further review, had to rescind its HUBZone status 1 week later. Had the information been processed under the standard mapping procedures, the mapping system software would have identified the area as a metropolitan county and noted that it did not meet the criteria to be a HUBZone, as only nonmetropolitan counties qualify in their entirety. In this case, the lack of regular updates led to program officials using a manual process that resulted in an incorrect determination.

HUBZone Areas Vary with Respect to Characteristics Associated with Economic Distress

Qualified HUBZone areas experience a range of economic conditions. HUBZone program officials told us that the growth in the number of HUBZone areas is a concern for two reasons. First, they stated that expansion can diffuse the impact or potential impact of the program on existing HUBZone areas. Specifically, they noted that as the program becomes less targeted and contracting dollars more dispersed, the program could have less of an impact on individual HUBZone areas. We recognize that establishing new HUBZone areas can potentially provide economic benefits for these areas by helping them attract firms that make investments and employ HUBZone residents. However, diffusion—less targeting to areas of greatest economic distress—could occur with such an expansion. Based on 2000 census data, about 69 million people (out of 280 million nationwide) lived in the more than 14,000 HUBZones.[17] Considering that HUBZone firms are encouraged to locate in HUBZone areas and compete for federal contracts (thus facilitating employment and investment growth), the broad extent of eligible areas can lessen the very competitive advantage that businesses may rely on to thrive in economically distressed communities. Second, while HUBZone program officials thought that the original designations resulted in HUBZone areas that were economically distressed, they questioned whether some of the later categories—such as redesignated and difficult development areas—met the definition of economic distress.

To determine the economic characteristics of HUBZones, we compared different types of HUBZone areas and analyzed various indicators associated with economic distress. We found a marked difference in the economic characteristics of two types of HUBZone areas: (1) census tracts and nonmetropolitan counties that continue to meet the eligibility criteria and (2) the redesignated areas that do not meet the eligibility criteria but remain statutorily eligible until the release of the 2010 census data. For example, approximately 60 percent of metropolitan census tracts (excluding redesignated 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 (see fig. 5). In addition, about 75 percent of metropolitan census tracts (excluding redesignated tracts) had a median household income that was less than 60 percent of the metropolitan area median household income; in contrast, about 10 percent of redesignated metropolitan census tracts met these criteria. (For information on the economic characteristics of nonmetropolitan census tracts, see app. III.)

[17]The figure for residents of HUBZone areas includes only those areas within the 50 states and District of Columbia.

Figure 5: Comparison of Indicators Associated with Economic Distress, by HUBZone Metropolitan Census Tracts and Redesignated Tracts

		Metropolitan census tracts (no redesignated areas) Number	Metropolitan census tracts (no redesignated areas) Percentage	Redesignated metropolitan census tracts Number	Redesignated metropolitan census tracts Percentage
Poverty rate	40% or more	2,237	25.77	8	0.63
	30.0 - 39.9%	2,926	33.71	43	3.36
	20.0 - 29.9%	2,911	33.53	560	43.82
	10.0 - 19.9%	519	5.98	548	42.88
	Less than 10%	88	1.01	119	9.31
Unemployment rate	20% or more	1,558	17.95	54	4.23
	15.0 - 19.9%	1,641	18.90	62	4.85
	10.0 - 14.9%	2,719	31.32	274	21.44
	5.0 - 9.9%	2,230	25.69	602	47.10
	Less than 5%	533	6.14	286	22.38
Percentage of metropolitan area median household income	Less than 40%	1,935	22.29	31	2.43
	40.0 - 49.9%	1,949	22.45	4	0.31
	50.0 - 59.9%	2,636	30.37	88	6.89
	60.0 - 69.9%	1,539	17.73	473	37.01
	70% or more	622	7.17	682	53.36
Percentage of metropolitan area median housing value	Less than 50%	3,380	38.94	215	16.82
	50.0 - 59.9%	1,589	18.30	212	16.59
	60.0 - 69.9%	1,326	15.27	246	19.25
	70.0 - 79.9%	852	9.81	210	16.43
	80% or more	1,534	17.67	395	30.91
	Total	**8,681**		**1,278**	

Source: GAO analysis of 2000 decennial census data.

Note: This table only provides descriptive statistics for those metropolitan-qualified census tracts that were located (1) within the 50 states or District of Columbia and (2) in a metropolitan area as defined in 2006.

Similarly, we found that about 46 percent of nonmetropolitan counties (excluding redesignated 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 (see fig. 6). Also, about 54 percent of nonmetropolitan counties (excluding redesignated counties) had a median housing value that was less than 80 percent of the state nonmetropolitan median housing value; in contrast, about 32 percent of redesignated counties met these criteria.

Figure 6: Comparison of Indicators Associated with Economic Distress in HUBZone Nonmetropolitan Counties and Redesignated Nonmetropolitan Counties

		Nonmetropolitan counties (no redesignated areas) Number	Percentage	Redesignated nonmetropolitan counties Number	Percentage
Poverty rate	40% or more	12	2.48	0	0
	30.0 - 39.9%	56	11.59	7	1.03
	20.0 - 29.9%	156	32.30	137	20.18
	10.0 - 19.9%	232	48.03	438	64.51
	Less than 10%	27	5.59	97	14.29
Unemployment rate	20% or more	7	1.45	0	0
	15.0 - 19.9%	22	4.55	2	0.29
	10.0 - 14.9%	91	18.84	49	7.22
	5.0 - 9.9%	294	60.87	465	68.48
	Less than 5%	69	14.29	163	24.01
Percentage of state nonmetropolitan area median household income	Less than 40%	1	0.21	0	0
	40.0 - 49.9%	1	0.21	0	0
	50.0 - 59.9%	6	1.24	0	0
	60.0 - 69.9%	33	6.83	1	0.15
	70% or more	442	91.51	678	99.85
Percentage of state nonmetropolitan area median housing value	Less than 50%	36	7.45	19	2.80
	50.0 - 59.9%	38	7.87	24	3.53
	60.0 - 69.9%	84	17.39	66	9.72
	70.0 - 79.9%	103	21.33	108	15.91
	80% or more	222	45.96	462	68.04
	Total	**483**		**679**	

Source: GAO analysis of 2000 decennial census data.

Note: This table only provides descriptive statistics for those qualified nonmetropolitan counties that are located within the 50 states and District of Columbia and that were considered to be nonmetropolitan as of 2006.

Overall, difficult development areas appear to be less economically distressed than metropolitan census tracts and nonmetropolitan counties (see fig. 7). For example, 6 of 28 difficult development areas (about 21 percent) had poverty rates of 20 percent or more. In contrast, about 93 percent of metropolitan census tracts (excluding redesignated areas) and about 46 percent of nonmetropolitan counties (excluding redesignated areas) met this criterion. See appendix III for additional details on the economic characteristics of Indian Country areas and additional analyses illustrating the economic diversity among qualified HUBZone areas.[18]

Figure 7: Indicators Associated with Economic Distress in HUBZone Difficult Development Areas

		Difficult development areas	Number	Percentage
Poverty rate	40% or more		1	3.57
	30.0 - 39.9%		0	0
	20.0 - 29.9%		5	17.86
	10.0 - 19.9%		13	46.43
	Less than 10%		9	32.14
Unemployment rate	20% or more		2	7.14
	15.0 - 19.9%		5	17.86
	10.0 - 14.9%		11	39.29
	5.0 - 9.9%		8	28.57
	Less than 5%		2	7.14
Percentage of state nonmetropolitan area median household income	Less than 40%		1	3.57
	40.0 - 49.9%		0	0
	50.0 - 59.9%		0	0
	60.0 - 69.9%		2	7.14
	70% or more		25	89.29
Percentage of state nonmetropolitan area median housing value	Less than 50%		3	10.71
	50.0 - 59.9%		2	7.14
	60.0 - 69.9%		3	10.71
	70.0 - 79.9%		5	17.86
	80% or more		15	53.57
		Total	**28**	

Source: GAO analysis of 2000 decennial census data.

Note: This table only provides descriptive statistics for those qualified difficult development areas that are located in nonmetropolitan areas within Alaska and Hawaii.

In expanding the types of HUBZone areas, the definition of economic distress has been broadened to include measures that were not in place in the initial statute. For example, one new type of HUBZone area—difficult development areas—consists of areas with high construction, land, and utility costs relative to area income, and such areas could include

[18]We do not report on the economic characteristics of qualified base closure areas because these areas do not coincide with areas for which census data are collected.

neighborhoods not normally considered economically distressed. As a result, the expanded HUBZone criteria now allow for HUBZone areas that are less economically distressed than the areas that were initially designated. Such an expansion could diffuse the benefits to be derived from steering businesses to economically distressed areas.

SBA Has Limited Controls to Ensure That Only Eligible Firms Participate in the HUBZone Program

The policies and procedures upon which SBA relies to certify and monitor firms provide limited assurance that only eligible firms participate in the HUBZone program. Internal control standards for federal agencies state that agencies should document and verify information that they collect on their programs. However, SBA obtains supporting documentation from firms in limited instances and rarely conducts site visits to verify the information that firms provide in their initial application and during periodic recertifications—a process through which SBA can monitor firms' continued eligibility. In addition, SBA does not follow its own policy of recertifying all firms every 3 years—which can lengthen the time a firm goes unmonitored and its eligibility is unreviewed—and has a backlog of more than 4,600 firms to recertify. Furthermore, SBA largely has not met its informal goal of 60 days for removing firms deemed ineligible from its list of certified firms. We found that of the more than 3,600 firms that were proposed for decertification in fiscal years 2006 and 2007, more than 1,400 were not processed within 60 days. As a result, there is an increased risk that ineligible firms may participate in the program and have opportunities to receive federal contracts based on HUBZone certification.

SBA Largely Relies on Self-Reported Data for HUBZone Certifications and Recertifications, Increasing the Risk That Ineligible Firms Can Participate

To certify and recertify HUBZone firms, SBA relies on data that firms enter in its online application system; however, the agency largely does not verify the self-reported information.

SBA's Certification and Recertification Processes Are Similar

The certification and recertification processes are similar. Firms apply for HUBZone certification using an online application system, which employs automated logic steps to screen out ineligible firms based on the information entered on the application. For example, firms enter information such as their total number of employees and number of employees that reside in a HUBZone. Based on this information, the system then calculates whether the number of employees residing in a

HUBZone equals 35 percent or more of total employees, the required level for HUBZone eligibility.

HUBZone program staff review the applications to determine if more information is required. While SBA's policy states that supporting documentation normally is not required, it notes that agency staff may request and consider such documentation, as necessary. No specific guidance or criteria are provided to program staff for this purpose; rather, the policy allows staff to determine what circumstances warrant a request for supporting documentation. In determining whether additional information is required, HUBZone program officials stated that they generally consult sources such as firms' or state governments' Web sites that contain information on firms incorporated in the state.[19] In addition, HUBZone program officials stated that they can check information such as a firm's address using the Central Contractor Registration (CCR) database.[20] According to HUBZone program officials, they are in the process of obtaining Dun and Bradstreet's company information (such as principal address, number of employees, and revenue) to cross-check some application data.[21] While these data sources are used as a cross-check, the data they contain are also self-reported.

The number of applications submitted by firms grew by more than 40 percent from fiscal year 2000 to fiscal year 2007, and the application approval rate varied. For example, as shown in table 1, 1,527 applications were submitted in fiscal year 2000, and SBA approved 1,510 applications (about 99 percent). In fiscal year 2007, 2,204 applications were submitted, and SBA approved 1,721 (about 78 percent). Of the 2,204 applications submitted in fiscal year 2007, 383 (about 17 percent) were withdrawn. Either the firms themselves or SBA staff can withdraw an application if it is believed the firm will not meet program requirements. HUBZone program staff noted that they withdraw applications for firms that could, if they made some minor modifications, be eligible. Otherwise, firms would

[19]For example, the Georgia Secretary of State's Web site contains a search feature that provides information such as the principal office address for firms incorporated in Georgia.

[20]CCR is a database managed by the Department of Defense that maintains information on all businesses that want to contract with the federal government. Businesses are required to provide information such as their address and the goods and services they provide. Contracting officers use the data to make contracting decisions.

[21]According to HUBZone program officials, they plan to use data from the standard company reports that Dun and Bradstreet maintains. They noted, however, that such data may not be available for all firms that apply for the program.

have to wait 1 year before they could reapply. The remaining 100 applications (about 5 percent) submitted in fiscal year 2007 were declined because the firms did not meet the HUBZone eligibility requirements. See appendix IV for details on the characteristics of current HUBZone firms.

Table 1: Number and Status of Applications for HUBZone Program, Fiscal Years 2000-2007

	2000	2001	2002	2003	2004	2005	2006	2007
Applications submitted	1,527	3,027	3,560	3,047	3,294	3,023	3,156	2,204
Applications approved	1,510	2,570	2,662	2,160	2,195	2,167	2,386	1,721
Percentage of applications approved	98.9	84.9	74.8	70.9	66.6	71.7	75.6	78.1
Applications withdrawn	0	418	653	576	864	663	704	383
Percentage of applications withdrawn	0	13.8	18.3	18.9	26.2	21.9	22.3	17.4
Applications declined	17	39	245	311	235	193	66	100
Percentage of applications declined	1.1	1.3	6.9	10.2	7.1	6.4	2.1	4.5

Source: GAO analysis of data from HUBZone Certification Tracking System (as of Jan. 22, 2008).

Note: SBA does not track the number of applications started by a firm but not submitted to SBA for review. The total for applications submitted in 2007 does not include two applications still in process as of January 22, 2008.

To ensure the continued eligibility of certified HUBZone firms, SBA requires firms to resubmit an application. That is, to be recertified, firms re-enter information in the online application system, and HUBZone program officials review it. In 2004, SBA changed the recertification period from an annual recertification to every 3 years.[22] According to HUBZone program officials, they generally limit their reviews to comparing resubmitted information to the original application. The officials added that significant changes from the initial application can trigger a request for additional information or documentation. If concerns about eligibility are raised during the recertification process, SBA will propose decertification or removal from the list of eligible HUBZone firms. Firms

[22]Until the online recertification system became available in 2005, the annual recertification process consisted of firms e-mailing HUBZone program officials a statement that the firms continued to meet the eligibility criteria.

that are proposed for decertification can challenge that proposed outcome through a due-process mechanism. SBA ultimately decertifies firms that do not challenge the proposed decertification and those that cannot provide additional evidence that they continue to meet the eligibility requirements. For example, as shown in table 2, SBA began 3,278 recertifications in fiscal year 2006 and had completed decertification of 1,699 firms as of January 22, 2008. Although SBA does not systematically track the reasons why firms are decertified, HUBZone program officials noted that many firms do not respond to SBA's request for updated information. We discuss this issue and others related to the timeliness of the recertification and decertification processes later in this report.

Table 2: Number and Status of Recertifications of HUBZone Firms, Fiscal Years 2005-2007

	Year recertification began		
	2005	2006	2007
Number of firms subject to recertification[a]	1,101	3,278	2,419
Withdrawn by SBA headquarters[b]	5	18	8
Reviews still in process as of January 22, 2008[c]	5	17	45
Firms recertified	331	890	278
Firms still proposed for decertification as of January 22, 2008[d]	58	654	1,794
Percent still proposed for decertification as of January 22, 2008	5.3	20.0	74.2
Firms decertified[e]	702	1,699	294
Percentage decertified	63.8	51.8	12.2

Source: GAO analysis of data from the HUBZone Certification Tracking System (as of Jan. 22, 2008).

Notes: SBA did not adopt the policy of recertifying firms every 3 years until 2004; therefore, the first year of reportable results was 2005.

[a]These data are based on the year that SBA began the recertification.

[b]According to SBA officials, they withdrew (or rescheduled to the next year) some recertifications because, for example, a HUBZone firm may not have the technical capabilities to fill out the application online as required. In these cases, SBA will allow the firm additional time to obtain the necessary technical capabilities by conducting the recertification the following year.

[c]These are cases where SBA has yet to make a determination as to whether a firm should be recertified or proposed for decertification.

[d]Firms that are proposed for decertification can challenge that proposed outcome through a due-process mechanism.

[e]This category includes firms determined to be ineligible, and thus decertified by SBA, and firms that requested decertification. Firms that were determined to be ineligible by SBA were proposed for decertification before actually being decertified by SBA.

SBA's Certification and Recertification Processes Provide Limited Assurance That Information Supplied by Firms Is Accurate

We found that SBA verifies the information it receives from firms in limited instances. In accord with SBA's policy, HUBZone program staff request documentation from firms and conduct site visits when they feel it is warranted. The HUBZone Certification Tracking System does not readily provide information on the extent to which SBA requests documentation from firms or conducts site visits; therefore, we conducted reviews of applications and recertifications. Specifically, we reviewed the 125 applications and 15 recertifications submitted or begun in September 2007. For the applications submitted in September 2007, HUBZone program staff

- requested additional information but not supporting documentation for 10 (8 percent) of the applications;
- requested supporting documentation for 45 (36 percent) of the applications; and
- conducted one site visit.

After reviewing supporting documentation for the 45 applications, SBA ultimately approved 19 (about 42 percent). Of the remaining 26 applications, 21 (about 47 percent of the 45 applications) were withdrawn by either SBA or the firm, and 5 (about 11 percent of the 45 applications) were denied by SBA. For the 15 firms that SBA began recertifying in September 2007, HUBZone program staff requested information and documentation from 2 firms and did not conduct any site visits.[23]

In the instances when SBA approved an application without choosing to request additional information or documentation (about 50 percent of our application sample), HUBZone program staff generally recorded in the HUBZone system that their determination was based on the information in the application and that SBA was relying on the firm's certification that all information was true and correct. In requesting additional information, HUBZone staff asked such questions as the approximate number of employees and type of work performed at each of the firm's locations.

[23]We excluded from our analysis three applications submitted in September 2007 and two firms that began the recertification process in September 2007 because these actions were still in process as of January 22, 2008 (the date we received the data). Of the 125 applications, SBA approved 90 and declined 7. The remaining 28 were withdrawn by either SBA or the firm. The 15 recertifications resulted in 14 firms being recertified and 1 firm being decertified.

When requesting supporting documentation, HUBZone staff requested items such as copies of driver's licenses or voter's registration cards for the employees that were HUBZone residents and a rental/lease agreement or deed of trust for the principal office.

Internal control standards for federal agencies and programs require that agencies collect and maintain documentation and verify information to support their programs.[24] The documentation also should provide evidence of accurate and appropriate controls for approvals, authorizations, and verifications. For example, in addition to automated edits and checks, conducting site visits to physically verify information provided by firms can help control the accuracy and completeness of transactions or other events.

According to HUBZone program officials, they did not more routinely verify the information because they generally relied on their automated processes and status protest process.[25] For instance, they said they did not request documentation to support each firm's application because the application system employs automated logic steps to screen out ineligible firms. For example, as previously noted, the application system calculates the percentage of a firm's employees that reside in a HUBZone and screens out firms that do not meet the 35 percent requirement. But the automated application system would not necessarily screen out applicants that submit false information to obtain a HUBZone certification. HUBZone program officials also stated that it is not necessary to conduct site visits of HUBZone firms because firms self-police the program through the HUBZone status protest process. However, relatively few protests have occurred in recent years.[26] In addition, officials from SBA's HUBZone office did not indicate a reliable mechanism HUBZone firms could use to identify information that could be used in a status protest. For example, it is unclear how a firm in one state would know enough about a firm in

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[24] GAO, *Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C., August 2001).

[25] The HUBZone status protest process allows SBA, contracting officers, or any interested party to protest the qualified HUBZone status of any awardee or apparent awardee of a federal contract. An interested party is any firm that submits an offer for a specific HUBZone contract or submits an offer in full and open competition and whose opportunity for award will be affected by a price evaluation preference given to a qualified HUBZone firm.

[26] In fiscal years 2005 and 2006, there were 21 protests; in fiscal year 2007, there were 23 protests.

another state, such as its principal office location or employment of HUBZone residents, to question its qualified HUBZone status.

Rather than obtaining supporting documentation during certification and recertification on a more regular basis, SBA waits until it is conducting examinations of a small percentage of firms to consistently request supporting documentation. The 1997 statute that created the HUBZone program authorized SBA to conduct program examinations of HUBZone firms. Since fiscal year 2004, SBA's policy has been to conduct program examinations on 5 percent of firms each year.[27] Over the years, SBA has developed a standard process for conducting these examinations. SBA uses three selection factors to determine which firms will be examined each year.[28] After firms have been selected for a program examination, SBA field staff request documentation from them to support their continued eligibility for the program. For instance, they request documents such as payroll records to evaluate compliance with the requirement that 35 percent or more of employees reside in a HUBZone and documents such as organization charts and lease agreements to document that the firm's principal office is located in a HUBZone. After reviewing this documentation, the field staff recommend to SBA headquarters whether the firm should remain in the program. As shown in table 3, in fiscal years 2004 through 2006 nearly two-thirds of firms SBA examined were decertified, and in fiscal year 2007, 430 of 715 firms (about 60 percent) were decertified or proposed for decertification. The number of firms decertified includes firms that the agency determined to be ineligible, and were decertified, and firms that requested to be decertified.

[27]Before fiscal year 2004, program examinations were conducted on an as-needed basis.

[28]The selection factors are: the top 250 firms (based on dollar volume of contracts), firms that have had their eligibility questioned by the public or others in a given year, and a random selection of other firms (to reach the total of 5 percent of firms).

Table 3: Number and Status of SBA Examinations of HUBZone Firms, Fiscal Years 2004-2007

	Year program examination began			
	2004	2005	2006	2007
Number of firms subject to program examinations[a]	556	703	688	715
Withdrawn by SBA headquarters[b]	37	21	10	28
Reviews still in process as of January 22, 2008[c]	0	0	5	25
Firms that retained certification	168	235	208	232
Firms still proposed for decertification as of January 22, 2008[d]	0	0	6	82
Firms decertified[e]	351	447	459	348
Percentage decertified	63.1	63.6	66.7	48.7

Source: GAO analysis of data from the HUBZone Certification Tracking System (as of Jan. 22, 2008).

[a]SBA selects a large number of firms to examine each year but withdraws a number of them before they are assigned to an analyst. Therefore, the program examinations we included in our analysis are limited to those that were assigned to an analyst. These data are based on the year that SBA began the program examination.

[b]According to SBA officials, they withdrew (or rescheduled to the next year) some program examinations because, for example, a HUBZone firm may not have the technical capabilities to fill out the required form. In these cases, SBA will allow the firm additional time to obtain the necessary technical capabilities by conducting the program examination the following year.

[c]These are cases where SBA has yet to make a determination as to whether a firm should be recertified or proposed for decertification.

[d]Firms proposed for decertification can challenge that proposed outcome through a due-process mechanism.

[e]This category includes firms determined to be ineligible, and thus decertified by SBA, and firms that requested decertification. Firms determined to be ineligible by SBA were proposed for decertification before actually being decertified by SBA.

Because SBA limits its program examinations to 5 percent of firms each year, firms can be in the program for years without being examined. For example, we found that 2,637 of the 3,348 firms (approximately 79 percent) that had been in the program for 6 years or more had not been examined. In addition to performing program examinations on a limited number of firms, HUBZone program officials rarely conduct site visits during program examinations to verify a firm's information. When reviewing the 11 program examinations that began in September 2007, we found that SBA did not conduct any site visits to verify the documentation provided.[29]

As a result of SBA's limited application of internal controls when certifying and monitoring HUBZone firms, the agency has limited assurances that only eligible firms participated in the program. By not obtaining documentation and conducting site visits on a more routine basis during the certification process, SBA cannot be sure that only eligible firms are part of the program. And while SBA's examination process involves a more extensive review of documentation, it cannot be relied upon to ensure that only eligible firms participate in the program because it involves only 5 percent of firms in any given year.

Because SBA Has Not Complied with Its Policy of Recertifying Firms Every 3 Years, Some Firms Went Unmonitored for Longer Periods, and SBA Has Not Specified Time Frames for Eliminating the Large Backlog

As previously noted, since 2004, SBA's policies have required the agency to recertify all HUBZone firms every 3 years. Recertification presents another opportunity for SBA to review information from firms and thus help monitor program activity. However, SBA has failed to recertify 4,655 of the 11,370 firms (more than 40 percent) that have been in the program for more than 3 years. Of the 4,655 firms that should have been recertified, 689 have been in the program for more than 6 years.

SBA officials stated that the agency lacked sufficient staff to comply with its recertification policy. According to SBA officials, staffing levels have been relatively low in recent years. In fiscal year 2002, the HUBZone program office, which is located in SBA headquarters in Washington, D.C., had 12 full-time equivalent staff. By fiscal year 2006, the number had dropped to 8 and remained at that level as of March 2008. Of the 8, 3 conduct recertifications on a part-time basis.

SBA hired a contractor in December 2007 to help conduct recertifications, using the same process that SBA staff currently use.[30] According to the contract, SBA estimates that the contractor will conduct 3,000 recertifications in fiscal year 2008; in subsequent years, SBA has the option to direct the contractor to conduct, on average, 2,450 recertifications

[29]We excluded one program examination that was begun in September 2007 from our analysis because this action was still in process as of January 22, 2008 (the date we received the data).

[30]As noted previously, SBA officials generally limit their recertification reviews to the information provided by firms but can request documentation or conduct site visits.

annually for the next 4 years. Although SBA has contracted for these additional resources, the agency lacks specific time frames for eliminating the backlog. As a result of the backlog, the periods during which some firms go unmonitored and are not reviewed for eligibility are longer than SBA policy allows, increasing the risk that ineligible firms may be participating in the program.

SBA Lacks a Formal Policy on Time Frames for Decertifying Firms, Which Provides Ineligible Firms with an Opportunity to Obtain Contracts

While SBA policies for the HUBZone program include procedures for certifications, recertifications, and program examinations, they do not specify a time frame for processing decertifications—which occur subsequent to recertification reviews or examinations and determine that firms are no longer eligible to participate in the HUBZone program. If SBA suspects that a firm no longer meets standards or fails to respond to notification of a recertification or program examination, SBA makes a determination and, if found ineligible, removes the firm from its list of certified HUBZone firms. Although SBA does not have written guidance for the decertification time frame, the HUBZone program office negotiated an informal (unwritten) goal of 60 days with the SBA Inspector General (IG) in 2006.[31]

In recent years, SBA ultimately decertified the vast majority of firms proposed for decertification but, as shown in table 4, has not met its 60-day goal consistently. From fiscal years 2004 through 2007, SBA failed to resolve proposed decertifications within its goal of 60 days for more than 3,200 firms. However, SBA's timeliness has improved. For example, in 2006, SBA did not resolve proposed decertifications in a timely manner for more than 1,000 firms (about 44 percent). In 2007, over 400 (or about 33 percent) were not resolved in a timely manner. SBA staff acknowledged that lags in processing decertifications were problematic and attributed them to limited staffing. SBA plans to use its contract staff to address this problem after the backlog of recertifications is eliminated.

[31]In May 2006, the SBA IG found that firms proposed for decertification as a result of 2004 program examinations were not processed timely and therefore recommended that the HUBZone program office set a maximum timeframe for decertifying firms and removing them from the SBA list once they no longer meet the eligibility criteria. See SBA Inspector General, *HUBZone Program Examination and Recertification Processes*, Report Number 6-23 (Washington, D.C., May 23, 2006).

Table 4: Summary of SBA's Efforts to Decertify Firms Ineligible for the HUBZone Program, Fiscal Years 2004-2007

	Year firms proposed for decertification			
	2004	**2005**	**2006**	**2007**[a]
Firms proposed for decertification[b]	559	1,390	2,428	1,227
Withdrawn by SBA	24	18	8	14
Firms actually decertified	314	1,082	2,032	890
Firms that retained certification	217	288	370	183
Cases that have not been resolved	4	2	18	140
Number of firms proposed for decertification but not resolved within 60 days	473	1,306	1,057	408

Source: GAO analysis of data from HUBZone Certification Tracking System (as of Jan. 22, 2008).

[a]SBA conducted 3,134 recertifications and program examinations, which are often precursors to proposals for decertification, in fiscal year 2007, which was 832 less than the previous year.

[b]Firms proposed for decertification have the ability to challenge that proposed outcome through a due-process mechanism. These data are based on the year that SBA proposed the firm for decertification.

In addition, we and the SBA Inspector General found that SBA does not routinely track the reasons why firms are decertified.[32] According to SBA officials, a planned upgrade to the HUBZone data system will allow SBA to track this information. While SBA does not currently track the specific reasons why firms are decertified, our analysis of HUBZone system data shows that firms were primarily decertified because firms either did not submit the recertification form or did not respond to SBA's notification. According to HUBZone officials, firms may fail to respond because they are no longer in business or are no longer interested in participating in the program. But firms also may not be responding because they no longer meet the eligibility requirements. Tracking the various reasons why firms are decertified could help SBA take appropriate action against firms that misrepresent their HUBZone eligibility status.

While we were unable to determine how many firms were awarded HUBZone contracts after they were proposed for decertification, our analysis showed that 90 of the firms proposed for decertification in fiscal years 2004 through 2007 received HUBZone set-aside dollars after being decertified. However, some of these firms may have been awarded the

[32]See SBA Inspector General, Rep. No. 6-23.

contracts before they were decertified. As a consequence of generally not meeting its 60-day goal, lags in the processing of decertifications have increased the risk of ineligible firms participating in the program.

SBA Has Not Implemented Plans to Assess the Effectiveness of the HUBZone Program, and Most Agencies Have Not Met Contracting Goals

SBA has taken limited steps to assess the effectiveness of the HUBZone program. While SBA has a few performance measures in place that provide some data on program outputs, such as the number of certifications and examinations, the measures do not directly link to the program's mission. SBA has plans for assessing the program's effectiveness but has not devoted resources to implement such plans. Although Congress's goal is for agencies to award 3 percent of their annual contracting dollars to qualifying firms located in HUBZones, most federal agencies did not meet the goal for fiscal year 2006—the total for federal agencies reached approximately 2 percent. Factors such as conflicting guidance on how to consider the various small business programs when awarding contracts and a lack of HUBZone firms with the necessary expertise may have affected the ability of federal agencies to meet their HUBZone goals.

SBA Has Limited Performance Measures and Has Not Implemented Plans to Evaluate the Effectiveness of the Program

While SBA has some measures in place to assess the performance of the HUBZone program, the agency has not implemented its plans to conduct an evaluation of the program's benefits. According to the Government Performance and Results Act (GPRA) of 1993, federal agencies are required to identify results-oriented goals and measure performance toward the achievement of their goals. We have previously reported on the attributes of effective performance measures.[33] We noted that for performance measures to be useful in assessing program performance, they should be linked or aligned with program goals and cover the activities that an organization is expected to perform to support the intent of the program.

We reviewed SBA's performance measures for the HUBZone program and found that although the measures related to the core activity of the program (providing federal contracting assistance), they were not directly linked to the program's mission of stimulating economic development and

[33] See GAO-03-143 and GAO, *Small Business Administration: Additional Measures Needed to Assess 7(a) Loan Program's Performance*, GAO-07-769 (Washington, D.C., July 13, 2007).

creating jobs in economically distressed communities. According to SBA's fiscal year 2007 *Annual Performance Report*, the three performance measures were:

- number of small businesses assisted (which SBA defines as the number of applications approved and the number of recertifications processed),
- annual value of federal contracts awarded to HUBZone firms, and
- number of program examinations completed.[34]

The three measures provide some data on program activity, such as the number of certifications and program examinations and contract dollars awarded to HUBZone firms.[35] However, they do not directly measure the program's effect on firms (such as growth in employment or changes in capital investment) or directly measure the program's effect on the communities in which the firms are located (for instance, changes in median household income or poverty levels).

While SBA's performance measures for the HUBZone program do not link directly to the program's mission, the agency has made attempts to assess the effect of the program on firms. In fiscal years 2005 and 2006, SBA conducted surveys of HUBZone firms. According to SBA data on the surveys, HUBZone firms responding to the 2005 survey reported they had hired a total of 11,461 employees as a result of their HUBZone certification, and HUBZone firms responding to the 2006 survey reported they had hired a total of 12,826 employees (see table 5). Based on the firms that responded to the 2005 survey, the total capital investment increase in HUBZone firms as a result of firm certification was approximately $523.8 million as of August 31, 2005. As of September 12, 2006, the total capital investment increase based on firms responding to the 2006 survey was approximately $372.6 million. SBA did not conduct this survey in fiscal year 2007, but officials stated that they planned to conduct a similar survey during fiscal year 2008.

[34]SBA also measures its cost per small business assisted and cost per federal contract dollar for the HUBZone program, but these are classified as efficiency measures.

[35]Our assessment of the databases that contain information on the agency's performance measures—the HUBZone Certification Tracking System and FPDS-NG—concluded that these data were sufficiently reliable for the purposes of reporting on services provided to HUBZone firms and contracts awarded to HUBZone firms.

Table 5: Results of SBA Surveys of HUBZone Firms, Fiscal Years 2005-2006

Fiscal year	HUBZone firms at beginning of fiscal year[a]	Total number of HUBZone firms responding to survey	Reported number of employees hired as a result of firms' HUBZone certification	Reported number of employees residing in a HUBZone hired as a result of firms' HUBZone certification	Reported increase in capital investment as a result of firms' HUBZone certification (in millions)
2005[b]	10,682	3,500	11,461	7,063	$523.8
2006[c]	12,776	3,460	12,826	9,489	372.6

Source: SBA.

[a]The number of HUBZone firms at the beginning of the fiscal year serves as a proxy measure of total surveys sent to firms because SBA could not provide data on the total number of surveys sent to firms.

[b]Aggregated survey data as of August 31, 2005.

[c]Aggregated survey data as of September 12, 2006.

However, the survey results have several limitations. For instance, the 2005 and 2006 surveys appear to have had an approximate response rate of 33 percent and 27 percent, respectively, which may increase the risk that survey results are not representative of all HUBZone firms. It also is unclear whether the survey results were reliable because SBA did not provide detailed guidance on how to define terms such as capital investment, which may have led to inconsistent responses. Finally, while the surveys measured increased employment and capital investment by firms—which provided limited assessment of, and could be linked to, the program's effect on individual firms—they did not provide data that showed the effect of the program on the communities in which they were located. Since the purpose of the HUBZone program is to stimulate economic development in economically distressed communities, useful performance measures should be linked to this purpose.

Similarly, the Office of Management and Budget (OMB) noted in its 2005 Program Assessment Rating Tool (PART) that SBA needed to develop baseline measures for some of its HUBZone performance measures and encouraged SBA to focus on more outcome-oriented measures that more effectively evaluate the results of the program.[36] Although OMB gave the

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

HUBZone program an assessment rating of “moderately effective,” it stated that SBA had limited data on, and had conducted limited assessments of, the program’s effect. The assessment also emphasized the importance of systematic evaluation of the program as a basis for programmatic improvement.

The PART assessment also documented plans that SBA had to conduct an analysis of the economic impact of the HUBZone program on a community-by-community basis using data from the 2000 and 2010 decennial census. SBA stated its intent to assess the program’s effect in individual communities by comparing changes in socioeconomic data over time. Variables that the program office planned to consider included median household income, average educational levels, and residential/commercial real estate values. Additionally, in a mandated 2002 report to Congress, SBA identified potential measures to more effectively assess the HUBZone program.[37] These measures included assessing full-time jobs created in HUBZone areas and the larger areas of which they were a part, the amount of investment-related expenditures in HUBZone areas and the larger areas of which they were a part, and changes in construction permits and home loans in HUBZone areas. While SBA has recognized the need to assess the results of the HUBZone program, SBA officials indicated that the agency has not devoted resources to implement either of these strategies for assessing the results of the program.[38] Yet by not evaluating the HUBZone program’s benefits, SBA lacks key information that could help it better manage the program and inform Congress of its results.

We also conducted site visits to four HUBZone areas (Lawton, Oklahoma; Lowndes County, Georgia; and Long Beach and Los Angeles, California) to better understand to what extent stakeholders perceived that the HUBZone program generated benefits. For all four HUBZone areas, the perceived benefits of the program varied, with some firms indicating they

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[37]Small Business Administration, *Report to the Committees on Small Business of the House of Representatives and the Senate on Implementation of the HUBZone Program* (Washington, D.C., 2002).

[38]The Small Business Reauthorization and Manufacturing Assistance Act of 2004 required SBA’s Office of Advocacy to conduct a study that measured the effectiveness of definitions relating to HUBZone qualified areas for the purposes of economic impact on small business development and jobs creation. The study was also to contain any proposed changes to existing definitions. We were unable to incorporate the results of the study in our review because the report was not issued until late May 2008.

have been able to win contracts and expand their firms and others indicating they had not realized any benefits from the program. Officials representing economic development entities varied in their knowledge of the program, with some stating they lacked information on the program's effect that could help them inform small businesses of its potential benefits. (See appendix V for more information on our site visits.)

Most Federal Agencies Did Not Meet Their Contracting Goals for the HUBZone Program

Although contracting dollars awarded to HUBZone firms have increased since fiscal year 2003—when the statutory goal of awarding 3 percent of federally funded contract dollars to HUBZone firms went into effect—federal agencies collectively still have not met that goal.[39] According to data from SBA's goaling reports, for fiscal years 2003 through 2006, the percentage of prime contracting dollars awarded to HUBZone firms increased but was still about one-third short of the statutory goal for fiscal year 2006 (see table 6).

Table 6: HUBZone Percentage of Total Prime Contracting Dollars Eligible for Small Business Awards, Fiscal Years 2003-2006

Fiscal year	Total prime contracting dollars (in billions)	Prime contracting dollars awarded to HUBZone firms (in billions)	Governmentwide goal for percentage of small-business-eligible prime contracting dollars awarded to HUBZone firms	Percentage of total small-business-eligible prime contracting dollars awarded to HUBZone firms
2003	$277.5	$3.4	3	1.23
2004	299.9	4.8	3	1.60
2005	320.3	6.2	3	1.93
2006	340.2	7.2	3	2.11

Sources: *Report on Annual Procurement Preference Goaling Achievements* (FY 2003) and *Small Business Goaling Reports* (FY 2004–2006).

Note: Fiscal year 2006 is the most recent year for which SBA has published a small business goaling report.

[39]The HUBZone Act established participation goals for certified firms starting with fiscal year 1999. The fiscal year 1999 goal was 1 percent of the year's total value of prime contract awards, and the fiscal year 2000 goal was 1.5 percent. The act increased the goal by one-half percent each year, reaching 3 percent in fiscal year 2003 and each fiscal year thereafter.

In fiscal year 2006, 8 of 24 federal agencies met their HUBZone goals.[40] Of the 8 agencies, 4 had goals higher than the 3 percent requirement and were able to meet the higher goals. Of the 16 agencies not meeting their HUBZone goal, 10 awarded less than 2 percent of their small-business-eligible contracting dollars to HUBZone firms. According to SBA's most recent guidance on the goaling process, agencies are required to submit a report explaining why goals were not met, along with a plan for corrective action.[41]

Federal agencies may not have met their HUBZone goals for various reasons, which include uncertainty about how to properly apply federal contracting preferences. For instance, federal contracting officials reported facing conflicting guidance about the order in which the various small business programs—the HUBZone program, the 8(a) program, and the service-disabled veteran-owned small business program—should be considered when awarding contracts. The 2007 *Report of the Acquisition Advisory Panel* concluded that contracting officers need definitive guidance on the priority for applying the various small business contracting preferences to specific acquisitions.[42] The report stated that each program has its own statutory and regulatory requirements. It also noted that both SBA and the Federal Acquisition Regulatory Council (FAR Council) have attempted to interpret these provisions but that their respective regulations conflict with each other.[43] According to the report, in general, SBA's regulations provide for parity among most of the programs and give discretion to the contracting officer by stating that the contracting officer should consider setting aside the requirement for 8(a),

[40]We limited our analysis to the 24 agencies that SBA assessed through its Small Business Procurement Scorecards, which provide an assessment of federal achievement in prime contracting to small businesses by the 24 Chief Financial Officers Act agencies.

[41]Small Business Administration, Office of Government Contracting, *Goaling Guidelines for the Small Business Preference Programs for Prime and Subcontract Federal Procurement Goals and Achievements* (Washington, D.C., July 2003).

[42]*Report of the Acquisition Advisory Panel to the Office of Federal Procurement Policy and the United States Congress* (Washington, D.C., January 2007). The Acquisition Advisory Panel was authorized by Section 1423 of the Services Acquisition Reform Act of 2003. The Panel's statutory charter was to review and recommend any necessary changes to acquisition laws and regulations as well as government-wide acquisition policies with a view toward ensuring effective and appropriate use of commercial practices and performance-based contracting.

[43]The FAR Council oversees development and maintenance of the Federal Acquisition Regulation (FAR), which governs federal agency acquisitions of goods and services.

HUBZone, or service-disabled veteran-owned firms' participation before considering setting aside the requirement as a small business set-aside. However, according to the report, the FAR currently conflicts with SBA's regulations by providing that, before deciding to set aside an acquisition for small businesses, HUBZone firms, or service-disabled veteran-owned small firms, the contracting officer should review the acquisition for offering under the 8(a) program.

Officials at three of the four agencies we interviewed (Commerce, DHS, and SSA) regarding the awarding of contracts to small businesses stated that contracting officers occasionally faced uncertainty when applying the guidelines on awarding contracts under these programs. In March 2008, a proposal to amend the FAR was published with the purpose of ensuring that the FAR clearly reflects SBA's interpretation of the Small Business Act and SBA's interpretation of its regulations about the order of precedence that applies when deciding whether to satisfy a requirement through award under these various types of small business programs.[44] Among other things, the proposed rule is intended to make clear that there is no order of precedence among the 8(a), HUBZone, or service-disabled veteran-owned small business programs. The proposed rule stated that SBA believes that, among other factors, progress in fulfilling the various small business goals should be considered in making a decision as to which program is to be used for an acquisition.

Federal contracting officials from the four agencies also explained that it was sometimes difficult to identify HUBZone firms with the required expertise to fulfill contracts. For example, DHS acquisition officials stated that market research that their contracting officers conducted sometimes indicated there were no qualified HUBZone firms in industries in which DHS awarded contracts. Specifically, a contracting officer in the U.S. Coast Guard's Maintenance and Logistics Command explained that for contracts requiring specialized types of ship-repair work, the Coast Guard sometimes could not find sufficient numbers of HUBZone firms with the capacity and expertise to perform the work in the time frame required. SSA officials also stated that the agency awards most of its contracts to firms in the information technology industry and that contracting officers at times have had difficulty finding qualified HUBZone firms operating in this industry due to the amount of infrastructure and technical expertise required. Officials representing the Defense Threat Reduction Agency (an

[44] See 73 Fed. Reg. 12699 (Mar. 10, 2008) for the proposed regulation.

agency within DOD) also stated they often have difficulty finding qualified HUBZone firms that can fulfill their specialized technology needs. Lastly, Commerce officials explained that a review of the top 25 North American Industry Classification System (NAICS) codes under which the agency awarded contracts in fiscal year 2007 showed that fewer than 100 HUBZone firms operated in 13 of these 25 industries, including 5 industries that had fewer than 5 firms operating.[45] They noted that these small numbers increased the difficulty of locating qualified HUBZone firms capable of meeting Commerce's requirements. We did not validate the statements made by these federal contracting officials related to the difficulty they face in awarding contracts to HUBZone firms.

Finally, according to contracting officers we interviewed, the availability of sole-source contracting under SBA's 8(a) program could make the 8(a) program more appealing than the HUBZone program. Through sole-source contracting, contracting officers have more flexibility in awarding contracts directly to an 8(a) firm without competition. According to U.S. Coast Guard contracting officers we interviewed, this can save 1 to 2 months when trying to award a contract. Sole-source contracts are available to HUBZone program participants but only when the contracting officer does not have a reasonable expectation that two or more qualified HUBZone firms will submit offers. Contracting officers we interviewed regarding HUBZone sole-source contracts stated that this is rarely the case. In fiscal year 2006, $5.8 billion (about 44 percent) of all dollars obligated to small business 8(a) firms were awarded through 8(a) sole-source contracts. In contrast, about 1 percent of the contracts awarded to HUBZone firms were HUBZone sole-source contracts.

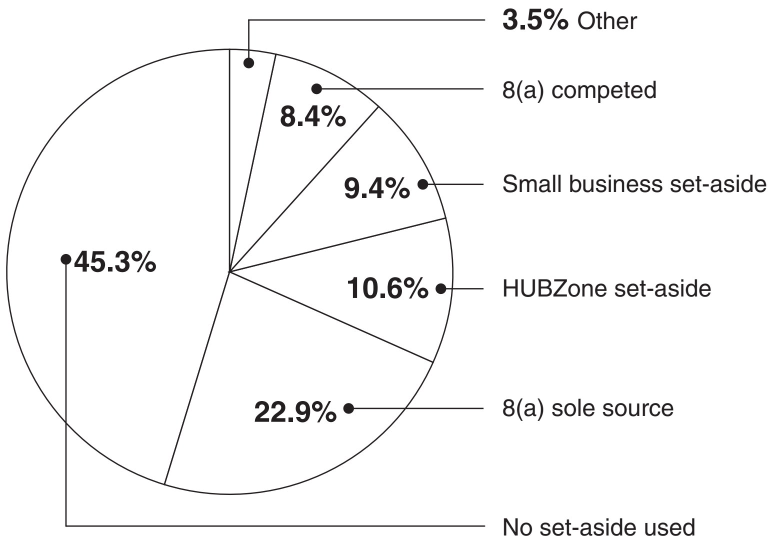
[45]NAICS was developed as the standard for use by federal statistical agencies in classifying business establishments for the collection, analysis, and publication of statistical data related to the business economy of the United States. NAICS was developed under the auspices of the Office of Management and Budget (OMB) and adopted in 1997 to replace the old Standard Industrial Classification system.

Identifying Contract Dollars Awarded Based on a Particular Designation Is Difficult Because Dollars Can Be Counted under Multiple Socioeconomic Subcategories

Because agencies can count contracting dollars awarded to small businesses under more than one socioeconomic subcategory, it can be difficult to identify how many contract dollars firms received based on a particular designation. Small businesses can qualify for contracts under multiple socioeconomic programs. For example, if a HUBZone certified firm was owned by a service-disabled veteran, it could qualify for contracts set aside for HUBZone firms, as well as for contracts set aside for service-disabled veteran-owned businesses. The contracting dollars awarded to this firm would count toward both of these programs' contracting goals.

We reviewed FPDS-NG data on contracts awarded to HUBZone firms in fiscal year 2006. We found that approximately 45 percent of contracts awarded to HUBZone firms were not set aside for any particular socioeconomic program (see fig. 8). The next largest percentage, about 23 percent, were 8(a) sole-source contracts awarded to HUBZone firms that also participated in SBA's 8(a) business development program. These firms did not have any competitors for the contracts awarded. HUBZone set-aside contracts, or contracts for which only HUBZone firms can compete, accounted for about 11 percent of the dollars awarded to HUBZone firms.

Figure 8: Dollars Obligated to HUBZone Firms, by Types of Set-aside Contracts, Fiscal Year 2006



Source: GAO analysis of FPDS-NG data.

Note: Percentages do not add to 100 percent due to rounding. The "other" category includes various types of contracts, such as HUBZone sole-source contracts (contracts awarded to HUBZone firms when a contracting officer does not have a reasonable expectation that two or more qualified HUBZone firms will submit an offer). 8(a) competed contracts are those for which only 8(a) firms can bid. Small business set-aside contracts are those exclusively set aside for small businesses. HUBZone set-aside contracts are those set aside solely for firms with a HUBZone certification. 8(a) sole-source contracts are individual contracts awarded directly to 8(a) firms without any other firms competing for those contracts. No set-aside used refers to contracts awarded without a set aside for any particular program.

This ability to count contracts toward multiple socioeconomic goals makes it difficult to determine how HUBZone certification may have played a role in winning a contract, especially when considering the limited amount of contract dollars awarded to HUBZone firms relative to the HUBZone goal. It can also make it more difficult to isolate the effect of HUBZone program status on economic conditions in a community.

Conclusions

The map contained on the HUBZone Web site is the primary means of disseminating HUBZone information. The map offers small businesses an easy and readily accessible way of determining whether they can apply for HUBZone certification. However, those positive attributes have been undermined because the map reflects inaccurate and out-of-date information. In particular, as of May 2008, SBA's HUBZone map included 50 ineligible areas and excluded 27 eligible areas. As a result, ineligible small businesses have been able to participate in the program, while eligible businesses have not been able to participate. By working with its contractors to eliminate inaccuracies and more frequently updating the map, SBA will help ensure that only eligible firms have opportunities to participate in the program.

Although SBA relies on federal law to identify HUBZone areas, statutory changes over time have resulted in more areas being eligible for the program. Specifically, revisions to the statutory definition of HUBZone areas since 1999 have nearly doubled the number of areas and created areas that can be characterized as less economically distressed than areas designated under the original statutory criteria. While establishing new HUBZone areas could provide economic benefits to these new areas, as the program becomes less targeted and contracting dollars more dispersed, the program could have less of an effect on individual HUBZone areas. Such an expansion could diffuse the benefits that could be derived by steering businesses to economically distressed areas. Given the potential for erosion of the intended economic benefits of the program, further assessment of the criteria used to determine eligible HUBZone areas, in relation to overall program outcomes, may be warranted.

The mechanisms that SBA uses to certify and monitor firms provide limited assurance that only eligible firms participate in the program. SBA does not currently have guidance on precisely when HUBZone program staff should request documentation from firms to support the information reported on their application, and it verifies information reported by firms at application or during recertification in limited instances. Also, SBA does not follow its policy of recertifying all firms every 3 years. Further, SBA lacks a formal policy on how quickly it needs to make a final determination on decertifying firms that may no longer be eligible for the program. From fiscal years 2004 through 2007, SBA failed to resolve proposed decertifications within its informal goal of 60 days for more than 3,200 firms. More routinely obtaining supporting documentation upon application and conducting more frequent site visits would represent a more efficient and consistent use of SBA's limited resources. It could help ensure that firms applying for application are truly eligible, thereby reducing the need to spend a substantial amount of resources during any decertification process. In addition, an SBA effort to consistently follow its current policy of recertifying firms every 3 years, and to formalize and adhere to a specific time frame for decertifying firms, would help prevent ineligible firms from obtaining HUBZone contracts.

By not evaluating the HUBZone program's benefits, SBA lacks key information that could help it better manage the program and inform Congress of its results. SBA has some measures to assess program performance, but they are not linked to the program's mission and thus do not measure the program's effect on the communities in which HUBZone firms are located. While SBA identified several strategies for assessing the program's effect and conducted limited surveys, it has not devoted resources to conduct a comprehensive program evaluation of the program's effect on communities. We recognize the challenges associated with evaluating the economic effect of the program, such as isolating the role that HUBZone certification plays in obtaining federal contracts and generating benefits for communities. Because contract dollars awarded to firms in one small business program also could represent part of the dollars awarded in other programs, contract dollars awarded to HUBZone firms at best represent a broad indicator of program influence on a community's economic activity. In addition, the varying levels of economic distress among HUBZone areas can further complicate such an evaluation. Despite these challenges, completing an evaluation would offer several benefits to the agency and the HUBZone program, including determining how well it is working across various communities, especially those that suffer most from economic distress. Such an evaluation is particularly critical in light of the expansion in the number of HUBZone areas, the potential for erosion of the intended economic benefits of the program from such expansion, and the wide variation in the economic characteristics of these areas.

Recommendations for Executive Action

To improve SBA's administration and oversight of the HUBZone program, we recommend that the Administrator of SBA take the following actions:

- 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.

- 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.

- 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.

- Formalize and adhere to a specific time frame for processing firms proposed for decertification in the future.
- 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.

Agency Comments and Our Evaluation

We requested SBA's comments on a draft of this report, and the Associate Administrator for Government Contracting, and Business Development provided written comments that are presented in appendix II. SBA agreed with our recommendations and outlined steps that it plans to take to address each recommendation.

First, SBA stated that it recognizes the valid concerns we raised concerning the HUBZone map and noted that efforts are under way to improve the data and procedures used to produce this important tool. Specifically, SBA plans to issue a new contract to administer the HUBZone map and anticipates that the maps will be updated and available no later than August 29, 2008. Further, SBA stated that, during the process of issuing the new contract, the HUBZone program would issue new internal procedures to ensure that the map is continually updated.

Second, SBA stated that it appreciates our concern about the need to obtain supporting documents in a more consistent manner. In line with its efforts to formalize HUBZone processes, the agency noted that it was formulating procedures that would provide sharper guidance as to when supporting documentation and site visits would be required. Specifically, SBA plans to identify potential areas of concern during certification that would mandate additional documentation and site visits.

Third, SBA noted that the HUBZone program had obtained additional staff to work through the backlog of pending recertifications and stated that this effort would be completed by September 30, 2008. Further, to ensure that recertifications will be handled in a more timely manner, SBA stated that the HUBZone program has made dedicated staffing changes and will issue explicit changes to procedures.

Fourth, SBA stated that it is aware of the need to improve the effectiveness and consistency of the decertification process. SBA noted that it would issue new procedures to clarify and formalize the decertification process and its timelines. Among other things, SBA stated that the new decertification procedure would establish a 60-day deadline to complete any proposed decertification.

Finally, SBA acknowledged that using HUBZone performance measures in a more systematized way to evaluate the program's effectiveness would be beneficial and would provide important new information to improve and focus the HUBZone program. Therefore, SBA stated that it would develop an assessment tool to measure the economic benefits that accrue to areas in the HUBZone program and that the HUBZone program would then issue periodic reports accompanied by the underlying data.

We also provided copies of the draft report to Commerce, DOD, DHS, and SSA. All four agencies responded that they had no comments.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the Ranking Member, House Committee on Small Business, other interested congressional committees, and the Administrator of the Small Business Administration. We will also make copies available to others upon request. In addition, the report will be available at no charge on the GAO Web site at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-8678 or shearw@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix VI.

Sincerely yours,

William B. Shear

William B. Shear
Director, Financial Markets and
Community Investment

Appendix I: Objectives, Scope, and Methodology

To review the Small Business Administration's (SBA) administration and oversight of the HUBZone program, we examined (1) the criteria and process that SBA uses to identify and map HUBZone areas and the economic characteristics of such areas; (2) the mechanisms that SBA uses to ensure that only eligible small businesses participate in the HUBZone program; and (3) the actions SBA has taken to assess the results of the program and the extent to which federal agencies have met their HUBZone contracting goals.

To identify the criteria that SBA uses to identify HUBZone areas, we reviewed applicable statutes, regulations, and agency documents. Because the HUBZone program also uses statutory definitions from the Department of Housing and Urban Development's (HUD) low-income-housing tax credit program, we reviewed the statutes and regulations underlying the definitions of a qualified census tract and difficult development area. To determine the process that SBA uses to identify HUBZone areas, we interviewed SBA officials and the contractor that developed and maintains the HUBZone map on SBA's Web site. We also reviewed the policies and procedures the contractor follows when mapping HUBZone areas. Using historical data provided by SBA's mapping contractor, we determined how the number of HUBZone areas has changed over time.[1] We also used these historical data to determine if SBA had complied with its policy of asking the contractor to update the map every time the HUBZone area definition changed or new data used to designate HUBZone areas (for example, HUD's lists of difficult development areas and unemployment data from the Bureau of Labor Statistics or BLS) became available. To assess the accuracy of the current HUBZone map, we compared the difficult development areas on the map with the statutory definition of a difficult development area. We also compared HUD's 2008 list of qualified census tracts to the areas designated on the map and analyzed 2007 unemployment data from BLS (the most recent available) to determine if all of the nonmetropolitan counties that met the HUBZone eligibility criteria were on the map.

Once we identified the current HUBZone areas, we used 2000 census data (the most complete data set available) to examine the economic characteristics of these areas. The 2000 census data are sample estimates

[1]Because updates to the map were completed on an as-needed basis, the contractor did not have a history file for each year. In instances where there was no history file for a given year, we kept values unchanged until the next year for which data were available.

and are, therefore, subject to sampling error. To test the impact of these errors on the classification of HUBZone areas, we simulated the potential results by allowing the estimated value to change within the sampling error distribution of the estimate and then reclassified the results. As a result of these simulations, we determined that the sampling error of the estimates had no material impact on our findings. For metropolitan and nonmetropolitan-qualified census tracts, nonmetropolitan counties, and difficult development areas in the 50 states and District of Columbia, we looked at common indicators of economic distress—poverty rate, unemployment rate, median household income, and median housing value.[2] In measuring median household income and median housing value, we compared each HUBZone with the metropolitan area (for metropolitan-qualified census tracts) in which it was located or with the state nonmetropolitan area (for nonmetropolitan-qualified census tracts, nonmetropolitan counties, and difficult development areas) to put the values into perspective.[3] We limited our analysis of Indian Country to poverty and unemployment rates because Indian lands vary in nature; therefore, no one unit of comparison worked for all areas when reporting median housing income and median housing value. We could not examine the economic characteristics of base closure areas because they do not coincide with areas for which census data are collected.

To further examine the economic characteristics of qualified HUBZone areas, we analyzed the effect of hypothetical changes to the economic criteria used to designate qualified census tracts and nonmetropolitan counties. (We report the results of this analysis in app. III.) First, we adjusted the economic criteria used to designate qualified census tracts: (1) a poverty rate of at least 25 percent or (2) 50 percent or more of the households with incomes below 60 percent of each area's median gross income.[4] Second, we adjusted the criteria used to designate nonmetropolitan counties: (1) a median household income of less than 80 percent of the median household income for the state nonmetropolitan

[2]We excluded the U.S. possessions and territories because census data were not available for all of them.

[3]Median housing value is the median value for specified owner-occupied housing units in 1999 dollars.

[4]In addition, there is a requirement that the population of all census tracts that satisfy either one or both of these criteria cannot exceed 20 percent of the total population of the respective area. While varying the poverty and income criteria independently of each other may have resulted in a violation of the population cap, our analysis is for illustrative purposes only.

area or (2) an unemployment rate not less than 140 percent of the state or national unemployment rate (whichever is lower). In both cases, we made the criteria more stringent as well as less stringent. We assessed the reliability of the census and BLS data we used to determine the economic characteristics of HUBZone areas by reviewing information about the data and performing electronic data testing to detect errors in completeness and reasonableness. We determined that the data were sufficiently reliable for the purposes of this report.

To determine how SBA ensures that only eligible small businesses participate in the HUBZone program, we reviewed policies and procedures established by SBA for certifying and monitoring HUBZone firms and internal control standards for federal agencies.[5] We also interviewed SBA headquarters and field officials regarding the steps they take to certify and monitor HUBZone firms. We then assessed the actions that SBA takes to help ensure that only eligible firms participate against its policies and procedures and selected internal controls. In examining such compliance, we analyzed data downloaded from the HUBZone Certification Tracking System (the information system used to manage the HUBZone program) as of January 22, 2008, to determine the extent of SBA monitoring. Specifically, we analyzed the data to determine (1) the number of applications submitted in fiscal years 2000 through 2007 and their resolution; (2) the number of recertifications that SBA performed in fiscal years 2005 through 2007 and their results; (3) the number of recertifications conducted of HUBZone firms based on the number of years firms had been in the program; (4) the number of program examinations that SBA performed in fiscal years 2004 through 2007 and their results; (5) the number of program examinations conducted of HUBZone firms based on the number of years firms had been in the program; and (6) the number of firms proposed for decertification in fiscal years 2004 through 2007. We also analyzed Federal Procurement Data System-Next Generation (FPDS-NG) data to determine the extent to which firms that had been proposed for decertification or had actually been decertified had obtained federal contracts.

Because the HUBZone Certification Tracking System does not readily provide information on the extent to which SBA requests documentation from firms or conducts site visits during certification and monitoring, we

[5] GAO, *Internal Control Management and Evaluation Tool*, GAO-01-1008G (Washington, D.C., August 2001).

conducted reviews of all 125 applications, 15 recertifications, and 11 program examinations begun in September 2007 and completed by January 22, 2008 (the date of the data set). For applications, we selected those that were logged into the system in September 2007. For recertifications and program examinations, we selected those cases where the firm had acknowledged receipt of the notice that they had been selected for review in September 2007; we chose September 2007 because most of the cases had been processed by January 22, 2008. Further, we analyzed (1) FPDS-NG data for fiscal year 2006 (the most recent year available at the time of our analysis) and (2) Dynamic Small Business Source System (DSBSS) data as of December 12, 2007, to identify select characteristics of businesses that participated in the program. DSBSS contains information on firms that have registered in the Central Contractor Registration system (a database that contains information on all potential federal contractors) as small businesses. We assessed the reliability of the HUBZone Certification Tracking System, FPDS-NG, and DSBSS data we used by reviewing information about the data and performing electronic data testing to detect errors in completeness and reasonableness. We determined that the data were sufficiently reliable for the purposes of this report.

To determine the measures that SBA has in place to assess the results of the HUBZone program, we reviewed SBA's performance reports and other agency documents. We then compared SBA's performance measures for the HUBZone program to our guidance on the attributes of effective performance measures.[6] To determine the extent to which federal agencies have met their contracting goals, we (1) analyzed data from FPDS-NG and (2) reviewed SBA reports on agency contracting goals and accomplishments, such as federal contracting dollars awarded by agency for the various small business programs, for fiscal years 2003 through 2006. We also reviewed Federal Acquisition Regulation and SBA guidance and other relevant documentation. In addition, we interviewed small business and contracting officials at a nongeneralizable sample of agencies (the Departments of Commerce, Defense, Homeland Security and the Social Security Administration) to determine what factors affect federal agencies' ability to meet HUBZone contracting goals.[7] We selected

[6]See GAO, *Tax Administration: IRS Needs to Further Refine Its Tax Filing Season Performance Measures*, GAO-03-143 (Washington, D.C., Nov. 22, 2002).

[7]Because in a nongeneralizable sample some elements of the population being studied have no chance or an unknown chance of being selected as part of the sample, results from nongeneralizable samples cannot be used to make inferences about a population.

agencies that received a range of scores as reported in SBA's fiscal year 2006 Small Business Procurement Scorecard and awarded varying amounts of contracts to HUBZone firms.[8]

To explore benefits that the program may have generated for selected firms and communities, we visited a nongeneralizable sample of four HUBZone areas: Lawton, Oklahoma; Lowndes County, Georgia; and Long Beach and Los Angeles, California. In selecting these areas, we considered geographic dispersion, the type of HUBZone area, and the dollar amount of contracts awarded to HUBZone firms. During each site visit, we interviewed officials from the SBA district office, the Chamber of Commerce, a small business development center, and certified HUBZone firms, with the exception of the city of Long Beach, where we did not meet with the Chamber of Commerce.

We conducted this performance audit from August 2007 to June 2008 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[8]For fiscal year 2006, SBA issued its first Small Business Procurement Scorecard, which provides an assessment of federal achievement in prime contracting to small businesses by the 24 Chief Financial Officers Act agencies.

Appendix II: Comments from the Small Business Administration

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

June 6, 2008

The Small Business Administration (SBA) welcomes this review of the Historically Underutilized Business Zone (HUBZone) program and its procedures, and appreciates the suggested improvements and refinements. This important program serves more than 13,000 small businesses within the United States, and it is an important part of the effort to give small business greater access to federal contracting opportunities.

SBA is dedicated to providing the highest quality service, transparency, and accountability. As part of SBA's commitment to transparency and accountability, we are grateful for the forthright evaluation provided by GAO, and SBA takes seriously its recommendations. In the process of assisting the GAO audit and in the time since, certain facts have crystallized the need for an active and vigorous rededication to the HUBZone program.

SBA has instituted new management and oversight over the HUBZone program. New personnel are in place and they have been directed to institute new procedures to ensure consistency and timeliness of service. As part of this process several specific reforms are underway and SBA is working to institute other, more in-depth reforms. Lastly, the HUBZone program will update their contract to ensure the accuracy of the geographic maps.

SBA appreciates the GAO's efforts and in response to the five specific recommendations, we are taking the following steps:

Response to Recommendations

1. 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.

   While HUBZone-eligible areas are defined by statute, the HUBZone program generates a publicly available, user-friendly map that delineates those areas. To be effective, this map must be accurate and up-to-date. SBA recognizes the valid concerns raised by GAO concerning the HUBZone map, and efforts are underway to improve the data and procedures used to produce this important tool. SBA believes these efforts will address these issues and, in short order, provide a reliable map, and furthermore, ensure that the map is consistently updated as new information becomes available.

SBA's HUBZone office is in the process of issuing a new contract to administer the HUBZone map. The HUBZone program conducted market research by issuing a "sources sought" notice on May 22, 2008; responses were due by midnight, May 30, 2008. Seven responses were received. SBA is reviewing these responses and will quickly move ahead with the process. The established timeline for this new contract anticipates that the maps will be updated and available no later than August 29, 2008.

Further, during the process of issuing the new contract, the HUBZone program will issue new internal procedures to ensure that the map is continually updated. These new procedures will ensure that the appropriate HUBZone program staff:

- Access the OMB Bulletin website monthly for the most up-to-date statistical directives;
- Monitor the Bureau of Census quarterly for pertinent information;
- Monitor the Bureau of Indian Affairs website quarterly for the most recent statistical data;
- Receive and act on the periodic and direct communications from the Department of Defense on BRAC-related items; and,
- Monitor the Bureau of Labor Statistics unemployment data affecting non-metropolitan county status.

2. Develop and implement guidance to more consistently obtain supporting documentation upon application and conduct more frequent site visits, as appropriate, to ensure that firms applying for certification are eligible.

   SBA appreciates GAO's concern about the need to obtain supporting documents in a more consistent manner. In line with SBA's efforts to formalize HUBZone processes, the new management team is formulating procedures that will provide sharper guidance as to when supporting documentation and site visits will be required.

   Specifically, these new procedures will make better use of available information to focus oversight efforts. They include:

   - An electronic application with a function that evaluates certain critical eligibility factors (i.e. size, principal office location, and employment ratio) and alerts staff to possible anomalies;
   - Data verification for cases where the application information is contradictory (revenues vs. number of employees; phone area code and address; etc.);
   - Continue to use various internet search engines to obtain information on additional locations, state filings, affiliations, etc., to compare information submitted by firms seeking HUBZone certification;
   - When necessary, SBA will use a third-party database—Dun & Bradstreet—to compare data and will maintain files that record the findings; and,

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- Using the HUBZone tracking system, refer cases that appear fraudulent and/or deceptive to the OIG.

These procedures will be used to identify potential areas of concern during certification that will mandate additional documentation and site visits.

3. Establish a specific timeframe for eliminating the backlog for 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.

   The HUBZone program has obtained additional staff to work through the backlog of pending recertifications. This effort will be complete by September 30, 2008. SBA has been processing an average of 392 recertification actions per month, and year-to-date completed recertifications actions total 3,314. SBA's goal of 5,297 will be completed by the end of FY 08.

   Further, to ensure that recertifications will be handled in a more timely manner, the HUBZone program has made dedicated staffing changes and will issue explicit changes to procedures.

4. Formalize and adhere to a specific timeframe for processing firms proposed for decertification in the future.

   SBA is aware of the need to improve the effectiveness and consistency of the decertification process. Consequently, SBA has revamped staff responsibilities and will issue new procedures to clarify and formalize the decertification process and its timelines.

   Specifically, this new decertification procedure will:

   - Establish a formal, written policy of certified mail notification between SBA and a HUBZone firm proposed for decertification (this procedure already exists but it is not a formal policy);
   - Decertify any HUBZone firm that is determined to be non-responsive to the proposed decertification notice;
   - Decertify firms that submit information that indicates that they are no longer eligible; and,
   - Establish a 60 calendar day deadline to complete the process from the date that the proposed decertification process is received by the HUBZone firm.

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5. 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.

As GAO has acknowledged, SBA has some measures in place to assess the performance of the HUBZone program. However, as GAO concluded, to be more useful these measures should be used in a more systematized way to provide evaluation of the program's effectiveness. SBA acknowledges that this would be beneficial and would provide important new information to improve and focus the HUBZone program.

SBA will develop an assessment tool to measure the economic benefits that accrue to areas in the HUBZone program. This new assessment will be developed by the economic and analysis staff of SBA's Office of Policy and Strategic Planning in conjunction with the HUBZone program. Using this methodology, the HUBZone program will then issue periodic reports accompanied by the underlying data.

The development and discussion of this methodology is underway, and the final product is expected by August 1, 2008. To ensure the participation of stakeholders in the HUBZone program, SBA will publish this methodology and then accept public comment for four weeks. Subsequently SBA will publish a final methodology detailing the measures and procedures that will be used to provide this assessment of the HUBZone program's effectiveness.

It is important to note that in developing this new assessment SBA will rely on data that is already available to SBA, the HUBZone program, and/or publicly available through other Executive agencies. Reducing the burden of government is an important goal, and the small business community and their local and state governments will not be required to submit any new information in furtherance of this objective. This methodology will address GAO's concerns about the varying economic characteristics of the HUBZone areas and contracts being counted under multiple socioeconomic subcategories, which is a long-standing Federal government practice.

Fay E. Ott

Fay E. Ott
Associate Administrator
Office of Government Contracting
and Business Development
U.S. Small Business Administration

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Appendix III: Economic Characteristics of HUBZone Areas

In this appendix, we provide information on the economic characteristics of three types of HUBZone areas: (1) qualified census tracts, which have 50 percent or more of their households with incomes below 60 percent of the area median gross income or have a poverty rate of at least 25 percent and cannot contain more than 20 percent of the area population; (2) qualified Indian reservations, which include lands covered by a federal statutory definition of "Indian Country;" and (3) qualified nonmetropolitan counties, or those having a median household income of less than 80 percent of the median household income for the state nonmetropolitan area or an unemployment rate that is not less than 140 percent of the state average unemployment rate or the national average unemployment rate (whichever is lower). Other types of HUBZone areas are base closure areas and difficult development areas.

First, we report economic data for those HUBZone areas that are nonmetropolitan-qualified census tracts and Indian Country areas.[1] Second, to further illustrate the economic diversity among qualified HUBZone areas, we provide data on the effect of hypothetical changes to the economic criteria used to designate metropolitan-qualified census tracts and nonmetropolitan counties.

Based on poverty rates, nonmetropolitan-qualified census tracts appear to be as economically distressed as metropolitan-qualified census tracts. About 99 percent of nonmetropolitan census tracts (excluding redesignated areas, which no longer meet the economic criteria but by statute remain eligible until after the release of the 2010 decennial census data) had a poverty rate of 20 percent or more (see fig. 9). Similarly, about 93 percent of metropolitan census tracts (excluding redesignated areas) met this criterion.[2] However, there are some differences between the economic characteristics of nonmetropolitan- and metropolitan-qualified census tracts. For example, 402 of the 1,272 nonmetropolitan census tracts (about 32 percent) had housing values that were less than 60 percent of the area median housing value, while 57 percent of metropolitan census tracts had housing values that met this criterion.

[1] We provided similar data for metropolitan-qualified census tracts, nonmetropolitan counties, and difficult development areas previously in this report. We cannot provide similar data for base closure areas because they do not coincide with areas for which census data are collected.

[2] For more information on the economic characteristics of metropolitan-qualified census tracts, see figure 5.

Figure 9: Comparison of Indicators Associated with Economic Distress, by HUBZone Nonmetropolitan-Qualified Census Tracts and Redesignated Tracts

		Nonmetropolitan census tracts (no redesignated areas)		Redesignated nonmetropolitan census tracts	
		Number	Percentage	Number	Percentage
Poverty rate	40% or more	240	18.87	0	0
	30.0 - 39.9%	503	39.54	25	3.73
	20.0 - 29.9%	520	40.88	357	53.28
	10.0 - 19.9%	5	0.39	275	41.04
	Less than 10%	4	0.31	13	1.94
Unemployment rate	20% or more	136	10.69	4	0.60
	15.0 - 19.9%	185	14.54	11	1.64
	10.0 - 14.9%	418	32.86	121	18.06
	5.0 - 9.9%	454	35.69	412	61.49
	Less than 5%	79	6.21	122	18.21
Percentage of state nonmetropolitan area median household income	Less than 40%	40	3.14	2	0.30
	40.0 - 49.9%	66	5.19	0	0
	50.0 - 59.9%	228	17.92	2	0.30
	60.0 - 69.9%	366	28.77	60	8.96
	70% or more	572	44.97	606	90.45
Percentage of state nonmetropolitan area median housing value	Less than 50%	216	16.98	44	6.57
	50.0 - 59.9%	186	14.62	54	8.06
	60.0 - 69.9%	241	18.95	116	17.31
	70.0 - 79.9%	236	18.55	147	21.94
	80% or more	393	30.90	309	46.12
	Total	**1,272**		**670**	

Source: GAO analysis of 2000 decennial census data.

Note: This figure only provides descriptive statistics for those nonmetropolitan-qualified census tracts that are located within the 50 states and District of Columbia and that were considered to be nonmetropolitan as of 2006.

Overall, we found that qualified Indian Country areas tend to be economically distressed (see fig. 10). For example, 310 of the 651 Indian Country areas (about 48 percent) had poverty rates of 20 percent or more. In addition, Indian Country areas had much higher rates of unemployment than any other type of HUBZone area. For example, 160 Indian Country areas (about 25 percent) had unemployment rates of 20 percent or more. In contrast, metropolitan census tracts and nonmetropolitan counties (excluding redesignated areas) had unemployment rates that met this same criterion of about 18 percent and just less than 2 percent, respectively.

Figure 10: Comparison of Indicators Associated with Economic Distress, HUBZone-Qualified Indian Country Areas

		Indian Country areas Number	Percentage
Poverty rate	40% or more	87	13.36
	30.0 - 39.9%	85	13.06
	20.0 - 29.9%	138	21.20
	10.0 - 19.9%	154	23.66
	Less than 10%	187	28.73
Unemployment rate	20% or more	160	24.58
	15.0 - 19.9%	68	10.45
	10.0 - 14.9%	113	17.36
	5.0 - 9.9%	125	19.20
	Less than 5%	185	28.42
	Total	651	

Source: GAO analysis of 2000 decennial census data.

Note: We limited our analysis of Indian Country to poverty and unemployment rates because Indian lands vary in nature; therefore, there was no one unit of comparison that worked for all areas when reporting median housing income and median housing value.

As discussed above, qualified HUBZone areas are economically diverse; therefore, adjustments to the qualifying criteria could affect the number and type of eligible areas. Qualified census tracts must meet at least one of two economic criteria: (1) have a poverty rate of at least 25 percent or (2) be an area in which 50 percent or more of the households have incomes below 60 percent of the area's median gross income.[3] By using a poverty rate of 10 percent or more for metropolitan census tracts, however, 14,258 additional metropolitan census tracts could be eligible for the program (an increase of about 143 percent), depending on whether they met the other eligibility requirements (see table 7). In contrast, by using a poverty rate of 40 percent or more for metropolitan census tracts, the number of metropolitan census tracts (those tracts that currently meet eligibility criteria and those that are redesignated) could decrease from 9,959 to 2,270 (a decrease of about 77 percent).

[3]In addition, there is a requirement that the population of all census tracts that satisfy one or both of these criteria cannot exceed 20 percent of the total population of the respective area. While varying the poverty and income criteria independently of each other may have resulted in a violation of the population cap, our analysis is for illustrative purposes only.

Table 7: Effect of Selected Hypothetical Changes to the Eligibility Criteria for Metropolitan-Qualified Census Tracts

Criteria	Number of census tracts	Change in the number of census tracts	Percentage change from current number of eligible census tracts
Percentage of households at the poverty rate			
40 or more	2,270	(7,689)	(77.2)
10 or more	24,217[a]	14,258	143.2
Percentage of households with incomes below 60 percent of an area's median gross income			
75 or more	2,128	(7,831)	(78.6)
25 or more	38,271[a]	28,312	284.3

Source: GAO analysis of 2000 decennial census data.

[a]Number includes census tracts currently eligible for the program (including redesignated tracts), as well as additional census tracts that could be eligible if the criteria were made less stringent.

Qualified nonmetropolitan counties are also determined by two economic criteria: (1) a median household income of less than 80 percent of the median household income for the state nonmetropolitan area or (2) an unemployment rate not less than 140 percent of the state or national unemployment rate (whichever is lower). By using a county median household income of less than 90 percent of the median household income for the state nonmetropolitan area, 29 additional nonmetropolitan counties could be eligible for the program (see table 8). By using a county median household income of less than 70 percent of the median household income for the state nonmetropolitan area, the number of eligible HUBZone-qualified nonmetropolitan counties could decrease from 1,162 to 43 (about 96 percent).

Table 8: Effect of Selected Hypothetical Changes to the Eligibility Criteria for Nonmetropolitan Counties

Criteria	Number of nonmetropolitan counties	Change in the number of nonmetropolitan counties	Percentage change from current number of eligible nonmetropolitan counties
Percentage of median household income compared with median household income for state nonmetropolitan area			
Less than 70	43	(1,119)	(96.3)
Less than 90	1,191[a]	29	2.5
Percentage of unemployment rate compared with state or national unemployment rate			
Not less than 160	328	(834)	(71.8)
Not less than 120	1,327[a]	165	14.2

Source: GAO analysis of 2000 decennial census data.

[a]Number includes nonmetropolitan counties currently eligible for the program (including redesignated counties), as well as additional nonmetropolitan counties that could be eligible if the criteria were made less stringent.

Appendix IV: Characteristics of HUBZone Firms as of 2007

To examine the characteristics of HUBZone firms, we analyzed data from SBA's Dynamic Small Business Source System (DSBSS) as of December 12, 2007. DSBSS contains information on firms that have registered as small businesses in the Central Contractor Registration system (a database that contains information on all potential federal contractors). With the exception of information on the firms' HUBZone, 8(a), and Small Disadvantaged Business certifications, the data in the system are self-reported.[1] We found that HUBZone firms vary in size, ownership, types of services and products provided, and additional small business designations leveraged. Specifically, our analysis showed the following:

- The size of HUBZone firms varies. We chose two measures to describe the size of HUBZone firms—number of employees and average gross revenue. The average number of staff at HUBZone firms was 24. However, half of HUBZone firms had 6 or fewer employees. The average gross revenue for HUBZone firms was almost $3.5 million per year. However, half of HUBZone firms earned $600,000 or less annually.

- Ownership status is diverse. Approximately 30 percent of HUBZone firm owners were women, while 37 percent were minorities. Table 9 breaks out the owners of HUBZone firms based on race and ethnicity.

Table 9: HUBZone Firms' Ownership by Race and Ethnicity, 2007

Race/ethnicity	Number of firms	Percentage
African-American	2,269	16.7
Asian-American	546	4.0
Hispanic	1,138	8.4
Native American	1,062	7.8
White	8,568	63.1
Total	**13,583**	**100.0**

Source: GAO analysis of DSBSS data as of December 12, 2007.

[1]The 8(a) program is a business development program for firms owned by citizens who are socially and economically disadvantaged. SBA provides these firms with technical assistance, such as business counseling. While the 8(a) program offers a broad range of assistance to socially and economically disadvantaged firms, the Small Disadvantaged Business program is intended only to convey benefits in federal procurement to disadvantaged businesses.

- HUBZone firms operate in a variety of industries as defined by North American Industry Classification System (NAICS) codes, and many operate in multiple industries.[2] Table 10 lists the top 10 industries in which HUBZone firms operated and the number of HUBZone firms that provided a service or product related to that industry.

Table 10: Top 10 Industries in Which HUBZone Firms Operated, 2007

Industry (NAICS code)	Number of firms	Percentage of firms
Commercial and institutional building construction (236220)	1,761	2.4
Site-preparation contractors (238910)	1,353	1.8
Engineering services (541330)	1,277	1.7
Highway, street, and bridge construction (237310)	1,177	1.6
Computer systems design services (541512)	1,153	1.6
Industrial building construction (236210)	1,146	1.6
Other heavy and civil engineering construction (237990)	1,129	1.5
All other specialty trade contractors (238990)	1,117	1.5
Custom computer programming services (541511)	1,107	1.5
Administrative management and general management consulting services (541611)	1,076	1.5
Water and sewer line and related structures construction (237110)	1,036	1.4

Source: GAO analysis of DSBSS data as of December 12, 2007.

- HUBZone firms often have other small business designations. Although the majority of HUBZone firms had only the HUBZone designation, 32 percent had one additional designation, which was most often the service-disabled, veteran-owned designation.[3] Table 11 shows the extent to which HUBZone firms had other small business designations.

[2]NAICS, a data collection and analysis tool developed by the federal government, is a classification system that groups businesses based on similarities in the processes they use to produce goods or services.

[3]Section 308 of the Veterans Benefit Act of 2003 (P.L. 108-183) established a procurement program for service-disabled veterans. This program provides that contracting officers may award a sole source contract or set-aside contracts to service-disabled veteran-owned firms.

Table 11: HUBZone Firms' Small Business Designations, 2007

	Percentage of HUBZone firms	HUBZone firms	HUBZone firms that are also 8(a) firms	HUBZone firms that are also service-disabled veteran-owned firms	HUBZone firms that are also small disadvantaged businesses	HUBZone firms that are also women-owned firms
HUBZone firm designation only	56.2	7,639	0	0	0	0
HUBZone firm with one additional designation	32	4,350	8	679	191	3,472
HUBZone firm with two additional designations	7.8	1,065	848	127	951	204
HUBZone firm with three additional designations	3.8	516	514	89	516	429
HUBZone firm with four additional designations	0.1	13	13	13	13	13

Source: GAO analysis of DSBSS data as of December 12, 2007.

Appendix V: Details of Site Visits to HUBZone Areas

We conducted site visits to four HUBZone areas—Lawton, Oklahoma; Lowndes County, Georgia; and Long Beach and Los Angeles, California—to better understand to what extent benefits have been generated by the HUBZone program. These four areas represent various types of HUBZone areas (see table 12), and we found that the perceived benefits of the HUBZone program varied across these locations. The majority of the individuals we interviewed indicated that their firms had received some benefit from HUBZone certification. In most cases, they cited as a benefit the ability to compete for and win contracts, which in some cases had allowed firms to expand or become more competitive. However, representatives of a few firms indicated they had not been able to win any contracts through the program, which made it difficult to realize any benefits. We also asked local economic development and Chamber of Commerce officials if they were familiar with the HUBZone program. We found varying levels of familiarity with the program, and some officials representing economic development entities stated they lacked information on the program's effect that could help them inform small businesses of its potential benefits.

Table 12: Economic Characteristics of Site Visit Locations

Location	County	County population	FY 2006 contract dollars awarded to HUBZone firms in county (in millions)	County median household income (in 1999 dollars)	County poverty rate (1999)	Type of HUBZone area
Lawton, Okla.	Comanche	114,996	$42.9	$33,867	15.6%	Indian Country
Valdosta, Ga.	Lowndes	92,115	13.9	32,132	18.3%	Redesignated Nonmetropolitan County
Long Beach, Calif.	Los Angeles	9,519,338	62.2	42,189	17.9%	Census Tract
Los Angeles	Los Angeles	9,519,338	62.2	42,189	17.9%	Census Tract

Sources: 2000 census data, FY 2006 FPDS-NG data, and SBA HUBZone Web site.

Various representatives of HUBZone firms with whom we spoke stated that the HUBZone program provided advantages. The majority of representatives of HUBZone firms we interviewed stated that HUBZone certification had provided them with an additional opportunity to bid on federally funded contracts. Additionally, some of the business owners we interviewed who had received contracts stated that winning contracts through the HUBZone program had allowed their firm to grow (for example, to hire employees or expand operations). Representatives from two HUBZone firms located in Lawton, Oklahoma, that had received contracts through their HUBZone certification stated that the primary benefits associated with their HUBZone certification had been winning contracts that allowed them to hire additional employees and continue to build a reputation for their firms, which in turn had placed them in a better position to compete for additional contracts. Representatives of a HUBZone firm located in Valdosta, Georgia, stated that they had utilized the HUBZone program to obtain more contracts for their construction firm. They added that the program had allowed their firm to enter the federal government contracting arena, which provided additional opportunities aside from private-sector construction contracts. Representatives from three HUBZone firms in Los Angeles stated that they had won contracts through the program and had been able to build a stronger reputation for their firms by completing those contracts. Representatives of two of these firms also stated that the contracts they won through the program had helped their firms to grow and hire additional employees. For example, representatives from one HUBZone firm we interviewed stated that the firm had hired 10 to 15 full-time employees partly as a result of obtaining HUBZone contracts.

However, representatives of some HUBZone firms stated that the program has not generated any particular benefits for their firm. For example, representatives of two HUBZone firms in Lawton, Oklahoma, and one HUBZone firm in Valdosta, Georgia, stated that their HUBZone certification had resulted in no contracts or not enough contracts to provide opportunities to "grow" their firm. They noted that the HUBZone certification alone was not sufficient when competing for federally funded contracts, particularly because—based on their experience—few contracts were set aside for HUBZone firms. Our interviewees indicated that they planned to stay in the program but were unlikely to see any benefits unless additional contracts were set aside for HUBZone firms. A representative from one HUBZone firm located in Long Beach, California, stated that her HUBZone firm had not been awarded any contracts directly through the program, but because of the firm's HUBZone status, it had been able to perform work as a subcontractor on contracts that had HUBZone subcontracting goals. However, her firm had not grown or expanded employment through the program.

We also found that, while some local economic development and Chamber of Commerce officials with whom we spoke were familiar with the HUBZone program, others were not. For example, in Lawton, Oklahoma, local economic development and Chamber of Commerce officials were familiar with the program and its requirements, largely because the city of Lawton has been designated a HUBZone area. In Valdosta, Georgia, Chamber of Commerce officials and officials from various economic development authorities were not familiar with the program and its requirements, but the small business development center official we interviewed was familiar with the program. In Long Beach and Los Angeles, California, most of the small business development center and economic development officials with whom we met also were relatively unfamiliar with the program, its goals, and how small businesses could use the program. Finally, officials representing economic development entities in Lowndes County, Georgia, and Los Angeles, California, stated that they lacked information on the program's impact that could help them inform small businesses of its potential benefits.

Appendix VI: GAO Contact and Staff Acknowledgments

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Staff Acknowledgments

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