

AUDIT REPORT

SBA'S HUBZONE CERTIFICATION PROCESS





EXECUTIVE SUMMARY

SBA'S HUBZONE CERTIFICATION PROCESS

Report No.
19-08

March 28,
2019

What OIG Audited

This report presents the results of our audit of the Small Business Administration's (SBA's) Historically Underutilized Business Zone (HUBZone) certification process. The HUBZone program, administered by SBA's Office of the HUBZone Program (Program Office), provides small businesses that are located in economically challenged areas access to federal contracting opportunities to stimulate their local economies.

Our objectives were to determine (1) whether SBA's oversight ensured that only eligible firms were certified into the HUBZone program and (2) whether SBA performed certification reviews timely.

To answer our objectives, we selected a stratified random sample of 15 firms that were certified into the HUBZone program and received HUBZone contracts between April 1, 2017, and March 31, 2018. Contracts awarded to these firms represented approximately 62 percent of the HUBZone contracts awarded to firms certified into the HUBZone program during this period. We interviewed HUBZone program personnel and reviewed applicable regulations. In addition, we reviewed firms' HUBZone application materials.

What OIG Found

SBA program officials' oversight did not ensure that only eligible firms entered the HUBZone program. Of the 15 firms we reviewed, the Program Office certified 2 firms that did not meet the principal office eligibility requirement and 1 firm with insufficient documentation that it met the HUBZone employee residency requirement. These firms received approximately \$589,000 in HUBZone contract obligations. Ineligible firms undermine the integrity of the HUBZone program and divert HUBZone contract opportunities from eligible firms. Additionally, the Program Office did not perform certification reviews timely, delaying firms' ability to compete for HUBZone contracts and impeding the program's purpose of contributing to economic development of HUBZones.

OIG Recommendations

We recommended that SBA update and implement HUBZone guidance based on the current certification process, and we made four additional recommendations to improve the quality and timeliness of the HUBZone certification process.

Agency Response

We considered management comments on the draft report when preparing the final report. Based on management comments, we revised the wording in recommendation 1 from "eligibility reviews" to the broader term "program examinations." Management agreed with all five of the recommendations, and its planned actions resolve all the recommendations. SBA conducted a program examination for one firm and plans to conduct program examinations for the two remaining firms. Additionally, SBA plans to update and implement HUBZone guidance, as well as implement a plan to mitigate information technology issues affecting the HUBZone certification process.



**U.S. SMALL BUSINESS ADMINISTRATION
OFFICE OF INSPECTOR GENERAL
WASHINGTON, D.C. 20416**

Final Report Transmittal
Report Number: 19-08

DATE: March 28, 2019

TO: Linda E. McMahon
Administrator

FROM: Hannibal "Mike" Ware 
Inspector General

SUBJECT: SBA's HUBZone Certification Process

This report presents the results of our audit of the Small Business Administration's (SBA's) oversight of the HUBZone certification process. We conducted this audit in accordance with generally accepted government accounting standards.

SBA agreed to address all recommendations identified in the report. We considered management comments on the draft report when preparing the final report. Based on management comments, we revised the wording in recommendation 1 from "eligibility reviews" to the broader term "program examination," which encompasses a document review that closely aligns with conducting initial eligibility determinations.

We appreciate the courtesies and cooperation extended to us during this audit. If you have any questions, please contact me at (202) 205-6586 or Andrea Deadwyler, Assistant Inspector General for Audits, at (202) 205-6616.

cc: Pradeep S. Belur, Chief of Staff, Office of the Administrator
Robb N. Wong, Associate Administrator, Office of Government Contracting and Business Development
Barbara E. Carson, Deputy Associate Administrator, Office of Government Contracting and Business Development
Christopher M. Pilkerton, General Counsel
Martin Conrey, Attorney Advisor, Legislation and Appropriations
LaNae Twite, Director, Office of Internal Controls

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Introduction

The HUBZone Act of 1997 established the Historically Underutilized Business Zone (HUBZone) program under the Small Business Administration (SBA) to increase federal contracting opportunities by providing contracting preferences in the form of set-aside, sole-source awards, and price evaluation preferences for qualified small businesses located within HUBZones. HUBZones include areas located in qualified census tracts, nonmetropolitan counties, lands within the external boundaries of an Indian reservation, base closure areas, redesignated areas, or disaster areas. The intent of the HUBZone program is to promote employment opportunities, capital investment, and economic development in impoverished areas.

Information from various federal agencies determines HUBZone designations. While SBA maintains the HUBZone map that displays HUBZone areas and allows users to search by address to determine whether a particular location is in a HUBZone, it does not participate in the designation of HUBZones.

In fiscal year (FY) 2017, federal agencies awarded \$7.3 billion, or 1.7 percent of total eligible federal contracting dollars, to HUBZone firms. As of September 2018, the HUBZone program had 5,407 participating firms.

HUBZone Eligibility Requirements

To qualify for HUBZone certification, at the time of application, a firm must:

- Be a small business by SBA size standards;
- Be owned and controlled at least 51 percent by U.S. citizens, or eligible entities such as Indian tribes;
- Have its principal office, defined as the location where the greatest number of employees perform their work, within a HUBZone; and
- Have at least 35 percent of its employees residing in a HUBZone.

Program Certification Process

The Office of the HUBZone Program (Program Office) uses a three-level review process for all HUBZone applications and supporting documentation to ensure that it only admits eligible firms into the program. Each level of review evaluates whether a firm should be certified or declined entry into the HUBZone program. First level analysts review supporting documents including owners' proof of citizenship, principal office leases, payroll, employees' driver's licenses, and utility bills. The HUBZone program director or deputy director makes the final determination to certify or decline the applicant firm. Figure 1 summarizes these steps in the HUBZone certification process.

Figure 1. Summary of Steps in the HUBZone Certification Process



Prior Work

In 2013, we conducted an audit of the HUBZone program and found that 3 of the sampled 12 firms certified between July and December 2012 received certification without meeting the requirements of the program. Additionally, we found other inconsistencies in the review process that could lead to the admittance of firms that did not meet the requirements of the program. Finally, we found that SBA took longer to certify firms than the current and proposed regulations allowed.¹ The audit report contained three recommendations, including updating HUBZone guidance and identifying a means to meet the deadlines established by regulation through an improved business process. We closed the three recommendations based on information provided by SBA.

¹ SBA OIG Report 14-03, Opportunities Exist to Further Improve Quality and Timeliness of HUBZone Certifications (November 19, 2013).

In 2015, the Government Accountability Office (GAO) found that SBA lacks an effective way to communicate changes in HUBZone designations to affected firms and lacks key controls for its recertification process.² GAO recommended that SBA establish a mechanism to better ensure that it notifies firms of changes to HUBZone designations and implement additional controls over the recertification process.

In 2018, GAO found that SBA adopted a risk-based approach to HUBZone certification and recertification, but the extent of its risk assessment in developing this approach was unclear.³ GAO also found that SBA lacked complete documentation for 9 out of 12 Puerto Rican HUBZone firms reviewed and did not consistently follow its own procedures for quality control reviews when approving firms. GAO recommended that SBA update internal policy manuals to reflect current policies and procedures, and review and document staff compliance with procedures for reviewing firms.

Objectives

Our objectives were to determine (1) whether SBA's oversight ensured that only eligible firms were certified into the HUBZone program and (2) whether SBA performed certification reviews timely.

² GAO-15-234, Small Business Contracting: Opportunities Exist to Further Improve HUBZone Oversight (February 2015).

³ GAO-18-666, Small Business Contracting: Small Business Administration Could Further Strengthen HUBZone Eligibility Reviews in Puerto Rico and Programwide (September 2018).

Finding 1: Ineligible Firms Received \$589,000 in HUBZone Contract Obligations

The Program Office's oversight did not ensure that it certified only eligible firms into the HUBZone program due to weaknesses in the certification process. Despite a three-level review process for HUBZone certification, program officials did not detect fraud indicators in the application documents submitted for 2 of the 15 firms we reviewed. In addition, program officials certified a third firm into the program based on inaccurate calculations and insufficient documentation that it met HUBZone eligibility requirements. For the three firms, program officials certified them based on faulty and incomplete analysis of supporting documentation, which program officials did not detect as part of the quality review process. These deficiencies occurred because the Program Office did not have a standardized review process for the analysis or oversight of HUBZone certifications. The Program Office also did not update its written policies despite a prior OIG audit recommendation to update its HUBZone guidance. For the three firms in our sample that program officials did not detect as ineligible, we questioned \$589,000 in contract obligations⁴ these three firms received from April 1, 2017, to March 31, 2018, our period of review. (See appendix II for a schedule of our questioned costs.) Certifying ineligible firms into the HUBZone program undermines program integrity and diverts HUBZone contract opportunities from eligible firms.

Program Office Certified Ineligible Firms That Did Not Meet the Principal Office Requirement

Program officials did not detect indicators of fraud and certified 2 of the 15 firms we reviewed into the HUBZone program that did not meet principal office location requirements (Firms A and B). While these firms represented to the Program Office that their principal office locations were in HUBZones, we identified inconsistencies in their application materials that should have prompted HUBZone analysts to conduct further research based on these fraud indicators.

We found that Firm A and Firm B misrepresented their eligibility to obtain certification into the HUBZone program.⁵ HUBZone analysts did not conduct additional research based on inconsistencies in the firms' application materials, and the Program Office certified Firm A and Firm B into the HUBZone program. Program officials provided us a copy of a briefing memorandum to the SBA Deputy Administrator that stated HUBZone analysts should use publicly available mapping software to check principal office locations, but we found no indications or evidence of these reviews for either Firm A or Firm B. This memorandum also stated that HUBZone analysts should conduct other internet research for higher-risk firms. According to program officials, analysts did not conduct more extensive research because they deemed the firms low-risk; however, we found that the Program Office did not have any established criteria for determining risk levels. Specifically, the Program Office did not have guidance for identifying high-risk firms, potential fraud indicators, or actions to take when it identified instances of potential fraud.

Firm A

We determined that Firm A obtained HUBZone certification although it was ineligible, due to misrepresentations that the Program Office did not detect. Firm A's HUBZone application listed its principal office location as the personal residence of the only two employees of the firm, the owner and the sales manager (husband and wife). To support its principal office and residency assertions,

⁴ The contract obligations include contracts awarded using HUBZone contracting preferences in the form of set-asides, sole-source awards, and price evaluation preferences.

⁵ We referred issues identified with Firm A and Firm B to our Investigations Division for review.

Firm A provided a copy of a lease agreement to SBA that stated the firm's owner was the landlord and was leasing the property to the firm, with the sales manager signing on behalf of the firm. In addition, the HUBZone analyst did not require utility bills to support principal office claims because the lease stated that the landlord was responsible for utilities. We also identified property tax records dating back to 1988 that revealed that the firm's owner did not own the claimed principal office location at any time and concluded that the firm's owner could not be the landlord for this location.

We conducted an unannounced site visit to the claimed principal office and personal residence location during business hours, and we found no evidence that a business was operating from that location. Consequently, we contacted the firm and briefly spoke by telephone with the sales manager, who told us that we needed to make an appointment as they were only at the location two times per week. Furthermore, property tax records revealed the firm's owner and sales manager owned a non-HUBZone property as their personal residence for which they claimed a homestead exemption.

Accordingly, we concluded that the reported address was neither the two employees' personal residence nor the principal office location. Because the employees of Firm A did not reside in a HUBZone, Firm A also did not meet the 35-percent residency requirement. Firm A received \$559,479 in HUBZone contract obligations during our review period at the expense of eligible HUBZone firms.

Firm B

Firm B gained HUBZone certification by misrepresenting its principal office eligibility, and program officials did not detect inconsistencies in the firm's application. Specifically, Firm B did not comply with HUBZone regulations requiring that all representations and supporting information contained in an application must be complete and accurate as of the date of submission.⁶ At the time of its application on June 20, 2017, Firm B claimed that it paid \$3,000 per month to rent a building in a HUBZone as its principal office location (Site 1), which we determined did not exist.⁷ Firm B also failed to disclose a second office location that was not in a HUBZone (Site 2).

The firm's application included a lease and rent checks as supporting evidence for its principal office location. However, the firm's owner served as the lessor and lessee on the lease, which we concluded should have raised questions about the legitimacy of the lease. Moreover, the rent checks Firm B provided as support were payable to another firm that was owned by the same owner as Firm B, and those checks listed Site 2 as Firm B's address. Finally, the lease for the claimed HUBZone address at Site 1, with an effective date of January 2017, stated the location included 6,000 square feet of office space and 5,000 square feet of indoor storage space. However, the lease also noted that the building was "to be located" at Site 1, which should have led the Program Office to further review the firm's assertions that a building matching the lease description did, in fact, exist.

Through searches of publicly available mapping software and property tax records, we determined that at the time of the Program Office's review in August 2017, these sources displayed a small barn, contrary to the description of a large office space and indoor storage listed on the corresponding lease. (Figure 2 includes photographs from our search of Site 1, the claimed

⁶ 13 CFR 126.302.

⁷ The firm submitted 4 months of rent checks, from March to June 2017, as evidence to support its principal office location.

HUBZone location.) Tax records revealed not only the photographs in figure 2, but also that improvements to this site were valued at only \$1,000, which was inconsistent with the lease description of the office building. The figure 2 photographs, dated September 2017 and January 2018, show a trailer but no commercial building at the site, again contrary to the principal office description included in Firm B's lease agreement. Additionally, our searches of city building permit records showed that Firm B did not apply for a building permit at Site 1 until January 2018, well after its June 2017 application.⁸

Firm B also did not disclose Site 2 in its June 2017 HUBZone application, although the Program Office requires firms to list all locations. The property at Site 2 (and the address listed on the rent checks) contained a large office building with the firm's name on it but that building was not located within a HUBZone at the time of the application. Firm B previously claimed this address as its principal office location from November 2012 through December 2015, during the firm's prior participation in the HUBZone program. The Program Office later decertified Firm B in December 2015 because the census tract including Firm B's principal office (Site 2, its large office building and the location listed on the rent checks) was no longer a designated HUBZone. Firm B's website listed Site 2 as its only office location as of October 2017.

Based on our audit, the Program Office contacted Firm B to request supplemental documentation to review its eligibility. In September 2018, Firm B provided a lease addendum stating that no building existed at the claimed principal office location (Site 1) and that the lessor would provide temporary facilities, which Firm B would rent for \$3,000 per month. The firm also provided an updated location list that included the large office building (Site 2) as a secondary location.⁹ In a subsequent meeting, SBA officials told us that even with the supplemental information they still would have certified Firm B into the HUBZone program, but they did not provide a clear justification. The supplemental information reinforced our position that a large office building at Site 1 did not exist at the time of the application. It also raised further questions as to why Firm B claimed that it paid \$3,000 per month in rent for a nonexistent building, and that it would continue to pay \$3,000 per month for undefined temporary facilities that we determined to be a trailer (see Figure 2). The firm's disclosure of Site 2 as a secondary location also supported our position that it omitted required information from its application.

Consequently, we maintain that Firm B did not comply with HUBZone regulations requiring complete and accurate application information, and it should not have been certified into the HUBZone program. While Firm B did not receive new HUBZone contracts during the period we examined, the Program Office's lack of oversight and inadequate review posed a risk that Firm B could have received HUBZone contracts at the expense of eligible firms, thereby undermining the integrity of the program.¹⁰

⁸ The building permit was issued in May 2018.

⁹ Due to subsequent changes in HUBZone census tract designations, in January 2018, Site 2 was once again located in a HUBZone.

¹⁰ Firm B received \$21.7 million in task orders between June 20, 2017, and March 31, 2018, from an indefinite quantity, indefinite delivery HUBZone contract awarded in 2014. HUBZone regulations, 13 CFR 126.601(h)(1), permit a firm to continue to receive task orders on an existing HUBZone contract after it is subsequently decertified.

Figure 2. Firm B's Purported Principal Office Location (Site 1)



Source: County tax records, photograph dated May 9, 2014.



Source: Publicly available map image, photograph dated September 2017.



Source: County tax records, photograph dated January 13, 2018.

Program Office Certified Firm Based on Inaccurate Analysis and Insufficient Documentation of Eligibility for the 35-Percent Residency Requirement

The Program Office certified 1 of the 15 firms (Firm C) we reviewed based on inaccurate analysis and insufficient documentation. Specifically, analysts did not include all salaried full-time employees in their calculations to determine the total number of Firm C employees and did not obtain sufficient documentation that the firm met the 35-percent employee HUBZone residency requirement. Because the analyst incorrectly calculated compliance with the 35-percent residency requirement based on five total employees, the analyst determined that two employees needed to be HUBZone residents to meet this requirement. However, we determined that Firm C had 12 employees and it needed documentation that 5 of them resided in a HUBZone to meet the residency requirement. Although the firm provided documentation regarding HUBZone residency for five employees, the documentation supporting one employee's residency was a photocopy of an envelope from a utility company, which the Program Office's guidance did not list as an acceptable proof of residency. Consequently, the firm only had documentation that 33 percent of its employees were HUBZone residents. The Program Office did not follow its three-level review process for Firm C, which may have contributed to the lack of follow-up conducted to obtain sufficient documentation and could have identified the error in payroll employee calculations. Consequently, we were unable to determine whether Firm C, which received \$29,712 in HUBZone contract obligations, was eligible for the program.

Analysis and Oversight Not Standardized, Prior OIG Recommendation Not Implemented

The Program Office inappropriately certified these three firms because it did not have an established standardized analysis and oversight process for the review of HUBZone applications. Moreover, the Program Office did not implement a prior OIG recommendation to update the HUBZone guidance to reflect its current certification process. To close the recommendation, program officials developed interim guidance on the certification review process and stated that they planned to issue an updated standard operating procedure (SOP) by August 31, 2016. However, they did not issue the SOP. Program officials told us that although they submitted a draft SOP through SBA's internal clearance process, they did not finalize the SOP due to the transition in SBA's leadership. They also stated that they did not resubmit the draft SOP through the clearance process because of proposed changes to the HUBZone regulations and the planned implementation of a new certification system. Additionally, the Program Office did not have a formalized quality control process as part of its multiple levels of review to promote compliance with interim guidance, including the use of publicly available mapping software. According to program officials and analysts, analysts relied on verbal guidance from the HUBZone program officials to review and process HUBZone certification applications in lieu of updated written policy documents. This lack of formalized guidance led to inconsistent follow-up with firms for additional documentation, inaccurate analysis, and subjective screenings that differed in quality at all levels during application reviews, and an increased likelihood of certifying ineligible firms.

Recommendations

We recommend that the Administrator require the Associate Administrator for the Office of Government Contracting and Business Development to:

1. Conduct program examinations for Firms A, B, and C; take timely action to decertify these firms if found to be ineligible; and refer the firms for suspension and debarment proceedings, if warranted based on eligibility review results.

2. Update and implement HUBZone guidance based on the current certification process, including standardizing the analysis and oversight process (to include conducting independent research and analyses to identify indicators of potential fraud), and training HUBZone Office employees on this guidance.

Finding 2: Delays in the HUBZone Certification Process Impeded the Program’s Purpose of Increasing Economic Development in HUBZones

The Program Office did not make eligibility determinations for 4 of the 15 certified firms in our sample within the 90-day regulatory requirement¹¹ and did not timely assign applications to analysts for certified and pending firms. These deficiencies occurred because the Program Office did not have formalized guidance, had staff turnover, experienced information technology (IT) issues, and had lengthy hold times with limited monitoring. Delays in certifying eligible firms postponed their ability to obtain HUBZone contracts, impeding the program’s purpose of increasing economic development in HUBZones.

Firms Not Certified Timely

The Program Office did not make eligibility determinations within 90 calendar days for 4 of the 15 certified firms we reviewed. Specifically, the certification process for these four firms took an average of 126 calendar days, excluding times that analysts placed applications on hold to request additional documents from firms.¹² We found that the Program Office took an average of 30 calendar days to assign these applications. The Program Office’s performance measures stated that program officials should assign applications to analysts for review within 15 calendar days of receipt of a complete application.

Additionally, the timeframe to become certified into the HUBZone program, including hold times, was sometimes much longer than 90 days. HUBZone analysts placed firms’ applications on hold at any point in the review process if the analysts needed additional documents from the firms. Consequently, the Program Office subtracted hold times from its calculations of the overall certification timeliness. By including hold times, we found that the total processing time for the four firms averaged 176 days, as shown in table 1.

Table 1. Delays in Eligibility Determinations for Certified Firms

Firm	Days to assign completed application	Days to complete review after assignment (excluding hold times)	Total days (excluding hold times)	Days over 90-day requirement (excluding hold times)	Days on hold	Total days (including hold times)	Days over 90-day requirement (including hold times)
Firm 1	30	94	124	34	43	167	77
Firm 2	47	93	140	50	87	227	137
Firm 3	21	119	140	50	33	173	83
Firm 4	22	76	98	8	40	138	48
Average	30	96	126	36	51	176	86

¹¹ 13 CFR 126.306(a).

¹² We calculated the timeframes by defining the start date as the date the applicant firm uploaded its supporting documentation to the online system.

We also reviewed firms pending certification as of May 8, 2018, to determine whether the Program Office was actively monitoring firms in the certification process and found that program officials did not assign applications to analysts for 22 of 220 firms pending certification. Of the 22 applications, 14 were not assigned to an analyst within 15 calendar days. The days in which these 14 applications were unassigned to an analyst ranged from 23 to 39 days, with an average of 29 days.

Lack of Formalized Guidance, IT Issues, Staff Turnover, and Lengthy Hold Times Contributed to Delays

Delays in the HUBZone certification process occurred because of a lack of formalized guidance, IT issues, and staff turnover. SBA did not have updated and standardized guidance specifying how analysts were to review application materials. SBA also experienced IT issues that rendered the document repository for application materials unavailable, halting assignments and analysts' ability to review supporting documents. SBA did not have alternative procedures in place to mitigate disruptions from IT issues. Program officials expect that moving HUBZone processes to the new Certify.SBA.gov system will eliminate problems associated with the outdated systems, but the anticipated implementation date of this new system is not until February 2019.¹³ Further, according to program officials, staff turnover delayed assigning and reviewing applications. Accordingly, program officials streamlined the processes for SharePoint One Track documentation upload and application assignment. They also added two employees on detail assignments to the Program Office to assist in reviewing HUBZone applications. Additionally, the Program Office launched a pilot program in which district offices and small business development centers worked with firms to ensure their HUBZone applications were complete prior to submission. Although the Program Office had established these timeliness initiatives for the HUBZone certification process, it did not have an overall plan to improve timeliness.

Additionally, hold times frequently exceeded the Program Office's stated timeframe that firms have a maximum of 10 business days to submit additional documentation. HUBZone analysts stated that they occasionally allowed firms more than 10 business days to submit documents, but our analysis indicated that hold times commonly exceeded this standard. Of the 15 certified firms we reviewed, 10 firms had holds over the 10-business-day metric, ranging from 11 to 39 business days. Hold times for all of the 15 firms in our sample averaged 16 business days. In addition, because the Program Office did not have policies establishing a standardized review process, analysts did not have guidance on the quality or type of supporting documentation needed resulting in unnecessary holds. For example, one analyst placed a firm on hold for 30 business days because the analyst asked for additional supporting documents to evidence the 35-percent employee residency requirement. However, the firm had already met this requirement based on the original documentation submitted.

Program Officials had limited ability to monitor whether analysts promptly removed holds upon receipt of requested documents and began to conduct their reviews. First level analysts controlled application hold times because they were able to place firms' applications on hold to request additional documents from the firms at any point during the review process and remove the hold when they received the documents. However, firms often provided the documents directly to analysts via email, and analysts sometimes did not update HUBZone Certification Tracking System to reflect the date those documents were received. In addition, the Program Office's practice of

¹³ SBA is modernizing its application and certification process for federal contracting programs. Certify.SBA.gov, when completed, should provide a unified certification process across multiple SBA contracting programs, including the HUBZone program.

subtracting hold times from calculations of overall timeliness and analysts' performance metrics may have created an incentive for analysts to leave firms on hold after firms provided documents, to improve their performance and the performance of the program overall. Because the Program Office allowed for extended hold times, did not require timely updating of the system of record and did not monitor reasons for holds, it had limited ability to determine whether analysts removed holds promptly upon receipt of documents and whether certification times were accurate.

Delays Impede Program's Purpose and Ability to Meet More Stringent Standard in Future

If the Program Office does not certify eligible firms in the timeframe required, those firms might miss opportunities to compete for HUBZone contracts. This impedes the program's purpose of providing federal contracting assistance to eligible small businesses in an effort to increase economic development in HUBZones.

Furthermore, the National Defense Authorization Act for FY 2018 requires the Program Office to certify firms in 60 days beginning January 1, 2020. Without a standardized review process, the Program Office will not be able to comply with making eligibility determinations within this more stringent timeline.

Recommendations

We recommend that the Administrator require the Associate Administrator for the Office of Government Contracting and Business Development to:

3. Implement a plan to mitigate or remedy IT issues affecting the HUBZone certification process.
4. Review the HUBZone certification process and implement a plan to meet the current and future certification timelines.
5. Monitor hold times to ensure that the Program Office accurately reports overall timeliness of eligibility determinations.

Analysis of Agency Response

SBA management provided formal comments that are included in their entirety in appendix III. SBA management concurred with all five recommendations, and its planned actions resolve all the recommendations.

In its comments, SBA management stated it did not believe Firm B misrepresented its compliance by providing documentation describing a replacement building that it intended to construct at the site of its asserted principal office. They further stated that the report did not refute SBA's determination that, based on the facts that existed at the time of Firm B's certification, the firm was eligible for certification.

We reiterate our position as outlined in the finding, that at the time of application Firm B did not comply with HUBZone regulations. Our conclusion that Firm B failed to disclose complete and accurate application information considers more factors than just Firm B's intent to build, as SBA management's response indicates. We contend that Firm B's application needed additional scrutiny due to the inconsistencies we identified. Firm B omitted application information disclosing its second office location, had not applied for any building permits for the Site 2 location as of the date of its application, and provided a lease of which we questioned the legitimacy. SBA's response confirms that it did not further investigate Firm B's assertions at the time of its application review. OIG stresses that firms should submit transparent, accurate, and complete information at the time of application.

Summary of Actions Necessary to Close the Recommendations

The following provides the status of the recommendations and the necessary actions to close them.

- 1. Resolved.** SBA management concurred with our recommendation, stating that it conducted a program examination of Firm B and that it will conduct program examinations of Firms A and C. Management plans to complete final action on this recommendation by July 31, 2019. This recommendation can be closed once management provides evidence that it completed the program examinations of the three firms that OIG identified, takes timely action to remove any firms found to be ineligible, and provides a determination of whether questioned costs should be disallowed for the firms that it reviewed.
- 2. Resolved.** SBA management concurred with our recommendation, stating that it will update and implement HUBZone guidance based on the current certification process by: (1) issuing internal guidance, to include conducting independent research and analyses to identify indicators of potential fraud, (2) updating the standard operating procedures for HUBZone certification, (3) training HUBZone Office employees on the updated guidance, and (4) revising staff performance plans. Management plans to complete final action on this recommendation by October 31, 2019. This recommendation can be closed once management demonstrates that it has implemented updated guidance to reflect its current certification process and provided evidence of training held and revised staff performance plans.
- 3. Resolved.** SBA management concurred with our recommendation, stating that it hired a senior IT expert to manage the Office of Government Contracting and Business Development's technology modernization initiative, including delivery of the Certify.SBA.gov system full operational capability to replace the HUBZone Certification Tracking System. Management also stated that it anticipates completing a re-baseline of the

Certify.SBA.gov system by the end of the third quarter of FY 2019. The re-baseline will address the technology and design changes needed to remediate control weaknesses in the HUBZone certification business application. Management plans to complete final action on this recommendation by January 1, 2020. This recommendation can be closed once management provides evidence of a fully functioning HUBZone certification business application within Certify.SBA.gov.

4. **Resolved.** SBA management concurred with our recommendation, stating that it will revise staff performance plans and evaluate performance against those plans to ensure that the Program Office meets current and future HUBZone certification timelines. Management plans to complete final action on this recommendation by January 31, 2020. This recommendation can be closed when management provides evidence that it evaluated staff performance against the revised plans.
5. **Resolved.** SBA management concurred with our recommendation, stating that it will monitor hold times by the actions outlined in its response to recommendations 2 and 4 and building relevant reporting routines. Management plans to complete final action on this recommendation by January 31, 2020. This recommendation can be closed when management provides evidence that it implemented the planned actions identified in its response to recommendations 2 and 4, as well as demonstrates that it has implemented relevant reporting routines.

Appendix I: Objectives, Scope, and Methodology

This report presents the results of our audit of SBA's HUBZone certification process. Our objectives were to determine (1) whether SBA's oversight ensured that only eligible firms were certified into the HUBZone program and (2) whether SBA performed certification reviews timely.

To answer our objectives, we reviewed relevant sections of the Small Business Reauthorization Act of 1997 and federal laws and regulations pertinent to the HUBZone program, including United States Code and Code of Federal Regulations sections, and the National Defense Authorization Act for FY 2018. Additionally, we reviewed the HUBZone program website and related information available to the public. Further, we interviewed SBA analysts and program officials to understand the certification process.

We selected and reviewed a judgmental sample of 15 firms certified into the HUBZone program that also received HUBZone contracts between April 1, 2017, and March 31, 2018. We obtained a universe of 1,002 firms that the Program Office certified into the program during our period of review. We identified 39 firms that received HUBZone certification and HUBZone contract obligations during this period. Next, we stratified this sample into three categories: high (\$1 million or more in HUBZone contract dollars), medium (\$100,000–\$999,999 in HUBZone contract dollars), and low (less than \$100,000 in HUBZone contract dollars). We then randomly selected 5 firms from each category to result in our sample of 15 firms. At the time we obtained contracting information on May 21, 2018, these 15 firms obtained approximately \$29.4 million in HUBZone contracts during our period of review, which represented approximately 62 percent of the HUBZone contracts awarded to firms certified into the HUBZone program during the same period.

For the 15 firms in our sample, we reviewed their applications, supporting documents, HUBZone program staff members' analyses, and third-party sources of information to assess the HUBZone certification process. We also analyzed information regarding firms pending certification as of May 8, 2018.

We conducted this performance audit 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 objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Use of Computer-Processed Data

We relied on data that the Program Office obtained from the Federal Procurement Data System-Next Generation (FPDS-NG) to select our sample of 15 HUBZone firms because federal agencies are required to submit most contract action data directly to FPDS-NG.¹⁴ This was the official source of information on federal contracting; and, for the purposes of our review, we deemed it sufficiently reliable. We also used SBA's HUBZone Certification Tracking System and SharePoint One Track, checked this information against third-party sources of information, and requested additional information from program officials to check the validity and completeness of information contained in these systems. We relied on data from the Program Office to analyze firms pending certification decisions as of May 8, 2018, after gaining an understanding of the process used to generate this

¹⁴ 48 CFR Part 4.603(b).

data. As a result, we believe the information was reliable for the purposes of answering our objectives.

Review of Internal Controls

SBA's internal control systems SOP provides guidance on implementing and maintaining effective internal control systems, as required by OMB Circular A-123.¹⁵ OMB Circular A-123 provides guidance to federal managers on improving the accountability and effectiveness of federal programs and operations by establishing, maintaining, and assessing internal controls.¹⁶

We assessed the control environment in which the Program Office conducted HUBZone certification reviews. We interviewed program officials with the responsibility for HUBZone program oversight, analyzed information in SBA databases, and reviewed public facing guidance for applicants. We found weaknesses in internal controls over the HUBZone certification process. Specifically, we found that the Program Office did not have updated written guidance for the certification review process. In addition, its electronic document repository was sometimes not available to HUBZone analysts. We made recommendations in this report to address these deficiencies.

¹⁵ SOP 00 02, Internal Control Systems (January 1986).

¹⁶ OMB Circular A-123, Management's Responsibility for Enterprise Risk Management and Internal Control (July 15, 2016).

Appendix II: Questioned Costs

Table 2. OIG Schedule of Questioned Costs for the HUBZone Program¹⁷

Description	Amount	Explanation
Ineligible Costs	\$589,191	The HUBZone Office certified ineligible firms and a firm with insufficient documentation of eligibility into the HUBZone program
Total Questioned Costs	\$589,191	

Source: Generated by OIG based on OIG's analysis of HUBZone-certified firms' contract obligations awarded between April 1, 2017, and March 31, 2018.

¹⁷ Questioned costs are expenditures that are not supported by adequate documentation at the time of the audit or otherwise do not comply with legal, regulatory, or contractual requirements.

Appendix III: Agency Comments



U.S. Small Business
Administration

Office of HUBZone Program | 409 Third Street, SW, Suite 8000 | Washington, DC 20416

Date: March 14, 2019

To: Riccardo R. Buglisi, Director,
Business Development Programs
Office of Inspector General

Thru: Robb Wong, Associate Administrator for 
Government Contracting and Business Development

From: Arthur E. Collins, Jr., Deputy Director,
Office of HUBZone Program,
Office of Government Contracting and Business Development

Subject: SBA's HUBZone Certification Process, Project 18009

Thank you for the opportunity to respond to the Office of Inspector General's Draft Report of February 14, 2019, regarding the U.S. Small Business Administration's HUBZone Certification Process. Based on our review, the Office of Government Contracting and Business Development offers the following comments and concurs with your recommendations.

Comments and suggested changes to the draft report:

1. Regarding Firm B, SBA has a serious policy concern that one conclusion in the report (i) improperly substitutes OIG's assessment of eligibility for SBA's reasoned eligibility determination based on the same set of facts; and (ii) discourages a company from applying to the HUBZone program where the company does not have a full business plan. We believe that deeming Firm B's statements of intent to be a misrepresentation creates a disincentive to apply to the program and may have unintended policy impacts.

The square footage of a principal office location is not material to HUBZone program eligibility. However, without conducting a visit to the site, the OIG concludes that the firm misrepresented its principal office eligibility because the firm's supporting documentation included statements about the intended square footage of a replacement building to be located at the site of its principal office. At the time of application, the firm at issue had a

small facility on the HUBZone site that served as its principal office, which appears to have been of sufficient size to accommodate the number of employees the firm claimed to be working from that location. The SBA does not believe that the firm misrepresented its compliance by providing documentation describing a replacement building that it intended to construct at the site of its asserted principal office.

Dismissing the small facility as a possible legitimate principal office location is contrary to the goal of the HUBZone program to promote capital infusion and job growth in underutilized areas. Furthermore, the firm disclosed to SBA in its lease that a permanent office had not yet been built and, afterward, clarified to SBA that the firm was using its small facility as the principal office.

The report does not refute SBA's determination that, based on the facts that existed at the time of Firm B's certification, the firm was eligible for certification. We reiterate that had SBA used Google maps to view the principal office location, and had SBA seen the small facility rather than the replacement building, the firm would have been certified into the HUBZone program based on its small facility used as a principal office and the firm's representations that most of its employees worked at the HUBZone site.

The SBA certifies firms based on the facts as they exist at the time the firm authorized processing of its application and continuing thereafter, through the date of certification. SBA does not take firms' plans or future conditions into consideration in making eligibility determinations.

2. Regarding Firm A, Firm B, and Firm C, the report recommends (Recommendation 1) that SBA "Conduct eligibility reviews for Firms A, B, and C...." We suggest that in lieu of the term "eligibility review," the term "program examination" be used. We suggest this because our regulations do not provide a mechanism for us to reopen a closed (i.e., completed) initial eligibility determination. However, our regulations do provide a mechanism for us to conduct a "program examination" whenever we deem necessary. While "program examination" is a broad term, it encompasses conduct of full document reviews, which are essentially identical to the initial eligibility determinations. Accordingly, we have conducted a program examination on one of the subject firms and will conduct program examinations on the other two firms.

Recommendation 1. Conduct eligibility reviews for Firms A, B, and C; take timely action to decertify these firms if found to be ineligible; and refer the firms for suspension and debarment proceedings, if warranted based on eligibility review results.

Response. We have conducted a program examination of Firm B and will conduct program examinations of Firms A and C. We will take timely action to decertify these firms if found to be ineligible and refer the firms for suspension and debarment proceedings, if warranted based on the results of the program examinations.

Recommendation 2. Update and implement HUBZone guidance based on the current certification process, including standardizing the analysis and oversight process (to include conducting independent research and analyses to identify indicators of potential fraud), and training HUBZone Office employees on this guidance.

Response. We will update and implement HUBZone guidance based on the current certification process by: (1) issuing internal guidance regarding the current certification process, which shall include conducting independent research and analyses to identify indicators of potential fraud (e.g., using Google Maps to view an asserted principal office location), (2) updating the standard operating procedures for HUBZone certification, (3) training HUBZone Office employees on this updated guidance, and (4) revising staff performance plans.

Recommendation 3. Implement a plan to mitigate IT issues affecting the HUBZone certification process.

Response. The Associate Administrator, Office of Government Contracting and Business Development (AA/GCBD), jointly with the SBA Chief Information Officer (CIO), have made progress toward mitigating IT issues affecting the HUBZone certification process by recruiting and hiring a senior IT expert to assume program management of GCBD's technology modernization initiative, including delivery of Certify Full Operational Capability (FOC) and replacement/decommissioning of the HUBZone Certification Tracking System (HCTS), the SBA Subcontracting Network (SubNet), and the Dynamic Small Business Search (DSBS). The AA/GCBD anticipates completion of Certify program re-baselining by the end of FY19/Q3 that will address the technology and design changes needed to remediate controls weaknesses in the HUBZone certification business application and to ensure that the application: (1) Performs with availability of 99% or better; (2) Automates verification of eligibility criteria whenever possible (e.g., matching principal office and employee residence locations to SBA HUBZone Map data); (3) Automates calculations whenever possible (e.g., % of employees residing in HUBZones); (4) Alerts analyst and program official users to the elements of the firm's application that require additional review; (5) Automates workflow management reporting, performance alerts, and data visualization, of certification statistics, including aging, throughput, touchpoints, efficiency, and user activities; and (6) Can flexibly implement statutory changes by 1/1/2020, as required.

Recommendation 4. Review the HUBZone certification process, and implement a plan to meet the current and future certification timelines.

Response. Reference is made to Recommendation 2. We will review the HUBZone certification process and implement a plan to meet the current and future certification timelines. We will do this by: (1) revising staff performance plans for FY 2020, and (2) evaluating performance against those plans, beginning with the first quarter of FY 2020.

Recommendation 5. Monitor hold times to ensure that the Program Office accurately reports overall timeliness of eligibility determinations.

Response. Reference is made to Recommendations 2 and 4. We will monitor hold times to ensure that the Program Office accurately reports overall timeliness of eligibility determinations. We will do this by: (1) revising staff performance plans for FY 2020, (2) building relevant reporting routines, and (3) evaluating performance against the revised performance plans, beginning with the first quarter of FY 2020.

Should you require additional information in this regard, please do not hesitate in contacting Mr. Collins.