

SBA's Oversight of HUBZone Program Participants' Continuing Eligibility



Audit Report

Report 24-23

August 15, 2024



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NOTICE:

Pursuant to the James M. Inhofe National Defense Authorization Act for Fiscal Year 2023, Public Law 117-263, Section 5274, any nongovernmental organizations, and business entities identified in this report have the opportunity to submit a written response for the purpose of clarifying or providing additional context as it relates to any specific reference contained herein. Comments must be submitted to ALGA@sba.gov within 30 days of the final report issuance date. We request that any comments be no longer than two pages, Section 508 compliant, and free from any proprietary or otherwise sensitive information. The comments may be appended to this report and posted on our public website.



U.S. Small Business Administration Office of Inspector General

EXECUTIVE SUMMARY

SBA's Oversight of HUBZone Program Participants' Continuing Eligibility

What OIG Reviewed

This report presents the results of our audit of the U.S. Small Business Administration's (SBA) oversight of the Historically Underutilized Business Zone (HUBZone) program. The program provides small businesses that are located in economically distressed communities access to federal contracting opportunities to stimulate their local economies. In fiscal year (FY) 2022, SBA reported that federal agencies awarded over \$16.3 billion, or 2.7 percent of prime federal contracting dollars, to 5,818 HUBZone businesses.

In FY 2021, SBA began conducting program examinations every 3 years to verify whether HUBZone firms continued to meet eligibility requirements. In FY 2022, SBA completed 1,252 triennial program examinations.

Our objectives were to determine whether SBA's oversight ensured triennial program examinations were completed in a timely manner, and certified HUBZone firms met continuing eligibility requirements in accordance with regulations and internal guidance.

To address our objectives, we reviewed applicable laws, regulations, and agency guidance, and interviewed program officials. For FY 2022 triennial program examinations, we reviewed a sample of 20 firms and underlying supporting documentation to analyze SBA's practices and assessed annual certification and decertification actions taken in FY 2022.

What OIG Found

We found SBA completed almost all 1,252 triennial program examinations timely and

correctly validated 18 of the 20 firms we reviewed (90 percent) met eligibility requirements.

Notwithstanding, we have identified some opportunities to further improve eligibility review practices, and enhance functionality of the HUBZone information system that notifies participants of their annual recertification requirements.

What OIG Recommended

We made four recommendations for SBA to establish authoritative guidance for verifying that firms met eligibility requirements at the time of the triennial program examinations and improve system functionality for sending timely recertification notifications to all HUBZone firms.

Agency Response

SBA management partially agreed with Recommendations 1, 3, and 4, and disagreed with Recommendation 2. Management's planned actions resolved Recommendations 1, 3, and 4. Specifically, management proposed a rule change to strengthen HUBZone residency requirements and plans to replace the HUBZone information system with a new system with better functionality. However, SBA's planned action for a rule change to reinforce the policy of accepting a firm's self-certification for size representation in the certification database does not meet the underlying intent of Recommendation 2. Therefore, OIG will seek resolution of this recommendation in accordance with our audit follow-up policy.



**OFFICE OF INSPECTOR GENERAL
U.S. SMALL BUSINESS ADMINISTRATION**

MEMORANDUM

Date: August 15, 2024

To: Isabella Casillas Guzman
Administrator

From: Hannibal "Mike" Ware
Inspector General

A handwritten signature in black ink, appearing to read "Mike Ware", written over the printed name of the Inspector General.

Subject: SBA's Oversight of HUBZone Program Participants' Continuing Eligibility (Report 24-23)

This report presents the results of our audit of *SBA's Oversight of HUBZone Program Participants' Continuing Eligibility* (Project 23002). We considered management comments on the draft of this report when preparing the final report. SBA management partially agreed with three recommendations and disagreed with one recommendation, which is pending resolution.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact me or Andrea Deadwyler, Assistant Inspector General for Audits, at (202) 205-6586.

cc: Dilawar Syed, Deputy Administrator, Office of the Administrator
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Introduction

The Historically Underutilized Business Zone (HUBZone) program was established by the Small Business Reauthorization Act in 1997.¹ The program provides small businesses located in economically distressed communities access to federal contracting opportunities to stimulate their local economies. Congress designed the HUBZone program to fuel growth by increasing job opportunities, capital investment, and economic development. HUBZone areas are designated based on economic and population data from the U.S. Census Bureau and other federal and state agencies every 5 years.

Each year, the federal government has a goal of awarding at least 3 percent in total federal contracting dollars to certified HUBZone firms.² Firms certified in the HUBZone program can qualify for set-aside and sole-source contracts. HUBZone certified firms have a 10-percent price evaluation preference on contract opportunities that are open to all businesses. These contracting features allow HUBZone firms to gain favorable benefits to win contracts with limited or no competition, or to win against other bids even if their proposal is 10 percent higher.

SBA reported that federal agencies awarded over \$16.3 billion, or 2.7 percent of prime federal contracting dollars, to HUBZone businesses in FY 2022. In FY 2022, the HUBZone program had 5,818 participating firms.

HUBZone Eligibility Requirements

To qualify for the HUBZone program, a firm must:

- be a small business by applicable SBA size standards;
- be at least 51 percent owned and controlled by U.S. citizens, or entities such as Community Development Corporations, Alaska Native Corporations, or Indian tribes;
- have its principal office within a HUBZone³; and
- have at least 35 percent of its employees residing in a qualified HUBZone.⁴

¹ Small Business Reauthorization Act of 1997. Pub. L. No. 105-135, § 602, 111 Stat. 2627 (1997).

² Small Business Act (15 USC § 644(g)(1)(A)(iii)).

³ Except for concerns owned by Tribal governments.

⁴ 13 C.F.R. § 126.200(a-d).

Initial and Continued Eligibility Determinations

The Office of the HUBZone Program administers the HUBZone program. HUBZone program officials implemented procedures to ensure firms comply with eligibility requirements at the time of initial certification, and firms undergo more rigorous reviews every 3 years. Additionally, SBA requires firms to self-certify eligibility status every year for annual recertifications.

Initial Certification. Program officials review HUBZone program applications and certify a firm's eligibility to participate. The Small Business Act requires that SBA verify the eligibility of applicants within 60 days of receiving complete application documents.⁵

Annual Recertification. Every year after their initial certification, firms are required to self-certify they continue to meet eligibility requirements to remain in the program.⁶ Participants are generally not required to provide any supporting documentation for annual recertifications. However, firms that fail to recertify may be decertified from the HUBZone program.

Triennial Program Examination. SBA began conducting triennial program examinations in FY 2021. The FY 2018 National Defense Authorization Act (NDAA) mandated changes to SBA's program examination process and required SBA to conduct program examinations every 3 years to verify whether HUBZone firms continued to meet eligibility requirements. The NDAA also required SBA to use a risk-based framework to complete program examinations,⁷ consistent with a recommendation made by the U.S. Government Accountability Office (GAO).⁸

In response to the legislative mandate and GAO recommendation, SBA issued guidance in 2020 to adopt a risk-based framework for conducting program examinations when recertifying HUBZone firms.⁹ Currently, the program office uses this framework, and the level of review is driven primarily by the value of HUBZone contracts awarded and designated risk level (see Table 1). In 2022, officials conducted 1,252 triennial program examinations.

⁵ Small Business Act (15 USC § 657a(d)(3)).

⁶ 13 C.F.R. 126.500(a)(3), *Maintaining HUBZone Status*.

⁷ National Defense Authorization Act for Fiscal Year 2018. Pub. L. No. 115-91, § 1701, 131 Stat. 1801 (2017).

⁸ U.S. Government Accountability Office, GAO-15-234, *Small Business Contracting: Opportunities Exist to Further Improve HUBZone Oversight* (February 2015).

⁹ SBA Procedural Notice 6000-20011, "Framework for HUBZone Continuing Eligibility Program Examinations," December 16, 2020.

Table 1. SBA’s Risk-based Framework for Conducting Triennial Program Examinations

Risk Level	Value of Total Small Business Contracts Awarded*	Type of Review	Percentage of Reviews Conducted in FY 2022
Level 1	\$0	Analyst reviews documentation to verify firm’s eligibility.	42%
Level 2	\$0 – 250,000	Program officials conduct a site visit to verify principal office.	11%
Level 3	\$250,000 or greater	Two levels of review: Analyst performs document review of eligibility. Senior analyst performs quality assurance review.	47%

*Note: SBA’s risk framework to conduct 1,252 program examinations in FY 2022 was based on the combined total small business prime contract dollars awarded to HUBZone firms in FYs 2019 and 2020.

Source: OIG generated based on program information provided by HUBZone program officials

Continuing Eligibility Requirements

During program examinations, HUBZone officials review documents to validate that firms continue to meet eligibility criteria, such as principal office and employee residency requirements. HUBZone regulations require firms to have their principal office—the location with the greatest number of employees at any one location—within a HUBZone.

To meet the employee residency requirement, a firm must attempt to maintain at least 35 percent of its employees are residents of a HUBZone, when performing on a HUBZone contract.¹⁰ Firms must demonstrate efforts for attempting to meet the standard, such as with written offers of employment or published advertisements. At a minimum, firms must maintain that at least 20 percent of their employees reside in a HUBZone to meet the residency requirement.

Under a 2019 rule change to the regulations, SBA established that firms can continue to count employees as a legacy HUBZone employee if they demonstrate that the employee lived in the HUBZone at the time of certification and for at least 180 days after the firm was certified. When recertifying, firms must demonstrate that employees lived in a HUBZone for 180 days before and

¹⁰ 13 C.F.R. § 126.200(e).

after certification. In both instances, firms must show that each legacy employee maintained continuous employment. The rule change was made to provide flexibility to firms in being able to meet the 35 percent residency requirement.¹¹

HUBZone Information Systems

Program officials use two systems to track firms participating in the HUBZone program: HUBZone Certification Tracking System (HCTS) and Dynamic Small Business Search (DSBS). SBA analysts use HCTS to review support such as office leases, utility bills, and employee residency documents to determine a firm's eligibility, while contracting officers use DSBS to identify small businesses certified for contracting opportunities. Program officials use the tracking system to send reminders to firms when it is time for them to recertify. The tracker interfaces with the search system to update the registry of HUBZone firms' certification status automatically, which federal contracting officers rely on to verify certified HUBZone status before awarding preferential contracts. SBA's Office of the Chief Information Officer (OCIO) manages HCTS.

Objectives

Our objectives were to determine whether SBA's oversight of the HUBZone program ensured (1) certified HUBZone firms met continuing eligibility requirements in accordance with federal regulations and internal guidance; and (2) triennial program examinations were completed in a timely manner.

Results

To address longstanding challenges, SBA has enhanced internal controls over the HUBZone program by implementing a risk-based approach for program examinations, improving the annual certification process, and addressing issues with data reliability. These improvements have led to an increase in timely recertifications, which allows firms to maintain their HUBZone status and bring economic opportunities into distressed communities.

¹¹ 84 Federal Register 65222, November 26, 2019.

We identified additional opportunities for SBA to improve its oversight of the program. Specifically, SBA can enhance triennial program examinations by strengthening eligibility review practices, improving the quality of documents used to verify a legacy employee residency requirement, and ensuring HUBZone firms meet small size standards. SBA can also improve the annual recertification process by enhancing functionality of the notification system. Implementing procedures and guidance for eligibility and size determinations and strengthening controls over the annual certification process will ensure that only eligible small businesses continue to gain access to HUBZone contracting opportunities.

Finding 1: Triennial Program Examinations Completed Timely but Opportunities Exist to Improve Eligibility Review Practices

Program officials used a risk-based approach to balance HUBZone program requirements with available resources, resulting in timely triennial program examinations. During the examinations, they ensured firms met most program eligibility requirements. While officials proactively ensured firms were compliant, we identified opportunities to strengthen oversight controls and guidance related to eligibility review practices for principal office, residency, legacy employee, and size requirements. Standardizing procedures to improve eligibility reviews reduces the risk of ineligible businesses taking advantage of contracting opportunities intended for the HUBZone certified small business community.

SBA Completed Triennial Program Examinations Timely

Agency regulations require SBA to complete triennial program examinations within 90 calendar days after receiving all requested information.¹² Additionally, the NDAA for FY 2018 requires SBA to use a risk-based framework to complete program examinations.¹³ To meet the congressional mandate, we found program officials implemented a risk-based framework and established a process to recertify firms triennially, allowing officials to complete program examinations timely.

In FY 2022, program officials conducted 1,252 triennial program examinations and issued eligibility determinations within 90 days nearly 100 percent of the time. According to program officials, they balanced staff work assignments by having existing but limited personnel focus on

¹² 13 C.F.R. § 126.503(a)(2).

¹³ National Defense Authorization Act for Fiscal Year 2018. Pub. L. No. 115-91, § 1701, 131 Stat. 1801 (2017).

higher-risk examinations. We also found SBA's methodology for designating firms to various levels of examination was consistent with stated procedures for assigning risk.

SBA's timely completion of triennial program examinations ensures eligible firms are certified promptly, which allows firms to compete for HUBZone contracts.

Strengthening Review Practices for Principal Office and Employee Residency Requirements

Program officials generally ensured firms met principal office and employee residency eligibility requirements during triennial program examinations. We reviewed 20 firms with the largest HUBZone contract values and determined SBA correctly validated that 18 of 20 firms (90 percent) met these requirements for continued certification. During program examinations, HUBZone officials reviewed documents to validate that firms continued to meet eligibility criteria, such as principal office and employee residency requirements.

We identified two firms that were granted continuing certification without sufficient evidence they met the principal office or employee residency requirements. Program officials granted continuing certification to Firm A without sufficient evidence that they met the principal office requirement at the time of the program examination. Officials granted Firm B continuing certification although there was insufficient evidence that they met the employee residency requirement at the time of the program examination.

After notifying program officials of our findings, they subsequently provided additional information bringing Firms A and B into compliance for principal office and employee residency requirements. We provide an expanded discussion of the triennial program examination practices applicable to these two firms in Appendix 2.

Improving Documentation Used to Verify Legacy Employee Requirements

Firms can also count employees who no longer live in a HUBZone as a HUBZone resident under legacy status. The 2019 rule change introduced the legacy employee provision to provide flexibility to HUBZone firms whose employees may decide to live in areas outside of a qualified HUBZone. Under the new provision, SBA established that firms could continue to count employees as a legacy HUBZone employee if they demonstrate the employee lived in the HUBZone at the time of certification, and for at least 180 days after the firm was certified. When recertifying, firms must demonstrate that employees lived in a HUBZone for 180 days before and after certification. In both instances, firms must show that the legacy employee maintained

continuous employment. This rule change provided flexibility to firms in being able to meet the 35 percent residency requirement.¹⁴

However, to verify an employee's residence, SBA's current regulations prioritize driver's licenses or voter registration cards. Although a driver's license or voter registration card may prove an employee resided in a HUBZone when it was issued, it does not prove the employee lived at the HUBZone address for at least 180 days after a firm's certification. This current document priority does not reasonably consider the heightened risk that is inherent in the legacy rule change since firms stand to receive credit for employing people who no longer live in a HUBZone.

With the legacy provision having specific requirements for an employee to reside in a HUBZone for a minimum period, the residence should be validated with documents that support residency for the required period. Documents such as leases, utility bills, or property tax records are more likely to validate the employee resided in a HUBZone for at least 180 days after the date of the firm's last certification. Using relevant and appropriate documents to assess legacy status will ensure firms will benefit, but not abuse, the flexibility offered by the rule change.

Ensuring HUBZone Firms Meet Small Business Size Standards

HUBZone regulations require firms to meet all HUBZone eligibility criteria to remain certified, which includes being a small business.¹⁵ Regulations also require that firms meet size standards corresponding to the North American Industrial Classification System (NAICS) code under which a firm conducts business. Depending on the type of industry, the measure of whether a business is small is determined by the firm's average annual receipts or by the number of people employed.¹⁶

The agency's regulations for conducting program examinations do not explicitly discuss evaluation procedures related to size verification. The agency relies on firms to self-certify their status as a small business, and we found SBA regulations do not expressly require any documentation to ensure businesses meet size standards during program examinations.¹⁷ Further, the workbook used by analysts to conduct program examinations does not have

¹⁴ 84 Federal Register 65222, November 26, 2019.

¹⁵ 13 C.F.R. § 126.200 and § 126.500.

¹⁶ 13 C.F.R. § 121.201.

¹⁷ 13 C.F.R. § 126.200(b) and 126.304.

procedures to evaluate for this requirement, nor does it include specific guidance for analysts to use annual receipts or employee count information to assess the business's size.

Standard operating procedures require program analysts to verify that the business is small for initial certification and require firms to provide 3 years of federal tax returns for analysts to review during program evaluations. Though the standard operating procedures do not expressly state that analysts should use the tax returns during a program examination to assess the program participant's business size, tax forms are a primary method SBA uses for assessing compliance with revenue-based sized standards. Further, these procedures have not been updated since 2007 and currently do not reflect changes made to the requirements in 2020, which require using a 5-year averaging period for all revenue-based size standards.¹⁸

Consistent with our review, program officials informed us that analysts are not required to verify the firm is small in any NAICS code during examinations. As a result, at the time of recertification, SBA's process did not check for a key component of eligibility and therefore, cannot ensure that only small businesses continue to gain access to HUBZone contracting opportunities.

Recommendations

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

Recommendation 1: Revise regulations to require documents that can be verified to ensure firms complied with 13 CFR § 126.200(d)(3), that a legacy employee resided in a HUBZone for at least 180 days following the most recent certification (or recertification).

Recommendation 2: Update and implement standard operating procedures to request documents, as permitted under 13 CFR 126.304(b)(1), to verify during program examinations that firms meet size standards in the North American Industry Classification System code in which they perform on HUBZone contracts.

¹⁸ 13 C.F.R. § 121.104 (c)(1).

Finding 2: Annual Recertification Process is Generally Effective but Opportunities Exist to Strengthen Processes

SBA regulations require firms to attest to their continued eligibility through an annual self-certification process.¹⁹ Normally, this occurs within 30 days of a firm's certification anniversary date, when firms must submit their annual recertification through HCTS, the HUBZone portal. When functioning as designed, HCTS alerts firms prior to their anniversary date that a recertification is due. SBA may propose decertification for firms that fail to recertify.²⁰

For the 5,818 firms participating in the HUBZone program in FY 2022, we found 3,100 firms (53 percent) completed their annual recertification timely. While 685 firms (12 percent) did not recertify timely, these firms ultimately recertified that they met program requirements in FY 2022, resulting in a recertification rate of 65 percent overall.

For the 2,033 firms that did not recertify for FY 2022, SBA decertified 1,552 firms (27 percent). We were unable to determine the certification status of the remaining 481 firms (8 percent) as these firms neither recertified nor were they decertified by SBA during the FY 2022 cycle, or they recertified outside of their normal recertification window for FY 2022, making recertification timeliness not calculable for FY 2022 (see Table 2 for a breakdown of annual recertification results).

Table 2. HUBZone Firms' Annual Recertification Results for FY 2022

Status of Certification	No. of Firms	Percentage of Firms
Recertified Timely	3,100	53%
Recertified Untimely	685	12%
Decertified during FY22	1,552	27%
Data Undeterminable	481	8%
Total	5,818	100%

Source: SBA OIG analysis of HUBZone data for FY 2022.

The U.S. Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government* states that federal agencies should use quality information to achieve programmatic

¹⁹ 13 C.F.R. §126.500(a).

²⁰ 13 C.F.R. §126.500(a)(4).

goals and remediate internal control deficiencies.²¹ SBA's tracking system did not always send notifications to HUBZone firms because changes made within a firm's profile can cause disruptions to expected notification cycles. This challenge impacts SBA's ability to use quality information for annual recertification dates—an important aspect of program officials' oversight of the program.

HUBZone program officials have been aware of system challenges since at least 2015, when GAO found the HUBZone program experienced delays in recertifying firms because HCTS did not always notify firms of their recertification deadline.²² GAO closed the recommendation based on SBA's plans to improve the recertification process and timelines, but challenges remain with the notification module.

While it is the program participants' responsibility to certify annually, program officials send notifications reminding each participant to recertify before the renewal date. When program officials become aware of missed notifications, they send a request to SBA's Office of the Chief Information Officer (OCIO) to manually notify the firms. This leads to additional delays, incorrect handling of requests, and unreliable data records. Program officials expend significant effort to manually troubleshoot an automated notification system that functions inconsistently. They remediate for system challenges by reviewing weekly reports of missed notifications and by coordinating with OCIO for a manual fix. The added effort impacts the timeliness of annual recertifications and until errors are identified and remedied, firms continue to operate as being certified and eligible for contracting benefits.

Finally, SBA's current technology limitations do not allow for efficient monitoring and correction. Without the benefit of a reliable annual recertification system, program officials do not have quality information to efficiently monitor that firms meet requirements to be eligible for federal contracts set aside for HUBZone firms.

²¹ U.S. Government Accountability Office, GAO-14-704G, *Standards for Internal Control in the Federal Government*, (September 2014), Principle 13.

²² U.S. Government Accountability Office, GAO-15-234, *Small Business Contracting: Opportunities Exist to Further Improve HUBZone Oversight*, (February 2015).

Recommendations

We recommend the Administrator require the Associate Administrator for the Office of Government Contracting and Business Development, in collaboration with the Office of the Chief Information Officer to:

Recommendation 3: Improve the HCTS system notification module to ensure recertification notifications are sent timely and consistently to all HUBZone firms.

Recommendation 4: In the interim, establish procedures to verify completion of annual recertifications by defining parameters, timing, and other requirements as needed, including expected OCIO response times when the HUBZone program office requires manual HCTS processing.

Finding 3: Decertified Firms were Removed from DSBS

Agency regulations require SBA to change a firm's HUBZone certification in the Dynamic Small Business Search (DSBS) database after SBA decertifies the firm.²³ When a firm is decertified from the HUBZone program, HUBZone officials are responsible for updating the firm's profile in HCTS to indicate the firm no longer meets eligibility requirements. The firm's updated certification status in the HCTS then automatically updates the DSBS indicating the HUBZone status change.

Of the 1,812 firms SBA decertified from the HUBZone program in FY 2022, 1,810 firms' profiles, or 99 percent, were properly reflected as decertified. Overall, we found that updates flowed automatically from the HCTS to the DSBS, and for the two instances when the transmittal did not automatically occur, SBA officials requested manual updates. SBA's process was effective because SBA officials conducted adequate oversight to ensure decertification information flowed between both systems, automatically and through manual updates.

Because program officials were committed to ensuring the data is accurately reported, contracting officers had up-to-date information regarding HUBZone firms' eligibility status prior to awarding contracts. Timely updates and accurate information in DSBS help contracting officers make appropriate decisions and prevent ineligible firms from receiving HUBZone contract awards intended for businesses that operate in economically distressed communities.

²³ 13 C.F.R. § 126.504.

Evaluation of Agency Response

SBA management provided formal written comments that are included in their entirety in Appendix 3. Management partially agreed with Recommendations 1, 3, and 4, and disagreed with Recommendation 2. We found the agency's planned actions are sufficient to resolve Recommendations 1, 3, and 4.

Management's proposed corrective actions did not address Recommendation 2; therefore, this recommendation is unresolved. In accordance with our audit follow-up policy, we will attempt to reach agreement with SBA management on the unresolved recommendation within 60 days after the date of this final report. If we do not reach agreement, OIG will notify the audit follow-up official.

Summary of Actions Necessary to Close the Recommendations

The following section summarizes the status of our recommendations and the actions necessary to close them.

Recommendation 1

We recommend the Administrator direct the Associate Administrator of the Office of Government Contracting and Business Development to revise regulations to require documents that can be verified to ensure firms complied with 13 CFR § 126.200(d)(3), that a legacy employee resided in a HUBZone for at least 180 days following the most recent certification (or recertification).

Status: Resolved

SBA management partially agreed with the recommendation stating they submitted a proposed rule change to the Office of Management and Budget (OMB) to limit certified HUBZone small businesses to have only one legacy HUBZone employee at a time. Management stated that OIG's proposal to change the regulations related to the documentation requirement for legacy employees essentially alters the definition of "reside" used for the program. They also stated that the definition of "reside" should be consistent for all HUBZone employees and creating an alternate definition and documentation standard for legacy employees would be confusing and burdensome for program participants.

In addition to the rule change, management proposed to enhance the HUBZone Standard Operating Procedures (SOP) to clarify proof of residency requirements for legacy employees for

the 180-day period following recertification. SBA plans to complete final action by January 6, 2025.

The intent of the recommendation is to ensure the 180-day residency requirement is met using quality information, and we do not believe revising the regulations to strengthen the documentation requirement changes the definition of “reside.” Although SBA’s proposed rule change to limit the number of legacy employees does not directly address the recommendation; the alternative solutions proposed by SBA to enhance the program’s SOPs to clarify the proof of residency requirement for legacy employees reduces the risk of SBA recertifying potentially ineligible firms for HUBZone status. Therefore, SBA’s planned actions satisfy the intent of this recommendation, and it can be closed when management provides evidence that the program office revised the SOP.

Recommendation 2

We recommend the Administrator direct the Associate Administrator of the Office of Government Contracting and Business Development to update and implement standard operating procedures to request documents, as permitted under 13 CFR 126.304(b)(1), to verify during program examinations that firms meet size standards in the North American Industry Classification System (NAICS) code in which they perform on HUBZone contracts.

Status: Unresolved

SBA management disagreed with the recommendation, emphasizing that at the time of certification or recertification, a firm’s size cannot be determined to be a small business categorically but rather in relation to an individual procurement action. Management stated that the firm’s size is based on whether it is small under the size standard for the NAICS code assigned to a procurement action.

SBA further stated that while it is accurate that current regulations for conducting program examinations do not explicitly discuss evaluation procedures related to size verification, it is a mischaracterization to conclude that SBA relies on firms to self-certify their status as a small business. In the absence of express instructions or prohibitions in agency regulations, the HUBZone program office follows established procedures and relies on federal agencies to verify size during the contracting process. SBA noted OIG found no evidence during the audit that any firm that received a HUBZone contract was other than a small business.

Additionally, SBA stated it has submitted a proposed rule change to OMB specifying that, for purposes of certification and program examinations, SBA will accept a firm’s size representation in the System for Award Management (SAM.gov), or successor system, unless there is evidence

to the contrary. In that case, SBA will request a formal size determination pursuant to 13 CFR §121.1001(b)(8) where information may call into question the SAM.gov size representation.

We were unable to verify whether the firms we selected to review met the applicable size standards since the supporting documentation necessary to confirm the size eligibility requirement were not part of SBA's program examination files. Therefore, we maintain our position that program examination procedures should include steps to verify size compliance at the time of continuing eligibility reviews. SBA's proposed rule change to accept a firm's size representation in SAM.gov reinforces OIG's concern that self-certification is SBA's prevailing practice for size since firms certify their size in this system. Additionally, SBA's reliance on federal agencies to verify size before awarding contracts has the effect of shifting SBA's responsibility to the procuring agency where there is no express requirement for contract officers to verify a HUBZone firm's size, other than to check Dynamic Small Business Search (DSBS) or SAM.gov for certification status.²⁴

Notably, the DSBS webpage indicates that SBA has verified certifications for HUBZone and other socioeconomic and veteran preference programs, giving database users a measure of assurance that the agency has verified all eligibility components to confer certification. We believe SBA's reliance on self-certification for a key requirement—size—and the expectation for contracting officers to conduct their due diligence to verify size at the time of award, is not consistent with federal regulations, the DSBS database assertion, or SBA's standard operating procedures for collecting supporting documentation to check for compliance with sized standards.

This recommendation is unresolved. In accordance with our audit follow-up policy, we will attempt to reach agreement with SBA management on the unresolved recommendation within 60 days after the date of this final report. If we do not reach agreement, OIG will notify the audit follow-up official.

Recommendation 3

We recommend the Administrator direct the Associate Administrator of the Office of Government Contracting and Business Development, in collaboration with the Office of the Chief Information Officer, to improve the HCTS system notification module to ensure recertification notifications are sent timely and consistently to all HUBZone firms.

Status: Resolved

²⁴ FAR 19.1303(a) and (b).

SBA management partially agreed with the recommendation, stating that the HUBZone system of record should ensure recertification notifications are sent timely and consistently to all HUBZone firms. However, management stated that since the HCTS system will be phased out in August 2024 for initial applications and November 2024 for recertifications, improving the specific HCTS system notification module is neither financially nor technically feasible.

Alternatively, SBA plans to launch a new system of record and provide OIG with a demonstration of the new system's automatic notification functionality. Management plans to complete final action by January 6, 2025.

This recommendation can be closed when management provides evidence of a new system of record for the HUBZone program, with the functionality to ensure recertification notifications are sent timely to HUBZone firm.

Recommendation 4

We recommend the Administrator direct the Associate Administrator of the Office of Government Contracting and Business Development, in collaboration with the Office of the Chief Information Officer to, in the interim, establish procedures to verify completion of annual recertifications by defining parameters, timing, and other requirements as needed, including expected OCIO response times when the HUBZone program office requires manual HCTS processing.

Status: Resolved

SBA management partially agreed with the recommendation, stating that SBA's new system of record for recertification is expected to be launched in several months. Management asserted that working with the new system will be more expeditious than adding procedures to address limitations of the existing HCTS system. Management further stated that they implemented procedures in FY 2023 to verify completion of annual recertifications and, since the collection of data for this audit, have increased the verification of annual recertifications to approximately 100 percent.

Management offered to provide a description and documentation of the changes implemented by the Office of the Chief Information Officer in FY 2023 and requested that the recommendation be closed without further action.

This recommendation can be closed when management provides evidence of implemented procedures that improved the verification of annual recertifications for the HUBZone program.

Appendix 1: Scope and Methodology

The scope of this audit focused on the U.S. Small Business Administration's (SBA) oversight of the continuing eligibility of 5,818 firms active in the Historically Underutilized Business Zone (HUBZone) Program in fiscal year (FY) 2022. To meet our objectives, we reviewed relevant sections of the Small Business Reauthorization Act of 1997, Title 13 of the Code of Federal Regulations, and other public laws, regulations, and agency guidance. We interviewed SBA personnel responsible for oversight and administration of the HUBZone Program to understand the information systems, data, and tools used in the processes related to annual recertification, program examination, and decertification. We obtained information through interviews, data from information systems, and process maps and performed the following:

- Analyzed data from HUBZone Certification Tracking System (HCTS) to assess whether the annual recertifications of 5,818 firms active in FY 2022 were completed within required timeframes.
- Compared SBA's risk-based framework with federal contract award data to recreate the agency's risk methodology used to assign Levels 1, 2, and 3 program examinations.
- Selected a judgmental sample of 20 active firms for a review of program examinations conducted in FY 2022. These firms had the largest value of HUBZone contracts,²⁵ representing 66 percent of HUBZone contract award dollars during the period.
- Reviewed the sample of program examination files in HCTS, eligibility workbooks, and procedural guidance to assess SBA's exam methodology and eligibility determinations for ownership, small business size, principal office, and employee residency requirements.
- Assessed the FY 2022 universe of 1,252 triennial examinations for completion within required timeframes.
- Verified the FY 2022 universe of 1,812 decertified firms with profile updates affecting continuing eligibility information in the tracking system, and for timely and consistent updates of the firms' certification status in the Dynamic Small Business Search (DSBS) database.²⁶

²⁵ OIG developed the sample based on the data available at the time of risk assessment, which was combined dollar values of HUBZone sole-source, set-asides, and price evaluation preferences for FYs 2019–2020.

²⁶ 13 C.F.R. § 126.503(a)(2).

We conducted this performance audit in accordance with the U. S. Government Accountability Office's (GAO) *Generally Accepted Government Auditing Standards*.²⁷ These standards require that we plan and perform the audit to obtain sufficient and 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.

Use of Computer-processed Data

We relied on computer-processed data from HCTS, SBA's system of record for the HUBZone program, and DSBS, the database that contracting officers in the federal government use to search for small businesses and verify a firm's HUBZone certification. We obtained direct login to HCTS for access to participant firms' documentation in the SharePoint repository for program examinations. We obtained continuing eligibility certification reports from management and assessed the reliability of data by verifying the records were complete, recorded within expected parameters, and represented valid measures of certification dates. We reconciled the information against reports generated for compatible processes and obtained an understanding of the differences.

We also used data provided by program officials that identified the total value of contracts awarded to all active HUBZone firms in FY 2022. We reconciled award amounts with data extracted from federal award databases such as System for Award Management (SAM.gov), Federal Procurement Data System-Next Generation, and USAspending.gov. We determined any significant differences were due to changes in queries used to extract data.

We believe the computer-processed data is reliable for the purposes of this audit.

²⁷ U.S. Government Accountability Office, GAO-21-368G, *Government Auditing Standards, 2018 Revision*, (Technical Update April 2021).

Assessment of Internal Controls

For this audit, we identified the following internal control components and underlying internal control principles (Table 1-1) as being significant to the audit objectives.

Table 1-1. Internal Controls Assessed

Internal Control Component	Internal Control Principle
Control Environment	<ul style="list-style-type: none">• Exercise oversight responsibility
Control Activities	<ul style="list-style-type: none">• Design control activities• Design activities for the information system• Implement control activities
Information and Communication	<ul style="list-style-type: none">• Use quality information
Monitoring	<ul style="list-style-type: none">• Perform monitoring activities• Evaluate issues and remediate deficiencies

Source: OIG analysis

We assessed the operational effectiveness of the internal controls and identified deficiencies we believe could affect SBA’s oversight of HUBZone Program Participants’ Continuing Eligibility.

The internal control deficiencies we found are discussed in the “Finding” sections of this report; however, because our review was limited to aspects of these internal control components and underlying principles, the findings may not identify all internal control deficiencies that may have existed when this audit took place.

Prior Audit Coverage

The following lists the Office of Inspector General’s (OIG) and U.S. Government Accountability Office’s (GAO) previous audit coverage related to the objective of this report:

Report Number	Report Title	Report Date
SBA 19-08	<i>SBA’s HUBZone Certification Process</i>	March 28, 2019
GAO-18-666	<i>Small Business Contracting: Small Business Administration Could Further Strengthen HUBZone Eligibility Reviews in Puerto Rico and Program-wide</i>	September 24, 2018

Appendix 2: Detailed Analysis of SBA’s Eligibility Review Practices for Triennial Program Examinations

As discussed in Finding 1 of this report, we reviewed 20 firms with the largest HUBZone contract values and determined that SBA correctly validated 18 of 20 firms (90 percent) for continued certification. The following is an expanded discussion of the triennial program examination practices that resulted in SBA certifying Firm A without ensuring the firm met the principal office requirement and Firm B without ensuring the firms met employee residency requirements.

Principal Office Requirement – Firm A

HUBZone regulations require firms to have their principal office—the location with the greatest number of employees—within a HUBZone. During Firm A’s initial certification review in 2015, the analyst was unable to verify the location of the principal office during a site visit but recommended the firm for certification without adequate support to justify an eligible determination.

Routine triennial program examinations began in FY 2021. During a program examination in 2022, the analyst found the claimed principal office was not located within a HUBZone and as a result, proposed decertification. In response, Firm A provided an updated schedule of locations, but it included two additional locations that were not previously listed. The firm also updated its list of employees and their assigned work locations to correct which location should be considered the principal office. These changes were significant and should have prompted staff to take reasonable measures to verify conflicting information. Moreover, during our review, publicly available maps showed that one of the sites was an empty field with no buildings. By accepting the information at face value, the program office determined the firm continued to be eligible without sufficient and appropriate support.

During our review, the program office reached out to the firm to obtain additional information. After substantiating that the greatest number of employees worked at one of the four locations listed, the program office deemed Firm A compliant with the principal office requirement.

Employee Residence Requirement – Firm B

To meet the employee residency requirement, a firm must attempt to maintain that at least 35 percent of its employees reside in a HUBZone, when performing on a HUBZone contract.²⁸ According to HUBZone regulations, firms must demonstrate substantive and documented efforts for meeting the standard—with documents such as written offers of employment and published advertisements—and will have failed to attempt to maintain the employee residency requirement if the percentage falls below 20 percent.²⁹

For Firm B, program officials maintained sufficient documentation to demonstrate 32 employees resided in a HUBZone, falling short of the required minimum of 39 employees. During our review, the program office contacted the firm to obtain additional documentation, and after substantiating the seven additional employees resided in a HUBZone, the program office deemed Firm B compliant with the employee residency requirement.

²⁸ 13 C.F.R. §126.200(e)(1).

²⁹ 13 C.F.R. §126.103, Attempt to Maintain.

Appendix 3: Agency Response

SBA RESPONSE TO THE AUDIT REPORT



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

Date: July 15, 2024

To: Hannibal “Mike” Ware
Inspector General
Office of Inspector General (OIG)

From: Larry Stubblefield
Deputy Associate Administrator
Office of Government Contracting and Business Development

Subject: Response OIG Project 23002
SBA’s Oversight of HUBZone Program Participants’ Continuing Eligibility

LARRY STUBBLEFIELD
Digitally signed by LARRY STUBBLEFIELD
Date: 2024.07.09 17:47:18 -04'00'

SBA appreciates the role OIG plays in working with management in ensuring that SBA’s programs are administered effectively, and for the feedback provided in this draft report. We have carefully considered each recommendation and understand the importance of the work you do to support the invaluable implementation of the agency’s service to small businesses.

This draft report presents the results of OIG's audit of SBA’s Oversight of HUBZone Program Participants’ Continuing Eligibility (Project 23002), in which OIG sought to determine whether SBA’s oversight ensured triennial program examinations were completed in a timely manner, and certified HUBZone firms met continuing eligibility requirements in accordance with regulations and internal guidance.

SBA highlights that OIG found that SBA correctly established and documented a risk-based framework for conducting program examinations and that the HUBZone program met required timeframes for conducting 1,250 program examinations within this framework. Likewise, OIG found that SBA successfully recertified or decertified 92% of cases slated for recertification and that 99% of decertified firms were correctly displayed in the Dynamic Small Business Search Catalog.

SBA values OIG’s recognition of the improvements made to internal controls in the HUBZone program that have resulted in a stronger program. Specifically, OIG acknowledged the HUBZone’s program assurance that only eligible firms remain certified and an increase in timely recertifications which allow firms to maintain their HUBZone status and bring economic opportunities to distressed communities. We would also like to acknowledge the ongoing exceptional and diligent work of the HUBZone program staff members. In our view, the results of the audit validate the challenges that are associated with outdated technology and the tremendous amount of work that HUBZone employees perform to ensure timely and accurate recertifications, despite those challenges.

OIG made the following four recommendations, and Management's responses to the recommendations in the draft report are as follows:

OIG Recommendation 1: Revise regulations to require documents that can be verified to ensure firms complied with 13 CFR § 126.200(d)(3), that a legacy employee resided in a HUBZone for at least 180 days following the most recent certification (or recertification).

SBA's Response to Recommendation 1: SBA partially concurs with the recommendation. SBA acknowledges OIG's concerns related to legacy employees but has already submitted a proposed rule change to the Office of Management and Budget (OMB), which proposes a more effective solution. Within this proposed rule change, a certified HUBZone small business concern would be limited to having only one legacy HUBZone employee at a given time.

SBA contends that OIG's proposal to change the regulations related to the documentation requirement for legacy employees essentially alters the definition of "reside" used for the program. The definition of "reside" should be consistent for all HUBZone employees and creating an alternate definition and documentation standard for legacy employees would be confusing and burdensome for program participants.

SBA proposes to provide documentation of a change to the HUBZone Standard Operating Procedures to enhance proof of residency requirements for legacy employees for the 180-day period following recertification.

Recommendation 1 Due Date: January 6, 2025

OIG Recommendation 2: Update and implement standard operating procedures to request documents, as permitted under 13 CFR 126.304(b)(1), to verify during program examinations that firms meet size standards in the North American Industry Classification System code in which they perform on HUBZone contracts.

SBA's Response to Recommendation 2: SBA does not concur with the recommendation. As in prior disagreements between SBA and OIG regarding making a size determination at the time of certification or recertification, SBA continues to emphasize that a firm cannot be determined to be a small business or not a small business categorically, but rather qualifies as small or not small in relation to an individual procurement action, based on whether it is small under the size standard for the North American Industry Classification System (NAICS) code assigned to that action.

OIG's comment that, "The agency's regulations for conducting program examinations do not explicitly discuss evaluation procedures related to size verification," is accurate. However, OIG's statement that, "The agency relies on firms to self-certify their status as a small business," is mischaracterized. SBA regulations at 13 CFR §126.200 neither discuss documentation nor self-certification. The HUBZone program office follows SBA procedures regarding size standards and appropriately relies on federal agencies to verify size during the contracting process. SBA highlights that OIG found no evidence during the audit that any firm that received a HUBZone contract was other than small.

As mentioned above, SBA has submitted a proposed rule change to OMB. Within this proposed rule change, SBA proposes to specify in its regulations that, for purposes of certification and program examinations, SBA will accept a concern's size representation in SAM, or successor system, unless there is evidence indicating that the concern is other than small. SBA will request a formal size determination pursuant to 13 CFR §121.1001(b)(8) where any information it possesses calls into question the SAM size representation.

OIG Recommendation 3: Improve the HCTS system notification module to ensure recertification notifications are sent timely and consistently to all HUBZone firms.

SBA's Response to Recommendation 3: SBA concurs with the spirit of this recommendation, however highlights that the HCTS system is sunsetting for initial applications in August 2024 and for recertification in November 2024. Therefore, improving the specific HCTS system notification module is neither financially nor technically feasible.

SBA agrees that the HUBZone system of record should ensure recertification notifications are sent timely and consistently to all HUBZone firms. Following the launch and commencement of the new system of record, SBA proposes to provide OIG with a demonstration of the system's automatic notification functionality.

Recommendation 3 Due Date: January 6, 2025

OIG Recommendation 4: In the interim, establish procedures to verify completion of annual recertifications by defining parameters, timing, and other requirements as needed, including expected OCIO response times when the HUBZone program office requires manual HCTS processing.

SBA's Response to Recommendation 4: SBA concurs with the spirit of this recommendation, however, offers two opposing points with regard to OIG's suggested actions. First, as indicated in Recommendation 3, SBA's new system of record for recertification is expected to be launched in several months. Establishing additional procedures would likely take longer than the launch of the new system.

More importantly, SBA contends that procedures were implemented in FY23 to verify completion of annual recertifications, and since the collection of data for this audit, has increased the verification of annual recertification to approximately 100%. SBA offers to provide a description and documentation of the changes implemented by OCIO in FY23 and respectfully requests that this Recommendation be closed without further action.