United States Government Accountability Office

# GAO

Testimony

Before the Committee on Small Business and Entrepreneurship, U.S. Senate

For Release on Delivery
Expected at 10:00 a.m. EDT
Thursday, June 16, 2011

# SMALL BUSINESS PROGRAMS

# Efforts to Address Internal Control Weaknesses and Potential Duplication

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GAO
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June 16, 2011

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# Highlights

Highlights of GAO-11-558T, a testimony before the Committee on Small Business and Entrepreneurship, U.S. Senate

## Why GAO Did This Study

Economic development programs—administered efficiently and effectively—can contribute to the well-being of the economy at the least cost to taxpayers. Such programs can encompass small business development and contracting. To encourage such contracting, Congress created programs—such as the Historically Underutilized Business Zone (HUBZone), service-disabled veteran-owned small business, and 8(a) Business Development programs—that give contracting preferences to some types of small businesses: in economically distressed communities; to those owned by service-disabled veterans; and to those with eligible socially and economically disadvantaged owners. This testimony addresses (1) potential duplication in economic development programs and (2) internal controls weaknesses in three small business programs. This testimony is based on related GAO work from 2008 to the present and updates it as noted.

GAO examined programs at the Departments of Commerce, Housing and Urban Development, and Agriculture and the Small Business Administration (SBA) to assess program overlap, collaboration, and measures of effectiveness (GAO-11-477R). GAO also reviewed data from SBA and the Department of Veterans Affairs (VA) and conducted site visits. The reports identified opportunities to increase program efficiencies and made recommendations to improve internal controls and develop outcome-oriented measures.

View GAO-11-558T or key components. For more information, contact William B. Shear at (202) 512-8678 or shearw@gao.gov.

## What GAO Found

Results of GAO's work on 80 economic development programs at the four agencies indicate that the design of each appears to overlap with that of at least one other in terms of the economic development activities they can fund. For example, the agencies administer 54 programs that fund "entrepreneurial efforts," which include business development. SBA has 19 such economic development programs. To address issues arising from potential overlap and fragmentation, GAO relied on previously identified collaborative practices agencies should consider using to maximize performance and results. GAO found that agencies' collaborative efforts were not comprehensive but conducted on a case-by case basis. Further, the agencies generally have not measured outcomes. For instance, SBA has not yet developed outcome measures that directly link to the mission of its HUBZone program. In 2005 and 2008, GAO made recommendations to Commerce and SBA, respectively, aimed at improving the data and methods they rely on to measure the outcomes of some of their economic development programs. Generating key information on outcomes (that measure effectiveness) could help agencies better manage programs. Such information also would enable decision makers to better identify opportunities to realign resources, and if necessary, consolidate or eliminate some programs.

As GAO has reported, three small business programs have had varying degrees of internal control weaknesses that affected program oversight. First, in a June 2008 report, GAO determined that SBA's mechanisms for certifying and monitoring firms in the HUBZone program gave limited assurance that only eligible firms participated. For certification and recertification (of initial and continued eligibility), SBA requested documentation or conducted site visits to validate self-reported data in limited instances. In response to GAO's recommendations, SBA has issued guidance requiring supporting documentation upon application and conducted site visits to certified firms. Second, in a May 2010 report, GAO reported that VA has faced challenges in effectively responding to a 2006 statutory mandate to verify the eligibility of small businesses owned by service-disabled or other veterans. Although such businesses self-certify their contracting eligibility, VA (unique among federal agencies) must maintain a database of these firms, verify their status, and only give contracting preferences to verified firms. GAO reported that VA had verified only about 14 percent of firms in its database. Since GAO recommended that VA develop a plan for a more effective verification program, VA stated that it has taken steps to improve its verification process, including awarding contracts to expedite the processing of applications. And finally, in a March 2010 report, GAO found that while SBA conducts annual reviews of 8(a) firms to help ensure continued eligibility, GAO found that key controls needed to be strengthened. GAO's review of a sample of 8(a) firms identified an estimated 55 percent in which SBA staff failed to complete required procedures to assess eligibility criteria. In response to GAO's recommendation that SBA provide more guidance to staff on annual review procedures, SBA stated that it issued a new guide in August 2010.

Chair Landrieu, Ranking Member Snowe, and Members of the Committee:

I am pleased to be here to discuss (1) potential duplication in economic development programs and (2) internal controls in place to help ensure that only eligible small businesses participate in federal procurement programs that provide them certain contracting preferences such as set-asides. In March 2011 and more recently in May 2011, we reported on potential duplication among federal economic development programs, and in this statement I will discuss this work.[1] We focused on this area because economic development programs that are administered efficiently and effectively can contribute to the well-being of the nation's economy at the least cost to taxpayers. Absent a common definition for economic development, we previously developed a list of nine activities most often associated with economic development. These activities include: planning and developing strategies for job creation and retention, developing new markets for existing products, building infrastructure by constructing roads and sewer systems to attract industry to undeveloped areas, and establishing business incubators to provide facilities for new businesses' operations.[2]

We recently completed an examination of 80 economic development programs at four agencies—the Departments of Commerce (Commerce), Housing and Urban Development (HUD), and Agriculture (USDA) and the Small Business Administration (SBA)—where we assessed potential for overlap in the design of the programs, the extent to which the four agencies collaborate to achieve common goals, and the extent to which the agencies have developed measures to determine the programs' effectiveness. SBA administers 19 of the 80 programs. According to the agencies, funding provided for these 80 programs in fiscal year 2010

[1]See GAO, *Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue*, GAO-11-318SP (Washington, D.C.: Mar. 1, 2011); GAO, *List of Selected Federal Programs That Have Similar or Overlapping Objectives, Provide Similar Services, or Are Fragmented Across Government Missions*, GAO-11-474R (Washington, D.C.: Mar. 18, 2011); and GAO, *Efficiency and Effectiveness of Fragmented Economic Development Programs Are Unclear*, GAO-11-477R (Washington D.C.: May 19, 2011).

[2]In commenting on our May 2011 report (GAO-11-477R), the Department of Commerce stated, among other things, that prior GAO reports have focused on the types of investments made without an appropriate definition of economic development. Because federal agencies do not have a standard definition of what constitutes economic development, we identified programs using a list of activities that are generally accepted as being directly related to economic development.

amounted to $6.2 billion, of which about $2.9 billion was for economic development efforts, largely in the form of grants, loan guarantees, and direct loans.[3] The 80 programs and their fiscal year 2010 funding are listed in appendix I.

Small business contracting programs are a subset of the 80 economic development programs we examined. To encourage small business contracting, Congress has created programs—such as the Historically Underutilized Business Zone (HUBZone), service-disabled veteran-owned small business, and 8(a) Business Development programs—that give contracting preferences to specific categories of small businesses. The HUBZone program provides set-aside and other contracting preferences to small businesses in economically distressed communities, or HUBZones, with the intent of stimulating economic development in those areas. The service-disabled veteran-owned small business program permits awards of set-aside and sole-source contracts to any small business owned and controlled by one or more service-disabled veterans. The 8(a) program helps eligible socially and economically disadvantaged small businesses by providing business development support, such as counseling and technical assistance, and providing opportunities to obtain federal contracts on a set-aside basis or noncompetitively up to specified dollar amounts.

SBA is responsible for administering the HUBZone and 8(a) programs. SBA, along with federal procuring agencies, also administers the service-disabled veteran-owned small business program. Pursuant to the Veterans Benefits, Health Care, and Information Technology Act of 2006 (or 2006 Act), the Department of Veterans Affairs (VA) has the unique authority to award contracts to veteran-owned small businesses and service-disabled veteran-owned small businesses on a priority basis. The 2006 Act also requires VA to maintain a database of veteran-owned and service-disabled veteran-owned small businesses and verify the ownership, control, and veteran or service-disabled status of businesses listed in its database.

My testimony today discusses several reports we have issued in the past few years. Specifically, I will discuss our work on (1) potential duplication and fragmentation in economic development programs and (2) internal

[3] In March 2011, we reported that the funding provided for these 80 programs in fiscal year 2010 amounted to $6.5 billion, of which about $3.2 billion was for economic development efforts, according to data received from the agencies (GAO-11-318SP and GAO-11-474R). We are reporting different funding figures in this product because SBA revised the original information they provided to us in December 2010.

controls in small business contracting programs. My discussion of internal controls in small business contracting programs will focus on the HUBZone program, VA's efforts to verify the veteran-owned and service-disabled veteran-owned small businesses to which it awards contracts, and the 8(a) program.

This testimony draws primarily from reports we issued from 2008 through May 2011, and updates that information where noted. For our March 2011 and May 2011 reports on potential duplication and fragmentation in economic development programs, we relied on our previous work, ongoing work following up on recommendations from the previously issued reports, and the preliminary results of our ongoing evaluation of economic development programs at four federal agencies.[4] For example, for the most recent work we gathered new information related to program missions, targeted populations, and funding for the programs. Agency officials self reported the data on program funds, which were determined to be sufficiently reliable for the purposes of this review. We focused on Commerce, HUD, SBA, and USDA. Using the Catalog of Federal Domestic Assistance and other agency documents, we identified 80 federal programs administered by the four agencies that could fund economic development activities. We also met with officials from each of the agencies to discuss each program and the program missions. Because SBA officials view all of their programs as being related to economic development, we included all SBA programs in this review.

For our June 2008 report on internal controls in the HUBZone program, we compared the actions that SBA takes to certify HUBZone firms with its policies and procedures and selected internal control standards.[5] For

[4]See GAO-11-318SP; GAO-11-474R; GAO-11-477R; GAO, *Rural Economic Development: Collaboration between SBA and USDA Could Be Improved*, GAO-08-1123 (Washington, D.C.: Sep.18, 2008); GAO, *Small Business Administration: Additional Actions Are Needed to Certify and Monitor HUBZone Businesses and Assess Program Results*, GAO-08-643 (Washington, D.C.: Jun. 17, 2008); GAO, *Rural Economic Development: More Assurance Is Needed That Grant Funding Information Is Accurately Reported*, GAO-06-294 (Washington, D.C.: Feb. 24, 2006); GAO, *Economic Development Administration: Remediation Activities Account for a Small Percentage of Total Brownfield Grant Funding*, GAO-06-7 (Washington, D.C.: Oct. 27, 2005); GAO, *Economic Development: Multiple Federal Programs Fund Similar Economic Development Activities*, GAO/RCED/GGD-00-220 (Washington, D.C.: Sep. 29, 2000); and GAO, *Economic Development: Observations Regarding the Economic Development Administration's May 1998 Final Report on its Public Works Program*, GAO/RCED-99-11R (Washington, D.C.: Mar. 23, 1999).

[5]GAO-08-643.

example, we reviewed data for 125 applications to determine the extent to which SBA requested documentation from firms to support applications. We also compared HUBZone performance measures with our guidance on the attributes of effective performance measures. For our May 2010 report on VA's efforts to contract with veteran-owned and service-disabled veteran-owned small businesses, we reviewed the agency's verification guidelines and procedures for reviewing applications and conducting site visits to determine VA's progress in verifying the veteran status, control, and ownership of businesses.[6] We also reviewed files for a sample of verified businesses to determine how well VA followed its procedures and to identify any deficiencies in the process. For our March 2010 report on internal controls in the 8(a) program, we visited 5 of the 68 SBA districts and reviewed files of 136 8(a) firms to assess SBA's compliance with its eligibility review procedures.[7] We collected recent annual review information from each file, including evidence supporting eligibility criteria. For more information on our scope and methodology, see the referenced reports.

The work on which this statement is based was performed from August 2007 to May 2011 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

# Background

The purpose of the HUBZone program, established by the HUBZone Act of 1997, is to stimulate economic development in economically distressed communities (HUBZones) by providing federal contracting preferences to eligible small businesses.[8] The types of areas in which HUBZones may be located are defined by law and consist of census tracts, nonmetropolitan counties, Indian reservations, redesignated areas (that is, census tracts or

[6] GAO, *Department of Veterans Affairs: Agency Has Exceeded Contracting Goals for Veteran-Owned Small Businesses, but It Faces Challenges with Its Verification Program*, GAO-10-458 (Washington, D.C.: May 28, 2010).

[7] GAO, *Small Business Administration: Steps Have Been Taken to Improve Administration of the 8(a) Program, but Key Controls for Continued Eligibility Need Strengthening*, GAO-10-353 (Washington, D.C.: Mar. 30, 2010).

[8] HUBZone Act of 1997, Pub L. No. 105-135, Title VI, 111 Stat. 2592, 2627-2636 (1997).

nonmetropolitan counties that no longer meet the criteria but remain eligible until after the release of the first results from the 2010 census or 3 years after they ceased being qualified), and base closure areas.[9]

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

- must be small by SBA size standards;[10]
- must be at least 51 percent owned and controlled by U.S. citizens;[11]
- principal office—the location where the greatest number of employees perform their work—must be located in a HUBZone; and
- at least 35 percent of the full-time (or full-time equivalent) employees must reside in a HUBZone.

The Veterans Benefits Act of 2003, which established the service-disabled veteran-owned small business program, permits contracting officers to award set-aside and sole-source contracts to any small business concern owned and controlled by one or more service-disabled veterans.[12] Veteran means a person who served in the active military services, and who was discharged or released under conditions other than dishonorable. Service-disabled means that the disability was incurred or aggravated in the line of duty in active service.[13] A firm also must qualify as a small business under the North American Industry Classification System (NAICS) industry-size standards.[14]

[9]See GAO-08-643 for a definition of each type of area.

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

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

[12]If the business is publicly owned, at least 51 percent of the stock must be held by one or more service-disabled veterans. The service-disabled veteran(s) must manage and control daily business operations. In the case of a veteran with permanent and severe disability, the spouse or permanent caregiver of such veteran may control the business.

[13]38 U.S.C. §§ 101(2), 101(16).

[14]Federal statistical agencies use NAICS as the standard in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. business economy.

A firm must meet several initial eligibility requirements to qualify for the 8(a) program (a process known as certification), and then meet other requirements to continue participation. A concern meets the basic requirements for admission to the program if it is a small business that is unconditionally owned and controlled by one or more socially and economically disadvantaged individuals who are of good character and U.S. citizens, and demonstrates the potential for success.[15]

## What GAO Has Found to Indicate Potential Duplication, Overlap, or Fragmentation among Economic Development Programs

Our work involving 80 economic development programs at four agencies—Commerce, HUD, SBA, and USDA—indicates that the design of each of these fragmented programs appears to overlap with that of at least one other program in terms of the economic development activities that they are authorized to fund. For example, as shown in table 1, the four agencies administer a total of 54 programs that can fund "entrepreneurial efforts," which include helping businesses to develop business plans and identify funding sources. SBA accounts for 19 of these 54 programs, and it administers programs contained in six of the nine economic activities. (The 19 SBA programs are listed in the table in appendix I.)

[15]For more information on key eligibility requirements for 8(a) program participation, see GAO-10-353.

**Table 1: Overlap and Fragmentation Among Selected Agencies Authorized to Fund Economic Development Activities**

| | Programs by Agency | | | | |
|---|---|---|---|---|---|
| Activity | Commerce | HUD | SBA | USDA | Total |
| Entrepreneurial efforts | 9 | 12 | 19 | 14 | 54 |
| Infrastructure | 4 | 12 | 1 | 18 | 35 |
| Plans and strategies | 7 | 13 | 13 | 7 | 40 |
| Commercial buildings | 4 | 12 | 4 | 7 | 27 |
| New markets | 6 | 10 | 6 | 6 | 28 |
| Telecommunications | 3 | 11 | 2 | 8 | 24 |
| Business incubators | 5 | 12 | — | 7 | 24 |
| Industrial parks | 5 | 11 | — | 5 | 21 |
| Tourism | 5 | 10 | — | 4 | 19 |

Source: GAO analysis of information from Commerce, HUD, SBA, and USDA.

Note: In December 2010, USDA officials provided us information on the economic activities that each of their economic development programs can fund, which we reported in our March 2011 report (GAO-11-318SP). In April 2011, they provided revised information for six of their programs that we incorporated into our May 2011 report (GAO-11-477R).

Our prior work going back more than 10 years also identified potential overlap and fragmentation in economic development programs. Among other things, we found that legislative or regulatory restrictions that target funding on the basis of characteristics such as geography, income levels, and population density (rural or urban) differentiated many programs.

While some of the 80 programs we assessed fund several of the nine economic development activities, almost 60 percent (46 of 80) fund only one or two activities. These smaller, narrowly scoped programs appear to be the most likely to overlap because many can only fund the same, limited types of activities. For example, narrowly scoped programs comprise 21 of 54 programs that can fund entrepreneurial efforts. Moreover, most of the 21 programs target similar geographic areas.

To address issues arising from potential overlap and fragmentation in economic development programs, we previously have identified collaborative practices agencies should consider using to maximize the performance and results of federal programs that share common outcomes.[16] These practices include leveraging physical and administrative resources, establishing compatible policies and procedures, monitoring collaboration, and reinforcing agency accountability for collaborative efforts through strategic or annual performance plans. Preliminary findings from our ongoing work show that Commerce, HUD, SBA, and USDA appear to have taken actions to implement some of the collaborative practices, such as defining and articulating common outcomes, for some of their related programs. However, the four agencies have offered little evidence so far that they have taken steps to develop compatible policies or procedures with other federal agencies or searched for opportunities to leverage physical and administrative resources with their federal partners. Moreover, we found that most of the collaborative efforts performed by program staff on the front line that we have been able to assess to date have occurred only on a case-by-case basis. As a result, the agencies do not appear to be consistently monitoring or evaluating these collaborative efforts in a way that allows them to identify areas for improvement. We reported in September 2008 that the main causes for limited agency collaboration include few incentives to collaborate and lack of a guide on which agencies could rely for consistent and effective collaboration. In that same report, we recommended that SBA and USDA take steps to adopt a formal approach to encourage further collaboration. To date, the two agencies have entered into a memorandum of understanding and USDA has recently taken some action to monitor the collaborative efforts of its field office staff. In failing to find ways to collaborate more, agencies may miss opportunities to leverage each other's unique strengths to more effectively promote economic development and efficiently use taxpayer dollars set aside for that purpose.

In addition, a lack of information on program outcomes has been a long-standing concern. This information is needed to determine if potential overlap and fragmentation has resulted in ineffective or inefficient programs. More specifically:

- Commerce's Economic Development Administration (EDA), which administers eight of the programs we reviewed, continues to rely on a

[16]GAO, *Results-Oriented Government: Practices That Can Help Enhance and Sustain Collaboration among Federal Agencies*, GAO-06-15 (Washington, D.C.: Oct. 21, 2005). Also see GAO-08-1123.

potentially incomplete set of variables and self-reported data to assess the effectiveness of its grants. This incomplete set of variables may lead to inaccurate claims about program results, such as the number of jobs created. Moreover, in only limited instances have EDA staff requested documentation or conducted site visits to validate the self-reported data provided by grantees. We first reported on this issue in March 1999 and issued a subsequent report in October 2005. In response to a recommendation we made in 2005, EDA issued revised operational guidance in December 2006 that included a new methodology that regional offices were to use to calculate estimated jobs and private-sector investment attributable to EDA projects. However, during our recently-completed review we found that the agency still primarily relies on grantee self-reported data and conducts a limited number of site visits to assess the accuracy of the data. While acknowledging these findings, EDA officials stated that they do employ other verification and validation methods in lieu of site visits. These methods include reviews to ensure the data are consistent with regional trends and statistical tests to identify outliers and anomalies.

- SBA has not yet developed outcome measures that directly link to the mission of its HUBZone program, or implemented its plans to evaluate the program based on variables tied to program goals. We reported in June 2008 that while SBA tracks a few performance measures, such as the number of small businesses approved to participate in the program, the measures do not directly link to the program's mission. Therefore, we recommended that the agency further develop measures and implement plans to assess the effectiveness of the program. While SBA continues to agree that evaluating the outcomes of the HUBZone program is important, to date the agency has not yet committed resources for such an evaluation.

- The USDA's Office of Rural Development, which administers 31 of the programs we reviewed, has yet to implement the USDA Inspector General's (IG) 2003 recommendation on ensuring that data exist to measure the accomplishments of one of its largest rural business programs—the Business and Industry loan program, which cost approximately $53 million to administer in fiscal year 2010. USDA officials stated that they have recently taken steps to address the IG's recommendation, including requiring staff to record actual jobs created rather than estimated jobs created. However, an IG official stated that these actions are too recent to determine whether they will fully address the recommendation.

Without quality data on program outcomes, these agencies lack key information that could help them better manage their programs. In addition, such information would enable congressional decision makers and others to make decisions to better realign resources, if necessary, and identify opportunities for consolidating or eliminating some programs.

Building on our past work, we are in the planning phase of a new, more in-depth review that will focus on a subset of these 80 programs, including a number of SBA programs. We plan to evaluate how funds are used, identify additional opportunities for collaboration, determine and apply criteria for program consolidation, and assess how program performance is measured.

More generally, as the nation rises to meet the current fiscal challenges, we will continue to assist Congress and federal agencies in identifying actions needed to reduce duplication, overlap, and fragmentation; achieve cost savings; and enhance revenues. As part of current planning for our future annual reports, we are continuing to look at additional federal programs and activities to identify further instances of duplication, overlap, and fragmentation as well as other opportunities to reduce the cost of government operations and increase revenues to the government. We will be using an approach to ensure governmentwide coverage through our efforts by the time we issue of our third report in fiscal year 2013. We plan to expand our work to more comprehensively examine areas where a mix of federal approaches is used, such as tax expenditures, direct spending, and federal loan programs. Likewise, we will continue to monitor developments in the areas we have already identified. Issues of duplication, overlap, and fragmentation will also be addressed in our routine audit work during the year as appropriate and summarized in our annual reports.

## Control Weaknesses Hinder the Effectiveness of Small Business Contracting and Business Development Programs

As GAO has reported, three small business programs have had varying degrees of internal control weaknesses that affected program oversight. For example, in a June 2008 report, GAO determined that SBA's mechanisms for certifying and monitoring firms in the HUBZone program gave limited assurance that only eligible firms participated.

## SBA Has Taken Some Steps to Improve Administration of the HUBZone Program, but the Agency Has Yet to Evaluate Its Effectiveness

In our June 2008 report on the HUBZone program, we found that (1) SBA's mechanisms for certifying and monitoring firms provided limited assurance that only eligible firms participated in the program and (2) the agency had not evaluated the effectiveness of the program.[17] Specifically, for certification and recertification, firms self-reported information on their applications and SBA requested documentation or conducted site visits of firms to validate the self-reported data in limited instances. Our analysis of the 125 applications submitted in September 2007 showed that SBA requested supporting documentation for 36 percent of the applications and conducted one site visit. To address these deficiencies, we recommended that SBA develop and implement guidance to more consistently obtain supporting documentation upon application and conduct more frequent site visits to help ensure that firms applying for certification were eligible.

SBA has made some progress in better ensuring that participating firms are eligible for the HUBZone program. According to agency officials, SBA conducted 911 site visits to certified firms in fiscal year 2009 and made 1,142 site visits in fiscal year 2010. In March 2010, SBA issued a guide for analysts to use when reviewing applications to help ensure a standardized and more efficient review of applications. The guidance provides examples of the types of documentation that SBA staff should collect from applicants and also offers tips for identifying fraudulent claims and documents.

We also reported that SBA had not followed its policy of recertifying firms (the process through which SBA can monitor firms' continued eligibility) every 3 years and as a result had a backlog of more than 4,600 firms that had gone unmonitored for more than 3 years. We recommended that the agency eliminate the backlog and take the necessary steps to better ensure recertifications were completed in a more timely fashion. In September 2008, SBA eliminated the backlog by hiring more staff. The agency recently provided us with a flow chart that describes the most recent steps they had taken to recertify firms in a timely manner and the resources that they planned to dedicate to this effort.

Finally, as discussed previously, we found that SBA had not implemented plans to assess the effectiveness of the HUBZone program and recommended that SBA develop performance measures and implement

[17] GAO-08-643.

plans to do so. In August 2008, SBA issued a notice of methodology in the *Federal Register* for measuring the impact of the HUBZone program. However, the proposed methodology was not well developed. For example, it did not incorporate expert input or a previous study conducted by SBA's Office of Advocacy. We do not believe that this effort was useful for addressing our recommendation. While SBA continues to agree that evaluating program outcomes is important, to date the agency has not yet committed resources for such an evaluation.

## VA Faced Challenges in Verifying Veteran-Owned and Service-Disabled Veteran-Owned Firms

In May 2010, we reported that VA had made limited progress in implementing an effective verification program.[18] The 2006 Act requires that VA give priority to veteran-owned and service-disabled veteran-owned small businesses when awarding contracts to small businesses and provides for the use of sole-source and set-aside contracts to achieve contracting goals VA must establish under the Act.[19] The Act also requires VA to maintain a database of veteran-owned and service-disabled veteran-owned small businesses and verify the ownership, control, and veteran or service-disabled status of businesses in the database. The database would be available to other federal agencies. Furthermore, businesses conducting contract work for VA must be listed in the database to receive contracting preferences for veteran-owned and service-disabled veteran-owned small businesses. This verification requirement is unique to VA. For other federal agencies, the service-disabled veteran-owned small business program is a self-certification program and therefore is susceptible to misrepresentation (that is, ineligible firms participating in the program).

While the 2006 Act requires VA to use the veteran preferences authorities to award contracts only to verified businesses, VA's regulation did not require that this take place until January 1, 2012. Since our May 2010 report, Congress passed the Veterans Small Business Verification Act requiring VA to accelerate its time frame for verifying all businesses in its

[18]GAO-10-458.

[19]Pub. L. No. 109-461, § 502, 120 Stat. 3403, 3431 (2006), codified at 38 U.S.C. § 8127, as amended.

mandated database. VA has set a target date of July 31, 2011, to do so.[20] In fiscal year 2009, 25 percent of the contracts awarded using veteran preference authorities went to verified businesses. At the time of our report, VA had verified about 2,900 businesses—approximately 14 percent of businesses in its database of veteran-owned and service-disabled veteran-owned small businesses. Among the weaknesses we identified in VA's verification program were files missing required information and explanations of how staff determined that control and ownership requirements had been met. VA's procedures call for site visits to further investigate the ownership and control of higher-risk businesses, but the agency had a large and growing backlog of businesses awaiting site visits. Furthermore, VA contracting officers awarded contracts to businesses that were denied after the verification process. Finally, although site visit reports indicate a high rate of misrepresentation, VA had not developed guidance for referring cases of misrepresentation for investigation and enforcement action. Such businesses would be subject to debarment under the 2006 Act.

To help address the requirement to maintain a database of verified businesses, we recommended that VA develop and implement a plan for a more thorough and effective verification program. More specifically, we recommended that the plan address actions and milestone dates for improving the program, including updating data systems to reduce manual data entry and adding guidance on how to maintain appropriate documentation, on when to request documentation from business owners or third parties, and on how to conduct an assessment that addresses each eligibility requirement. We also recommended that VA conduct timely site visits at businesses identified as higher risk and take actions based on site visit findings, including prompt cancellation of verified status.

According to VA officials, they have taken a number of actions to address our recommendations. For example, VA officials told us they had awarded contracts to help expedite the processing of applications, including

[20]The Veterans Small Business Verification Act, Pub. L. No. 111-275, § 104, 124 Stat. 2864, 2867 (2010), requires that effective October 13, 2010, no new small business applicant may appear in VA's database unless it has been verified as owned and controlled by a veteran or service-disabled veteran. Additionally, VA was required to notify all unverified businesses in its veteran-owned small business and service-disabled veteran-owned small business database as of October 13, 2010, about the need to provide supporting business documents that establish the veteran ownership and control of the small business. Firms were required to do so by 90 days of receipt of the notification in order to avoid removal from VA's database.

conducting site visits and reviewing documentation supplied by applicants. As of March 29, 2011, they said that 607 site visits had been conducted and 195 of the applicants visited (32 percent) did not meet the control requirement. Also, VA officials reported a queue of 6,431 active applications pending verification and said they had acquired the capability to process 500 applications per week and expected to have processed about 15,000 applications by July 31, 2011. Furthermore, VA officials told us that as part of their implementation of the requirements of the Veterans Small Business Verification Act, all applicants are now required to submit specified documents establishing their eligibility with respect to ownership and control before a verification decision can be made. VA officials told us they were in the process of testing a new case management system that will reduce the manual input of data, which they plan to implement by June 1, 2011. VA's development of an effective verification program could provide an important tool for SBA's oversight of the governmentwide contracting program for service-disabled veteran-owned small businesses. That is, VA's database could serve as a resource for federal agencies to use when assessing whether a firm is actually service-disabled veteran-owned.

## SBA's Key Controls for Determining Continued 8(a) Eligibility Needed to Be Strengthened

We reported in March 2010 that while SBA relies primarily on its annual reviews of 8(a) firms to help ensure the continued eligibility of firms in the program, we observed inconsistencies and weaknesses in annual review procedures related to determinations of continued eligibility.[21] For example, SBA did not consistently notify or graduate 8(a) firms that exceeded industry averages for economic success or graduate firms that exceeded the net worth threshold of $750,000 (see table 2). We noted that the lack of specific criteria in the current regulations and procedures may have contributed to the inconsistencies that we observed and that SBA had taken steps to clarify some, but not all, of these requirements in a proposed rule change.[22]

[21]GAO-10-353.

[22]The proposed rule has since been finalized. See 76 Fed. Reg. 8222 (Feb. 11, 2011) (to be codified at 13 C.F.R. pts. 121 and 124). This rule became effective on March 14, 2011.

**Table 2: Estimated Percentage of Time That SBA Did Not Complete Selected Annual Review Procedures Relating to 8(a) Eligibility**

| Requirement not met | Estimated percentage |
| --- | --- |
| Taking action when a firm exceeded industry averages for economic success by | |
| • Notifying firms that exceeded four of seven industry averages for 1 year | 26% |
| • Graduating or explaining retention of firms that exceeded four of seven industry averages for 2 consecutive years | 4 |
| Reviewing net worth or graduating firms in which individuals exceeded adjusted net worth limitations | 7 |
| Performing required eligibility reviews because of a change in the firms' ownership | 4 |
| Completing required annual reviews | 2 |
| Documenting supervisory reviews | 23 |
| Imposing remedial actions or obtaining waivers for firms not meeting business activity targets | 10 |

Source: GAO analysis of a random sample of 123 8(a) firms.

Note: These estimates are based upon a random sample. For information on our methodology, see GAO-10-353.

We also reported that SBA's program offices did not maintain comprehensive data on or have a system in place to track complaints about the eligibility of firms in the 8(a) program. District staff were not aware of the types and frequency of complaints across the agency. As a result, SBA staff lacked information that could be used to help identify issues relating to program integrity and help improve the effectiveness of SBA oversight. Although complaint data are not a primary mechanism to ensure program eligibility, continuous monitoring is a key component in detecting and deterring fraud.

We recommended that SBA provide more guidance to help ensure that staff more consistently follow annual review procedures and more fully utilize third-party complaints to identify potentially ineligible firms. According to SBA officials, they have taken some actions to address these recommendations. For example, SBA officials told us that in August 2010 they had provided staff with a new guide for conducting annual reviews of the continuing eligibility of firms in the 8(a) program. Additionally, SBA officials said they were providing training to staff on the recently published revisions to regulations governing the 8(a) program. These revisions provided more clarification on factors that determine economic disadvantage (such as total assets, gross income, retirement accounts) for continuing eligibility in the program. SBA officials also said that they have been incorporating changes into their Web site that will allow third parties to submit complaints about potentially ineligible firms in the 8(a) program.

Chair Landrieu, Ranking Member Snowe, this concludes my prepared statement. I would be happy to respond to any questions you or other Members of the Committee may have at this time.

## Contacts and Staff Acknowledgments

For further information on this testimony, please contact me at (202) 512-8678 or shearw@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Key contributors to this testimony include Paige Smith, Assistant Director; Tania Calhoun; Andy Finkel; Janet Fong; Triana McNeil; Harry Medina; Barbara Roesmann; Kathryn Supinski; and Bill Woods.

# Appendix I: Economic Development Programs

Table 3 lists the 80 economic development programs and provides information about their funding, when available. Using the Catalog of Federal Domestic Assistance and other agency documents, we identified 80 federal programs administered by the four agencies listed below—the Departments of Commerce (Commerce), Housing and Urban Development (HUD), and Agriculture (USDA) and the Small Business Administration (SBA)—that could fund economic development activities. We did not include tax credit programs aimed at economic development in this review.

**Table 3: FY 2010 Funding for Economic Development Programs**

| Agency | Program Name | FY 2010 Funding[a] |
|---|---|---|
| Commerce | Community Trade Adjustment Assistance | $0 |
| Commerce | Grants for Public Works and Economic Development Facilities | 158,930,000 |
| Commerce | Economic Development/Support for Planning Organizations | 31,391,000 |
| Commerce | Economic Development/Technical Assistance | 9,800,000 |
| Commerce | Economic Adjustment Assistance | 45,270,000 |
| Commerce | Research and Evaluation Program | 1,963,000 |
| Commerce | Trade Adjustment Assistance | 18,987,000 |
| Commerce | Global Climate Change Mitigation Incentive Fund | 25,000,000 |
| Commerce | Minority Business Enterprise Centers | 8,601,193 |
| Commerce | Native American Business Enterprise Centers | 1,351,500 |
| Commerce | Minority Business Opportunity Center | 1,512,500 |
| USDA | Empowerment Zones | 500,000 |
| USDA | Woody Biomass Utilization Grant Program | 5,000,000 |
| USDA | 1890 Land Grant Institutions Rural Entrepreneurial Outreach Program/Rural Business Entrepreneur Development Initiative/BISNET | 0 |
| USDA | Distance Learning and Telemedicine Loans and Grants | 33,300,000 |
| USDA | Rural Telephone Loans and Loan Guarantees | 0 |
| USDA | Public Television Station Digital Transition Grants | 4,500,000.00 |
| USDA | Community Connect Program | 18,000,000.00 |
| USDA | Rural Broadband Access Loans and Loan Guarantees | 29,000,000.00 |
| USDA | Rural Electrification Loans and Loan Guarantees | 0 |
| USDA | Assistance to High Energy Cost Rural Communities | 17,500,000 |
| USDA | Denali Commission Loans and Grants | 0 |
| USDA | State Bulk Fuel Revolving Fund Grants | 0 |
| USDA | Small Business Innovation Research | 22,000,000 |
| USDA | Biomass Research and Development Initiative Competitive Grants Program | 0 |
| USDA | Schools and Roads—Grants to States | 0 |

| Agency | Program Name | FY 2010 Funding[a] |
|---|---|---|
| USDA | Schools and Roads—Grants to Counties | 0 |
| USDA | Community Facilities Loans and Grants | 36,800,000 |
| USDA | Water and Waste Disposal Loans and Grants (Section 306C) | 489,100,000 |
| USDA | Water and Waste Disposal Systems for Rural Communities | 0 |
| USDA | Emergency Community Water Assistance Grants | 13,000,000 |
| USDA | Technical Assistance and Training Grants | 19,500,000 |
| USDA | Grant Program to Establish a Fund for Financing Water and Waste Water Projects | 500,000 |
| USDA | Solid Waste Management Grants | 3,400,000 |
| USDA | Value Added Producer Grants | 19,400,000 |
| USDA | Biobased Products and Bioenergy Program | 2,000,000 |
| USDA | Agriculture Innovation Center | 0 |
| USDA | Small Socially-Disadvantaged Producer Grants | 3,500,000 |
| USDA | Intermediary Re-lending | 8,500,000 |
| USDA | Business and Industry Loans | 52,900,000 |
| USDA | Rural Business Enterprise Grants | 38,700,000 |
| USDA | Rural Cooperative Development Grants | 8,300,000 |
| USDA | Rural Business Opportunity Grants | 2,500,000 |
| USDA | Rural Economic Development Loans and Grants | 0 |
| USDA | Biorefinery Assistance Program | 245,000,000 |
| USDA | Rural Energy for America Program | 99,400,000 |
| USDA | Rural Microentrepreneur Assistance Program | 9,000,000 |
| HUD | Community Development Block Grant (CDBG)/Entitlement Grants | 2,760,223,970 |
| HUD | CDBG/Special Purpose/Insular Areas | 6,930,000 |
| HUD | CDBG/States | 1,176,594,747 |
| HUD | CDBG/Non-entitlement CDBG Grants in Hawaii | 5,791,797 |
| HUD | CDBG/Brownfields Economic Development Initiative | 17,500,000 |
| HUD | CDBG/Section 108 Loan Guarantees | 6,000,000 |
| HUD | Section 4 Capacity Building for Affordable Housing and Community Development | 50,000,000 |
| HUD | Rural Innovation Fund | 25,000,000 |
| HUD | CDBG Disaster Recovery Grants | 100,000,000 |
| HUD | Indian CDBG | 65,000,000 |
| HUD | Hispanic Serving Institutions Assisting Communities | 6,250,000 |
| HUD | Alaska Native/Native Hawaiian Institutions Assisting Communities | 3,265,000 |
| HUD | Sustainable Communities Regional Planning Grant Program | 98,000,000 |
| HUD | Community Challenge Planning Grant Program | 40,000,000 |
| SBA[b] | 8(a) Business Development Program | 56,817,000 |
| SBA | 7(j) Technical Assistance | 3,400,000 |

| Agency | Program Name | FY 2010 Funding[a] |
|---|---|---|
| SBA | Procurement Assistance to Small Businesses | 3,164,000 |
| SBA | Small Business Investment Companies | 24,262,000 |
| SBA | 7(a) Loan Program | 95,090,000 |
| SBA | Surety Bond Guarantee Program | 1,000,000 |
| SBA | SCORE | 7,000,000 |
| SBA | Small Business Development Centers | 113,000,000 |
| SBA | 504 Loan Program | 36,232,000 |
| SBA | Women's Business Centers | 14,000,000 |
| SBA | Veterans' Businesses Outreach Centers | 2,500,000 |
| SBA | Microloan Program | 25,315,000 |
| SBA | PRIME | 8,000,000 |
| SBA | New Markets Venture Capital Program | 0 |
| SBA | 7(a) Export Loan Guarantees | 0 |
| SBA | HUBZone | 2,200,000 |
| SBA | Small Business Technology Transfer Program | 0 |
| SBA | Small Business Innovation Research Program | 0 |
| SBA | Federal and State Technology Partnership Program | 2,000,000 |
| | **Grand Total** | **$6,238,641,707** |

Source: GAO analysis of information from Commerce, HUD, SBA, and USDA.

[a]According to agency officials, the programs listed above that did not receive funding in fiscal year 2010 are still active programs and are denoted with "0."

[b]SBA officials provided revised fiscal year 2010 funding figures for 18 of their 19 economic development programs since their original submission to us in December 2010.

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