

option) with respect to any period during the month in which the individual refused, subject to good cause and other exceptions determined by the State. These exceptions include the statutory exception for single custodial parents of children under the age of six who cannot obtain needed child care, which is included in the regulations at § 261.15. The State also has the option to terminate the case.

In addition to the child care exception, each State may establish its own criteria for determining when not to impose a penalty on an individual, that is, when an individual has "good cause" for not engaging in work. States may also establish other rules governing penalties as needed.

Under the Family Violence Option, a State may waive work requirements in cases where compliance would make it difficult for an individual to escape domestic violence or would unfairly penalize individuals who are or have been victimized by such violence or individuals who are at risk of abuse. The State must determine that the individual receiving the program waiver has good cause for failing to engage in work.

The final regulations include a cross-reference to the State penalty for failure to impose sanctions in accordance with section 407(e) of the Act (at § 261.54). We added this reference for the convenience of the reader; it does not represent an additional requirement.

*Comment:* We received many comments urging us to change the language of the regulations concerning the pro rata reduction of a recipient's assistance. The commenters thought that the way in which we paraphrased the statute altered its meaning and excluded certain types of pro rata reductions. Most urged us to clarify that a State can make a pro rata reduction based on any reasonable method; some asked us to indicate that a pro rata reduction is based on the head-of-household's share of assistance or on the share of those refusing to work. A few commenters also noted that States should have the flexibility to define the timeframe for applying a pro rata reduction. Several commenters suggested that the NPRM inappropriately restricted a State's ability to impose a greater penalty.

*Response:* We recognize that the language we used in the NPRM may have caused confusion concerning the meaning of a pro rata reduction, and we have modified the regulations to reflect the statutory language more closely. It was not our intention to prescribe one method of proration or to proscribe other legitimate methods; a State may

make a pro rata reduction based on any reasonable method. With respect to imposing a greater penalty, we think that the NPRM's regulatory text and preamble were very clear that a State could impose a penalty greater than a pro rata reduction, up to and including terminating the case, and thus have not substantially altered the regulations in that regard.

*Comment:* One commenter, concerned about the burden on caseworkers of tracking an individual's participation, urged us to establish specific, fixed penalties on an individual for certain periods of time for refusal to work. The commenter gave an example of reducing the grant by the individual's share for the first month of refusal and gradually increasing it.

*Response:* As we indicated above, a State may establish any method of pro rata reduction that it chooses that comports with section 407(e) of the Act. Since we do not intend to dictate one proration method over another, it would not be appropriate to adopt the penalty scheme that the commenter suggests.

*Comment:* Several commenters expressed the same concern in this section that they did in § 261.13 regarding the applicability of employment protections to welfare recipients. They urged us to ensure that good cause exceptions in this section protect recipients from penalty where the individual refused to work due to a violation of employment laws, such as sexual harassment or other forms of job discrimination. Others urged us to provide guidance about appropriate good cause exceptions.

*Response:* States have the flexibility to define "good cause" as they deem appropriate. Because of the States' extensive experience in this area, we think it is not necessary to provide specific guidance regarding what good cause exceptions a State should acknowledge. However, we have included a new regulatory section at § 260.35 to reference employment protections under other laws that apply to working welfare recipients. We certainly agree that welfare recipients should not have to choose between unsafe or discriminatory working conditions and losing benefits, especially where there are protections under Federal law.

*Comment:* A commenter urged us to exempt from the work requirements any foster parents with birth children in the home.

*Response:* The statute does not provide for an exemption from the work requirements for such individuals; however, States may define "good cause" as they find appropriate. Since

the statute specifically gives States the authority to establish good cause and other exceptions, we do not intend to dictate specific good cause criteria, other than the child care exception provided for at section 407(e)(2).

*Section 261.15—Can a Family Be Penalized if a Parent Refuses To Work Because He or She Cannot Find Child Care? (§ 271.15 of the NPRM)*

A State may not reduce or terminate assistance to a single custodial parent caring for a child under age six for refusing to engage in required work, if the parent demonstrates an inability (as determined by the State) to obtain needed child care. This exception applies to penalties the State imposes for refusal to engage in work in accordance with either section 407 or section 402(a)(1)(A)(ii) of the Act. The parent's demonstrated inability must be for one of the following reasons:

- Appropriate child care within a reasonable distance from the individual's home or work site is unavailable;
- Informal child care by a relative or under other arrangements is unavailable or unsuitable; or
- Appropriate and affordable formal child care arrangements are unavailable.

This penalty exception underscores the pivotal role of child care in supporting work and also recognizes that the lack of appropriate, affordable child care can create unacceptable hardships for children and families.

We have substantially modified this section of the regulations, in part by moving much of what constituted § 271.15 under the NPRM to a new section, § 261.56. This new section specifies the State's responsibilities in carrying out the penalty exception, while § 261.15 describes the impact of the provision on the individual. We have also moved the State penalty provision associated with this child care exception (formerly § 274.20) to a newly created § 261.57. Our intent in making these changes is to preserve the informational and contextual nature of subpart A of part 261 and to make the State's responsibilities and the possible penalty associated with them easier to follow. In this section of the rule, we have added cross-references to these two new sections for clarity.

Readers can find all comments associated with this exemption in the preamble discussion for § 261.56.

*Section 261.16—Does the Imposition of a Penalty Affect an Individual's Work Requirement? (§ 271.16 of the NPRM)*

Section 408(c) of the Act, as amended by section 5001(h) of Pub. L. 105-33,

clarifies that penalties against recipients under TANF "shall not be construed to be a reduction in any wage paid to the individual." In the NPRM, we indicated that imposing such a penalty does not require the State to reduce the number of hours of work required, as it would otherwise do if the individual's wages decreased, due to the provisions of the Fair Labor Standards Act.

In the final rule, we have modified this section of the regulations to reflect the statutory language more precisely. This change does not signify any shift in our interpretation of the provision: we continue to believe that Congress intended to permit a State to sanction an individual who is subject to the Fair Labor Standards Act (FLSA) without also being forced to reduce the individual's required hours of work. FLSA requirements, including the Federal minimum wage, apply to any welfare recipients that meet the broad definition of "employees" under that law, which includes participants in many work activities. By indicating that a penalty does not reduce the individual's wages, the State does not need to recalculate hours of work subject to FLSA. A State is, of course, free to decide to reduce the work hours of a sanctioned individual or to reassign the individual to activities that are not subject to FLSA.

In addition to the comments described below, we received several comments expressing support for the inclusion of this provision in the regulations. Others indicated that some readers were confused by the intent of this section; we hope the explanation above and the change in the regulatory text have reduced this confusion.

*Comment:* Some commenters urged us to delete the last clause in § 271.16 of the NPRM, which indicated that a penalty would not result in a reduction in the number of hours of required work. Others asked us to substitute the word "participation" for the word "work" in that clause.

*Response:* We have removed the last clause from the regulation because we did not want to preclude a State from reducing an individual's hours of work.

*Comment:* Some commenters thought this provision would act as an incentive for States to penalize recipients to avoid the minimum wage requirements and urged us to monitor sanctions under this provision by collecting data on State sanctions. Another commenter inquired whether this provision applied where the penalty is disqualification of the individual from the program, such as for an intentional program violation.

*Response:* The commenters seem to be suggesting that a State would have an

incentive to penalize a recipient because this provision prevents the State from considering the penalty to be a reduction in wages and therefore it could engage the recipient in hours of work for which he or she is not compensated. We do not agree. An individual's hours of work are established in accordance with the FLSA based on the benefits the family receives, long before and independent of the sanctioning process. The State may only impose a work sanction for failure to engage in required work. If an individual thinks that the State has penalized him or her inappropriately, he or she has recourse to appeal the sanction decision; section 402(a)(1)(B)(iii) of the Act requires the State to provide opportunities for recipients who have been adversely affected to be heard in a State administrative or appeal process.

With respect to monitoring sanctions and application of this provision, readers should understand that no individual is sanctioned "under this provision"; rather, this provision applies to any recipient who is sanctioned. Thus, no sanctioned recipient is considered to have had a reduction in wages as a result of the penalty.

Readers should also note that we have improved the information we are collecting about sanctions and should refer to Appendix A for further discussion of these data requirements.

*Comment:* Some commenters urged us to clarify that a penalty against a family is not a reduction in assistance or other payments. They thought the phrase "reduction in any wage paid to the individual" raised doubt about this point. One commenter specified that States should be relieved of FLSA liability regardless of whether the individual is in a wage or nonwage work assignment.

*Response:* We think the language of the provision is clear and does not need further interpretation. As we indicated above, the FLSA requirements apply to any welfare beneficiaries that meet the broad definition of "employees" under that law; thus, the term "wage" is the appropriate one to use.

*Comment:* One commenter thought we should specifically state that the FLSA does not apply where the State has sanctioned an individual, so as to protect a State from reducing an individual's hours out of fear of violating the FLSA to the point where he or she would no longer count toward the participation rate. As an alternative, the commenter suggested that we deem an individual's hours of work, as determined by the FLSA, as

automatically meeting the work requirement or give States broader authority to include the value of other benefits when calculating an individual's work obligation.

*Response:* Because the FLSA includes other provisions not affected by this provision, it would not be accurate to state that the FLSA does not apply. We think the regulatory language explains the interaction of the FLSA and this provision adequately. Regarding the commenter's suggested alternative, the statute is very clear about the number of hours an individual must be engaged in work to count toward the participation rate (see subpart B). Regarding the comment suggesting broad authority for a State to include other benefits in calculating an individual's work obligation, this matter is governed by the FLSA and thus is outside the scope of these regulations.

*Comment:* One commenter urged us to clarify that, although a sanction would not result in a reduction in the number of required hours of work, it might result in a reduction in certain activities, in order to comply with Federal, State and local labor laws.

*Response:* As we have indicated, this provision is intended to avoid forcing a State to reduce the hours an individual must work because his or her benefits decreased as a result of a penalty imposed under TANF, as it would otherwise have to do in accordance with Federal labor law. If the State chooses to reduce the individual's hours of work, or to shift the individual to other appropriate activities, it has the flexibility to do so. If there are State or local labor laws that restrict the State's actions in this area, it is the State's responsibility to adhere to applicable laws.

#### *Subpart B—What Are the Provisions Addressing State Accountability?*

##### *Section 261.20—How Will We Hold a State Accountable for Achieving the Work Objectives of TANF? (§ 271.20 of the NPRM)*

Work is the cornerstone of welfare reform. Research has demonstrated that early connection to the labor force helps welfare recipients make important steps toward self-sufficiency. The rigorous work participation requirements embodied in the legislation provide strong incentives to States to concentrate their resources in this crucial area.

This summary section makes the legislation's focus on work and the requirements for work clear, while other sections address each of these areas in more detail.

This section describes what a State must do to meet the overall and two-parent work participation rates. It explains that a State must submit data to allow us to measure each State's success with the work participation rates. It notes that a State meeting the minimum rates will have a reduced MOE requirement, while a State failing to meet them risks a financial penalty.

We received only one comment relating to this section alone.

*Comment:* Regarding the reference to data that a State must submit for us to calculate the participation rates, the commenter contended that the process for calculating the participation rates is too complicated. As an alternative the commenter suggested that a State should calculate its own participation rate, which we should then review.

*Response:* Section 411(a) of the Act requires States to report to us various data necessary to calculate the participation rates. Therefore, we think that it is clear that Congress intended us to make the calculations of the participation rates and gives us the authority to specify the data elements we need. As we have done prior to the publication of final regulations, we will continue to work in partnership with States to ensure that data are accurate and correctly portray their participation rates.

*Section 261.21—What Overall Work Rate Must a State Meet? (§ 271.21 of the NPRM)*

Section 407(a) of the Act establishes two minimum participation rates that a State must meet beginning with FY 1997.

The first, the overall work rate, is the percentage of all families receiving assistance who must participate in work activities by fiscal year. This section lists the statutory overall participation rate that applies to each fiscal year.

The second is the work rate for two-parent families, which we address at §§ 261.23 and 261.24.

We received no comments concerning this section.

*Section 261.22—How Will We Determine a State's Overall Work Rate? (§ 271.22 of the NPRM)*

This section of the regulation restates in clear terms the participation rate calculation specified in the statute. In particular, without changing its meaning, we have phrased the denominator in a way that we think is easier to understand than the statutory language.

We received many requests for guidance concerning how, for purposes of the participation rates, we treat a

family that the State exempts from work requirements.

A State has the flexibility to establish any exemptions it chooses; however, with two exceptions (discussed below), the legislation offers no room to remove categories of recipients from the denominator, as prior law did. PRWORA embodies the views that: (1) Work is the best way to achieve independence; and (2) each individual should participate to his or her greatest ability. As waiver projects have demonstrated, innovative State programs can often find meaningful ways for nearly every recipient to participate in work-related activities. Therefore, the statute and the regulation require nearly all families to be included in the calculation of the participation rates.

The two exceptions to this requirement are certain families that are subject to a penalty and, at State option, families in which a single custodial parent is caring for a child under 12 months of age. When directed by the State's reported data to do so, we will disregard from the calculation for a month—that is, not include in either the numerator or the denominator—families: (1) Receiving assistance that are subject to a penalty for refusing to engage in work required in accordance with section 407 of the Act, but that have not been subject to a penalty for more than three of the last 12 months; and (2) in which a single custodial parent is caring for a child under one year of age. The latter exception is limited by statute to a maximum of 12 months for any parent. Although the first exception is not a State option under the statute, a State may choose to include a sanctioned family in the rate even though it has been subject to a penalty for three or fewer months in the last 12 because the family is nevertheless working enough hours to count toward the participation rate. In such a situation, we would include the family in both the numerator and denominator of the calculation.

The policy described above with respect to families subject to a penalty is slightly different from that of the NPRM. We are removing "excepted" families from the entire calculation, rather than just the denominator. We have made this change after reexamining Congressional intent. We think it unlikely that very many individuals would have been subject to a sanction while still working sufficient hours to count in the numerator, but we believe it would not be consistent with Congressional intent to permit inclusion in the numerator but not in the denominator. By creating the exception

to inclusion in the denominator, Congress intended to avoid penalizing a State when it tries to get a nonparticipating individual to participate. However, Congress did not intend to create an advantage for such a State by allowing "excepted" individuals to be included in the numerator when they were not in the denominator. Therefore, if a State wishes to count a family in the numerator, that family must also appear in the denominator.

The regulation makes clear that a State may count as a month of participation any partial months of assistance, if, in each full week of assistance in that month, an adult in the family is engaged in work for the minimum weekly average number of hours. These families are already included in the denominator since they are recipients of assistance in that month.

This provision ensures that a State receives credit for its efforts in the first and last months that a family receives assistance. Without it, a State would have an inadvertent incentive to start and end assistance as close as possible to the beginning of the month, rather than as families need it. We think that measuring work in full weeks of assistance during a partial month is consistent with the spirit of PRWORA. We have established the same policy for partial months of assistance under the two-parent rate at § 261.24.

In the preamble to the proposed regulation for this section, we included a significant discussion about the relationship among waivers granted under the Family Violence Option (FVO), work participation rates, and a State's access to penalty forgiveness under "reasonable cause." We recognized that there were circumstances under which a State should and would temporarily waive work requirements for domestic violence victims. Two questions we considered were: (1) How such waivers would affect the calculation of the participation rates; and (2) how they would affect a State's penalty liability.

As we discussed earlier in the preamble, instead of changing the basic calculation of the work participation rates, we chose to address this situation through our penalty liability determinations. We chose this targeted approach so as not to provide blanket exemptions for those who have ever suffered domestic violence, but instead to provide appropriate protections and supports for TANF recipients who need them.

Because of the nature of the comments we received on the domestic

violence provisions in the proposed rule, we decided to consolidate the discussion of those comments in the preamble and to consolidate the regulatory provisions in a new subpart B of part 260. You can find the consolidated preamble discussion in the earlier section entitled "Treatment of Domestic Violence Victims."

As the result of the comments and the changes we made to part 260 of the rule, we have also revised the language that was proposed at § 271.52(b)(1). Under the revised language, we no longer define the criteria for "reasonable cause" related to federally recognized domestic violence waivers in this section, but cross-reference the regulatory provisions in part 260. Also, we have added language to § 261.52 indicating we would take waivers of work requirements granted under subpart B of part 260 into account in deciding if a State is eligible for a penalty reduction based on the degree of its noncompliance. Please see § 261.52 for further discussion of these issues.

We received many comments concerning our proposal to redefine "family" to include in the participation rate any families the State has excluded (based on defining a family as "child-only") for the purpose of avoiding a penalty. We have removed this provision from this section, as well as from § 261.24 describing the two-parent participation rate. Please refer to the earlier preamble discussion in the section entitled "Child-Only Cases" for further discussion of this decision and the comments that relate to it.

*Comment:* One commenter thought that the overall participation rate as we described it in this section could be interpreted as either having a State average the 12 monthly rates or calculate a weighted average, taking caseload size into account.

*Response:* The statute does not provide for a weighted average in calculating the participation rates; rather, it specifically states that the annual rate is the average of the State's monthly rates for the fiscal year. Moreover, readers should understand that States are not responsible for calculating the participation rates. We calculate the rates based on the data that States report to us. For further discussion of the required data and reporting provisions, please refer to part 265 of this chapter.

*Comment:* Several commenters suggested that we exclude certain groups of individuals from the participation rate, in addition to those specified in the regulations. In particular, various commenters urged us to remove from the rate calculation:

women in the third trimester of a pregnancy; cases that include a child and a grandparent who is over 60 years of age; families not receiving cash assistance; individuals working for employers that engage in discriminatory conduct; cases engaged in federally mandated administrative reviews prior to a sanction; and individuals who have received assistance for fewer than 60 days and therefore are not required to participate. Another commenter agreed with our statement that States should establish whatever exemptions they choose, but thought those State-exempted individuals should be removed from the rate calculation.

*Response:* As we indicated in the NPRM and the above discussion, we believe the statute is very clear regarding the calculation of the participation rates and does not give us the flexibility to exclude additional categories of individuals from the calculations. The participation rates are written in terms of "families receiving assistance" that include an adult, thus we could not limit the rates to those receiving cash assistance. (For further discussion of the definition of assistance, please refer to § 260.30 of this chapter.)

Concerning individuals in work activities where the employer engages in discriminatory conduct, again, we do not think we have the latitude to remove such families from the denominator; however, we fully expect States to conduct programs that are lawful and uphold employment laws that apply to working welfare recipients. Please refer to the section entitled "Recipient and Worker Protections" for a more detailed discussion of this issue.

It is not entirely clear to us what the commenter means by "federally mandated administrative review process prior to being placed in sanction." There is no longer a federally mandated conciliation process, as there was under the JOBS program. It is possible that the commenter is referring to the provision at section 402(a)(1)(B)(iii) of the Act, requiring an explanation in the State plan of how the State will provide opportunities for recipients who have been adversely affected to be heard in a State administrative or appeal process. If so, recipients appealing an adverse action may already be under a sanction and therefore would not be included in the rate, if they have not been subject to one for more than three months in the last 12. Further, there is nothing in the statute to suggest that State administrative or appeal process should be lengthy; on the contrary, we hope States will establish expedited processes, in the interests of both the

families and the State. We think there is neither the need nor the authority to remove such families from the participation rates.

Regarding the commenter's concern that individuals are not required to participate in work activities until they have received 60 days of assistance, the commenter is confusing the requirement on individuals to work with the requirement on States to achieve certain participation rates. Although the activities may be the same, they are separate requirements under the law. Please refer to the discussion at § 261.10 for further explanation of this distinction.

The statute is clear in giving a State the flexibility to establish "such good cause and other exceptions" as it chooses, but does not remove those with good cause exceptions from the rate calculations. We encourage States to adopt fair and practical good cause exceptions. While we understand the commenter's concern that a State has no incentive to create good cause exceptions if the excepted families remain in the denominator, it is worth noting that the overall participation rate leaves room to grant good cause exceptions under a variety of different circumstances.

*Comment:* A commenter suggested that there should be follow-up on individuals for three months following employment and that such individuals should be included in the participation rate as an incentive to States to find employment for recipients. The commenter stated that currently individuals are not included in the rate once they become employed.

*Response:* Neither the statute nor the regulations excludes employed recipients from the participation rate, as long as they are still actually receiving TANF assistance. In fact, unsubsidized employment is the first work activity that permits TANF recipients to be considered "engaged in work" and other forms of employment immediately follow it. Moreover, recognizing that the participation rate calculations did not give States credit for those who became employed and left the welfare rolls, Congress created a "caseload reduction credit" for that purpose. (See subpart D for discussion of the Caseload Reduction Credit.)

We do require States to collect data on families no longer receiving assistance (please refer to § 265.3), but we believe it is burdensome and impractical to require all States to follow such families for any period of time. We do agree that this is important information in understanding the effect of the TANF program and encourage States to

conduct follow-up studies where possible. Also, we have designed the initial high performance bonus system to give us follow-up information on the employment of recipients without imposing a substantial new burden on State TANF agencies.

*Comment:* One commenter stated that the denominator of the participation rate changes daily and that we need a standardized formula to allow programs to meet their goals. Another asked whether the rate is calculated based on a sample or the universe of cases, suggesting that the universe was preferable where feasible.

*Response:* While the denominator of the participation rate can change from month to month, States will have ongoing access to information about their caseloads, which should enable them to adjust for shifts in the number and types of cases. The participation rates are based on monthly data of families receiving assistance that include an adult. Therefore, a family that receives assistance for even one day in a month contributes to the total number of families receiving assistance in that month. We think the participation rate calculations are quite clear. However, we have incorporated some opportunities in the penalty relief provisions to consider a State's special circumstances. For example, in reducing the work participation penalty, the final rule adds a new adjustment factor that could help States that substantially increase the number of participants, but fail the participation rate because they are experiencing significant caseload increases.

Regarding whether a State should report the universe of caseload data, § 265.5 permits a State to report participation and other data for the universe or a sample of cases and outlines acceptable sampling methods. States should weigh the advantages and disadvantages of sampling and make their own decisions about whether to report on a universe or sample basis.

*Comment:* One commenter urged modifying the regulations to ensure that, if one parent in a two-parent family is subject to a penalty but the other parent continues to work the minimum hours required for the overall participation rate, the family should count toward the overall rate. If the second parent subsequently is subject to a penalty, the commenter thought we should measure the months of sanction in the last 12 months separately for each parent, thus maximizing the time a family would be excluded from one or both participation rates.

*Response:* First, we think it is clear in both the statute and these regulations

that families, and not individuals, are subject to penalties. The State has the flexibility to determine the amount of the penalty, up to and including terminating the case, but must impose a penalty that is at least a pro rata reduction of the family's assistance (see § 261.14 for further discussion of pro rata reductions). Thus, we would look at whether the family, not the individual, is a sanction case.

If the family continues to receive assistance and meets the standard for being "engaged in work" under the overall rate while being sanctioned, as it would in the commenter's example, then the State may choose to count that family in the numerator and denominator of the calculation. However, since it is a family and not an individual that is subject to a penalty, should the other parent subsequently refuse to work and the State take action, it would simply be a second sanction for the family and does not call for separate tracking for purposes of calculating the denominator.

*Comment:* One commenter objected to the fact that two-parent families are counted twice, once in the two-parent participation rate, and once as part of the overall rate. The commenter thought that two-parent families should be counted only in their own rate.

*Response:* The composition of the overall participation rate is statutory. The two-parent rate measures State success with that sub-population, while the overall rate measures success with the entire caseload of families that include an adult.

*Comment:* Several commenters expressed support of the provision excluding a single custodial parent caring for a child under 12 months of age from the participation rate calculation. However, some commenters thought that we should not tie the exclusion from the rate to whether the State has adopted the option not to require the parent to engage in work. In essence, they argue that there are two separate decisions: whether to require the parent to work and whether to exclude the parent from the rate. Others questioned whether this provision allows for a one-time exclusion of up to 12 months or whether the parent could be excluded again should he or she be caring for another child under one year old.

*Response:* Based on the comments and after reexamining the statutory provision, we agree that we need not link the State's option not to require a single custodial parent of a child under 1 to work to the exclusion of such parents from the rate calculations. The State can make separate decisions about

exempting and excluding a family from its rate. The statute describes a certain individual, that is, "a single custodial parent caring for a child who has not attained 12 months of age" and then separately indicates that "such an individual" may be disregarded in calculating the participation rates. We have re-written the regulation to allow disregard of a family with such an individual, since the rates actually measure families and not individuals.

Regarding whether this is a one-time provision or is renewable, the law plainly states that a parent may be disregarded from the rate for not more than 12 months. We interpret this language to mean a cumulative, lifetime limit of 12 months for any single custodial parent, but not necessarily a one-time disregard. Thus, if a parent were disregarded from the rate for four months while caring for one child under a year old, he or she could be disregarded for as much as 8 months with a subsequent baby.

*Comment:* We received many comments in support of the provision to give a State credit for a month of participation if the individual is engaged in work for the minimum average number of hours in each full week the family receives assistance in a partial month; however, some commenters found the provision too narrow to accommodate States that assign an individual to an activity weeks after the beginning of a benefit period. Some urged us to count an individual's time in assessment toward the participation rate. Another suggestion was that we should only consider a month of assistance (partial or full) to begin from the time the individual is assigned to a countable activity. One commenter thought we should only count families in the denominator from the first full month of assistance. One commenter asserted that we should include only recipients, and no applicants, in the participation rate; thus, this provision would affect only partial months following approval of assistance.

*Response:* The law and these regulations permit participation in only 12 specific work activities to count toward the participation rates. (Please refer to subpart C.) While we appreciate the time it takes a State to assess an individual and assign him or her to an activity, we do not have the flexibility to add assessment to the list of allowable activities. By the same token, we cannot simply decide that some period of time for which an individual receives assistance—such as time prior to assignment in a work activity or a partial month of assistance—should not

be considered a period of assistance and therefore exclude the individual's family from the participation rate for that month. On the contrary, if a family receives assistance for any portion of a month, then we must include the family in the denominator of the participation rate for that month, subject to the caveat in the paragraph below.

With respect to the assertion that we should not include applicants in the participation rate, we agree that States should not be forced to count individuals in the participation rates while their applications are pending. At the same time, we do not want to deny States that are successful in moving applicants into work activities credit for their efforts. It is for this very reason that we wanted to give States credit in the participation rates for a partial month of assistance where an adult works at a level equivalent to the standard for a full month. Further, under these final rules, we will give States some discretion to decide when a family begins to receive assistance, for the purposes of the participation rates. If a State pays benefits retroactively, i.e., for the period between application and approval, the State would have the option to consider the family to be receiving assistance either during the retroactive period or only during the month of payment.

This comment included an example in which the State "prorated [benefits] from the date of application," even though it did not approve the application until about four weeks later. Each State has some flexibility to decide when benefits begin; in this example, the State chose the date of application. The statute is unclear whether receipt of assistance for a prior period is assistance in that prior month or only during the month of payment. Thus, when a State chooses to pay retroactively back to the date of application, it has the option to choose whether the recipient is receiving assistance during the month or part of the month covered by the retroactive payment. Because many States require applicants to engage in some form of work, such as job search, this partial month provision should prove to be an advantage for States that pay benefits retroactively for the application period.

**Section 261.23—What Two-Parent Work Rate Must a State Meet? (§ 271.23 of the NPRM)**

As in § 261.21, this section restates the minimum work participation rates for two-parent families established in the statute.

As States are aware, the two-parent participation rate increases sharply.

Congress has high expectations that States will help the vast majority of adults in two-parent families find jobs or participate in other work activities. We note that most States had difficulty meeting the less ambitious JOBS participation rates for unemployed parent families (UPs), the primary two-parent cases under AFDC, and about half the States subject to the rates in FY 1997 failed the two-parent TANF participation rate. For several reasons, the new rates under TANF are much more demanding than they were under JOBS. First, the TANF rate is a "two-parent" rate, not a rate just for UPs. Secondly, the denominator includes much more of the caseload; it recognizes many fewer exemptions. Finally, PRWORA lifted the restrictions on providing assistance to two-parent families. Thus, in some States, many more two-parent families could be eligible for assistance and subject to the work requirements than under prior law.

We strongly encourage each State to consider carefully what it must do to get two-parent families working. In some cases, States may need to make substantial changes to their program designs. In the first few years of operating TANF, the participation rates are at their lowest and caseload reduction credits may significantly reduce the minimum required rates. We think it is important for States to capitalize on this initial period to invest in program designs that will allow them to achieve the higher participation rates in effect in later years. We intend to assist States in this endeavor through technical assistance and by sharing promising models as they emerge.

We received only one comment relating to this section.

*Comment:* A commenter urged us to eliminate the two-parent participation rate once the two-parent caseload represents less than five percent of a State's overall caseload.

*Response:* We do not have the authority to eliminate the participation requirement related to the two-parent caseload. The statute is very clear about the required minimum rates that States must achieve and the penalty associated with failing to meet participation rates. We have tried to give States some relief with respect to the demanding two-parent participation rate through both the structure of the caseload reduction credit and the penalty reduction provisions. Please refer to subparts D and E for further discussion of these areas.

**Section 261.24—How Will We Determine a State's Two-Parent Work Rate? (§ 271.24 of the NPRM)**

The regulations express the two-parent work participation rate in terms very similar to those we used for the overall rate. Any family that includes a disabled parent is not considered a two-parent family for purposes of the participation rate. Thus, we do not include such a family in the numerator or denominator of the two-parent rate.

It is important to note that, in accordance with the statute, we calculate both participation rates in terms of families, not individuals. Whether we include the family in the numerator depends on the actions of individuals, but an entire family either counts toward the rate or does not. In the case of a two-parent family, whether a family counts may depend on the actions of both parents.

In response to issues raised by the comments, and questions raised by States dealing with interim participation rate calculations, we have added language to the final regulations clarifying what constitutes a two-parent family in the two-parent participation rate calculation. We have found that States had divergent readings of which parents to consider in determining whether a family was a two-parent family. Therefore, we included this provision to ensure greater consistency across States in measuring participation among two-parent families.

The final regulations state that, for the purposes of this calculation, a two-parent family includes, at a minimum, all families with two natural or adoptive parents (of the same minor child) receiving assistance and living in the home, unless both are minors and neither is a head-of-household.

The preamble to the NPRM indicated that providing a noncustodial parent with TANF services need not cause a State to consider the family a two-parent family for the participation rate. This policy has not changed in the final regulations and is consistent with the new definition of a two-parent family. A State may, but is not required to, treat a family in which a noncustodial parent receives TANF assistance as a two-parent family.

As in § 261.22, where States direct us to, we exclude from the participation rate calculation for a month the families that are subject to a penalty for refusing to engage in work required in accordance with section 407 of the Act, but have not been subject to a penalty for more than three of the last 12 months. This is a change from the NPRM, which only excluded them from

the numerator of the calculation. Please refer to the discussion at § 261.22 for an explanation of this change.

Section 408(a)(7) of the Act limits the receipt of Federal TANF assistance to 60 months for any family, unless the family qualifies for a hardship exception or disregard of a month of assistance. (In our discussion of § 264.1, we explain that months of receipt are disregarded when the assistance was received either: (1) by a minor child who was not the head of a household or married to the head of a household; or (2) while an adult lived in Indian country or in an Alaska Native Village with 50 percent or greater unemployment.) We have received inquiries concerning the effect of a time-limit exception or disregard on the participation rates. In fact, the time limit does not have a bearing on the calculation of the participation rate. All families must be included in the participation rate, unless they have been removed from the rate for one of the two work-related exemptions (i.e., the family is subject to a penalty, but has not been sanctioned for more than three of the last 12 months; or the parent is a single custodial parent of a child under one year of age and the State has opted to remove the family from the rate).

We received many of the same comments about the calculation of the two-parent participation rate that we received in connection with the calculation of the overall participation rate. In particular, please refer to the preamble for § 261.22 for discussion of the comments and our responses about excluding groups of recipients from the participation rate and counting partial months of participation.

As we indicated in § 261.22, we have not kept in the final rules our proposal to redefine families to include in the participation rate any families that the State has excluded (based on its defining a family as a child-only family) for the purpose of avoiding a penalty. Please refer to the earlier preamble section entitled "Child-Only Cases" for further discussion of this decision and the comments that relate to it.

*Comment:* One commenter asked what the definition of a two-parent family is and whether it includes a household in which both parents are not available for work. Another commenter stated a family's status as two-parent or not often changes in the course of a month and that, therefore, a family should not be considered a two-parent family in a month in which its status change.

*Response:* We believe that Congress did not intend to exclude from the definition of a two-parent family a

family with two parents receiving assistance, neither of whom is disabled, even if they are "not available for work" or the family's status changed during the month. We interpret the statute to mean that, if a State grants assistance for both parents in a family (and neither is disabled), then it must be considered and reported as a two-parent family. If one parent is coming and going from the family in the month and the State does not provide assistance for that parent, then it seems reasonable not to consider it a two-parent family.

*Comment:* Several commenters noted that the NPRM did not define the term "disabled parent," thus making it unclear which families should be excluded from the two-parent participation rate. Some urged us to leave the definition to States or to define it broadly to accommodate State policy. Others specifically urged defining it to include people who are temporarily disabled or incapacitated.

*Response:* We have not defined the term "disabled parent" in the final regulations so that each State may define the term as it deems appropriate.

*Comment:* Commenters urged removing from the denominator all persons exempt from work requirements based on valid State welfare reform waivers in effect prior to enactment of PRWORA.

*Response:* Please refer to subpart C of part 260 for discussion of how we will treat welfare reform waivers under the participation rates.

*Comment:* One commenter thought that we should remove families that are subject to a penalty from the calculation for the entire duration of a penalty rather than only if they have been in penalty status for less than three of the last 12 months. Alternatively, the commenter thought we should remove such a family if it has been subject to a penalty for less than three months in a fiscal year instead of the preceding 12 months.

*Response:* We do not have the authority to make either of the changes the commenter suggested because the statute is very precise about this provision. It specifies that sanctioned families are removed from the rate, but not if the family has been subject to the penalty for more than three months within the preceding 12-month period.

**Section 261.25—Does a State Include Tribal Families in Calculating These Rates? (§ 271.25 of the NPRM)**

States have the option of including in the participation rates families in the State that are receiving assistance under an approved Tribal family assistance

plan or under a Tribal work program. If the State opts to include such families, they must be included in the denominator as well as the numerator.

*Comment:* A commenter urged that any rewards or bonuses a State receives due to including Tribal participants in the calculations should be shared with the Tribes in question.

*Response:* Nothing in these regulations precludes a State from sharing rewards or bonuses with Tribes; however, we do not have the authority to require a State to do so.

*Comment:* One commenter was confused by our discussion in the preamble to the NPRM. We said that where the State opts to include families receiving assistance under a Tribal TANF or Tribal NEW program, the families must be in the denominator as well as the numerator "where appropriate." The commenter asked us to clarify whether a State is free to include or exclude such families from the numerator and denominator. The commenter also asked us to clarify the standards of participation and activities that applied for a State to count such a Tribal family.

*Response:* A State may, at its option, include or exclude families receiving assistance under a Tribal TANF or Tribal NEW program from the denominator of the State TANF participation rates. To be included in a State participation rate numerator for a month, a family must meet the standards for counting a family in that rate, both with respect to hours of participation and allowable activities. These standards apply whether the family receives assistance under a State TANF program, a Tribal TANF program, or a Tribal NEW program. We realize that many Tribal programs will have different standards of work and different activities, but to count toward a State rate, the family must meet the standards associated with that rate.

We wanted to be clear that, if a State did plan to count a family receiving assistance in a Tribal program, that family had to be included in just the same way that a State TANF family would be included, that is, in the denominator of the rate as well as the numerator. But since inclusion in the numerator is not automatic (because the family must meet the hours of participation in allowable activities), we added the phrase "where appropriate." Since this was confusing, we modified the preamble discussion in the final rules.

*Subpart C—What Are the Work Activities and How Do They Count?*

*Section 261.30—What Are the Work Activities? (§ 271.30 of the NPRM)*

Section 407(d) of the Act specifies the 12 work, training, and education activities in which individuals may participate in order to be “engaged in work” for the purpose of counting toward the work participation rate requirements. Congress did not define these activities further. While some have commonly understood meanings from their use over time or from prior employment and training programs, several of the activities, such as “vocational educational training” and “job readiness assistance,” are subject to interpretation.

In considering whether to provide greater definition of the activities as part of the NPRM, we examined legislative intent and sought the views of a variety of groups on the matter. Most groups urged us to leave further definition to the States. Some urged us to define work activities in ways that fostered education while promoting work, emphasizing the importance of education and training in empowering many recipients to find meaningful employment, let alone to advance. Ultimately, we chose not to define the individual work activities in the NPRM in favor of giving States greater flexibility; we have not changed that position in the final regulations.

Because this flexibility could also be used in ways that do not further Congressional intent, under the data collection requirements at § 265.9, we are requiring each State to provide us with its definitions of work activities for its TANF program and with a description of work activities for any separate State program that requires them. We are concerned that different TANF definitions could affect the vulnerability of States to penalties for failure to meet the participation rate. This data collection will help us determine whether this is in fact a serious problem; to the extent possible, we want to ensure an equitable and level playing field for the States. Over the next several years, we will carefully assess the types of programs and activities States develop and will share the results of our findings. If necessary at some time in the future, we will initiate further regulatory action.

We would also like to remind States about some key research findings from prior welfare-to-work programs. According to the Manpower Demonstration Research Corporation’s publication, *Work First*, the most successful work first programs have

shared some characteristics: a mixed strategy including job search, education and training, and other activities and services; an emphasis on employment in all activities; a strong, consistent message; a commitment of adequate resources to serve the full mandatory population; enforcement of participation requirements; and a cost-conscious management style.

While the most successful programs consistently and strongly emphasize work, the actual program designs recognize and address the critical role education plays in preparing adults for work. As more and more recipients engage in work, State caseloads may reflect higher proportions of the educationally disadvantaged. In combination with other work activities, education may become more important in improving basic communication, analytical, and work-readiness skills of recipients. Thus, States may need to integrate adult basic skills, secondary education, and language training with high-quality, vocational education programs. Such program designs encourage recipients to continue acquiring educational skills necessary for higher-skill, higher-wage jobs.

We encourage States to adopt program designs that take advantage of existing educational opportunities. States may use the statutory flexibility to design programs that promote educational principles by:

- Actively encouraging adults and children to finish high school or its equivalent;
- Expecting family members to attain basic levels of literacy and to supplement their education in order to enhance employment opportunities;
- Encouraging family literacy; and
- Promoting community-based work-related vocational education classes, created in collaboration with employers.

States could also make it easier for individuals to combine school and work. For example, they could develop on-campus community work experience program positions, where child care is also available. They could also encourage schools to use work-study funds for students on welfare and then count the hours worked in those programs toward work requirements.

While we have not regulated the definition of work activities, we want to ensure that recipients and children both experience positive outcomes. This is a particularly significant issue when child care is the work activity. For this to happen, child care arrangements should be well developed, implemented and supported.

Research has found that quality child care is critical to the healthy

development of children and that providers who choose to care for children create more nurturing environments than those who feel they have no choice and are providing care only out of necessity. Thus, States should assess whether recipients have an interest in providing child care before assigning them to this activity.

In addition, States should provide training, supervision and other supports to enhance caregiving skills if they wish recipients to attain self-sufficiency. Such supports, including training in health and safety (e.g., first aid and CPR), nutrition, and child development, would assist the development of both the caregivers and the children in care.

Finally, the stability of child care arrangements affects outcomes for both parents and the children in care. When parents feel comfortable with their child care arrangements, their own participation in the work force becomes more stable. This stability, in turn, fosters emotional security for children. Thus, States should take stability into account when assigning participants to child care as a work activity.

The majority of those who commented on this section of the proposed regulations supported our decision not to define work activities beyond the statutory list. We discuss other comments below.

*Comment:* Several commenters made suggestions about the content of work activities. Some urged us generally to ensure the quality of work activities by establishing minimum standards for the activity and for the provider. Others made suggestions about specific activities, urging us to give guidance or make requirements concerning particular elements of an activity. For example, one commenter thought that vocational educational training should conform to the definition of vocational education in the Carl D. Perkins Vocational Education Act; another suggested discontinuing on-the-job contracts with employers that do not provide long-term employment. In essence, these commenters wanted us to define certain of the activities or ensure that certain activities would be counted as work.

*Response:* We appreciate and share the commenters’ concerns that work activities be designed to meet the needs of recipients and be effective in helping them become self-sufficient. However, we think that the goals and objectives of the legislation will be better served by having each State define the work activities. We believe States will use the flexibility of the statute to formulate a variety of reasonable interpretations leading to greater innovation,



experimentation, and success in helping families become self-sufficient quickly. It is true that States could conceivably include a range of activities that may not enhance work skills or might not be considered valid work experience by potential employers. However, in light of the five-year time limit and the criteria for the high performance bonus, we expect that States will work to establish programs that promote a family's long-term success in the workplace.

*Comment:* One commenter pointed out that we omitted the statute's limitation of the activity of "work experience" to instances where sufficient private-sector employment is not available.

*Response:* We have amended the regulations to reflect the statute's limitation.

*Comment:* A couple of commenters urged us to require that work activities comport with Federal employment laws in order to count for participation. One suggested that we require employers to post appropriate nondiscrimination notices. Another stated that Congress failed to include any provision limiting work activities to work at the minimum wage.

*Response:* We agree fully with the commenters that all TANF work activities should be lawful and should not subject participants to discrimination, unsafe working conditions or other circumstances prohibited by employment law. Nevertheless, we do not think the appropriate way to address the issue is to exclude certain work activities from the participation rate calculation in some States. Adjusting the rates would be administratively cumbersome and not necessarily equitable. As we have discussed earlier in the section of the preamble entitled "Recipient and Workplace Protections," there are other entities, such as the EEOC, DOL and our Office of Civil Rights, that enforce compliance with civil rights and employment laws. Their mechanisms for monitoring and enforcing compliance are not linked to the timing of the participation rate calculation. In other words, a finding of noncompliance that they might issue would not necessarily be available within our timeframes for calculating participation rates. Moreover, even if we did receive timely information about noncompliance with employment requirements, because the participation rates may be based on sample data, it might be very difficult to determine the appropriate adjustments to make to the rates based on such findings.

Given these complications, we have not modified the regulation as the commenters suggest. We think it makes better sense to support the enforcing entities in carrying out their responsibilities. If, over time, we find significant problems that could warrant adjustments within the TANF program, we will consult with States, labor interests, Congress, and other interested parties about the appropriate steps to address these problems.

We have also included a new regulatory section at § 260.35 that addresses employment protections available to TANF recipients. Please refer to the preamble section entitled "Recipient and Workplace Protections" for a discussion of additional comments related to this issue.

We have addressed the Fair Labor Standards Act (FLSA) at § 260.35 of the final rule, in the preamble to § 261.16, and in the preamble discussion entitled "Recipient and Workplace Protections." Please refer to those preamble sections for further discussion of the application of FLSA, including the minimum wage requirement, to TANF work activities.

*Comment:* We received support from a number of commenters for the discussion of the importance of education to TANF recipients that we included in the preamble to the NPRM. In response, we have repeated much of that discussion in this preamble to the final rule. We also received support for our guidance concerning the provision of child care as a work activity.

A couple of commenters urged us to incorporate that discussion, particularly our program design suggestions, into the text of the regulation itself. They argued that States would not create broader activities that combine work and education unless we specifically regulated in this area. Similarly, one commenter urged us to specify that we would not penalize a State for including a range of educational activities, from literacy programs through post-secondary education, in its definitions of work activities.

One commenter thought the proposed rule did not truly support the integration of work and education because it allowed each State to define the work activities. Instead, the commenter urged us to provide definitions that guide States in integrating work and education.

*Response:* We have not included our discussion of program designs within the text of the regulation. That discussion is intended to spark creative thinking about State choices in implementing TANF, rather than to prescribe a particular design for all States. It is also intended to underscore

the important role we think education can play in TANF.

We have not included the kind of blanket statement the commenter suggests absolving States of any potential penalty liability for including a wide array of educational components in its work definitions. There are statutory limits on counting educational activities in the participation rates; a State that exceeded those limits could be subject to a penalty. Readers should refer to § 261.33 for a discussion of the limits on counting participation in educational activities in the participation rates.

As we indicated above, we have opted not to define the work activities to a greater degree than the statute does. We think that the preamble discussion gives States ample suggestions of ways to integrate education with work activities. We are also available to work with any State and its education community to help them design programs that will meet their particular needs.

*Comment:* One commenter stated that there is no provision to count participants in a GED program, adult basic education or English as a Second Language (ESL) in the participation rates and urged making them countable work activities. Another commenter urged adding a basic skills "refresher" course for those already holding a GED. A third commenter encouraged us to include student internships as a work activity.

*Response:* While we have no authority to add to the list of 12 work activities, a State could provide the education programs described in the first two comments under the existing activities. In particular, we point out that GED is explicitly part of the eleventh activity: "satisfactory attendance at secondary school or in a course of study leading to a certificate of general equivalence for a recipient who has not received a high school diploma or a certificate of high school equivalency." Similarly, student internships, depending on their content, may well meet a State's definition of one or another of its work activities. We would be glad to provide technical assistance to a State that has questions about incorporating activities such as these into its program design.

*Comment:* One commenter urged us to require States to include vocational educational training among their work activities.

*Response:* We understand the commenter's interest in seeing that recipients have the opportunity to enroll in training programs that will give them the skills to qualify for and keep higher paying jobs; however, we do not have

the authority to require a State to provide any specific work component.

*Comment:* One commenter expressed support for the development of micro-enterprises and other forms of self-employment, particularly in rural settings. The commenter urged increasing flexibility in this area by counting the period necessary to develop a business as participation.

*Response:* Again, the State has the flexibility to design and define work activities that meet the needs of its caseload, including creating a micro-enterprise development program. It is unclear from the comment precisely what activities the commenter believes should be considered work that are excluded either by statute or by a State's policies. We agree that any legitimate hours of work in the development of a business could contribute to the participation rate; however, for example, if the recipient is waiting for a loan approval, but not otherwise participating, it hardly seems reasonable to count that time as participation. The fact that something has value or is integral to a countable activity does not necessarily mean it can count as participation. We would be happy to work with States that would like technical assistance in this area.

*Comment:* One commenter expressed support for the requirement that a State provide us with its work definitions, citing its value for research into effective employment-related services. Another commenter objected to this requirement, maintaining that States must already submit this information as part of the State TANF plans.

*Response:* We think it is important to know how States are defining the activities because of the implications they have for penalties. We want to ensure that we enforce the requirements of TANF in a way that is as equitable to States as possible. We also agree that the definitions will help with research into effective program designs. We think it is reasonable to collect these definitions as an annual addendum to other data collection. Unfortunately, the TANF State plans do not necessarily include a State's work activity definitions. However, we have revised the reporting requirements at § 265.9(d) to allow a State that included such information in its plan to reference the plan or attach the appropriate plan pages.

*Comment:* One commenter objected to "such a restricted list of countable work activities" protesting that low-grant States will not be able to make use of several of the components because recipients will have too much income to continue receiving assistance. The

commenter also stated that low-grant States will be adversely affected by the minimum wage requirements of the Fair Labor Standards Act (FLSA).

*Response:* States must weigh carefully their decisions about grant amounts and earnings disregards as they formulate State policy. The commenter is correct that a State's benefit rules may have implications for its participation rates, as well as for a family's time limit and for State budgets. However, these are largely matters of State discretion; the regulations reflect the statutory work activities. Readers should refer to the preamble at § 261.16 for a more detailed discussion of the FLSA and its effect on TANF work activities.

**Section 261.31—How Many Hours Must an Individual Participate To Count in the Numerator of the Overall Rate? (§ 271.31 of the NPRM)**

Section 407(c) of the Act specifies the minimum hours an individual must participate to count in the State's overall participation rate calculation. There are two related requirements. First, there is a minimum average number of hours per week for which a recipient must be engaged in work activities. The average weekly hours are reflected in the following table:

If the fiscal year is:	Then the minimum average hours per week is:
1997 .....	20
1998 .....	20
1999 .....	25
2000 or thereafter .....	30

Second, the law requires that at least an average of 20 hours per week of the minimum average must be attributable to certain specific activities. These activities are:

- Unsubsidized employment;
- Subsidized private-sector employment;
- Subsidized public-sector employment;
- Work experience;
- On-the-job training;
- Job search and job readiness assistance for no more than four consecutive weeks and up to six weeks total in a year;
- Community service programs;
- Vocational educational training not to exceed 12 months;
- Provision of child care services to an individual who is participating in a community service program.

(Note: the limitation that at least 20 hours come from certain activities does not apply to teen heads of households; however, there

are other limitations related to teen heads of households. Please refer to § 261.33 below.)

After an individual meets the basic level of participation, the following activities may count toward the total work requirement hours of work:

- Job skills training directly related to employment;
- Education directly related to employment for those without a high school diploma or equivalent;
- Satisfactory attendance at a secondary school or GED course for those without a high school diploma or equivalent.

In our consultations prior to drafting the NPRM, several people asked whether a State may average the hours of participation of different recipients to reach the minimum average hours required by the work participation rate, as they could in the JOBS program. PRWORA does not permit combining and averaging the hours of work of different individuals. However, the regulation and the statute permit averaging an individual's weekly work hours over the month to reach the minimum average number of hours per week required for that individual to be engaged in work.

We have reorganized the regulatory text slightly from the way it appeared in the NPRM for the sake of clarity, but this section still paraphrases the statute in simple, understandable terms.

The final regulations do not contain the chart we included in the NPRM depicting which work activities count in the first 20 hours and which count thereafter. We decided the chart no longer added to readers' understanding of the provision since legislative changes simplified the rules and its inclusion disrupted the regulatory text, making the policy more difficult to follow.

*Comment:* We received several comments expressing support for our clarification in the NPRM that a State may average an individual's weekly hours of work over a month. One commenter supported averaging, but without reference to an individual's hours in a month.

*Response:* For clarity, we would like to reiterate that the statute does not permit combining and averaging of hours of work of different individuals in the overall participation rate. Rather, it is an individual's hours of work from different weeks within a month that may be averaged.

*Comment:* Several commenters expressed concern about the effects of the FLSA in restricting the number of hours a State may require an individual to participate in certain work activities,

particularly work experience and community service. They emphasized the importance of these activities to individuals not ready for unsubsidized employment.

Concerned that the FLSA will impede a State's ability to meet the participation rate requirements, some commenters urged us to exempt these activities from the wage and hour requirements of the FLSA.

*Response:* We have no authority to exempt an activity from the requirements of the FLSA. We have tried to explain the basic effect of the requirements on TANF work activities in the preamble to § 261.16, but we urge interested parties to consult the Department of Labor's guidance entitled "How Workplace Laws Apply to Welfare Recipients (May 1997)" for more information. We would also like to point out that States have the option of increasing the amount of a family's grant and thus permitting an individual to engage in more hours of work in accordance with the FLSA. States should weigh policy decisions in this area very carefully; the interrelated effects on participation rates, a family's remaining months under the Federal time limit, and State spending on the TANF program are crucial aspects of TANF program design.

*Comment:* A couple of commenters expressed opposition to separating the work activities into those that count for the first 20 hours and those that count thereafter, questioning the regulation's support for educational attainment despite the preamble's discussion of its importance.

*Response:* The requirement that the three education-based activities can only count for participation after the first 20 hours is a statutory one; thus, we have no authority to alter it. That fact does not change our commitment to education for recipients who need it. We have suggested several possible models for combining education with other activities and stand ready to help States that would like technical assistance in this area.

*Comment:* A commenter urged us to make GED preparation and English as a Second Language (ESL) "stand alone, countable" activities because substantial portions of some State caseloads need basic education and language skills before they can hold even entry-level jobs.

*Response:* Clearly, both GED preparation and ESL fit within the list of 12 work activities enumerated in the statute.

We presume that the commenter's real concern is that the State cannot receive full participation credit for such

educational activities because of the requirement that the first 20 hours of participation be attributable to the noneducational activities. This is a statutory requirement that we have no authority to change in the regulations. We urge States and localities to consider combining work and educational activities where it is appropriate in order to maximize participation credit. Although some individuals will not be able to engage in multiple activities, this could be a viable solution for many recipients.

*Comment:* One commenter, in stressing the importance of education to permanent self-sufficiency, urged us to include time spent on homework and fieldwork when calculating an individual's hours of participation.

*Response:* As we have indicated, it is each State's responsibility to define its work activities in a reasonable manner; thus a State could choose to include homework time as part of an activity. However, we encourage States to consider carefully how Congress intended to treat homework in determining "engaging in work" to ensure that its interpretation is reasonable.

It is unclear to us exactly what the commenter means by "fieldwork"; if this refers to practical, career-based experience within the context of an educational activity, it might meet a State work activity definition. We have spoken to this issue in response to a comment about student internships above in the comments to § 261.30.

*Comment:* A commenter urged us to give partial credit for placing individuals in countable activities for fewer than the minimum average number of hours. For example, if the required hours are 20 and the individual participates for 10 hours per week, the commenter would have us count the case as 0.5 in the participation rate for that month. Another urged us to develop a means of giving a State credit for an individual's participation over a longer period of time than one month.

*Response:* The statute does not provide for counting a portion of a case in the participation rate and measures participation on a monthly basis; either the adult is engaged in work and the family counts in the rate or it does not and is not in the rate.

*Comment:* One commenter urged us to modify this section to include the provisions of § 261.35 or to include a cross-reference to it. That section indicates that we will count a single custodial parent caring for a child under the age of six as engaged in work if the parent participates in work activities for an average of at least 20 hours per week.

*Response:* The language of this section is consistent with the statute and does not need to incorporate the provisions of § 261.35 to take into account the full range of ways in which a family may meet the participation rate. We have tried to make these regulations easy to read. This means, in part, keeping sections reasonably short and separating different ideas into new sections. In this subpart in particular, we have tried to group all the provisions that relate to counting hours of work; it would be simply impractical to include all these provisions in one section.

We have decided not to reference § 261.35 to avoid multiple references to the other sections in subpart C, which we think readers will readily notice due to their proximity.

*Comment:* A couple of commenters urged us to give a State credit for an individual's "excused" absences from work, such as holidays or jury duty, as opposed to counting only actual hours of work. They thought that an absence beyond the individual's control should count as participation. Another commenter suggested that we count at least a portion of an individual's commute time when he or she must travel an extended distance to reach the job.

*Response:* The statute specifies the standard by which we must measure whether an individual is engaged in work. That standard is that a recipient "is participating in work activities for at least the minimum average number of hours per week" specified in the table in this section. Although the JOBS program gave us the discretion to establish a participation standard that considered scheduled hours and actual hours worked, TANF does not provide that flexibility.

However, consistent with ordinary practice for counting work time, a State could base the hours of work it reports on an employer's record of hours for which an employee is paid, thus accounting for paid holidays and jury duty days. Similarly, consistent with the ordinary practice for counting work time, we do not believe that commuting time can reasonably be considered "engaging in work" for any activity and therefore will not count it toward the participation rates.

*Section 261.32—How Many Hours Must an Individual Participate To Count in the Numerator of the Two-Parent Rate? (§ 271.32 of the NPRM)*

For two-parent families, section 407(c) of the Act specifies that the parents must be participating in work activities for a total of at least 35 hours per week and that a specified number of

hours be attributable to specific work activities. A State may have one parent participate for all 35 hours, or both parents may share in the work activities. If the family receives federally-funded child care assistance and an adult in the family is not disabled or caring for a severely disabled child, then the parents must be participating for a total of at least 55 hours per week. As before, a specified number of hours must be attributable to certain activities (listed below).

In the first situation (where the weekly total must be at least 35 hours), at least 30 hours must be attributable to the same narrow group of activities that applies to the 20-hour standard in the overall rate. In the second situation (where the weekly total must be at least 55 hours), 50 hours must be attributable to this narrow group of activities. Again, these are:

- Unsubsidized employment;
- Subsidized private sector employment;
- Subsidized public sector employment;
- Work experience;
- On-the-job training;
- Job search and job readiness assistance for no more than four consecutive weeks and up to six weeks total in a year;
- Community service programs;
- Vocational educational training (for not more than 12 months);
- Provision of child care services to an individual who is participating in a community service program.

Therefore, no more than five of the relevant minimum hours may be attributable to education related to employment, high school (or equivalent), or job skills training activities.

During our consultations prior to developing the NPRM, many thought it was unclear whether the 35-hour requirement was a minimum for each week or a minimum weekly average, as is the case in the overall rate. For example, if a parent participated 40 hours one week and 30 hours the next, the question arose whether he or she would meet the minimum requirement for both weeks. To provide maximum flexibility for States to meet the program goals, we clarified in the proposed rule and have maintained in the final regulations that, as long as the parents' average total hours equal at least 35 hours per week, the individual meets the participation requirement.

Other than this clarification, we have mirrored the statute. As in § 261.31, we have reorganized the regulatory text slightly from the way it appeared in the NPRM to make it clearer, but this

section still paraphrases the statute in simple, understandable terms.

The majority of the comments on this section expressed support for our interpretation that the weekly hours requirement was a weekly average within a month and not a fixed number of hours for each week. Commenters emphasized that this will help States work flexibly with families and respond to emergencies or other family needs that affect hours of work in a particular week.

We also received many of the same comments in this section that we received in connection with the hours of work required for the overall participation rate. In particular, please refer to the preamble for § 261.31 for discussion of the comments and our responses about: the requirements of the FLSA; counting "excused" absences from work toward the participation rate; giving partial participation credit for participating below the hours of work standard; and reporting requirements for a week that spans two months.

*Comment:* A commenter noted that this section refers to "an individual" counting as engaged in work and urged us to substitute the word "family" instead.

*Response:* We recognize that both parents may actually be participating and contributing to the total number of hours required to be engaged in work, 35 or 55 hours depending on whether they receive federally-funded child care. We used the word "individual" because the statute, at section 407(c)(1)(B), uses that term. While this is not necessarily strictly accurate, it is no more accurate to describe the "family" as working; a family is counted in the participation rate, but it is one or two individuals who engage in work. We thought that relying on the language of the statute would be less confusing in this case.

*Comment:* One commenter advised us to modify this section to indicate that a family with a disabled parent should not be considered a two-parent family for the purposes of the participation rate calculations in accordance with the statute.

*Response:* The commenter is correct that the statute excludes families with a disabled parent from the two-parent participation rate calculation. We included this provision in subpart B where we describe the calculations for the participation rates. Please refer to § 261.24(d).

*Section 261.33—What Are the Special Requirements Concerning Educational Activities in Determining Monthly Participation Rates? (§ 271.33 of the NPRM)*

Section 407(c)(2)(C) of the Act provides that a teen who is married or the single head-of-household is deemed to be engaged in work for a month if he or she maintains satisfactory attendance at a secondary school or the equivalent or participates in education directly related to employment for an average of at least 20 hours per week. Paragraph (b) of this section paraphrases the language of this statutory provision.

To reinforce the emphasis on work, section 407 of the Act limits educational activities in two ways:

(1) An individual's participation in vocational educational training may count for participation rate purposes for a maximum of 12 months; and

(2) For each participation rate, not more than 30 percent of individuals determined to be engaged in work for a month may count by reason of participation in vocational educational training. In fiscal year 2000 and thereafter, this 30-percent limit also includes the teens deemed to be engaged in work by reason of maintaining satisfactory attendance at secondary school (or the equivalent) or participating in education directly related to employment, whom we described above.

When PRWORA was enacted, there was substantial controversy about precisely how the second limitation would apply. However, Pub. L. 105-33 modified this provision, making the limitation much clearer. The description above and the regulation at § 261.33 reflect the new provision, as amended by Pub. L. 105-33.

Based on some of the comments we received, we have made some minor modifications to the regulatory language as it appeared in the NPRM. The proposed regulatory language inadvertently suggested that only married heads-of-households, as opposed to any married teen, could be deemed to be engaged in work by virtue of this provision. In addition to correcting that error, we have modified the wording of the 30-percent cap to reflect the statute more closely.

We also want to explain the technical details of how we will interpret the provision relating to counting teens in educational activities for the purposes of calculating the participation rates. We are interpreting the deeming of teens as engaged in work based on satisfactory attendance in secondary school (or the equivalent) or 20 hours per week of

education directly related to employment to apply to both participation rates. While the provision might appear at first glance to apply to the overall rate alone, after considering Congressional intent and the legislative history, we think it is appropriate to apply it in the two-parent rate as well.

Because the two-parent rate, as amended by Pub. L. 105-33, permits the hours of the two parents to be combined to achieve the required weekly average, we needed to determine how many, if any, additional hours the parents would need to work in order to count in the two-parent rate when one parent was maintaining satisfactory attendance in high school or the equivalent. It seemed unreasonable and contrary to the spirit of the law to count the family without any additional hours; for example, that would allow a two-parent family to count based solely on the attendance of one parent in a GED class. Such a policy would support neither the educational welfare of the other parent nor the economic self-sufficiency of the family, faced with time-limited benefits.

To address these concerns, our rules incorporate the following policy for two-parent families: (1) we will consider satisfactory attendance at secondary school or the equivalent of a single head-of-household or married recipient under the age of 20 to equate to 20 hours per week of participation; thus, the parents would need a combination of 15 or 35 additional average hours per week (depending on which standard of hours applied to them) to count for the two-parent participation rate; and (2) if both parents in the family are under 20 years of age, we will consider them to be engaged in work if both meet the conditions of § 261.33(b), that is, if both are either satisfactorily attending school or equivalent or participating in education directly related to employment for at least 20 hours per week. Our rationale for equating satisfactory attendance in secondary school with 20 hours of participation is that the statute makes the presumption that such attendance is equivalent to 20 hours in education directly related to employment.

*Comment:* One commenter, while acknowledging the statutory origin of the 30-percent cap, nevertheless objected to the provision as it relates to teens in secondary education. The commenter stated that a mandated activity cannot have a cap.

*Response:* The commenter is correct that the 30-percent limitation is required by the statute; however, we would like to address the question of secondary education as a mandated activity. The commenter is referring to

section 408(a)(4) of the Act, which prohibits a State from using TANF funds to assist a single parent under the age of 18 who has not completed high school (or equivalent) unless he or she attends high school (or equivalent) or a State-approved alternative education or training program. Both provisions underscore the importance of basic education for teens but are distinct in their effects within TANF. Even if the teen populations and the activities described were identical, which they are not, the central difference between the two provisions is that one mandates what the teens must do and the other restricts what a State receives credit for in the participation rate.

*Comment:* We received several comments urging us to count post-secondary education toward the participation rate and recommending that the regulations explicitly indicate that it is a TANF work activity.

*Response:* As we have indicated above, we do not have the authority to create additional work activities beyond the 12 statutory activities. Nevertheless, depending on whether and how the State chose to incorporate it into its TANF structure, post-secondary education could fit within the definition of 1 or more of the 12 activities. The appropriateness of categorizing it as one activity versus another would depend on the nature of the post-secondary program, such as whether it were vocational training.

We would also like to emphasize that States have the flexibility to design programs that allow recipients to combine school and work. We have suggested some possible models for this in the preamble to § 261.30 and are ready to work with States that want help in pursuing such program designs.

*Comment:* A couple of commenters objected to the limitations on vocational educational training, both an individual's limit to 12 months and the 30-percent cap. They stressed that States should be free to design vocational programs that are effective in moving participants into permanent employment, which may require more than one year of training.

*Response:* States are free to design and operate vocational programs that take longer than one year to complete; the limitation is strictly about the period of time for which a State could receive credit for a recipient's participation in that program. The limitation, while potentially discouraging States from designing certain long-term programs, is statutory and beyond our authority to modify. Again, we would like to point out that combining vocational training with practical experience that could

count as another activity may be a viable approach in many cases. Moreover, States should consider that effective vocational education programs, or other programs that succeed in moving recipients from welfare to work, will contribute to the likelihood that the State will qualify for a high performance bonus or caseload reduction credit. We are awarding the high performance bonuses based on several criteria, including the number of new hires, increases in earnings and job retention. Thus, in spite of the limits on counting vocational educational training as participation, there are other incentives to designing effective vocational education programs.

*Comment:* A commenter noted that the proposed regulations and preamble did not indicate that a State has discretion to determine how to measure the 12-month limit on counting an individual's participation in vocational educational training.

The commenter also urged us to amend the regulations to indicate that a State that combines education with other activities would necessarily be able to count these activities in the participation rates.

*Response:* States have limited flexibility in this area. If a family is included in the numerator of a participation rate for a month by virtue of participation in vocational educational training, then that month counts against the 12-month limit for that individual.

If a State reports hours of participation in an activity that meet the requirements of this subpart, then the hours would count in the participation rates, and the month would count as a month or participation in the activity, regardless of whether the individual performed them in combination or separately.

We have stressed the possibility of combining education and work activities in part because of the statutory limits, reflected in these regulations, on how educational activities may count for participation purposes. In addition, we believe that encouraging recipients to acquire new and more advanced skills after they have entered the work world will help them attain and keep higher-paying jobs, leading to more economic security for families.

*Section 261.34—Are There Any Limitations in Counting Job Search and Job Readiness Assistance Toward the Participation Rates? (§ 271.34 of the NPRM)*

Section 407(c)(2)(A)(i) of the Act limits job search and job readiness assistance in several ways.

First, an individual generally may not count as engaged in work by virtue of participation in job search and job readiness assistance for more than six weeks. No more than four of these weeks may be consecutive. During our consultations prior to drafting the NPRM, we were asked whether these limitations applied for the lifetime of the individual, per spell of assistance, or per fiscal year.

Based on those consultations, after an analysis of the statute, we decided in the NPRM to interpret it as a fiscal-year limit for two policy reasons. First, since the participation rate itself is tied to the fiscal year, it makes sense to apply the limitation to the same timeframe. Second, a different policy could force States to place individuals in other, less appropriate activities just to meet the participation rate. Moreover, research indicates that job search activities are an instrumental component in effective work program designs.

The statutory language supports the fiscal-year interpretation. The job search language at section 407(c)(2)(A)(i) of the Act limiting the weeks of participation states that the limit is "notwithstanding paragraph (1)." Paragraph (1) refers to the determination of whether a recipient is engaged in work for a month "in a fiscal year." Thus the reference to paragraph (1) puts the job search limitation in the context of a calculating whether an individual is engaged in work in the fiscal year. Based on these considerations, we clarified in the proposed rules that the six-week limitation applies to each fiscal year and have not changed that interpretation in the final regulations.

The legislation and our rules allow the 6-week limit on job search and job readiness assistance to extend to 12 weeks if the unemployment rate of a State exceeds the national unemployment rate by at least 50 percent, or if the State could qualify as a needy State for the Contingency Fund.

Finally, our rules paraphrase the statute (at section 407(c)(2)(A)(ii) of the Act) in allowing a State to count three or four days of job search and job readiness assistance during a week as a full week of participation on one occasion for the individual.

*Comment:* We received many comments in support of our interpretation that the job search and job readiness limit applies on a fiscal-year basis. However, one commenter thought we were too specific and should allow States to interpret the limitation.

*Response:* We have not modified the regulation as the commenter suggests. We think it is reasonable to apply one standard to all States. Given the

overwhelming support for the fiscal-year interpretation and the statutory and policy support we provided for it above, the final regulations maintain that policy. This policy only limits the maximum job search and job readiness that count for participation purposes. States still have flexibility in determining how much an individual should actually participate in such activities, including the flexibility to apply the job search and job readiness limit on a lifetime basis for an individual if they so choose.

*Comment:* A commenter thought that the way in which we paraphrased the statute's limit on job search and job readiness to not more than four consecutive weeks was confusing and urged us to use the statutory wording.

*Response:* We have modified this section to follow the statute's language more closely. We have left the provision limiting the number of consecutive weeks separate in paragraph (c) because we think it is easier to follow this way, but have changed the wording within the paragraph in response.

*Comment:* A few commenters objected to limiting job search and job readiness to four consecutive weeks, arguing that there is no rationale for stopping at that point or that it is simply too short a period of time to ensure that recipients will find jobs. A couple of other commenters objected to the six-week total limitation for essentially the same reasons and urged us to create a longer time period.

*Response:* There is no limit on the amount of job search and job readiness a State may require of an individual. However, the statute imposes limitations on how much the activity counts toward the participation rate. We have no authority to extend the it counts, other than when a State meets the criteria for counting 12 weeks of job search and job readiness assistance instead of 6.

*Comment:* Two commenters recommended that we separate job search assistance from job readiness assistance and establish separate limits on each activity.

*Response:* In determining whether an individual is "engaged in work" for the participation rates, the statute provides for 12 different work activities. One of those activities is "job search and job readiness assistance"; the statute does not recognize them as separate components. As we indicated in the discussion at § 261.30, we do not have the discretion to add to those activities or to separate job search from job readiness. If a State has two different activities as part of its TANF program, it would have to count an individual's

participation in either one toward the limits described in this section.

*Comment:* A commenter suggested that we clarify the regulations to allow a State to apply the extended job search and job readiness provision to a "needy political subdivision" as it would if the State were a "needy State."

*Response:* The statute is very specific in describing the two conditions under which 12, rather than 6, weeks of job search and job readiness can count toward the participation rates. One of those conditions is when the "State" qualifies as "needy" under the Contingency fund definition. That definition applies to a State as a whole; therefore, there is no mechanism by which to apply it to a political subdivision.

*Comment:* One commenter recommended that the regulations ensure that a State has advance notice of whether it qualifies to count individuals for the extended 12 weeks of job search and job readiness in a fiscal year. The commenter argued that this would let the State plan which activities to make available to its recipients in order to meet its work participation rate.

*Response:* As we indicated above, there is no limit on the amount of job search and job readiness a State may require of an individual; the limitation is on how many hours of the activity count toward the participation rates. We hope that a State would not, as the commenter suggests, withhold access to job search and job readiness—or any activity, if it were the most appropriate for a recipient—and require participation in another activity, solely for the purpose of meeting the participation rate. The participation rates represent a requirement on the State, not a requirement on specific individuals, and the State can inherently meet the participation rates even if every individual is not in a countable activity.

Further, we have no ability to make an advance determination that a State qualifies for a 12-week job search limit because the data are not available in advance and the statute authorizes the 12-week limit based on a State's current situation.

*Comment:* One commenter objected to the provision permitting a State to count three or four days of job search and job readiness assistance as a full week of participation because the data collection system in the commenter's State does not allow it to count hours of participation on that basis.

*Response:* This provision is not a requirement. Any State that does not wish to count three or four days of this

activity as a full week of participation is not required to do so. The origin of the provision is statutory; we presume the intent was simply to make it easier for States to receive participation credit for this activity.

*Section 261.35—Are There Any Special Work Provisions for Single Custodial Parents? (§ 271.35 of the NPRM)*

Section 407(c)(2)(B) of the Act provides a special participation rule for single parents or caretakers with young children. A single parent or caretaker with a child under the age of six will be deemed to be engaged in work for a month if he or she participates in work activities for an average of at least 20 hours per week.

This provision has little relevance in FYs 1997 and 1998, when, for the overall rate, the required number of hours for all individuals is 20 hours per week. But, when the required number of hours rises to 25 hours per week in FY 1999 and to 30 hours per week thereafter, this provision allows single parents or caretakers to spend time with younger children. It also may enable those with young children to fulfill their work obligations while their children are in preschool activities.

The regulations paraphrase this statutory provision.

There were no substantive comments on this section.

*Section 261.36—Do Welfare Reform Waivers in a State Affect the Calculation of a State's Participation Rates? (§ 271.36 of the NPRM)*

This section is simply a cross-reference to subpart C of part 260, which addresses welfare reform demonstration waivers. We thought it would be helpful to include it so that readers would know to refer to this important exception to the work activities and hours specified in subpart C. We have changed the reference from what it was in the NPRM, in light of our consolidation of the regulatory provisions relating to waivers under part 260.

There were no comments on this section.

*Subpart D—How Will We Determine Caseload Reduction Credit for Minimum Participation Rates?*

*Section 261.40—Is There a Way for a State to Reduce the Work Participation Rates? (§ 271.40 of the NPRM)*

To ensure that States receive credit for families that have become self-sufficient and left the welfare rolls, Congress created a caseload reduction credit. The credit reduces the required participation rate that a State must meet for a fiscal

year. It reflects the reduction in the State's caseload in the prior year compared to its caseload under the title IV-A State plan in effect in FY 1995, excluding reductions due to Federal law or to State changes in eligibility criteria.

This provision enhances the inherent interest of States to help families become independent. As a State reduces its caseload, its risk of incurring a penalty lessens because lower work participation rates are easier to achieve. This provision also increases a State's chance of qualifying for a lower basic MOE requirement, which would reduce its risk of incurring an MOE penalty.

To establish the caseload base for FY 1995, we proposed using the number of AFDC cases and AFDC Unemployed Parents reported on ACF-3637. To avoid artificial reductions in the minimum participation rates, the NPRM included cases in any separate State program used to meet the maintenance-of-effort (MOE) requirement in determining the prior-year caseload. Under the proposed rules, we would not have granted a caseload reduction credit unless the State reported case-record information for its separate State programs.

*Comment:* Some commenters suggested that allowing States to reduce their work participation rates emphasizes caseload reduction over the goal of self-sufficiency. Others strongly supported the caseload reduction concept.

*Response:* By including this provision in the statute, Congress sought to recognize State success in moving individuals off assistance. We believe this provision comports closely with both statutory language and intent.

*Comment:* One commenter asked us to include explicit language to the effect that we would apply the caseload reduction credit to reduce the participation standards before evaluating State performance.

*Response:* Different groups will evaluate State performance in a variety of ways. For purposes of determining potential penalty liability, we will compare a State's actual participation rates with the rates that apply following any adjustments due to caseload reduction credits.

*Comment:* A substantial number of comments addressed our proposed method of using reported AFDC data to establish the 1995 caseload baseline. First, several correctly pointed out that the Statistical Report on Recipients Under Public Assistance is ACF-3637, not ACF-3697. In addition, many commenters thought that, to conform to the statute, the base-year calculation should include not only the AFDC

population, but also recipients of assistance under the Emergency Assistance program (EA) funded under title IV-A and cases receiving At-Risk and transitional child care benefits.

Other commenters suggested that two-parent families receiving TANF assistance are not comparable to AFDC Unemployed Parent (AFDC-UP) cases because TANF does not restrict two-parent families as AFDC-UP eligibility rules did. They argued that, to be fair, we ought to compare "apples to apples" and "oranges to oranges." Most recommended either not counting two-parent cases at all or allowing States to adjust the base-year caseload reports to include any two-parent cases that were not AFDC-UP cases. They also recommended adjusting the reports to correct inaccuracies.

*Response:* We agree with these commenters that, to some extent, our proposal compared "apples to oranges." In developing the NPRM, we recognized that the calculation should reflect an unduplicated count of cases receiving "assistance" under either AFDC or EA. However, from the data reported to us, we could not unduplicate the AFDC and EA case counts or determine which, if any, of the EA benefits constituted "assistance." In our consultations, many State staff told us that they would also not now be able to unduplicate AFDC and EA cases for fiscal years 1995 and 1996. Thus, for consistency, we limited the base-year data to AFDC cases reported on the ACF-3637. Based on the comments and further internal discussion, however, we believe it would be fairer to afford States the opportunity to adjust and correct baseline data if they can do so because adjustments would make the base-year and prior-year caseload figures more comparable. For example, it would not be appropriate to include certain EA cases in the base-year caseload because, as recipients of "one-time, short-term" benefits, such cases would not be receiving TANF "assistance" and do not show up in the prior-year TANF caseload. However, if there were EA cases in 1995 that received "assistance" and that did not receive both EA and AFDC benefits, it would be appropriate to include those cases in the base-year caseload.

To allow for more comparable caseload data, we have modified the final rule. We will adjust the base-year case count for any State that can provide accurate adjustment data or unduplicated case counts, for example, through a computer match of each month's 1995 AFDC and EA caseload and subsequent years. This includes reliable information on the actual

number of two-parent cases in its AFDC caseload for applicable years. However, we will only include EA cases to the extent that the assistance provided under EA would meet the TANF definition of assistance.

*Comment:* Some commenters suggested that some types of cases from FY 1995, such as State General Assistance (GA) cases, are not included in the baseline, but should be. They argued that analogous cases are served in separate State programs and thus will be included in the comparison year.

*Response:* We appreciate the commenter's point and agree that, in this regard, we are not comparing like cases. However, we cannot include GA or similar cases in the base-year because the statute specifies that we compare cases "that received aid under the State plan approved under part A (as in effect on September 30, 1995) during fiscal year 1995." To the extent that such cases are in the prior-year caseload, but not in the 1995 base because the State has expanded its eligibility criteria since 1995, the net caseload decrease calculation will adjust for this difference. Please refer to § 261.42 for additional discussion.

*Section 261.41—How Will We Determine the Caseload Reduction Credit? (§ 271.41 of the NPRM)*

In the proposed rule, we explained how difficult it was to develop an appropriate methodology to quantify the different types of caseload reductions. We had considered and rejected two alternatives, i.e., the use of Medicaid records to estimate the effect of eligibility changes (since Medicaid eligibility is based on the July 1996 AFDC eligibility rules) and a computer simulation model. Neither alternative could produce reasonably accurate estimates of the effect of eligibility changes on the caseload size. Nor did our extensive consultations provide a straightforward methodology that could be universally applied.

As a result, the NPRM proposed a caseload reduction methodology based on State-submitted information and estimates. These regulations incorporate the same basic approach. Under the final rules, we determine the appropriate caseload reduction for each State using the following process:

Step 1—We compare 1995 AFDC and Unemployed Parent caseload data to State-reported TANF and SSP-MOE caseload data for the prior-year.

Step 2—The State submits a Caseload Reduction Report that provides: a complete listing and implementation dates of State and Federal eligibility changes since FY 1995; a numerical estimate of the impact on the

caseload since 1995 of each eligibility change; an overall estimate of the net cases diverted from assistance as a result of eligibility changes; an estimate of the State's caseload reduction credit; the number and distribution of caseload closures and application denials, by reason; a description of the methodology for the estimate, as well as supporting data to document the information in the report; a certification that it incorporated all net reductions, there was an opportunity for public comment on the content of the report, and it considered such comments; and a summary of all public comments. (We have included the Caseload Reduction Report form and instructions at Appendix H.)

Step 3—We compare and analyze each State's methodology, estimates, and data to determine whether they are plausible. We may request that a State submit additional information within 30 days to support the estimates. In addition, we will conduct periodic on-site visits and examine case records to validate the information we have received.

Because eligibility changes often affect two-parent cases differently from the overall caseload and the two-parent rates are distinct, the NPRM required States to submit separate estimates and information for the overall and two-parent rates to receive a caseload reduction credit.

*Comment:* Many comments noted how difficult it is to measure the impacts of policy changes and achieve comparability or equity among States. One suggested that the only accurate way to determine the caseload impact of a policy change is to use experimental and control groups. A few commenters suggested using a "quality control" model or system based on sampling, exception criteria, and audits to establish the estimates of policy changes.

A number claimed that we had shifted the statutory burden and responsibility for calculating the caseload reduction credit from us to the States, with mixed views as to whether this was appropriate. One cited the specific statutory language requiring that the regulations "shall place the burden on the Secretary to prove that such families were diverted as a direct result of differences in such eligibility criteria." Some expressed concerns about the standards to which we might hold States seeking caseload reduction credits (i.e., in quantifying the effects of eligibility changes).

Another suggested that the Secretary has an obligation to pay for obtaining such data.

Others, while expressing concern with the proposal, agreed that it would be difficult for us to develop a sounder methodology that could be used in every State. Several commenters noted

that the methodology imposed a tremendous burden because States may not have retained or may never have collected the information needed to make estimates. Some urged working with States to find a reasonable or less burdensome method of measuring the caseload reduction. Others suggested that, working in partnership with States, we should provide technical assistance to help States do the required analysis.

*Response:* We are glad that commenters clearly understood the difficult dilemma posed in developing a caseload reduction methodology, and we are sympathetic to their concerns about the burden our proposed methodology would impose on States. However, we believe that the specific recommendations for methodological alternatives, such as a quality control model, ultimately would impose an even greater information collection burden on States, without a guarantee of more precise estimates. Therefore, in the final rule, we are retaining the same general approach, while adopting some suggested improvements. We have clarified that we will accept State estimates of the impact of eligibility changes and the resultant caseload reduction credit, unless they appear to be implausible, based on the common experience of other States. In these situations, we will ask the State to re-examine its estimate in light of this new or additional information.

At the same time, we have clarified our expectation that States provide aggregate information on the number and distribution of case closures, by reason. At a minimum, States must provide this information for the base year (1995) and prior year. The NPRM asked for a listing of reasons, but did not directly say we were looking for quantitative information that might reveal any significant shifts in the causes of case closures that might be associated with changes in State policies. We also decided to ask for similar data on application denials and added an explicit requirement that States report an overall estimate of the net number of cases diverted due to eligibility changes.

We understand that the caseload closure and application denial information that we are requesting may not directly measure the caseload effects of eligibility changes, especially over time as the effects of changes decay and reporting practices may shift. However, it is useful information for a State to consider in preparing its Report, it will give the public a context for assessing and commenting on the State's methodology and estimates, and it will give us a national set of data that will



enable us to judge the plausibility of individual State determinations.

As suggested, we have consulted—and intend to work in partnership with—States, State groups, and advocates to develop appropriate estimates, complete the caseload reduction analysis, and refine their estimating methodologies.

We thought it would be helpful for States to have all forms related to the rule published together. As a result, we have included, under Appendix H, the Caseload Reduction Report form and instructions for completing it. Although the form itself was not part of the NPRM, we addressed the burden associated with the caseload reduction estimates in our paperwork burden estimate. Anyone wishing to comment on the form or burden should submit comments to the Office of Management and Budget. Please refer to the section of the preamble titled "Paperwork Reduction Act" for further information.

Regarding the suggestion that the Secretary pay for obtaining such data, we would say: (1) Congress did not appropriate funding for this purpose; (2) many States can draw upon analyses done for other purposes to reduce the cost burdens associated with these determinations (For example, in proposing changes to eligibility rules, some States will routinely prepare estimates of caseload and budgetary impacts of those changes as part of the State budgetary and legislative process.); (3) if such estimates are not otherwise available, because of caseload reductions and the strong economy, in general, States have substantial funds available to do research and analysis; and (4) we expect the burden of these reports to diminish over time because State program rules should become less subject to change and States will have developed the methodological framework for producing their estimates.

*Comment:* Several commenters objected to using case closure information as the basis for estimates, because the reason for closure is often unknown and the coded reason is sometimes incorrect. Others suggested that different eligibility rules affect applicants as well as recipients and thus the reason for an application denial is just as important as case closure information in determining the effect of a policy on the caseload.

*Response:* While we recognize the deficiencies in both case closure information and application denial information, it is generally the most readily available State information that we can use to help assess the impact of policy decisions. Therefore, we have

retained the requirement of submitting case closure information in the final rule. Also, we have added a requirement to submit similar application denial information. In addition, we have clarified that we are looking for quantitative information.

While we are not requiring it, a State may conduct surveys or in-depth reviews to establish more accurate estimates of the effect of policy changes and use this information in place of case closure and application denial data from case files.

*Comment:* Numerous comments noted that the statute does not address whether there should be separate caseload reduction calculations for the overall and two-parent rates. Some thought that, if the State had achieved an overall caseload reduction, it was unfair to penalize it for an increase in two-parent households (especially when it implemented these policies to help keep families together—a purpose of the statute). Some commenters recommended applying an overall caseload reduction credit to both rates. Others liked our proposed approach of two separate calculations, each based on reductions in the applicable caseload. Many suggested that States should be afforded the option to choose whether to use one or two calculations. One commenter suggested that, if we retained the approach of two separate calculations, we should allow a State to request and submit estimates on only one rate, if a reduction credit were not appropriate for the other.

*Response:* Resolving this issue is critically important because of its impact on preparing families for work and self-sufficiency, the potential penalty liability of States, and the lack of guidance on Congressional intent. We were persuaded by the comments that providing an option would be an appropriate way to ensure that States that adopt policies to promote two-parent families would not be penalized. In particular, we thought it made sense to allow States credit for success with its total population, since the two-parent caseload is a subset of that total, generally a very small subset. It also allows us to give flexibility to States to accommodate differing circumstances. At the same time, we were concerned that allowing an option could reduce the strong Congressional mandate for two-parent families to prepare for and engage in work, because States that were particularly successful in achieving overall caseload reductions could reduce their target two-parent participation rates to minimal levels.

To help us make this decision, we analyzed caseload data for fiscal years

1995, 1996 and 1997, TANF participation rates for FY 1997, and preliminary participation rates for FY 1998. We determined that providing a State option would not nullify the two-parent participation requirements, as we had feared. In fact, our analysis showed that more States derive a greater caseload reduction credit from calculating two separate credits, i.e., applying the two-parent caseload reduction to the two-parent rate.

Based on this analysis and to accommodate State circumstances better, we have decided to allow States an option regarding the caseload reduction credit for the two-parent participation rate. A State may use the overall reduction credit for its two-parent rate or may opt to submit separate caseload reduction information on its two-parent caseload and base the credit for the two-parent rate on reductions in the two-parent caseload alone. States do not have the option of applying to the overall rate a reduction credit based on reductions in the two-parent caseload.

*Comment:* A commenter asked that the rules clarify that the State's methodology must account for the ongoing effects of an eligibility change beyond the initial year.

*Response:* We agree with this comment. The final rule requires estimates of the effects of all eligibility changes since FY 1995.

*Comment:* Many State commenters noted that it would be better to know their caseload reduction credits earlier in the year, but then noted that two weeks might not be enough time to provide any additional information requested by ACF. Several suggested that States need at least one month to provide supplemental information. Others suggested that we negotiate an appropriate deadline with each State, based on the information needed.

*Response:* We recognize that States may need more than two weeks to provide additional information. Therefore, we have modified the final rule to allow a State to negotiate the information deadline or submit it within 30 days of the request. We believe that it is important to resolve such matters within a short timeframe so that States will know what participation rates they must meet as soon as possible.

*Comment:* Several commenters suggested that States and the Department would both benefit from making each State's methodology and plan available for public review and comment. That way, other organizations would be able to provide another perspective on eligibility changes and their impacts on the caseload. For the

purpose of public review and comment as well as sharing methodologies and approaches among States, several commenters suggested that we electronically post each State's estimates and methodology.

*Response:* We agree that both States and the Department would benefit from public input on the estimates and methodology. Therefore, in the final rule, we have required a State to certify that it has provided the public an appropriate opportunity to comment on the estimates, methodology, and reductions. To allow time for public input, we have extended the due date of the Caseload Reduction Report until December 31 of each year. We also require a summary of the public input. To enable us to learn effective estimating techniques from each other, we intend to post electronically useful illustrative estimates, techniques, and comments on the ACF World Wide Web page at <http://www.acf.dhhs.gov>.

*Comment:* Several commenters objected to the requirement that the Governor certify the caseload reduction figures, e.g., "the not-too-subtle implication that States will not be truthful is both offensive and unnecessary." One suggested that surely the Governor's designee should be able to "certify" that the State had taken into consideration all reductions.

*Response:* We agree with the suggestion and have made the appropriate change in the rule.

*Comment:* A number of comments suggested that we strike the provision that requires a State to report disaggregated data on families in separate State programs in order to qualify for a caseload reduction. Some maintained that requirements for disaggregated data on separate State program cases exceed our authority. As an alternative, some suggested that aggregated caseload data should suffice.

*Response:* If a State moves a family receiving TANF assistance to a separate State program where it receives benefits meeting the definition of assistance, this change in the family's status would represent an eligibility change if we did not include separate State program (SSP) cases in the caseload count. Therefore, unless we require and receive the SSP information, it would be impossible to calculate the appropriate caseload reduction credit. However, we point out that, under the final rule, we have significantly reduced the amount of data we are requesting on SSP cases. Most of this cutback is due to a reduction in the number of programs and types of cases for which States must report data. This is one of the effects of changing the definition of assistance.

We have also reduced the burden by changing some data elements and changing the amount of data we expect on other individuals in the family (i.e., those not receiving assistance).

*Comment:* Some comments suggested reducing the data collection burden by actually treating a transfer to a separate State program as a change in eligibility and estimating the impact on the caseload reduction.

*Response:* We do not agree with this suggestion. Since we are expecting States to report case-record information on separate State programs, we believe actual caseload numbers will be available and there is no reason to develop or accept estimates.

Also, States and other commenters argued that, to the extent possible, the methodology should compare "apples" with "apples," not "oranges." We believe that including the SSP cases in the prior-year caseload best serves that objective. Because SSP cases will be receiving benefits that address their basic needs, we expect that, generally, they will be comparable to AFDC cases.

*Section 261.42—Which Reductions Count in Determining the Caseload Reduction Credit? (§ 271.42 of the NPRM)*

Congress enacted the caseload reduction provision to give States credit toward participation for families that have achieved self-sufficiency or left the welfare rolls due to work, marriage, child support, or other means of support. The statute does not give caseload reduction credit for Federal or State eligibility changes that deny assistance to vulnerable families.

In the NPRM we gave States full credit for caseload reductions, except when those caseload reductions arose from changes in rules that directly affect a family's eligibility for benefits (e.g., more stringent income and resource limitations, time limits, grant reductions, more restrictive residency, age, demographic or categorical factors). States could take credit for the calculable effects of mechanisms or procedural requirements used to enforce eligibility criteria (such as fingerprinting or other verification techniques) only to the extent that they identify or deter ineligible families under the State's rules.

We also proposed that, in order to qualify for a caseload reduction, a State must report data on families in separate State programs. Based on the type of family served or the nature of benefits provided, we proposed that we would exclude some families in separate State programs from this calculation, if a State demonstrated that the cases would not

have been included under AFDC or EA, based on specific data on the family.

*Comment:* In determining the Federal and State eligibility changes that do not count for the caseload reduction credit, a number of commenters recommended using a concept of net caseload change. They suggested that eligibility changes that result in caseload reductions should be offset by the positive policy choices of States that increase the caseload. To illustrate: if a State-imposed time limit resulted in the termination of 1,000 cases in a year, but the elimination of the "100-hour rule" and the "attachment to the workforce" requirements to encourage two-parent family formation added 300 families, only 700 cases would not count toward the State's caseload reduction credit. These commenters suggest that an alternative reading discourages States from adopting proactive policies that are consistent with the intent of the law, such as making work more attractive and encouraging and supporting the formation of two-parent families.

*Response:* Like commenters who offered these suggestions, we are very supportive of policies that promote work, enhance family formation and help make work pay. Given our desire to encourage family-supportive policies, we found this proposal to mitigate caseload reduction incentives appealing. We also think that the concept of a net eligibility decrease, taking all eligibility changes into consideration, provides an opportunity to improve the comparability of caseloads, i.e., it would result in comparing "apples to apples" rather than "apples to oranges." Many States have dramatically increased their earned income disregards and resource limits and eliminated various categorical requirements. Thus, many current recipients would not have been eligible under the 1995 AFDC criteria. To avoid penalizing States for such positive changes, we have adopted the recommendation of using the net number of cases diverted from TANF due to eligibility changes in determining the caseload reduction credit.

Two examples illustrate how the concept will actually work. Consider a State in which the caseload was 100,000 in FY 1995 and fell to 75,000 in FY 1997. The State estimates a caseload decrease of 15,000 due to time limits and other restrictive eligibility rules and a caseload increase of 10,000 because of increased earnings disregards and resource standards. In this example, the net caseload reduction due to eligibility changes is 5,000. This means that, of the actual decline of 25,000 cases, 20,000 count toward the caseload reduction

credit. Thus, the State's caseload reduction credit for FY 1998 is 20 percent, (because 20,000 is 20 percent of 100,000).

To demonstrate what happens when caseload increases due to eligibility changes exceed eligibility-related decreases, we simply reverse the example above. The State's caseload fell 25 percent, from 100,000 to 75,000 between FYs 1995 and 1997. In this example, the estimated decline attributable to time limits and other restrictions is 10,000. The estimated increase due to higher earnings disregards and resource limits is 15,000. Because the net effect of eligibility changes is a 5,000 increase in the caseload, there would be no net number of cases diverted from TANF as a result of eligibility changes. Since there is no net reduction, we do not disregard any cases from the actual decline of 25,000. Thus, the State would be entitled to the entire 25-percent caseload reduction credit.

*Comment:* Several commenters suggested that cases analogous to some cases in separate State programs were not included in the FY 95 baseline and therefore would improperly inflate the comparison year caseload, if included. All these commenters asked that we exclude families in separate State programs from the caseload reduction calculation. Others noted that, while the statute does not directly address this issue, there is a legitimate need to look at cases in separate State programs in the calculation. Otherwise, a State could do something like simply move half of its cases to a separate State program and assert a 50-percent caseload reduction.

*Response:* Congress did not intend to give States credit for caseload reductions resulting from changes in eligibility. We believe that when a State moves a family receiving TANF assistance to a separate State program, it would represent an eligibility change if we did not include it in the caseload count; therefore, we have not modified the regulation as some of the commenters suggest. However, as noted elsewhere, we have modified the reporting for separate State programs. This change has the effect of reducing the number and type of SSP cases reported by the State.

*Comment:* Commenters objected that we had inappropriately retained discretion (by using the language, "we will consider excluding cases") to exclude cases in separate State programs that duplicate TANF cases or were made ineligible for Federal benefits by Pub. L. 104-193. Several found that the three categories of exclusions appear to be more ambiguous and discretionary than

appropriate. Some commenters thought the third category—cases receiving tax credits, child care or transportation subsidies or other benefits for working families that are not directed at their basic needs—was particularly confusing. Most recommended that we explicitly exclude from the caseload reduction calculation, cases in separate State programs that: (1) duplicate cases in the TANF caseload; (2) provide assistance to immigrants made ineligible for Federal benefits; and (3) provide income support or services to low-income, working families for whom employment provides the primary source of income.

*Response:* Generally, we agree with the comments and have made appropriate changes in the final rule. If a State provides documentation on cases in separate State programs that meet either of the following conditions, we will exclude them from the caseload count: (1) cases that duplicate TANF cases; or (2) cases made ineligible for Federal benefits by PRWORA and that are receiving only State-funded cash assistance, nutrition assistance, or other benefits. We did not include the third exception suggested by commenters since these cases are no longer reported as SSP cases under the revised definition of assistance.

However, we note that these are the only circumstances under which we will exclude separate State program cases from the caseload reduction calculations. As we have indicated already, we believe that moving a family receiving TANF assistance to a separate State program where they are receiving assistance would represent a change in eligibility criteria if we did not include such programs in the caseload reduction calculation.

*Comment:* We had wide-ranging and divergent comments on the methodology and supporting data required of States. Several commenters noted that a State policy that denies assistance when an individual does not comply with work requirements, child support cooperation requirements, or other behavioral requirements is the same as any other eligibility requirement—it defines the categories of families that do or do not qualify for assistance. Some commenters suggested that enforcement mechanisms such as fingerprinting also deter eligible families. They recommended that States receive credit only to the extent that the number of families removed exceeds the number wrongly denied, deterred or removed. Several commenters requested that the final rule explicitly consider full-family sanctions, burdensome verification requirements, and

requirements that applicants engage in certain activities to be changes in conditions of eligibility. Most recommended that a State should not receive credit for any such changes in its policy. Others suggested just the opposite, that full caseload reduction credit is appropriate for all denials of assistance for failure to comply with a behavioral requirement.

*Response:* Under the final rules, we consider behavioral requirements that divert families to be eligibility changes, and we exclude them from assistance from the caseload reduction credit. We believe it is appropriate to treat both full-family sanctions and behavioral requirements as eligibility changes. Based on the comments, we have tried to clarify explicitly that no type of Federal or State eligibility change since FY 1995 that directly affects a family's eligibility for assistance will count in a State's caseload reduction credit. These changes include more stringent income and resource limitations, time limits, full-family sanctions, and other new requirements that deny families assistance when an individual does not comply with work requirements (e.g., applicant job search), cooperate with child support, or fulfill other behavioral requirements. A State may count the reductions attributable to enforcement mechanisms or procedural requirements that are used to enforce existing eligibility criteria (e.g., fingerprinting or other verification techniques) to the extent that such mechanisms or requirements identify or deter families otherwise ineligible under existing rules.

*Section 261.43—What Is the Definition of a "Case Receiving Assistance" in Calculating the Caseload Reduction Credit? (§ 271.43 of the NPRM)*

To determine the caseload reduction credit, we proposed to consider caseloads in both TANF and in any separate State programs that are used to meet the maintenance-of-effort (MOE) requirement. Using the definition of assistance proposed under part 270, we proposed to base the calculation on all cases in the State receiving AFDC in FY 1995 and TANF assistance for all other fiscal years.

*Comment:* Several commenters asked us not to use the definition of "assistance" to calculate caseloads for periods prior to the State's implementation of TANF. They argued that, since there was no definition of assistance similar to the TANF definition, many States granted assistance based on broader criteria. In particular, they pointed out that EA cases often did receive one-time, short-

term assistance. Since they were legitimate IV-A cases, the commenters maintained that the cases should be included in the number of cases receiving assistance in 1995.

*Response:* In the NPRM, we specified that the definition of "assistance" should be applied to the caseload count, but our methodology did not actually allow a State to use the definition until it had implemented the TANF program. The caseload information reported by States on ACF-3637, which applied to a State until it implemented the TANF program, reflected the AFDC and EA definitions. Under the final rule, to get caseload data that are comparable to TANF, we adjust the baseline AFDC and EA data, as appropriate, to estimate the unduplicated cases receiving benefits under State programs in those years that would have met the TANF definition of "assistance."

We point out that this final rule does not dictate the determination of caseload reduction credits for fiscal years 1997, 1998, or 1999. Thus, it does not cover the determination of credits for periods when States were still operating AFDC and EA programs. For such earlier periods, it would be appropriate to keep all unduplicated AFDC and EA cases in the calculations because the base-year and prior-year caseload figures would be comparable.

These rules cover caseload reduction credits that apply in FY 2000 and thereafter—after States had converted to TANF. Since the definition of "assistance" determines the prior-year caseload numbers, it is appropriate to adjust the 1995 caseload numbers to mirror the TANF definition of assistance, in order to compare "apples with apples." In some instances, that could mean that EA cases should not be part of the 1995 base.

*Comment:* One commenter recommended that we clarify this section to ensure that, in calculating the caseload reduction credit, we only include a percentage of the separate State program cases that equals the State's MOE requirement (either 75 or 80 percent). Otherwise, the commenter argued, the policy would discourage States from investing more than the required MOE amount.

*Response:* We agree with the comment and have revised the final rule accordingly.

**Section 261.44—When Must a State Report the Required Data on the Caseload Reduction Credit? (§ 271.44 of the NPRM)**

Under the NPRM, we required a State to submit its caseload report and estimates for each fiscal year by

November 15. We proposed to approve or reject a State's estimated reduction credit within 90 days, that is, by February 15.

*Comment:* Commenters expressed mixed feelings about the timeframes. On the one hand, nearly everyone wanted States to receive the caseload reduction credit and net participation requirement as early as possible. On the other hand, most commenters, and especially State commenters, suggested that the timeframes for responding to additional information requests from the Department and for resolving issues were not sufficient.

*Response:* To give the public an opportunity to comment on State estimates and ensure that States have adequate time to provide additional requested information, we have modified the final rule. The caseload reduction report and estimates are now due from States on December 31. States may negotiate the deadline for additional information or submit it within 30 days. As a result, we will provide States with their caseload reduction credits no later than March 31. Any extensions for submitting additional data that we grant to States must be consistent with this deadline.

**Subpart E—What Penalties Apply to States Related to Work Requirements?**

While PRWORA embodies State flexibility in program design and decision-making, it also embodies the principle of accountability. Where a State does not live up to the minimum standards of performance, it faces serious financial penalties. One of the principal areas of accountability is the State's provision of work and work-related activities to promote employment and self-sufficiency. The work participation rates are demanding, but designed to ensure that recipients move as quickly as possible into work and toward independence. This is especially important given the time-limited nature of Federal TANF benefits.

In structuring this part of the regulations, we have attempted to balance the imperative of State accountability in the work participation rates with the knowledge that each State enters TANF from a different standpoint and with different ideas about the best way to help its recipients.

**Section 261.50—What Happens if a State Fails To Meet the Participation Rates? (§ 271.50 of the NPRM)**

In accordance with section 409(a)(3) of the Act, as amended by Pub. L. 105-33, if we determine that a State has not achieved either or both of the minimum

participation rates in a fiscal year, we must reduce the SFAG payable for the following fiscal year. The initial penalty is five percent of the adjusted SFAG and increases by two percentage points for each successive year that the State does not achieve the participation rates. We reduce the penalty amount based on the degree of noncompliance, as discussed at § 261.51. The total work participation penalty can never exceed 21 percent of the adjusted SFAG. (See § 262.1(d) for a discussion of the total penalty limit under TANF.)

If a State fails to provide complete and accurate data on work participation, as required under section 411(a) of the Act and § 265.8 of the regulations, we may determine that a State has not achieved its participation rates, and the State will be subject to a penalty under this part. We also have the authority to penalize a State that does not report its work participation data for failure to report (under section 409(a)(2) of the Act). However, in this case, we thought it would be more appropriate to penalize the State for failure to meet its work rate. First, this policy is consistent with the approach we are taking when a State fails to report information related to other penalty determinations. Also, we did not want to create a situation where nonreporting States would face lesser penalties than reporting States, and we did not believe duplicate penalties were warranted.

We received some comments regarding the year in which we will impose a penalty. We have addressed these comments at § 262.1 of this chapter.

*Comment:* We received quite a few comments concerning our preamble language indicating that we would impose a penalty for failure to meet the work participation rates if a State failed to report complete and accurate data on the work participation rates. Some commenters objected to the policy altogether. Others suggested that we should only impose the work participation penalty where, as a result of incomplete or inaccurate data, we are unable to determine whether the State failed the participation rates. Another commenter suggested that we specify what "complete and accurate" means for the purposes of calculating the participation rates.

*Response:* Our intent in including this policy in the preamble was only to impose a work participation penalty based on a State's failure to report complete and accurate data if the lack of data impeded our ability to determine whether the State actually achieved the required rates. In fact, at § 262.3 of this chapter, we indicate that this is our

policy, stating that we will impose the participation rate penalty "if we find information in the reports \* \* \* to be insufficient or if we determine that the State has not adequately documented actions verifying that it has met the participation rates." For clarity, we have changed the wording above to indicate that we "may" impose such a penalty, and we will implement the policy as explained in § 262.3.

*Comment:* One commenter urged us to penalize a State where an entity with jurisdiction or group of people affected finds a systemic violation of any applicable Federal law (e.g., title VI of the Civil Rights Act).

*Response:* We think it is appropriate to defer to the entity that enforces a given Federal law to penalize a State that violates that law. In general, the laws the commenter alludes to include specific remedies for individuals that are adversely affected. At the same time, we encourage States to make sure recipients are informed of their rights to remedies under Federal, State and local laws.

If, at a later date, we learn of a specific problem in this regard, we will consider further action, but we think it is unnecessary to include such penalties in the regulation at this time.

*Section 261.51—Under What Circumstances Will We Reduce the Amount of the Penalty Below the Maximum? (§ 271.51 of the NPRM)*

The statute requires us to reduce the amount of the penalty based on the degree to which the State is not in compliance with the required participation rate. The required rate for a State is the rate at § 261.23, adjusted for any applicable caseload reduction credit; however, it specifies neither the measures of noncompliance nor the extent of reduction. The statute also gives us the discretion to reduce the penalty if the State's noncompliance resulted from certain specific causes; we address this latter issue separately, in the section entitled "Discretionary Reductions."

As we indicated earlier, we have not included in the final regulations the NPRM proposals that would have linked a State's decisions about implementing separate State programs to its eligibility for penalty relief. Thus, we have removed from § 261.51 the provision that would have denied penalty reduction to a State that diverted cases to a separate State program for the purpose of avoiding the work participation requirements. Please refer to the section entitled "Separate State Programs" for a discussion of this policy

and the comments that we received relating to it.

**Required Reduction**

We have significantly modified this part of the penalty reduction section after considering the comments we received. In the NPRM, we defined degree of noncompliance first by which of the rates a State missed and second by how far it came from meeting the required rate. Thus, if a State missed only the two-parent participation rate, we proposed imposing a penalty that equaled, as a percentage of the maximum possible penalty, no more than the State's percentage of two-parent cases. Second, if the State missed the overall rate (or both rates), we proposed reducing the penalty only if the State achieved a threshold of 90 percent of the required rate. Above 90 percent, the reduction was to be proportional.

The final regulations use five basic criteria to measure the degree of noncompliance: which participation rate the State failed; the amount by which it failed; how well it succeeded in increasing the number of recipients engaged in work (despite failing the participation rate(s)); the number of consecutive years in which the State failed the rates; and the number of rates that the State failed.

First, as in the NPRM, we will measure noncompliance on the basis of whether the State failed one or both rates for the fiscal year and which participation rate it failed, if only one. We believe that a State that fails the two-parent rate should be subject to a smaller penalty than a State that fails the overall rate or both. In addition, we believe that it is appropriate to consider the size of the two-parent caseload in deciding how much weight to give a failure of only the two-parent rate.

In looking at the data for FY 1996, we noted that the two-parent participation rate, on average, affected a very small percentage of a State's entire caseload—the mean State percentage was about 6.6 percent, but the median was only about 2.4 percent. We think a State that failed with respect to only a small percentage of its cases should not face a huge penalty. At the same time, we want to ensure that States make adequate commitments to achieving the two-parent participation rate and that our policies support State efforts to extend benefits to two-parent families. We have attempted to balance these goals.

Under this rule, the maximum penalty a State could face for failure to meet only the two-parent rate depends directly on how much of the State's total caseload consisted of two-parent

families. We have not created a similar proportional reduction for a State that fails only the overall rate because all cases, including two-parent cases, are reflected in the overall rate.

Second, we measure noncompliance on the basis of the severity of a State's failure to achieve the required rate. In drafting the regulation, we wanted to strike the right balance between the importance of work and the requirement to reduce the penalty based on the degree of noncompliance. Although our first inclination was to make reductions in direct proportion to the State's achievement toward the required rate, our experience in the JOBS program led us to consider creating a threshold below which we would grant no reduced penalty. We were concerned that, as in the JOBS Unemployed Parent participation rates, there would be States with negligible levels of achievement, particularly with respect to the two-parent caseload, and thus did not merit a reduced penalty. Given that experience, we thought it was essential to have a threshold.

In the NPRM, we set the participation threshold at 90 percent, in an effort to support the emphasis in the statute on making the work penalty meaningful. In particular, Pub. L. 105-33 amended the work penalty provision so that the amount was fixed, removing the discretion we had under PRWORA to set a lesser penalty amount. We thought (and continue to think) that this shows Congressional intent to provide a work penalty of consequence. To avoid undercutting this intent, our proposed rules required that a State make substantial progress in meeting the target rates before we would consider a reduction. We continue to believe that a threshold is a key part of the penalty structure.

We received extensive comments about the proposed 90-percent threshold. Some commenters accepted our reasoning for creating a threshold, but virtually all found a 90-percent standard to be excessively high. They argued that it bases large fiscal consequences on small and hard-to-measure differences in reported data. While the NPRM maintained that we did not want to give relief to States with negligible levels of achievement, thus leading us to a threshold, commenters asserted that a high threshold treats achievers and nonachievers the same. For example, a State that reaches 2 percent of the required rate and one that reaches 88 percent of that rate are subject to the same penalty. This, they argued, gives States a strong incentive not to serve families with significant barriers. Further, they pointed out that

it would also subject States with similar achievement levels to very different penalties. For example, with a 40-percent participation rate, a State that reaches 35 percent would be subject to a full penalty, but a State that reaches 38 percent would be subject to less than half the penalty. Although most commenters opposed having a threshold at all, believing that any threshold is arbitrary, many suggested that if we found it essential to have one, it should be set significantly lower. Most recommended a threshold of 50 to 75 percent. A few commenters suggested a lower threshold for the two-parent rate than for the overall rate.

After reviewing those comments and analyzing preliminary data, we have set the threshold at 50 percent. We chose this threshold both because it was the most widely recommended alternative level and because we believe it is a logical standard. Requiring States to reach at least half of the target rate draws a clear line between achievers and nonachievers. We think it is reasonable not to grant penalty reduction to States that are closer to a participation rate of zero than they are to achieving the requirement.

Under the final rules, we will reduce the penalty for any qualifying State in direct proportion to the State's level of achievement above a threshold of 50 percent. To achieve this, we will compute a ratio whose numerator is the difference between the participation rate a State actually achieved and the applicable threshold rate and whose denominator is the difference between the applicable required participation rate and the applicable threshold rate.

In the final rule, we have also clarified that the applicable required participation rate and the applicable threshold both reflect any caseload reduction credit that the State receives pursuant to subpart D of part 261. In other words, the standard against which we judge the degree of noncompliance recognizes that Congress wanted States to get credit for the caseload reductions they achieve, as long as they are not due to eligibility changes. If we did not include this clarification, the threshold standard for some States could actually be higher than the target (i.e., full compliance) rate provided under the statute.

For example, assume a State's adjusted target rate (i.e., after applying its caseload reduction credit) equals 30 percent. Further assume the State achieved 18 percent, which exceeds the threshold of 15 percent (one half of 30 percent) by 3 percentage points. The 3 percentage points equal 20 percent of 15 percent, the difference between the

required rate and the threshold. Therefore, we would reduce the penalty amount by 20 percent.

Commenters also urged us to consider a wide range of alternative means of measuring noncompliance. On the whole, they urged us to give States credit for their level of effort, rather than looking specifically to a percentage of the participation rate. One commenter offered that, if the purpose of penalties is to give States a strong incentive to take the requirements seriously rather than to punish those that fail, then a broader view of State achievement is in order. In particular, several commenters suggested variations of the following alternative factors for determining penalty reduction:

- An increase in a State's caseload (in either the current year or prior year);
- Improvement in a State's performance over the prior year;
- Increase in the number of participants in countable work activities in a State, or in the number of participants in work activities but below the required number of hours to count for participation; and
- The extent to which a State exceeded the overall rate, even though it missed the two-parent rate.

Some also suggested that we should recognize a combination of alternatives, perhaps without even specifying a comprehensive list in the regulation.

One set of extensive comments on this issue put forward an argument for treating any penalty reduction factors that we adopt in a formulaic way so that a State's penalty liability is clear. Although this can make for a complex provision, we have responded to this concern by adding some detail to the final rule. We believe that this formula will help States foresee the possible fiscal consequences of their policy decisions.

We considered all these alternatives measures from the perspective that our primary interest in the participation rates is to encourage work. As a result, we have modified the regulations to include as our third measure of noncompliance an adjustment factor that reflects a State's success in engaging additional recipients in countable work activities. The factor rewards a State that increases the number of individuals it engages in work by at least 15 percent over the previous fiscal year. If the number of individuals engaged in work decreases, the State would not be eligible for a penalty reduction, beyond the proportional reduction for failing only the two-parent rate. For this calculation, we will use the average monthly participation data, just as we do in

calculating the participation rates themselves.

We calculate the adjustment factor by dividing the change in the average number of individuals the State has engaged in work by 15 percent of the number it engaged in work the prior year. For example, if the State engaged an average of 2,000 individuals each month in the prior year, and 2,400 individuals in the current year, we would divide 400 (the change) by 300 (15 percent of 2,000, the prior year's average monthly number engaged in work). This would result in an adjustment factor of 1.33. In other words, in the example, the State's increase in participants exceeded 15 percent of the prior year's level by one third. Thus, under these rules, the State's penalty reduction would increase by one third, compared to the reduction it would have received if it had achieved only a 15-percent increase.

We chose to tie the adjustment factor to a 15-percent increase to approximate the average annual increase in the overall participation rate.

We based the adjustment factor on an increase in the number of participants in work instead of on an increase in the percentage of participants in work for two reasons. First, the proportional reduction above the threshold already takes a percentage of participants into account through the increase in the participation rate. Second, commenters made a persuasive argument that measuring individuals would reward States that actually showed greater success with work, where participation percentages would be affected by caseload changes that might have nothing to do with work or the State's efforts to engage individuals in work.

Readers will note that, in addition to the threshold, the adjustment factor also serves as a trigger for penalty reduction; the State must have an adjustment factor above zero to qualify for penalty reduction beyond the proportional reduction for failing only the two-parent rate. We needed to cut off the adjustment factor at zero because a negative number would actually increase the penalty above the amount described in § 261.50, which we have no authority to do. We then linked the presence of an adjustment factor to further penalty reduction because we did not want to reward a State with a decrease in the number of working recipients more than a State with a small increase (under 15 percent) in the number engaged in work.

Finally, we adjust the penalty reduction on the basis of whether the State failed both participation rates in

the current year and how many consecutive years it failed them. If the State met both participation rates in the previous year and only failed one rate in the penalty year, we will apply the full reduction to the penalty. If it failed both rates, but failed none the previous year, we will decrease the penalty reduction by one half.

For the second consecutive year of penalty liability, we will prorate the penalty reduction by 50 percent if the State failed just one rate; if it failed both rates, it is entitled to a 25 percent reduction.

If the State fails to meet the participation rates for three or more years in a row, we will not reduce the penalty at all. We think that this is a fair and reasonable approach to avoid rewarding a State that has not successfully addressed a persistent problem and that repeated failures is an appropriate indicator of the degree of noncompliance. A State with successive failures could still claim a discretionary work penalty reduction (as discussed below), claim a reasonable cause exception, or enter the corrective compliance process.

We have also added a paragraph indicating that we will adjust the calculations in this section to exclude cases for which a State has granted federally recognized good cause domestic violence waivers. Based on the comments we received in this area, and given our reasonable cause exception policy with respect to cases with federally recognized good cause domestic violence waivers, we thought these waivers should play a similar part in penalty reduction. For comments about domestic violence waivers, please refer to the preamble section entitled "Treatment of Domestic Violence Victims."

To summarize the entire penalty adjustment process, we begin with the proportional reduction based on the amount by which the State exceeded the 50-percent threshold. Second, we calculate the adjustment factor for increasing the number of individuals working and multiply the reduction by the adjustment factor if it is positive, arriving at an adjusted reduction. If the adjustment factor is zero or negative, there is no adjusted reduction. Then we multiply the adjusted reduction by the applicable penalty percentage, derived from whether the State failed just the two-parent rate. Finally, we adjust the penalty based on whether the State failed both rates and on the number of consecutive years of failure.

As we stated earlier, if a State does not qualify for an adjusted reduction, it still may be eligible for the proportional

penalty reduction for failing only the two-parent rate.

In spite of our desire to make this regulation as simple as possible, we realize that this process is more complex than the approach we adopted in the NPRM. We have taken very seriously the commenters' criticism that the proposed penalty reduction provision did not look broadly enough at State success in work. We think the new provision treats States more fairly and will be more effective at encouraging work. Factoring in multiple ways of looking at such success naturally makes the new methodology more complicated. In fact, we considered several of the other alternatives that commenters suggested, but ultimately decided that additional factors would make the calculation too convoluted, without adding to the balance or the work focus.

*Comment:* We received a great many comments about linking the size of the penalty for missing only the two-parent participation rate to the proportion that two-parent cases make up of the State's total caseload. Nearly all agreed with our approach; however, commenters put forward two additional ideas. First, one commenter suggested linking the size of the two-parent penalty to the national two-parent proportion, rather than varying the penalty based on each State's two-parent caseload. The second idea was to provide penalty relief for States that have made policy choices that have expanded the 2-parent caseload.

*Response:* We have not adopted either of these recommendations. While using a national caseload proportion would remove a possible inadvertent incentive for a State to reduce the size of its two-parent caseload, or a disincentive to expand eligibility, two-parent cases are not distributed evenly across the States. Moreover, we think the difference in penalty amounts would not be enough of an incentive to drive State policy regarding two-parent cases.

Regarding the issue of policies that increase the two-parent caseload, we think that our policy of adjusting the penalty base to reflect the two-parent caseload is the appropriate mechanism for helping States with the two-parent participation rate. (We also considered this issue in the context of the caseload reduction factor, as addressed above. Please refer to subpart D of this part for further discussion.)

*Comment:* As we indicated above, we received many comments suggesting alternative measures to use in penalty reduction. We listed above the ones that were most persuasive or appeared most

frequently. The comments included others that we have not listed.

*Response:* We think the new penalty reduction methodology we have adopted gives States credit fairly for making substantive progress in reaching the participation rates and supports State efforts to engage recipients in work. It should be viewed as a whole because its various components are designed to work in combination to achieve a balanced result. While there are other factors that might also have worked well, we believe that we have selected elements that would achieve these goals and are easily calculable.

*Comment:* A few commenters urged us to require a State to have a system for monitoring and enforcing compliance with Federal employment laws within its TANF program in order to qualify for a penalty reduction.

*Response:* As we have indicated earlier, we fully expect States to conduct programs that are lawful and to uphold employment laws that apply to working welfare recipients. We have chosen not to adopt this suggestion out of deference to the enforcement mechanisms already available under Federal law. However, we have created a new regulatory section at § 260.35 to reference existing employment and recipient protections. Please refer to the section entitled "Recipient and Workplace Protections" for a more detailed discussion of this issue.

#### Discretionary Reductions

The final regulations reflect the discretion that we have to reduce the amount of the penalty if the State could qualify as a needy State for the Contingency Fund. The definition of "needy State" at § 260.30 is based on especially high unemployment or large numbers of Food Stamp recipients in the State. (See subpart B of part 264 for more discussion of how a State qualifies for the Contingency Fund.)

Pub. L. 105-33 gave us the added discretion to reduce the penalty if the State failed to meet the participation rate due to extraordinary circumstances such as a natural disaster or regional recession. We have modified this provision from the NPRM to include substantial caseload increases among the examples of extraordinary circumstances. Although this criterion is not given as an example in the statute, based on the comments we received, we believe such a condition could constitute an extraordinary circumstance and think it is appropriate to include it.

To ensure that we take any such circumstances into consideration, States should submit information describing

the extraordinary circumstances and their effects on the ability of the State to meet the participation rates. We must provide a written report to Congress to justify any penalty reductions that we grant under this provision.

One criterion for discretionary reductions is similar to the criterion at § 262.5(a)(1) for granting a reasonable cause exception to a penalty due to a natural disaster. We will evaluate any information a State submits concerning the effects of a natural disaster on its ability to achieve the participation rates. If the material does not support granting a reasonable cause exception, we will consider whether it is sufficient for penalty reduction purposes. For example, if the disaster caused a failure in only one small area of the State, but the State missed the required participation rate by a significant amount, we would not grant a reasonable cause exception, but we might reduce the penalty in proportion to the TANF caseload in that area. We intend to use a similar approach to evaluating the effects of a regional recession.

*Comment:* Some commenters urged us to add other factors to the examples of discretionary reductions. Some suggested an open-ended example such as "other circumstances beyond the State's control" while others gave specific suggestions, including: caseload increase; sub-state recessions; widespread economic disruption from the closing of a plant or significant numbers of lay-offs; chronic unemployment; bad weather; and mismatch between available jobs and skills of recipients.

*Response:* As we indicated above, we have added substantial caseload increases to the list of examples of extraordinary circumstances; however, it is simply a list of examples. We believe the provision leaves the flexibility for a State to make a claim of "extraordinary circumstances" based on other factors. The final regulation indicates, as did the NPRM, that we will consider the objective evidence of extraordinary circumstances that a State submits. We have not specified the basis on which we will evaluate that evidence or apply a reduction. We believe this responds to the recommendation of commenters that we should have flexibility under our rules to address situations that we could not foresee at this writing. Since the extraordinary circumstances are likely to be different in each case, we think it is most appropriate to use the discretion available to us to evaluate the materials that a State submits to determine

whether its claim warrants a reduction in penalty amount.

*Section 261.52—Is There a Way To Waive the State's Penalty for Failing To Achieve Either of the Participation Rates? (§ 271.52 of the NPRM)*

Section 409(b) of the Act creates a reasonable cause exception to the requirement for certain penalties, including failure to meet the minimum participation rates. If we determine that a State has reasonable cause, we cannot impose a penalty.

We have included general reasonable cause criteria at § 262.5. These apply to any of the penalties for which there are reasonable cause exceptions. The preamble to § 262.5 discusses how we arrived at these criteria, as well as our general philosophy about the role of reasonable cause exceptions.

For the work participation rate penalty, two additional, specific reasonable cause exceptions apply. Under the regulation at § 261.52, a State may demonstrate that its failure can be attributed to its granting of federally recognized good cause domestic violence waivers under the Family Violence Option. In this case, the State must show that it would have achieved the required work rates if cases with these waivers were removed from both parts of the calculation (i.e., from the numerators described in §§ 261.22(b)(1) and 261.24(b)(1) and the denominators described in §§ 261.22(b)(2) and 261.24(b)(2)). A State must grant domestic violence waivers in accordance with criteria in subpart B of part 260 to be eligible to qualify as federally recognized good cause domestic violence waivers and to receive a reasonable cause exemption on these grounds. We have explained this policy and responded to comments on this subject in subpart B of part 260.

The regulation also provides that a State may receive a good cause exemption if it demonstrates that its failure to achieve the work participation rates can be attributed to the provision of assistance to refugees in a federally-approved alternative project.

Finally, this section of the regulation indicates that States may dispute our findings that they are subject to a penalty.

*Comment:* Many commenters urged us to expand the reasonable cause exceptions specifically available for failure to meet the work participation rates. They suggested a variety of additional criteria, such as a high incidence of recipients with severe employment barriers, a significant refugee population, correcting unlawful employment discrimination, conflicts

with other Federal requirements (including the FLSA) or litigation, and enforcing the nondisplacement provisions. Some commenters, paralleling the domestic violence exception, suggested that the provision of targeted services to other groups of recipients with significant barriers to employment should entitle a State to a reasonable cause exception. Others recommended many of the same criteria suggested for reducing a participation rate penalty, including caseload increases, economic downturns, and increases in the number of recipients the State engages in work or places in countable activities but below the hours standard. Many also suggested granting a reasonable cause exception for a combination of factors. Also, a number of commenters urged us to leave the reasonable cause criteria in this provision open-ended so that a State could present its arguments for an exception as situations arise and each could be evaluated on its own merits.

*Response:* Although these comments appear in the context of exceptions to the work participation rate penalty, many commenters made the same arguments regarding the general reasonable cause criteria at § 262.5. We have addressed comments that apply broadly to reasonable cause exceptions in that section.

We continue to believe that the best way to address a State's difficulty in meeting a program requirement is through the corrective compliance process. This holds true for the participation rates as much as, if not more than, any other requirement. Families, States, and the Federal government are better served by solving the problem than by forgiving it, or by imposing a penalty. It is for this reason that we have chosen to limit reasonable cause exceptions, particularly those that relate to a specific provision, as in the case of the participation rates, and have not added the criteria suggested. Nevertheless, under § 262.5, a State may present a case for a reasonable cause exception outside the ones specifically listed. We think that the revised language in this section, together with a State's ability to dispute our finding of a penalty, the corrective compliance process, and the opportunities for work penalty reduction, sufficiently recognize the difficulties States may face in meeting the participation rates.

*Section 261.53—May a State Correct the Problem Before Incurring a Penalty? (§ 271.53 of the NPRM)*

The process for developing a corrective compliance plan does not differ from one penalty to the next,



although the content of the plan naturally would. Thus, the regulation refers to § 262.6, the general section on submittal of a corrective compliance plan for any penalty.

Readers should note that § 262.6(e) establishes a maximum corrective compliance period for failure to meet the work participation requirements. Since we measure participation annually, we will measure compliance based on performance during the fiscal year that ends at least six months after we receive the State's corrective compliance plan.

In this section, we establish a specific threshold that States must achieve in order to be considered for a reduced work penalty under § 262.6(j) for making significant progress toward achieving compliance. A State must increase its participation rate during the compliance period enough to fill at least half the gap between the participation rate it achieved in the penalty year and the required rate for the compliance period. In other words, we will divide the difference between the rate achieved during the compliance period and the rate achieved during the penalty year by the difference between the required rate for the compliance period and the rate achieved during the penalty year; a result of at least 0.50, qualifies the State for a possible reduction.

You should note that, in this final rule, the required rate for the compliance period reflects any caseload reduction credit that the State receives under subpart D of part 261. We believe that this adjusted rate reflects the performance standard that Congress intended would apply to States.

We also believe that making more progress toward the rate than failure—that is, achieving at least 50 percent—is a reasonable standard for significant progress. Thus, at the point at which a State reaches this threshold, we may reduce its work penalty under the corrective compliance provision.

This approach is similar to the one taken in § 261.51, with respect to potential reductions in work penalties based on degree of noncompliance. In both cases, we expect significant compliance in order to merit a reduced penalty. However, we look at performance over different periods in the two provisions.

*Comment:* Several commenters thought that the 50-percent standard of achievement measured against the "new" rate was restrictive and arbitrary. Commenters proposed two basic alternatives. Many urged us to set a threshold of achievement based on a particular State's circumstances or to negotiate a State's threshold in the

corrective compliance plan process. Some thought that we should consider a State to be in compliance if it achieves the participation rate associated with the year for which it was subject to the penalty. (Presumably, if we were to use a threshold to reduce the penalty in this scenario, it would be applied against the latter rate.) One commenter thought that we should link the threshold to the average increase among States with corrective compliance plans, and another suggested that States should be able to show significant improvement by means other than reaching the threshold. Another commenter remarked that we made no provision for circumstances arising in the year following the penalty year that prevent a State from reaching the threshold.

*Response:* We note that this provision applies a second reduction to a State's penalty amount, the first (described at § 261.51) having been significantly expanded over the original proposal. This reduction follows a corrective compliance period in which the State should have been applying the steps of its plan to resolve the participation rate problem. Given these circumstances, we think it is appropriate to maintain a fairly rigorous standard for reducing a penalty still further. Moreover, we do not think that a 50-percent threshold is overly demanding—it simply requires a State to be more successful, rather than less successful, in coming into compliance. We measure progress against the "new" rate (i.e., the one that applies for the corrective compliance plan year) because to do otherwise would suggest that the State is not being held to the same standard as all the others for that year. Otherwise, we would effectively give a State an extra year to achieve the minimum participation rate. We expect a corrective compliance plan to allow a State to come into compliance with the applicable rates. Thus, the penalty reduction associated with corrective compliance should use that standard.

If circumstances arise during the corrective compliance plan period that prevent the State from achieving the threshold, it is free to claim a reasonable cause exception or develop a corrective compliance plan for the penalty year, but we do not think it is appropriate to reduce the prior penalty on that basis. In addition, the State might qualify for penalty relief under § 262.6(j)(2), relating to natural disasters or regional recessions during the compliance period.

*Section 261.54—Is a State Subject to Any Other Penalty Relating to Its Work Program? (§ 271.54 of the NPRM)*

In accordance with section 409(a)(14) of the Act, as amended by Pub. L. 105-33, if we determine that a State has violated 407(e) of the Act in a fiscal year, which relates to when a State must impose penalties on individuals who refuse to engage in required work, we must reduce the SFAG payable for the following fiscal year by between one and five percent of the adjusted SFAG.

*Comment:* One commenter thought we did not provide adequate guidance concerning the means by which we will judge whether a State has violated the sanctioning requirement. Without such guidance, the commenter thought that States might sanction families more severely than necessary to avoid a potential penalty.

*Response:* As we indicated at § 262.3, we will use the single audit to assess whether a State is complying with section 407(e) of the Act and thus whether it is liable for a penalty under this provision. We expect that, if there are widespread problems with States' sanctioning practices, our data collection and the audits will help identify them.

While we understand the commenter's concern that States will "over-sanction" to avoid this penalty, it is important to understand that this penalty applies both to a State's failure to sanction when it should have and to its imposition of a sanction when it should not have imposed one. Thus, a State that overreacts by sanctioning too readily could be equally liable for a penalty. If the commenter is concerned that States will impose larger sanctions than they would otherwise, we would point out that States have the explicit authority, independent of this penalty provision, to impose sanctions that are greater than pro rata reductions, up to and including terminating assistance to the case.

*Comment:* One commenter objected to our intention to collect sanction policy information via § 265.9, stating that such information was available in the TANF State plans.

*Response:* While some States may have included sanctioning policies in their TANF plans, the statute does not require it. Thus, we cannot count on obtaining this information through the plans. Also, at best, the plan information would only tell us about State policy, not State practice (e.g., the nature and scope of sanctions imposed).

*Section 261.55—Under What Circumstances Will We Reduce the Amount of the Penalty for Not Properly Imposing Penalties on Individuals? (§ 271.55 of the NPRM)*

The statute requires us to reduce the amount of the penalty based on the degree to which the State is not in compliance with the section 407(e) of the Act.

In determining the size of any reduction, we will consider two factors. First, we will examine whether the State has established a control mechanism to ensure that the grants of individuals are reduced for refusing to engage in required work. Second, we will consider the percentage of grants that the State has failed to reduce in accordance with the statute.

As we indicated in the preamble to § 261.14, States have the discretion to define the term pro rata reduction. Under § 265.9, as part of the annual report we require each State to provide us with a description of how it will carry out a pro rata reduction. This information will help us determine whether States are taking sanctions appropriately. Also, these definitions will help us determine whether States face an equitable and level playing field under this penalty provision.

Some commenters noted that the proposed rules incorrectly specified that reasonable cause and corrective compliance did not apply to this penalty. We have deleted the provision that included this inadvertent error.

*Comment:* One commenter urged us to clarify what we mean by control mechanisms.

*Response:* We did not want to limit a State's range of possible control mechanisms by creating a single definition. However, one example of a possible control mechanism would be a system that identifies cases in which an individual refused to participate, then cross-checks those cases against information on sanction actions, and corrects any errors in sanctioning.

Although we did not define a control mechanism in the regulation, there are some additional elements that we expect a State to include in a control mechanism to ensure appropriate sanctioning of recipients. Section 402(a)(1)(B)(iii) of the Act provides that a State must set forth objective criteria for fair and equitable treatment of recipients, including an explanation of how the State will provide an opportunity for recipients who have been adversely affected to be heard in a State administrative or appeal process. We think that any State mechanism that controls whether sanctions have been

imposed properly should ensure that recipients are informed of their rights to fair hearings and advised of the process for invoking that right. In addition, we encourage States to consider adding procedures to advise recipients of their rights to pursue other remedies that might be available under State and local laws.

*Comment:* A commenter, citing the fact that States have a right under the regulations at § 262.7 to appeal a finding that it is subject to a penalty, urged us to ensure that individuals are accorded a similar right.

*Response:* As we explained in the previous comment, section 402(a)(1)(B)(iii) of the Act accords recipients the right to appeal adverse actions. While we are not regulating this provision itself, we do expect that States will address this requirement as part of their sanctioning control mechanisms, and we will take it into consideration in determining any reduction to the amount of this penalty.

*Comment:* A commenter expressed concern that examining only sanctioning data, without data from cases not sanctioned, as the basis for the penalty would lead to unnecessarily harsh sanctions. The commenter recommended basing the penalty determination solely on whether the State has established control mechanisms.

*Response:* As we indicated in the previous section, this penalty applies to all violations of the sanctioning requirement, whether failing to sanction inappropriately or imposing sanctions inappropriately. For example, we anticipate sampling sanctioned cases to determine whether a State has imposed sanctions without evidence of a recipient's refusal to participate. Thus, a State has just as much incentive to exercise restraint in sanctioning as to impose sanctions too readily. At the same time, States may impose sanctions that are greater than pro rata reductions without violating section 407(e) of the Act.

*Comment:* A commenter urged us to base the penalty amount on the amount of the sanctions that should have been imposed, as a percentage of the total amount of grants the State awards, or as a percentage of the total grants that should have been reduced but were not.

*Response:* This approach seems overly complex to us. We see no advantage to basing the reduction on dollar amounts instead of case percentages.

*Comment:* A commenter recommended that we allow a tolerance for errors before imposing a penalty under this provision.

*Response:* We have built a tolerance for errors into the reasonable cause exceptions at § 262.5. In addition, States have the right to dispute our determination that it is subject to a penalty, in accordance with the provision at § 262.4.

*Comment:* A commenter urged us to deem 80-percent compliance as full compliance with the requirement because the penalty amount must be between 1 and 5 percent.

*Response:* We have not established a specific formula for determining and reducing the amount of the penalty. We will factor in objective evidence of whether the State has established a control mechanism, as discussed above, and of how many cases have been improperly sanctioned.

*Section 261.56—What Happens if a Parent Cannot Obtain Needed Child Care? (§ 271.15 of the NPRM)*

Readers will note that we have moved the substance of this section from § 271.15 of the NPRM to § 261.56 of the final rule. The proposed rules contained two sections dealing with the question of sanctions for parents of young children who refuse to work because they cannot find needed child care. The first section specifically addressed the statutory protections from sanctioning available to such individuals who could not obtain child care; the second dealt with the penalties that a State would face if it sanctioned individuals in violation of the exception. Because of the close interrelationship between these two provisions and the number of comments we received on them, we thought that putting the regulatory sections adjacent to one another would make the provisions easier to follow. We have retained § 261.15 to ensure that subpart A, which relates to the responsibilities of individuals under TANF, continues to discuss the child care exception.

To support the intent of the statute to move people to work, section 407(e) of the Act requires that States reduce or terminate assistance to individuals who refuse to engage in work required by section 407 of the Act. However, as we discussed in the preamble to § 261.15, a State may not reduce or terminate assistance to a single custodial parent caring for a child under age six for refusing to engage in required work, if the parent demonstrates an inability (as determined by the State) to obtain needed child care. This exception applies to penalties the State imposes for refusal to engage in work in accordance with either section 407 or section 402(a)(1)(A)(ii) of the Act. The

parent's demonstrated inability must be for one or more of the following reasons:

- Appropriate child care within a reasonable distance from the individual's home or work site is unavailable;
- Informal child care by a relative or under other arrangements is unavailable or unsuitable; or
- Appropriate and affordable formal child care arrangements are unavailable.

Refusal to work when the State determines an acceptable form of child care is available is not protected from sanctioning.

Because each State has the authority to determine whether the individual has adequately demonstrated an inability to obtain needed child care, we expect the State to define the terms "appropriate child care," "reasonable distance," "unsuitability of informal care," and "affordable child care arrangements." The State must also provide families with the criteria (including the definitions) that it applies in implementing the exception and the means by which a parent can demonstrate an inability to obtain needed child care.

To keep families moving toward self-sufficiency and to promote State compliance with this penalty exception, our rules provide that States must have processes or procedures in place that: (1) enable a family to demonstrate its inability to obtain needed child care; (2) inform parents that the family's benefits cannot be reduced or terminated when they demonstrate that they are unable to work due to the lack of needed child care for a child under the age of six; and (3) advise parents that the time during which they are excepted from the penalty will still count toward the time limit on Federal benefits at section 408(a)(7) of the Act, if applicable.

In response to numerous comments, as discussed below, the language in §§ 261.56 and 261.57 reflects these expectations. In this section, which focuses on the responsibilities of the State to inform parents, we also require that the information States provide must include the definitions or criteria that the State uses in its determination process.

The regulations for the Child Care and Development Fund (CCDF) reinforce the importance of providing this vital information to parents by also requiring the child care lead agency, as part of its consumer education efforts, to inform TANF parents seeking child care in the CCDF system of the existence of the child care exception and how to demonstrate an inability to obtain needed child care.

The CCDF rule requires the lead agency for child care to coordinate with the TANF agency in order to understand how the TANF agency defines and applies the terms of the statute regarding the penalty exception and to include the definitions of the terms or criteria in the CCDF plan.

We took this child care rule into consideration in drafting our proposed rule. Under § 271.15, we required that the definitions and criteria be submitted, but did not specifically require that the TANF agency submit them. Our goal was to ensure that this information was available for audit and penalty purposes and that it be part of the public record, not to create an unnecessary burden for States. We have not altered this policy in these final regulations.

We received many comments on the provisions in this section and made changes as discussed below.

*Comment:* Most commenters objected to having the responsibility for informing families about the child care exemption in the hands of the child care lead agency and urged that we give the responsibility to the TANF agency.

*Response:* In the NPRM, we did not specifically require the TANF agency to inform clients about the exception to sanctioning because the CCDF NPRM (now the CCDF final rule) already required it. In the NPRM preamble, we stated our expectation that States would inform clients, but did not name the entity responsible. Our intent was to avoid imposing an additional Federal burden on the States where the CCDF requirement addressed the situation adequately. However, advocates and States alike made a compelling argument that not all TANF clients covered by this protection would necessarily be referred to the child care lead agency. Therefore, we have revised the regulatory language at § 261.56. In the final rule, the TANF agency must inform clients of the existence of the child care exception to sanctions and how to demonstrate an inability to obtain needed child care. This requirement is in addition to the requirement, in the CCDF rules, that the CCDF agency inform TANF parents about the exception.

*Comment:* Many States objected to our requiring criteria and definitions, arguing that we had shifted the burden of proof from the individual to the State. We also received a few general comments to the effect that our rules did not adequately protect individuals from harsh State policies.

*Response:* We do not believe that requiring States to inform parents of their rights, including the definition of

key terms in those rights, shifts the burden of proof to States. The individual needs to know how the State defines key terms to determine whether the exception applies to his or her case.

Regarding the concern over harsh State policies, States have considerable latitude in implementing the child care protections. We think the final regulations protect families as much as possible, given the regulatory restraints of section 417.

*Comment:* A few commenters urged us to require States to inform recipients about available child care subsidies and to assist them in obtaining appropriate and affordable child care.

*Response:* While we agree that assisting recipients locate child care is a reasonable expectation, the statute at section 417 limits our ability to regulate in this area. Given that child care is widely recognized as a fundamental supportive service, necessary for recipients to obtain and maintain employment, we are confident that States will adopt practices that inform recipients about available child care providers. States understand the importance of employment retention and career advancement for recipients. In fact, the publication "Working Out of Poverty" by the NGA Center for Best Practices, recognizes the need to inform recipients of the availability of transitional supports such as child care and transportation assistance early, for example, during eligibility determinations and assessments, and as part of job search and job readiness programs.

*Comment:* Some commenters were concerned that the NPRM left room for a parent who wishes to use a particular type of child care that is not available to refuse appropriate available child care arrangements, without risk of a penalty. For example, they feared that a parent who wants only informal relative care, but has no relative available to provide care, could refuse affordable, suitable center-based care. States argue that this result would be contrary to Congressional intent and the goals of the Act. They urged us to make clear that refusing work under such circumstances is not protected under the child care exception to a sanction.

*Response:* This issue stems from an interpretation of the wording of the statute, which uses the phrase "one or more" in describing the reasons for a parent's demonstrated inability to obtain needed child care. However, we agree with the commenters that such a result would be contrary to Congressional intent, which was to protect individuals from sanction when there was no appropriate child care, not

to give families a loophole to avoid work requirements. Further, such an interpretation would be contrary to the best interest of the family, because the TANF clock continues to run during such a period. Therefore, we have revised the regulatory language at § 261.56 to clarify that refusing to work when an acceptable form of child care is available is not protected from sanctioning.

*Comment:* One commenter was concerned that the NPRM, as written, might create a larger problem of inadequate child care due to informal, uncertified or unlicensed child care providers. The commenter was concerned that this would result in caregivers with inadequate training in child development or basic life-saving skills, poor or no curriculum, or no health or dental care referrals.

*Response:* The statute, as reflected in the NPRM, intended to give parents some choice in child care arrangements. Informal care is only one possible type of child care arrangement that families could use. If the State uses CCDF funds to provide child care, the regulations governing the CCDF program require States to have standards for informal providers, as well as those providers who are licensed. Under TANF, we do not have the authority to regulate child care providers. Accordingly, we have not amended the rules in response to the comment.

*Section 261.57—What Happens if a State Sanctions a Single Parent of a Child Under Six Who Cannot Obtain Needed Child Care? (§ 274.20 of the NPRM)*

As we discussed in the prior section, the statute at section 407(e)(2) protects single custodial parents of children under age six from sanction for refusing to work when they cannot obtain needed child care. They must demonstrate that they could not obtain child care for one or more of the following three reasons: (1) Appropriate child care was not available within a reasonable distance from the parent's home or work site; (2) informal child care, by a relative or under other arrangements, was unavailable or unsuitable; and (3) appropriate and affordable formal child care arrangements were unavailable. However, refusal to work when an acceptable form of child care is available is not protected from sanctioning.

Section 409(a)(11)(A) of the Act directs the Secretary to reduce by no more than five percent of the adjusted SFAG, the SFAG payable to a State that violates this sanctioning protection. To

determine that a State is liable for a penalty, we must find that the State reduced or terminated assistance to a parent who qualified for a sanctioning exception under the definitions or criteria that the State developed regarding a parent's "demonstrated inability" to obtain needed child care.

We will consider the following factors in determining whether a State has violated the exception to the sanctioning requirement at section 407(e)(2) of the Act:

- Whether the State informs families about the exception to the penalty for refusing to work, including the fact that the exception does not extend the time limit on benefits;
- Whether the State informs families about the process or procedures by which they can demonstrate an inability to obtain needed child care;
- Whether the State has defined "appropriate child care," "reasonable distance," "unsuitability of informal care," and "affordable child care arrangements," and informed parents of these definitions;
- Whether the State notifies the parent of its decision to accept or reject the parent's demonstration in a timely manner;
- Whether the State has developed alternative strategies to minimize the amount of time parents are excepted from work requirements due to their inability to obtain needed child care. For example, a State that uses the services of a child care resource and referral office might grant "good cause" based on a statement from that office attesting to the unavailability of appropriate or affordable child care. However, it could implement a system for automatically rechecking the availability of care every few weeks. If the inability to work were due to difficulty in arranging transportation, the State could use bus and rail rates and schedules to help the recipient find appropriate child care within a reasonable distance.

We are not specifying the process or procedures that States should develop or the documents, if any, States should require. However, we suggest that, if States plan to require documents, they select ones that are readily available to families. We recommend that the process or procedures be simple and straight-forward. In addition, we recommend frequent contact with parents, since the penalty exception does not stay the time limit and there may be fluctuations in the availability of child care services.

We will impose the maximum penalty if a State does not have a process or procedure in place that enables families

to whom this provision applies to demonstrate that they have met the guidelines provided by the State. Additionally, we will impose the maximum penalty if there is a pattern of substantiated complaints from parents or organizations verifying that a State has reduced or terminated assistance in violation of the requirement at section 409(a)(11) of the Act. We may impose a reduced penalty if the State demonstrates that the incidents were isolated or that a minimal number of families were affected.

States faced with a penalty under this provision may claim reasonable cause and/or submit a corrective compliance plan as described in part 262.

We expect that, because of the interrelationship between TANF and CCDF, TANF staff will work in close coordination with the lead agency for child care. Our expectation is that TANF staff will provide families with information about the penalty exception and the process and procedures developed by the State to demonstrate an inability to obtain needed child care. Under the CCDF rule, ACF requires that the lead agency for the CCDF program provide the same information to TANF parents who are seeking child care in the CCDF system. In addition, ACF requires the lead agency for child care to include in the CCDF plan the TANF agency's definitions for "appropriate child care," "reasonable distance," "unsuitability of informal care," "affordable," and "child care arrangements." Thus, we expect the State TANF agency to share its definitions of these terms with the child care agency. Both agencies will then be able to share them with families whom they may be assisting with child care arrangements.

We received few comments on this section. They are discussed below. We also made one minor editorial change to § 261.57(c); the word "will" was changed to "may" in recognition of the variables that we need to consider in a decision to impose a reduced penalty.

*Comment:* One commenter suggested that we should review a sample of cases of sanctioned individuals to ensure that they were actually informed of their rights and that the State did not disregard a demonstration of the lack of availability of care.

*Response:* We agree. Since the primary vehicle for monitoring the requirement will be the single State audit, we are developing procedures that include the review of a sample of cases in which benefits have been reduced or terminated due to a parent's failure to comply with the work requirements.

*Comment:* One commenter disagreed with the proposed regulation because States are threatened with penalties based on isolated instances when they do not follow the procedures they have reported to us. The commenter argued that imposing a penalty for isolated noncompliance would have a chilling effect on enforcing work-related sanctions.

*Response:* We disagree with the comment. In the proposed rule, we stated that we would impose the maximum penalty of five percent if: (1) The State did not have a statewide process in place that enables families to demonstrate their inability to obtain child care (although the State's process does not need to be uniform statewide, there simply needs to be a process in all areas of the State); and (2) there were a pattern of substantiated complaints that verifies that a State had terminated assistance in violation of the requirement. A "pattern of substantiated complaints" does not include isolated cases that affect few families and occur in relatively few jurisdictions. This means that we will not impose a maximum penalty based on a few aberrant situations when it is clear that the State established a statewide procedure. Accordingly, we have not modified the final rules in this regard.

#### *Subpart F—How Do Welfare Reform Waivers Affect State Penalties?*

##### *Section 261.60—How Do Existing Welfare Reform Waivers Affect a State's Penalty Liability Under This Part? (§ 271.60 of the NPRM)*

Based on our changes to the regulatory provisions relating to waivers, we have modified this section. Under the NPRM, this section described how welfare waivers affected the participation rates. In the final rule, it merely cross-references subpart C of part 260, which addresses welfare reform demonstration waivers comprehensively.

We have responded to all comments relating to waivers in the preamble section entitled "Waivers."

#### *Subpart G—What Nondisplacement Rules Apply in TANF?*

##### *Section 261.70—What Safeguards Are There To Ensure That Participants in Work Activities Do Not Displace Other Workers? (§ 271.70 of the NPRM)*

The regulations incorporate the statutory prohibition against allowing an individual participating in TANF work activities from displacing another employee. A participant in a work activity may not fill a vacancy that exists because another individual is on

layoff from the same or equivalent job. Also, a participant may not fill a vacancy created by an involuntary reduction in workforce or by the termination of another employee for the purpose of filling a vacancy with a participant.

The statute and the final rule also require States to establish and maintain grievance procedures for resolving complaints of alleged violations of the restrictions on displacing workers. Readers should note that we have added a new reporting requirement at § 265.9(b)(7), under which each State must provide us with a description of its grievance procedures for resolving complaints of displacement as part of its annual report if it has not included a description in its State TANF plan.

We encourage States to take aggressive steps to ensure that the current work force is not harmed or their employment jeopardized in any way by a State's efforts to place welfare recipients in employment or work-related positions. Our ultimate goal, and that of States, is to increase the ranks of the employed, not to substitute one group of job-seekers for another. Displacing current workers is counter-productive and damages the overall stability of the labor force. We are confident that States will develop procedures for working with employers to protect against displacing other employees.

*Comment:* A few commenters urged us to establish minimum standards for State grievance procedures and to require that a State notify workers of those procedures and of the remedies available to displaced workers. Similarly, another commenter urged us to create standards for other aspects of this provision. At least one commenter recommended that, if we thought we did not have the authority to impose such requirements, then instead we should deny penalty reduction to States that do not establish effective grievance procedures or ensure widespread notice of their procedures.

Some commenters urged us to reference the WtW interim rules, which included more extensive nondisplacement provisions, and to recommend that States use one set of grievance procedures for both programs.

*Response:* Section 417 of the Act limits the authority of the Secretary to regulate the conduct of States or enforce TANF provisions, except where specifically provided for in the statute. Thus, it is not consistent with the principle of State flexibility embodied in PRWORA for us to regulate a State's administrative procedures. In particular, in this provision, there is an explicit

expectation of deference to State and local laws, which we have reflected in paragraph (c) of this section. Moreover, we do not have penalty authority with respect to the enforcement of the nondisplacement provision and would be reluctant to create a structure that duplicates or conflicts with existing enforcement mechanisms that have a clear foundation under law. For these reasons, we have not modified the regulation to establish minimum standards for grievance procedures or to deny access to penalty reduction.

Using one set of grievance procedures for both programs should prove easier for States, employers, and workers alike. We urge States to consider adopting this approach. However, we note that not all States have established WtW programs, and there may be reasons that a unified grievance procedure would not be appropriate.

*Comment:* One commenter urged us to add several provisions to the nondisplacement section in order to prevent displacement more broadly. The suggested additions included prohibiting filling a position that: would otherwise be a promotional opportunity for a current employee; did not comply with applicable personnel procedures; was caused by a strike or other labor dispute; or was an established unfilled public agency position, unless unfunded in the budget.

*Response:* The nondisplacement provisions in the statute are very explicit. Under PRWORA, we do not have the authority through regulations to expand the definition of nondisplacement, even if we support the commenter's suggestions. However, expanded definitions may be available under State law or policy.

*Comment:* One commenter asked us to explain how we would educate State welfare administrators regarding compliance with the nondisplacement provisions.

*Response:* The section entitled "Recipient and Workplace Protections" describes initiatives by various agencies within our Department and elsewhere in the Federal government to inform State agencies about the requirements of Federal employment laws. Please refer to that section for further information on these efforts.

#### **VII. Part 262—Accountability Provisions—General (Part 272 of the NPRM)**

As we noted earlier in the preamble under our discussion of waivers, we moved the waiver provisions of § 272.8 of the NPRM to subpart C of part 260. You will find the comments that we received on § 272.8 there.

*Section 262.0—What Definitions Apply to This Part? (§ 272.0 of the NPRM)*

This section cross-references the general TANF regulatory definitions established under part 260.

We received no comments on this section.

*Section 262.1—What Penalties Apply to States? (§ 272.1 of the NPRM)*

Section 409 includes 15 penalties that may be imposed on States. This rule covers 14 of the 15. This rule does not include the specific penalty dealing with substantial noncompliance with requirements under title IV–D (section 409(a)(8)). Our Office of Child Support Enforcement is addressing this penalty in a separate rulemaking. However, since the penalty is one of the TANF penalty provisions, the general procedures and the appeal process in this rulemaking will apply.

The penalties that we are regulating are:

(1) A penalty for using the grant in violation of title IV–A of the Act, as determined by findings from a single State audit and equal to the amount of the misused funds;

(2) An additional penalty of five percent of the adjusted SFAG, based on our determination that such misuse was intentional;

(3) A penalty of four percent of the adjusted SFAG for the failure to submit an accurate, complete and timely required report;

(4) A penalty of up to 21 percent of the adjusted SFAG for the failure to satisfy the minimum participation rates;

(5) A penalty of no more than two percent of the adjusted SFAG for the failure to participate in the Income and Eligibility Verification System (IEVS);

(6) A penalty of no more than five percent of the adjusted SFAG for the failure to enforce penalties on recipients who are not cooperating with the State Child Support Enforcement agency;

(7) A penalty equal to the outstanding loan amount plus interest for the failure to repay a Federal loan provided for under section 406;

(8) A penalty equal to the amount by which qualified State expenditures fail to meet the appropriate level of historic effort in the operation of the TANF program;

(9) A penalty of five percent of the adjusted SFAG for the failure to comply with the five-year limit on Federal funding of assistance;

(10) A penalty equal to the amount of contingency funds that were received for a fiscal year, but were not remitted by a State, if the State failed to maintain 100 percent of historic effort in the

operation of its TANF program in that year;

(11) A penalty of no more than five percent of the adjusted SFAG for the failure to maintain assistance to an adult single custodial parent who cannot obtain child care for a child under age six;

(12) A penalty of no more than two percent of the adjusted SFAG, plus the amount a State has failed to expend of its own funds, to replace the reduction to its SFAG due to the assessment of penalties under § 262.1 in the fiscal year that immediately succeeds the year in which the reduction was made;

(13) A penalty equal to the amount of the State's Welfare-to-Work formula grant for failure to maintain the required historic effort during a year in which a State receives this formula grant; and

(14) A penalty of not less than one percent and not more than five percent of the adjusted SFAG for failure to impose penalties properly against individuals who refuse to engage in required work in accordance with section 407 of the Act.

If applicable, in calculating the amount of the penalty, we will use the adjusted SFAG as defined in § 260.30. Except for the penalty at § 262.1(a)(12), all penalties are either a percentage of the adjusted SFAG or a fixed amount. In calculating the amount of these penalties, we will add all applicable penalty percentages together, and we will apply the total percentage reduction to the amount of the adjusted SFAG that would have been payable if we had assessed no penalties against the State. As a final step, we will subtract other (fixed) penalty amounts.

The penalty at § 262.1(a)(12) requires that we reduce a State's adjusted SFAG if, in the fiscal year immediately following the fiscal year when we have taken a penalty under this section, a State does not expend its own funds on the State's TANF program in the amount of the penalty (i.e., the amount by which we reduced the adjusted SFAG). Unlike the other penalties, this penalty represents both a percentage of the adjusted SFAG (up to two percent) and a fixed amount (the amount of the reduction a State has failed to expend replace with its own funds). We believe it is appropriate to calculate the amount of this penalty by including the amount of the penalty based on a percentage with other applicable penalty percentages. We will then subtract the fixed amount of this penalty with the other fixed-amount penalties. Finally, we will add the amount based on the percentage for this penalty and the fixed amount for this penalty to determine the total amount of this penalty.

We will not reduce a State's quarterly grant by more than 25 percent. If the 25-percent cap prevents us from recovering the full penalty imposed on a State all at once, we will apply the remaining amount to the SFAG payable for the immediately succeeding quarters until we have finally taken the penalty in full.

In preparing this final document, we noticed a few places where we should revise the regulatory text to be clearer.

- In both the preamble discussion and the regulations of the NPRM, we may not have described the Contingency Fund MOE penalty and the penalty for failure to replace penalty amounts clearly enough. Accordingly, we have clarified the regulation at § 262.1(a)(10) to say that we may penalize a State for failure to remit contingency funds if it does not incur State TANF expenditures (i.e., State expenditures within its TANF program) equal to at least 100 percent of its historical State expenditures. In determining Contingency Fund MOE requirements, historical State expenditures do not include expenditures under the IV–A child care programs.

- At § 262.1(a)(12), we have clarified that States must replace penalty amounts in the year after we actually take the penalties.

- At § 262.1(a)(2), we have clarified that the penalty for intentional misuse is in addition to the penalty for misuse.

We received some comments on the provisions in this section and have made a few changes to the regulations, as noted in our responses to the comments below.

*Comment:* Some commenters expressed the view that the regulations placed too much emphasis on penalties and included too many penalties. Another commenter mentioned that these provisions will lead to an adversarial relationship reminiscent of the one that previously surrounded quality control penalties under AFDC.

*Response:* The statute mandates all of the penalties included in these regulations. As we mentioned in the NPRM, it is clear that Congress intended for State flexibility to be balanced with State accountability. To assure that States fulfilled their new responsibilities under the TANF program, Congress established a number of penalties and requirements under section 409(a). The penalties indicate the areas of State performance that Congress found most significant and for which it gave us clear enforcement authority. While we want to maintain supportive partnerships with States, we cannot avoid our responsibilities under the statute. Although the regulation may seem unduly slanted toward penalties,

this is because we have limited authority to regulate outside the penalty provisions. Most of program policy and design is up to the States and is not the subject of regulations.

*Comment:* One commenter asserted that only one penalty, the one that will be imposed if a State fails to maintain assistance to an adult single custodial parent who cannot obtain child care for a child under age six, focuses on protecting and serving families and children.

*Response:* We do not agree with this observation. All of the penalties have been enacted to assure that States operate programs that promote the goals of the legislation. Many are designed to ensure that States use Federal and State funds appropriately to provide assistance to needy families and end dependence by promoting work and self-sufficiency. Even the penalty for failure to submit an accurate, complete and timely report supports program goals in that it requires States to submit information about what is happening to needy families and whether specific requirements are being met. Also, as we have said elsewhere in this preamble, the penalty system is part of a much broader structure that helps to protect families and promotes positive State responses to the opportunities under TANF.

*Comment:* A few commenters pointed out that some of the penalties are inter-related and can have an escalating impact on States, i.e., if a State fails one provision, it is likely to fail one or two others. A commenter suggested that instead of imposing penalties and requiring States to replace funds lost due to penalties, we should require States to reduce claims for disallowed costs. Another argued that States should reinvest penalty amounts since withholding funds may have the effect of making it more difficult for the States to achieve the goals of the program.

*Response:* In establishing this new block grant program, Congress wanted to give States flexibility to design programs that would best serve their families. It enacted the penalty provisions in order to assure that States use funds to achieve TANF program goals. The law requires States to replace penalty amounts with their own funds so that they will continue to serve needy families and meet the requirements of the Act. Congress also enacted a maximum on the total penalty amount that can be taken in any year in order to protect the interests of needy families and children in the State.

*Comment:* A commenter suggested that we should not design a system that perpetuates failure based upon failure,

but, instead, we should design a system that rewards States for excellence.

*Response:* Although it felt the penalties were necessary to focus State performance, Congress did not rely solely on penalties to ensure that States work towards achieving program goals. As we previously discussed, it also enacted provisions to reward States for excellence when it established bonuses for high performance and for decreases in out-of-wedlock births.

*Comment:* One commenter noted that the statute specifies that the penalty for failure to meet the basic MOE requirement applies for fiscal years 1998 through 2003 and suggested that we include this limit in our regulations.

*Response:* Since the TANF program is currently funded only through fiscal year 2002, we did not think it was necessary to include this limitation in our regulations. When Congress re-authorizes TANF, it could well extend this provision in the statute. As the rules are written, we would not need to reissue regulations to keep them current. If the provision were not extended, the penalty would no longer be in effect, and we would consider making conforming changes to the rules.

*Comment:* A commenter asked if there is a penalty that applies when a State fails to screen applicants and recipients and thus fails to deny assistance to fleeing felons, or parole or probation violators.

*Response:* The statute, at section 408(a)(9), prohibits States from using their Federal TANF funds to provide assistance to fugitive felons and probation and parole violators. While there is no specific penalty covering this prohibition, the penalty for misuse (or intentional misuse) of funds will apply if States provide TANF assistance to such individuals.

*Comment:* In the NPRM, we based penalties on the amount of the SFAG minus any reductions due to the implementation of a Tribal TANF program, without consideration of any transfers of funds to the Discretionary Fund of the Child Care and Development Fund (CCDF) and/or the Social Services Block Grant (SSBG). While one commenter expressed appreciation for the fact that we assessed penalties against the adjusted SFAG, other commenters asked that, for the sake of consistency and fairness (since we subtracted transferred amounts before applying the administrative cost cap), we should consider transfers of funds to the CCDF and/or the SSBG in determining the adjusted SFAG.

*Response:* As we discuss elsewhere, we have revised the definition of the

adjusted SFAG to remove any funds transferred to the Discretionary Fund of the CCDF and/or the SSBG. The adjusted SFAG will be the same as the SFAG for States without Tribal grantees and with no transfers of funds to the Discretionary Fund of the CCDF or the SSBG. You can find additional discussion of this issue in the preamble discussions for §§ 260.30 and 263.0.

*Comment:* We received some comments about our interpretation of the statutory language that requires penalties to be imposed "for the immediately succeeding fiscal year" or the "immediately succeeding fiscal quarter." Commenters pointed out that we did not follow the statute precisely, but did not express opposition to our interpretation.

*Response:* We are applying penalties for the fiscal year (or quarter) immediately following our final decision in order to establish a practical method for implementing the statute. This method allows us to give States the opportunity to plead reasonable cause and to correct violations under corrective compliance plans before we actually take a penalty. Consequently, as one commenter noted, it is possible that a State might incur a violation in FY 1998, be determined to be subject to a penalty in FY 1999, and actually have its funding reduced in FY 2000.

*Comment:* A commenter pointed out that, rather than limiting penalty reductions to a State's grant to 25 percent during a fiscal year, the statute prohibits us from reducing any quarterly payment by more than 25 percent. Another commenter asked us to clarify this provision.

*Response:* The commenter is correct that the statute does not permit us to reduce any quarterly payment by more than 25 percent. While on an annual basis, capping each quarter's reduction at 25 percent would be the same as capping the annual reduction at 25 percent, there could be a difference when penalty reductions begin mid-year, as provided under § 262.1(c)(1). We have modified the language at § 262.1(d) slightly to clarify that we will not withhold more than 25 percent of a State's quarterly grant.

*Comment:* A commenter asked that we assess the penalties in four equal quarterly installments during the year.

*Response:* The statute requires us to take some penalties by reducing the SFAG payable for the quarter that immediately follows our final decision. In these cases, if the amount exceeds 25 percent of the SFAG payable for that quarter, we will take the remaining amount from the next quarter's SFAG.

The statute requires us to take the majority of penalties by reducing the SFAG payable for the fiscal year that immediately follows our decision. In these cases, if taking the penalty in a single quarter would have an adverse impact on the State's ability to administer the TANF program, the State may ask that we take the penalty in two, three, or four quarterly installments in the fiscal year. However, we must take the full amount during that fiscal year unless we are prevented from doing so by the 25-percent cap. Also, we would take a minimum of the pro-rata share of the penalty amount from each quarter's grant; in other words, we would not allow States to defer a disproportionate share of the penalty amount to the latter part of the fiscal year.

*Comment:* A couple of commenters noted that, in paragraphs 272.1(c)(1) and (c)(2), we incorrectly categorized when we would take two of the penalties.

*Response:* The commenters are correct. We made errors in listing when we would take the penalties for failure to repay a Federal loan or to enforce child support penalties. We have corrected paragraphs § 262.1(c)(1) and (c)(2) of the regulations to indicate that we will take penalties for failure to repay a Federal loan by reducing the SFAG payable for the quarter that immediately follows our final decision and penalties for failure to enforce child support penalties by reducing the SFAG payable for the fiscal year that immediately follows our final decision.

*Comment:* Another commenter argued that, if we take penalties in the quarter following our final decision, it will be difficult for States to fill in with their own funds.

*Response:* The statute requires us to take any penalties for misuse of funds and failure to repay a Federal loan by reducing the SFAG payable for the quarter that immediately follows our decision. Generally, however, States will have an early indication that these penalties are likely to occur and will be able to plan accordingly.

#### *Section 262.2—When Do the TANF Penalty Provisions Apply? (§ 272.2 of the NPRM)*

Congress recognized that, in certain circumstances, States should face the consequences for failing to meet the requirements of the penalty provisions from the first day the State operates the TANF program. It also recognized, however, that States needed some lead time in implementing other TANF requirements.

Section 116(a)(2) of PRWORA delayed the effective date of some of the penalty provisions in title IV-A. For those

provisions where it did not delay the effective date, we believe that Congress intended that a State could be subject to a penalty from the first day it began to operate TANF.

During the interim period between publication of the NPRM and the effective date of final rules, we required States to implement the TANF provisions in accordance with their own reasonable interpretations of the statute. In the NPRM we stated that we would not impose a penalty if we were to find that a State's actions were inconsistent with the final regulations, but consistent with a reasonable interpretation of the statute. However, if we were to find that a State operated its TANF program in a manner that was not based on a reasonable interpretation of the statute, we would penalize the State.

We received a few comments in support of these provisions and a couple of other comments as discussed below. We made no changes to this section of the regulations.

*Comment:* In addition to the supportive comments, one commenter expressed the view that the penalties should not apply until the final regulations are adopted and the States have a reasonable period of time to adjust to the new provisions. Another commenter asked that we give States a hold-harmless period and not subject them to penalties while they implement the regulations.

*Response:* We have followed the statutory requirements for determining when penalties apply. We do not have the authority to delay the penalties. However, as we discussed in the preamble to § 260.40, prior to the effective date of these final regulations, we will not penalize States if they operated their TANF programs in a manner that is consistent with a reasonable interpretation of the statute. Also, we decided to delay the effective date of these rules so that States have a reasonable period of time to implement the new regulatory provisions. Please refer to § 260.40 for additional discussion of issues related to the effective date.

#### *Section 262.3—How Will We Determine if a State Is Subject to a Penalty? (§ 272.3 of the NPRM)*

We have concluded that no one method can be used for monitoring State performance. The following discussion explains the three methods—the single audit, data collection and reporting, and financial reporting—that we will use to determine State noncompliance with requirements that may lead to penalties.

#### Single Audit

Under the requirements of the Single Audit Act, as of July 1, 1996, States operating Federal grant programs meeting a monetary threshold of \$300,000 must conduct an audit under the Act. Most States must audit annually; a few may audit biennially. Because of the substantial funding under TANF, all TANF States meet the audit threshold.

The single audit is an organization-wide audit that reviews State performance in many program areas. We will implement the Single Audit Act through use of Office of Management and Budget (OMB) Circular A-133, "Audits of States, Local Governments, and Non-Profit Organizations." Because of amendments to the Act in 1996, OMB recently revised the Circular, merging former Circulars A-128 and A-133. It published the new Circular in the **Federal Register** on June 30, 1997, at 62 FR 35277.

In conducting their audits, auditors use a variety of tools, including the statute and regulations for each program and a compliance supplement issued by OMB. This supplement focuses on certain areas of primary concern to that program. We prepared, and OMB has issued, a TANF program compliance supplement for those penalties for which the single audit will be our primary or secondary compliance instrument. We will update the compliance supplement based on these final regulations.

The Single Audit Act does not preclude us or other Federal offices or agencies, such as the Office of the Inspector General (OIG), from conducting additional audits or reviews. In fact, there is specific statutory authority to conduct such additional audits or reviews. In particular, 31 U.S.C. 7503(b) states:

Notwithstanding subsection (a), a Federal agency may conduct, or arrange for additional audits that are necessary to carry out its responsibilities under Federal law or regulation. The provisions of this chapter do not authorize any non-Federal entity (or sub-recipient thereof) to constrain, in any manner, such agency from carrying out or arranging for such additional audits, except that the Federal agency shall plan such audits to not be duplicative of audits of Federal awards.

Additionally, we will conduct quality control reviews of selected State audits to determine whether States conducted their audits in accordance with the Single Audit Act, OMB Circular A-133, and the compliance supplement. Pursuant to OMB Circular A-133, sections \_\_\_\_ .400(a)(3) and (5), we will



take appropriate action when we find any audits to be deficient.

We will use the single audit, in conjunction with other reviews, audits, and data sources, as appropriate, to identify noncompliance for which the State may be liable. We will rely heavily on Single Audit Act activities for determining a State's liability for some penalties and will use the single audit to gather and verify information for other penalties. For example, we will use the single audit, supplemented by other reviews, audits, and activities under the Single Audit Act, to identify situations where a State used funds under section 403 in violation of the Act. (See § 263.10 on Misuse of Funds.) The misuse-of-funds penalty is the only penalty for which the statute identifies a specific method (i.e., the Single Audit Act) for determining penalty liability.

We will supplement information from the single audit with our own audits and reviews, and reviews and audits conducted by OIG and its contractors. We may identify a need to conduct such audits as the result of complaints from individuals and organizations, requests by the Congress to review particular areas of interest, information collected by our reporting systems, or other indications of problems in State compliance with TANF program requirements.

When we determine that a State is subject to a penalty for the misuse of funds, we may apply a second penalty if we determine that the State intentionally misused Federal TANF funds. (You will find the criteria for determining "intentional misuse" at § 263.12.) The single audit will be the primary vehicle for this penalty because of its link to the determination of misuse of funds.

The single audit will also help us identify noncompliance that could result in imposition of the following four penalties: (1) Failure to participate in the Income and Eligibility Verification System (see § 264.11); (2) Failure to comply with paternity establishment and child support enforcement requirements under title IV-D of the Act (see § 264.31); (3) failure to maintain assistance to an adult single custodial parent who cannot obtain child care for a child under age six (see § 261.57); and (4) failure to sanction recipients who refuse to work (see § 261.54). For these process-focused penalties, we determined that we can make appropriate use of the single audit, supplemented by other reviews and audits, to monitor State compliance.

The audit compliance supplement includes guidance to auditors on how to audit these areas. As in the case of the

misuse-of-funds penalty, we may conduct other reviews and audits, if necessary. For example, we anticipate that we may receive complaints from individuals and organizations concerning the penalty for a State's failure to maintain assistance to an adult single custodial parent who cannot obtain child care. A number of substantiated complaints might indicate that we need to conduct an additional review.

The single audit might identify a lack of State compliance in other penalty areas, e.g., the five-year limit on Federal assistance. If it does, we will not ignore those findings. Therefore, we will also impose a penalty based on single audit findings in other penalty areas.

For most programs, other than TANF, the Single Audit Act procedures provide for disallowance in cases of substantiated monetary findings. However, in accordance with section 409(a), under TANF, we will be taking penalties, rather than disallowances. When the single audit determines a specific violation, the penalty amount that we will apply is the penalty amount associated with the specific penalty provision or provisions, for example, misuse of funds and failure to end Federal assistance after 60 months of receipt. Likewise, where we, or OIG, conduct an audit or review, the penalty amount that will apply is the penalty amount associated with the specific penalty or penalties specified under section 409 and these rules.

#### Data Collection and Reporting

We will monitor State compliance with the penalties for failure to satisfy minimum participation rates (see § 261.21) and failure to comply with the five-year limit on Federal assistance (see § 264.1) primarily through the information required to be reported by section 411(a) (i.e., State reporting of disaggregated case-record information). (See part 265 and the Appendices for data collection and reporting requirements.)

We believe that Congress intended that the data elements in section 411(a) be used to gather information for these two penalty areas. Thus, we concluded that the section 411(a) data collection tools would be our primary means for determining these penalties. We may also need to conduct reviews in the future to verify the data submitted by States, particularly in these two areas where a fiscal penalty is applicable. States should maintain records to adequately support any report in accordance with 45 CFR 92.42.

Accurate data are essential if we are to apply penalties fairly. If the State

submits insufficient data to verify its compliance with the requirements, or if we determine that a State cannot adequately document the data that it has submitted to show that it has met its participation rates or the five-year time limit, we will enforce the participation rate penalty or five-year time-limit penalty.

In the consultations we held during the development of the NPRM, some participants recommended that we use the single audit as the means for determining all the penalties. However, since States must otherwise report the data that directly speak to their compliance in these two areas, and timely determination of State compliance is necessary, we did not accept that recommendation. Instead, we will rely on the quarterly reports required under part 265 of these regulations.

#### Financial Reporting

All States are subject to the basic MOE penalty for failure to maintain a certain level (i.e., 80 or 75 percent) of historic effort. Those States that choose to receive contingency funds under section 403(b) are subject to a separate maintenance-of-effort penalty for failure to maintain 100 percent of historic effort. Also, in a year that they receive WtW formula grants, States are subject to an additional penalty for failure to meet the basic MOE requirement.

We have developed a TANF Financial Report (see Appendix D of part 265). We designed this report to gather information required under sections 403(b)(4), 405(c)(1), 409(a)(1), 409(a)(7), 409(a)(10), 409(a)(12), 409(a)(13), 411(a)(2), 411(a)(3), 411(a)(5), including data on administrative costs and types of State expenditures. It will also gather financial information to enable us to award grant funds, close out accounts, and manage other financial aspects of the TANF program. In addition, we will use this report to monitor State compliance with the basic MOE and Contingency Fund requirements and to aid us in determining if Federal TANF funds have been used properly.

Consistent with section 5506(a) of Pub. L. 105-33, the TANF Financial Report is due 45 days after the end of each quarter. Upon receipt of the report for the fourth quarter, i.e., by November 14, we should have State-reported information indicating whether or not the State met its MOE requirements for the prior fiscal year.

On the TANF Financial Report, States will inform us of the amount of expenditures they have made for basic and Contingency Fund MOE purposes. For the basic MOE, States must inform

us of the amount of expenditures made in the State TANF program and in separate State programs. (See part 264, subpart B, for more information on the Contingency Fund MOE requirement.)

In addition, to collect the necessary information on all MOE programs—both those operated within the TANF program and separate State programs—we require supplemental information in an annual report. The annual report, which may be provided as a separate report or as an addendum to the fourth quarter TANF Data Report, requires that States submit for each program for which the State claims MOE expenditures, the total annual State expenditures and the total annual State expenditures claimed as MOE. (See § 265.9(c) for more information on the contents of the annual report.)

If we reduce a State's SFAG as the result of a penalty, the State must expend an equal amount of its own funds in the immediately succeeding fiscal year. If the State fails to replace the funds as required, the State is subject to the penalty at § 262.1(a)(12). The penalty amount is up to two percent of the adjusted SFAG plus the amount not expended to replace the reduction to the SFAG due to the penalty.

We will use the TANF Financial Report (or Territorial Financial Report) to determine if a State has complied with these replacement provisions. Instructions to the TANF Financial Report (see Appendix D) require States to include amounts that they are required to contribute as a result of any penalties taken against the State. (We will include a similar requirement in the Territorial Financial Report.)

As in the case of the penalties for failure to meet the participation rates or comply with the five-year limit on assistance, our program management responsibilities may require us to verify the data submitted by States on the TANF Financial Report and annual report, particularly data on MOE expenditures and "replacement funds." States should maintain records in accordance with 45 CFR 92.42. We will also use the annual report to help us to determine whether a State met its MOE requirements.

If the State submits insufficient MOE data to verify its compliance or if we determine that the State cannot adequately document data that it has submitted showing that it has met its MOE requirements, we will apply the penalties for failure to meet the basic MOE requirements (including the penalty related to WtW funding) and the Contingency Fund MOE requirements. For the basic MOE, we may have to

estimate the actual level of qualifying MOE expenditures. We would then base the amount of the penalty on the degree to which the State has not adequately demonstrated that it has met the applicable MOE requirement.

We will penalize States for failing to repay a loan provided under section 406 (see § 264.40). A specific vehicle for determining a State's compliance with these requirements is unnecessary. In our loan agreements with States, we will specify due dates for the repayment of the loans, and we will know if States are not making the required payments.

We will penalize States for failing to submit a report required under section 411(a) by the established due dates (see §§ 265.4 and 265.7). As noted before, we are requiring that the reports must not only be timely, but they must also be complete and accurate. Thus, we may take actions to review the accuracy of data reporting if appropriate. If we determine that the data required under section 411(a) are incomplete or inaccurate, we may apply the penalty for failing to submit a report. As discussed above, if the data that are inaccurate or incomplete pertain to other penalties (i.e., the participation rate, the five-year time limit on assistance, the basic MOE, the WtW MOE penalty, or the Contingency Fund MOE requirements) and their unavailability impedes our ability to determine a State's penalty liability, we will apply the penalties associated with these requirements in lieu of a reporting penalty.

Regardless of how we determine that a State is subject to a penalty, the determination of whether a State has access to a possible reasonable cause exception or corrective compliance depends on the specific penalty provision. States cannot avoid all penalties through the reasonable cause exception or a corrective compliance plan (see § 262.4).

We received a few comments on this section and made some changes to the regulations in response. A discussion of the comments and responses follows.

Also, in preparing the final rules, we noticed that we did not discuss how we will determine that a State is subject to a Welfare-to-Work formula grant penalty. We have added this discussion to the final rule.

*Comment:* Commenters suggested that we should permit the use of the single audit for uncovering noncompliance with additional requirements beyond those we identified in the NPRM.

*Response:* Although we discussed the direct and indirect uses of the single audit in determining compliance with a number of requirements, we wrote the

regulation itself more narrowly. We agree with these comments and have revised the regulation at § 262.3(a) to indicate that, in addition to using the single audit as the primary method to determine if a State is subject to certain penalties, we will use the single audit, as appropriate, as a secondary method of determining if a State is subject to other penalties.

*Comment:* A commenter noted that, in paragraph (c), our reference to § 275.6 of the NPRM was incorrect.

*Response:* We agree and have corrected § 262.3(c) to refer to verification of data in accordance with the provisions of § 265.7 of this chapter.

*Comment:* Commenters suggested that our standards for determining penalties are vague. Other commenters asked what we mean when we say that information in the data or financial reports is "insufficient."

*Response:* In some cases, our standards are specific, such as for determining work participation rates and compliance with time limits. However, we find that, given that this is a new program, it is impossible to draw sharp lines that fully define all situations, and it is appropriate to leave room for discretion in a block grant environment. Moreover, since States can dispute our determinations and have appeal rights, they have protection from arbitrary decisions.

Obviously, we want strong, clear standards for "complete and accurate" because the information reported by States in their data and financial reports is critical in determining States' compliance with TANF requirements and their potential penalty liability. However, our standards have to be fair at the same time.

In the preamble to part 265, you will find a broader discussion of the importance of accurate, complete and timely reporting of information.

#### *Section 262.4—What Happens if We Determine That a State Is Subject to a Penalty? (§ 272.4 of the NPRM)*

If we determine that a State is subject to a penalty, we will send the State agency a notice that it has failed to meet a requirement under section 409(a). This notice will: (1) Specify the penalty provision at issue, including the applicable penalty amount; (2) specify our source of information and the reasons for our decision; (3) invite the State to present its arguments if it believes that the information or method we used were in error or were insufficient, or that its actions, in the absence of Federal regulations, were based on a reasonable interpretation of the statute; and (4) explain if, how, and

when the State may submit a reasonable cause justification under 409(b) and/or corrective compliance plan under 409(c). States must postmark their responses to our notice within 60 days of their receipt of our notice.

For penalties where the reasonable cause and the corrective compliance plan provisions both apply, we encourage States to submit to us both their justification for reasonable cause and a corrective compliance plan within 60 days of receipt of our notice of failure to comply with a requirement. Our objective is to expedite the resolution of a State's failure to meet a requirement.

A State may choose to submit a reasonable cause justification without a corrective compliance plan. In this case, we will notify the State if we do not accept the State's justification of reasonable cause. Our notice will also inform the State that it has an opportunity to submit a corrective compliance plan. The State will then have 60 days from the date it receives this notice to submit a corrective compliance plan. (Under this scenario, we will send the State two notices—the first will inform the State that it may be subject to a penalty, and the second will inform the State that we determined that it did not have reasonable cause.) We have added a provision to the regulations to clarify this process. A State may also choose to submit only a corrective compliance plan if it believes that the reasonable cause factors do not apply in a particular case.

The reasonable cause and corrective compliance provisions in the statute do not apply to five penalties: (1) failure to repay a Federal loan on a timely basis; (2) failure to maintain the applicable percentage of historic State expenditures for the basic MOE requirement; (3) failure to maintain 100 percent of historic State expenditures for States receiving contingency funds; (4) failure to expend additional State funds to replace grant reductions due to the imposition of one or more penalties listed in § 262.1; and (5) failure to maintain 80, or 75, percent, as appropriate, of historic State expenditures during a year in which the State receives a Welfare-to-Work grant.

If, upon review of the State's submittal, we request additional information in order to determine reasonable cause, the State must provide this information within 30 days of the date of our request. We have established this deadline to make sure the process is not delayed. However, under unusual circumstances we may give the State an extension of the time to respond to our request for additional information.

We received some comments on this section. One expressed the view that our notification provisions were reasonable; others raised issues about the proposed rule. Below, we address the comments and resulting changes we made to the regulations. In addition to these changes, we reversed the order of subparagraphs (e) and (f) so that they follow the logical sequence of actions in the penalty process.

*Comment:* A commenter recommended that we send our notice that a State is subject to a penalty to the State agency director.

*Response:* In the NPRM we said we would notify the State. By State, we meant the State agency. We assume the commenter thought we would notify the Governor. We have modified the regulation to say that we will notify the State agency and added a definition of State agency to § 260.30.

*Comment:* One commenter suggested that we list in the regulation the four components of the initial penalty notice to the State that we included in the preamble to the NPRM.

*Response:* We agree with this suggestion and have amended the regulation at § 262.4(a) accordingly.

*Comment:* Another commenter asked that we include, in our penalty notice to a State, a description of the data and method we used to determine that the State is subject to a penalty.

*Response:* We thought that we covered this in the NPRM when we said we would specify which penalty we would impose and the reasons for the penalty. However, in the final rule at § 262.4(a), we have revised the language to list the source of information as one of the four specific components that we will include in our notice to the State.

*Comment:* A commenter asserted that States should be able to raise any relevant issue in response to a penalty notice and not be limited to responding on the three grounds of incorrect penalty determination, reasonable cause, or corrective compliance.

*Response:* Unfortunately, the commenter did not include any examples of issues that would not fit in these three categories. We think that a State will be able to include all relevant considerations under one of these three categories.

*Comment:* A few commenters noted that the regulation proposed at § 272.4(d) conflicted with § 271.55(c), which said that reasonable cause and corrective compliance were not available when a State was being penalized for failing to impose penalties on individuals.

*Response:* The proposed regulation at § 272.4(d) was correct. Reasonable cause

and corrective compliance are available when a State is being penalized for failing to impose penalties on individuals. The final rules at §§ 262.4(d) and 261.55 reflect this policy.

*Comment:* A commenter asked that we make reasonable cause and corrective compliance available to States that are being penalized for failing to expend additional State funds to replace penalty amounts.

*Response:* We do not have the authority to make this change, since the statute specifies that the reasonable cause exception and corrective compliance plan do not apply to this penalty.

*Comment:* Several commenters asked that we establish a time frame for when we will respond to a State's reply to our penalty notice.

*Response:* We have added a provision to the regulations at § 262.4(f) to say that, generally, we will respond within 60 days to the State's reasonable cause submittal, and that we will either accept or reject the State's corrective compliance plan within 60 days of our receipt of the plan.

*Comment:* A commenter asked whether a State may request reconsideration or submit additional information based on our decision, or whether its only recourse at that point is to file a formal appeal.

*Response:* Although there are no further formal steps available to the State short of a formal appeal, it is our hope that State and Federal staff will engage in an ongoing dialogue in an effort to address any penalty-related issue. This dialogue may begin as soon as the State is working to develop new policies or begins to have trouble meeting a requirement, and well before we notify the State that we intend to penalize it. It may continue until the issue is resolved, but will not extend the time frames States have for responding to our notices. Therefore, we advise States to make their complete and best arguments during the time allotted.

*Comment:* A number of commenters asserted that two weeks is not long enough for States to respond to our request for further information.

*Response:* We agree that under some circumstances two weeks may not be long enough, so we are increasing the time States have to respond to 30 days. Also, under unusual circumstances, we may give States an extension of the time that they have to respond to our request for information. We have amended the regulation at § 262.4(e) accordingly.

*Comment:* Commenters suggested that notices and requests be sent by certified mail so that there is evidence of receipt.

*Response:* A State may choose to send its responses by certified mail, but we are not convinced that we need to include this as a regulatory requirement.

*Comment:* A commenter asked that we specify in the regulations that we would not assess any penalties pending the resolution of a State's claim of reasonable cause.

*Response:* If a State claims reasonable cause and we find against the State, the State may then submit a corrective compliance plan or file an appeal to the HHS Departmental Appeals Board (DAB), as discussed in § 262.7. If the State does not take either action, we will assess the penalty in the quarter or fiscal year that immediately follows our final decision, as appropriate. However, if the State submits a corrective compliance plan, we will not assess a penalty until the corrective compliance process is completed. If the State appeals to the DAB, we will not assess the penalty until the appeals process is completed. If the DAB upholds our decision, we will take the penalty and charge interest back to the date of our final response that formally notifies the Governor of the State of an adverse action.

*Section 262.5—Under What General Circumstances Will We Determine That a State Has Reasonable Cause? (§ 272.5 of the NPRM)*

Under the provisions of section 409, we will not impose certain of the penalties if a State demonstrates that it had reasonable cause. Also, we will reduce or excuse certain penalties if a State corrects or discontinues the violations under an accepted corrective compliance plan.

After reviewing these statutory provisions, we decided that we should not consider the reasonable cause exception of the statute in isolation. Rather, we would view it in conjunction with the provision for developing corrective compliance plans. In this context, we acknowledge the new Federal and State roles under TANF and commit to working with States to minimize adversarial Federal-State issues. Our primary task is to help each State operate the most effective program it can to meet the needs of its caseload and the goals and provisions of the law. Through these rules, we hope to focus States on positive steps that they should take to correct situations that resulted in a determination that they are subject to a penalty, rather than to let them simply avoid the penalty. As such, we consider it appropriate to emphasize the use of the corrective compliance plan process over the reasonable cause exception. Consequently, we have decided to limit the list of reasonable cause criteria.

In the discussion that follows, we describe: (1) the factors that we will consider in deciding whether or not to excuse a penalty based on a State's claim of reasonable cause; (2) the contents of an acceptable corrective compliance plan; and (3) the process for applying these provisions. Our goal is to treat the reasonable cause and corrective compliance plan provisions as part of an integrated process.

We have included factors that would be applicable to all penalties for which the reasonable cause provision applies. We will find that a State has reasonable cause under the following situations: (1) Natural disasters and other calamities (e.g., hurricanes, tornadoes, earthquakes, fires, floods, etc.) whose disruptive impact was so significant as to cause the State's failure to meet a requirement; (2) formally issued Federal guidance that provided incorrect information resulting in the State's failure; and (3) isolated problems of minimal impact that are not indicative of a systemic problem (e.g., although a State's policies and procedures require that Federal TANF assistance be time-limited to five years and include computer safeguards to protect against violations, ten families somehow slip through and receive assistance for longer than five years).

We also have included two separate factors that would apply in cases when the State fails to satisfy the minimum participation rates, and one specific factor that would apply to cases when the State fails to meet the five-year limit. We discuss these specific factors in our preamble discussion of domestic violence and §§ 261.52 and 264.3.

As discussed elsewhere in this preamble, we have also added a factor that will apply if States fail to meet either of the first two deadlines for FY 2000 for submitting complete and accurate reports under the new reporting requirements. We added this factor in response to comments and out of our own concern about the possible concurrent demands of Y2K and TANF reporting requirements. States must be in a position to commit the systems resources necessary to become Y2K compliant in order to ensure that there is no disruption in the benefits to their neediest citizens.

We did not have the latitude under the law merely to extend the reporting deadlines (because they are set in statute). Also, we were unwilling to extend the "emergency reporting" into FY 2000 and provide a later effective date for the new reporting provisions because important TANF provisions (e.g., the work participation rates) depend upon consistent data and

policies throughout the entire fiscal year. Thus, we have addressed the concern as a reasonable cause issue.

Under the new provision, States that miss the deadlines for submitting complete and accurate data for the first two quarters of FY 2000 will receive reasonable cause if: (1) they can clearly demonstrate that their failure was attributable to Y2K compliance activities; and (2) they submit the required data by July 1, 2000.

In determining reasonable cause under all of these regulatory criteria, we will consider the efforts the State made to meet the requirement. We will also take into consideration the duration and severity of the circumstances that led to the State's failure to achieve the requirement. The burden of proof rests with the State to explain fully the circumstances, events, or occurrences that constitute reasonable cause for its failure to meet a particular requirement. The State must provide us with sufficient relevant information and documentation to substantiate its claim of reasonable cause. We have added a provision to the regulations to clarify the factors that we will consider and the State's burden of proof. If we find that the State has reasonable cause, we will not impose the penalty.

We received quite a number of comments on this section. We discuss the comments and the changes we made to the regulations below.

*Comment:* Virtually all commenters with comments on this section argued that our proposed list of reasonable cause factors was too narrow and that we needed to give ourselves more discretion. Commenters gave a number of examples of factors that we should consider, including good faith effort, circumstances beyond the State's control, inadequate Federal guidance, increases in a State's caseload, characteristics of the caseload, high unemployment rates or other labor market characteristics, changing economic conditions, and other adverse economic factors.

*Response:* As we noted in the NPRM, PRWORA did not specify any definition of reasonable cause or indicate what factors we should use in deciding whether to grant a reasonable cause exception for a penalty. In our deliberations on reasonable cause factors, we considered the diverse opinions expressed during our consultation process and our NPRM comment period, as well as the need to support the commitment of Congress, the Administration, and States to the work and other objectives of the TANF program. In keeping with these objectives, we are providing reasonable

cause factors for a limited number of circumstances that are beyond a State's control and placing a greater emphasis on corrective solutions for those circumstances a State can control. We strongly believe that States must correct problems that detract from moving families from welfare to self-sufficiency.

At the same time, we agree with the commenters that it would be difficult to foresee all possible circumstances under which we would want to grant reasonable cause. Accordingly, while we have included the same general factors that we included in the NPRM, we no longer limit ourselves to considering only these factors. While we do not anticipate routinely determining that a State had reasonable cause based on other factors, we do not want to preclude a State from presenting other circumstances. Also, we decided that we were more restrictive than we intended when we limited the third reasonable cause factor to isolated, nonrecurring problems. We have amended the regulations to say that we may grant a State reasonable cause when it has encountered isolated problems of minimal impact that are not indicative of a systemic problem.

*Comment:* A number of commenters were opposed to our provisions precluding reasonable cause if a State diverted families to a separate State program that achieved the effect of avoiding the work participation rates or diverted the Federal share of child support collections.

*Response:* As we previously discussed in the section of the preamble entitled "Separate State Programs," we have eliminated the proposed connection between a State's decisions on separate State programs and its eligibility for reasonable cause. Therefore, we have deleted the provisions that were at paragraphs § 272.5(c) and (d) of the proposed rule.

*Comment:* A commenter suggested that the regulations should provide that, as part of the process of determining when we would impose penalties and penalty amounts, we should give consideration to factors such as whether the State has administered its TANF program fairly, whether it has provided services and supports to families to enable them to comply with program requirements, and whether State-imposed requirements on families are reasonable.

*Response:* The TANF legislation assumed that States are in the best position to determine which families will be served and what assistance they will receive. As we previously discussed, our authority to regulate and judge State policies and actions are

limited, and we have decided not to stretch our regulatory authority by incorporating such factors into all our penalty determinations. There are other provisions in the statute (such as the bonus and ranking provisions, the annual reports to Congress, and annual reports on State child poverty rates) that provide an opportunity to look at whether at-risk families are being helped or hurt by State TANF programs. At the same time, there are a couple of penalty provisions (e.g., those dealing with the imposition of sanctions) where the issues of fairness and adequate recipient protections are more germane and we specifically address some of these issues. You should look to the preamble discussion entitled "Worker and Recipient Protections" and the preamble for part 261 for other ways we are addressing this concern.

*Section 262.6—What Happens if a State Does Not Demonstrate Reasonable Cause? (§ 272.6 of the NPRM)*

Section 409(c), as amended by section 5506 of Pub. L. 105-33, provides that, prior to imposing a penalty against a State, we will notify the State of the violation and allow the State the opportunity to enter into a corrective compliance plan. If a State does not claim reasonable cause or if it claims reasonable cause simultaneously with submitting a corrective compliance plan, it will have 60 days from the date it receives our notice of a violation to submit its corrective compliance plan. If, in response to our notice of a violation, the State initially submits only a claim of reasonable cause, and if we deny this claim, the State has 60 days from the date it receives our second notice (i.e., denying its reasonable cause claim) to submit its corrective compliance plan. If a State does not submit an acceptable corrective compliance plan on time, we will immediately send the State a formal notice of adverse action and assess the penalty. Outside of the notice(s), we will not remind the State that the corrective compliance plan is due.

The corrective compliance plan must provide a complete analysis of the situation and factors that prevented the State from meeting the requirement. It also must identify the time period in which the State will correct or discontinue the violation, and the milestones, including interim process and outcome goals, the State will achieve to assure that it will fully correct or discontinue the violation within the specified time period. In order to highlight the importance of corrective compliance, the plan must include a certification by the Governor

that the State is committed to correcting or discontinuing the violation in accordance with the plan.

We recognize that each plan must be specific to the violation (or penalty) since each State operates its TANF program in a unique manner. Thus, we will review each plan on a case-by-case basis. In determining whether or not to accept a plan, we will consider the extent to which the State's plan indicates that it will completely correct or discontinue, as appropriate, the situation leading to the penalty.

The steps that a State takes to correct or discontinue a violation may vary. For example, where we penalize a State for misusing Federal TANF funds, we would expect it to remove this expenditure from its TANF accounting records (charging it to State funds, as allowable) and provide steps to assure that such a problem does not recur. Where a State has reduced or denied assistance improperly to a single custodial parent who could not find child care for a child under six, correcting the violation might require that the State reimburse parents retroactively for the assistance that it improperly denied them. The State's corrective compliance plan also would have to describe the steps to be taken to prevent such problems in the future.

Section 409(c)(3) requires that a violation be corrected or discontinued, as appropriate, "in a timely manner." A State's timely correction of a problem is critical to assuring that the State is not subject to a subsequent penalty. At the same time, we recognize that the causes of violations will vary, and we cannot expect States to rectify all violations in the same time frame. Thus, we do not want to unduly restrict the duration of corrective compliance plans. At the same time, we do not want to allow States to prolong the corrective compliance process indefinitely and leave problems unresolved into future fiscal years. Accordingly, in our NPRM, we proposed that the period covered by a corrective compliance plan end no later than six months after the date we accept a State's corrective compliance plan. We have amended this provision, as discussed below.

We will consult the State on any modifications to the corrective compliance plan that we believe are necessary and seek mutual agreement on a final plan. Such consultation will occur only during the 60-day period for acceptance specified in the law. Any modifications to the State's corrective compliance plan resulting from such consultations will constitute the State's final corrective compliance plan and will obligate the State to take the actions

and meet the time frames specified in the plan.

We will either accept or reject the State's corrective compliance plan, in writing, within the 60-day period that begins on the date that we receive the plan. If a State does not agree to modify its plan as we recommend, we may reject the plan. If we reject the plan, we will immediately send a formal notice to the State of the adverse action. The State may appeal our decision to impose the penalty in accordance with the provisions of section 410 of the Act and the regulations at § 262.7.

If we have not rejected a plan in writing by the end of the 60-day period, the plan is deemed to be accepted, as required by the statute at section 409(c)(1)(D).

If a State corrects or discontinues the violation in accordance with its corrective compliance plan, we will not impose the penalty.

The statute permits us to collect some or all of the penalty if the State has failed to correct or discontinue the violation. Therefore, we may reduce the amount of the penalty if a State has not fully rectified the violation in one or more of the following limited situations: (1) The State made significant progress in correcting or discontinuing the violation; or (2) a natural disaster or regional recession prevented the State from coming into full compliance.

We received a number of comments on these provisions that led us to make some changes to the regulations. Also, we made some minor edits to ensure consistency within the parts of this regulation. We discuss the comments and changes below.

*Comment:* In the NPRM, we asked for comments from States and other interested parties on our proposal to restrict the time period for a corrective compliance plan. Commenters supported the general concept of a corrective compliance plan, and one commenter thought the six-month period was reasonable for most cases. However, most commenters replied that the period we had proposed was unreasonably short, especially since the statute does not require a short time frame. Many suggested that we extend the time period to 9, 12, or 24 months. Others suggested that the State should determine the time frame, or that it be part of the negotiation of the plan by the State and ACF and be determined on a case-by-case basis. Another commenter suggested that the period extend until 90 days after the close of the State's next legislative session. Commenters argued the need for more time based on the possible need to adjust contracts, re-design programs, change policies and

procedures, notify recipients, make data system changes, train staff, and get the State legislature to take necessary action.

*Response:* In responding to these comments, we want to reinforce the importance of achieving compliance with the statute quickly, but we also recognize that we need to consider a State's ability to make the changes necessary to achieve compliance within a fixed time frame. We are not interested in setting a time frame that States cannot meet, but we also do not want to give States more time than they absolutely need. In addition, in the case of the work participation rate and time-limit penalties, where we measure performance over the course of a fiscal year, we thought it was important that corrective compliance also be measured over the course of a fiscal year. Based on this thinking, we have revised the regulations. In general, the final rules provide more flexibility in establishing time frames for corrective compliance plans. For the work participation rate and time-limit penalties, they incorporate a modified six-month corrective compliance period. More specifically, they provide that the State achieve compliance for the first fiscal year that ends at least six months after our receipt of the corrective compliance plan. For example, if a State failed its work participation rate in a prior fiscal year and we received its corrective compliance plan on February 1, the State would have to achieve the participation rates in effect for the current fiscal year. If we received the plan after April 1, the State would have to achieve the participation rates in effect for the following fiscal year.

We made this adjustment to the rules in large part because we calculate liability for work participation and time-limit penalties based on fiscal year data. We also realized that there could be significant delays in the submittal of corrective compliance plans (because participation rate and time-limit information is not available immediately, and we need time both to resolve disputes about the penalty findings and to decide State claims for reasonable cause). Thus, we could not necessarily expect a State to achieve compliance during the first year following a failure.

Nevertheless, we would hope that a State could achieve compliance during that time frame. We would not want to see a State's failure extend into a third fiscal year. If it did, there could be negative consequences for the State. States especially need to work towards increasing their work participation rates as quickly as possible because: (1) the

rates increase over time; (2) the base penalty amount increases when a State incurs consecutive penalties; and (3) a State is eligible for a smaller reduction based on degree of noncompliance if it fails to meet the rates in successive fiscal years.

For both the work participation and time-limit penalties, a State will normally have indication that a problem exists during the year for which it is penalty-liable, and it should begin to address the problems well before it submits its corrective compliance plan. For example, by July of a fiscal year, a State should have a good idea of whether it is on track to meet its work participation requirements. If it is not, and does not begin to make changes soon, not only will it fail to meet the requirements for the current fiscal year, but it is unlikely that it will be able to increase its performance enough to meet the required rates for the next fiscal year. Our notice to a State that it is subject to a penalty should serve as confirmation of information the State already has. A corrective compliance plan period does not necessarily have to be lengthy in order to provide the State sufficient time for correcting or discontinuing a violation.

For the remaining penalties that are eligible for corrective compliance, we would permit a State to propose a time frame in its corrective compliance plan. We would expect the State to achieve compliance expeditiously, often in less than six months. States should correct some failures, for example, for failing to comply with IEVS requirements or submitting a data report late, within a month or two.

We expect each State to justify its time frame for each penalty. We will assess the time frame proposed by the State based on the nature of the violation, any unusual circumstances, and other factors that affect the speed with which the State can respond, such as whether it would need to make systems changes or take legislative action.

*Comment:* A commenter asked that we notify States of our acceptance of a corrective compliance plan and asked us to clarify when the corrective compliance period begins.

*Response:* We did not address these factors in the NPRM, but have revised the regulations to specify that we will accept or reject the plan in writing and that the time period for the corrective compliance plan begins on the date that the State receives our written acceptance of the plan. If we fail to respond, the time period for the corrective compliance plan begins on

the date that is 60 days after the date we received the State's plan.

*Comment:* Several commenters stated that 60 days is insufficient for a State to prepare a corrective compliance plan and recommended that we give States 90 days.

*Response:* We are prevented from making this change by the statute, which specifies that a State has 60 days from the date that it receives our notification to submit a corrective compliance plan.

*Comment:* A couple of commenters noted that the proposed rules at § 272.6 contained an incorrect citation.

*Response:* While the commenters were correct that the citation in the NPRM was erroneous, we have made changes to the paragraphs in that section that corrected that problem.

*Comment:* Some commenters expressed the view that the contents we specified for the corrective compliance plan are reasonable. Other commenters objected to our requiring certification of the plan by the Governor, and one commenter suggested that the certification be made by the director of the State agency.

*Response:* The Governor is responsible for submitting the State TANF plan and for committing State funds to the program. On this basis, we believe it is also important for the Governor to demonstrate awareness of and support for the corrective compliance plan.

*Comment:* A commenter asked that we consider a State's good faith effort in determining the amount of a penalty when a State fails to completely correct or discontinue the violation pursuant to its corrective compliance plan. Other commenters asked that we broaden the circumstances under which a penalty is reduced, with some recommending that we consider other factors such as natural disasters, economic circumstances, or other unanticipated or extreme events.

*Response:* We have said that we will reduce the penalty if the State can demonstrate that it made significant progress toward correcting or discontinuing the violation or that its failure was due to a natural disaster or regional recession. We believe this gives us sufficient latitude to consider mitigating circumstances and the good-faith effort a State has made. For a discussion of the specific standards we will use in deciding to reduce work participation rate penalties, please see the preamble for § 261.51.

*Comment:* A number of commenters opposed our provisions denying a penalty reduction if a State diverted families to a separate State program that

achieved the effect of avoiding the work participation rates or diverted the Federal share of child support collections.

*Response:* As we previously discussed, we have eliminated the connection between a State's decisions regarding its separate State programs and penalty reductions and have removed the provisions that appeared in § 272.6(i)(2) of the NPRM.

#### *Section 262.7—How Can a State Appeal our Decision To Take a Penalty? (§ 272.7 of the NPRM)*

Once we make a final decision to impose a full or partial penalty, we will formally notify the State that we will reduce the State's SFAG payable for the quarter or the fiscal year and inform the State of its right to appeal to the Departmental Appeals Board (the Board).

Section 410, which covers any adverse actions with respect to the State TANF plan or the imposition of a penalty under section 409, provides that the Secretary will notify the Governor of the State of the adverse action within five days. To facilitate the appeal, we will also send a copy of the notice to the State agency.

Within 60 days after the date a State receives this notice, the State may file an appeal of the action, in whole or in part, with the Board. We indicated in the NPRM that the statute allowed only 60 days for the Board to reach a decision after the appeal is filed. A number of commenters believed that the 60 days in the statute indicated a minimum time before a decision could be issued, not a maximum time. The NPRM interpretation was based on the conference report which indicated a Board decision was required "within 60 days" (H.R. Rep. No. 725, 104th Cong., 2d sess., p. 302). However, in light of the comments, we have re-examined the language of the statute itself, which states that a decision will be made in "not less than 60 days" after the appeal is filed. "Not less than" is usually interpreted as a minimum requirement, as the commenters indicated. Therefore, we have revised the regulation to allow a minimum time of 60 days before a decision is made. Nevertheless, we believe that penalties procedures should be handled as expeditiously as possible. We also believe that this is possible in the TANF penalty situation because the opportunity for reasonable cause and corrective compliance before most TANF penalties should have clarified the issues before the penalty decision.

We are requiring that the State submit its brief and the supporting documentation for its case when it files

its appeal. To further facilitate this process, we have added a provision to the regulation at § 262.7(a)(1) that ACF's notice must include sufficient factual and legal information on the basis for imposition of the penalty to allow the State to respond in an appeal. In addition, we have allowed the State the opportunity to respond to ACF's reply brief and to submit any additional documentation it considers necessary. A State should send a copy of any appeal documents to the Office of the General Counsel, Children, Families and Aging Division, Room 411-D, 200 Independence Avenue, S.W., Washington, D.C. 20201.

In the final rule, we have slightly increased the time for us to submit our reply brief and supporting documentation—to 45 days after our receipt of the State's submission. This 45 days, plus the 21 days allowed for the State's reply brief, will ensure that the DAB makes no determination prior to 60 days after a State has filed its appeal. Further, briefing and argument will be at the discretion of the Board, but could include an evidentiary hearing. A State's appeal to the Board will also be subject to the following regulations at part 16 of title 45: §§ 16.2, 16.9, 16.10, and 16.13–16.22, to the extent they are consistent with this section.

Section 410(b)(2) provides that the Board will consider an appeal on the basis of the documentation the State submits, along with any additional information required by the Board to support a final decision. In deciding whether to uphold an adverse action or any portion of such action, the Board will conduct a thorough review of the issues.

Finally, a State may obtain judicial review of a final decision by the Board by filing an action within 90 days after the date of the final decision. States may file either with the district court of the United States in the judicial district where the State agency is located or in the United States District Court for the District of Columbia. The district courts will review the final decision of the Board on the record established in the administrative proceeding, to determine if it is arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law, or unsupported by substantial evidence. The court's review will be on the basis of the documents and supporting data submitted to the Board.

We discuss below the comments on this section and our responses.

*Comment:* A number of commenters believed the time period for the appeal process was too constrained to allow

adequate consideration of the issues. These commenters noted that the statute could be interpreted to require a minimum of 60 days before a determination could be made, rather than the maximum the NPRM proposed.

*Response:* For the reasons previously discussed, we agree with the commenters and have revised the regulation accordingly.

*Comment:* One State indicated that the notice should include details on the reasons for the penalty.

*Response:* We agree with the commenter that the notice should contain sufficient detail on the factual and legal basis for the penalty to allow the State to respond and have revised the regulation. However, we believe the agency should have the opportunity to raise new issues in response to the State's brief and therefore have not specified that reasons not raised in the notice are waived. Since the State now has an opportunity to respond to the ACF brief and to submit additional documentation, we do not believe this policy will disadvantage the State.

*Comment:* One State noted that the practice of notifying the Governor differed from past practice of notifying the agency and suggested that we also notify the TANF agency.

*Response:* Although the statute requires notice to the Governor, we agree with the commenter that it would facilitate the process if we also give the TANF agency a copy of the notice and have amended the regulation accordingly.

*Comment:* A number of commenters suggested the State should be able to submit a reply brief as a matter of right. They also suggested the Board's authority to develop the record be clarified.

*Response:* The NPRM limited the State's right to submit a reply brief as a matter of right because of the limited time availability under the proposed 60-day maximum. Since we have eliminated this 60-day time issue in the final regulation, we agree with the commenters that the State should be able to submit an appeal as a matter of right and have amended the regulation.

We have also clarified that the Board's discretion to develop the record included the discretion to hold an evidentiary hearing. We would note that §§ 16.9 and 16.10 of this title, which are made applicable by § 262.7(e), contain additional detail on the Board's discretion to develop the record.

*Comment:* One State expressed concerns about using the Departmental Appeal Board as the forum for hearing appeals.

*Response:* The statute specifies the Departmental Appeals Board as the entity to hear appeals.

*Comment:* One commenter believed that we should include all sections of 45 C.F.R. part 16 as part of the appeal process. This commenter also believed that we should not treat failure to file a copy of an appeal with the Office of the General Counsel as a jurisdictional defect.

*Response:* We selected the provisions of part 16 that fill in the gaps in the TANF statutory framework. We have not added additional sections because we do not think they are necessary.

The failure to file the appeal with the Office of the General Counsel is not a jurisdictional defect. However, we would toll the time period for filing of our reply brief until OGC receives the brief.

*Comment:* One State noted that the specific provision on when the State's appeal is considered filed, at § 272.7(f)(1) of the NPRM, varied from the time contained in 45 C.F.R. 16.20, which we adopted in the NPRM.

*Response:* As part of the changes in the timing of an appeal in the final rule, we have deleted this NPRM provision and thus eliminated the conflict. However, we have also added a provision to § 262.7(e) to clarify that the named provisions of part 16 are adopted only to the extent that they are consistent with the specific provisions of this section.

#### **VIII. Part 263—Expenditures of State and Federal TANF Funds (Part 273 of the NPRM)**

##### *Section 263.0—What Definitions Apply to This Part? (§ 273.0 of the NPRM)*

###### Administrative Costs

###### (a) Background

Under the TANF statute, States may not spend more than 15 percent of either their Federal TANF funds or their State MOE dollars on administrative costs. At section 404(b), the statute excludes expenditures for "information technology and computerization needed for tracking or monitoring" from the administrative cost cap that applies to Federal TANF funds (i.e., the Federal cap).

The proposed rule addressed the subject of administrative costs in five separate places: (1) the definition of qualified expenditures at § 270.30 provided that, for MOE purposes, administrative costs were subject to a 15-percent cap (i.e., the MOE cap); (2) § 273.0 provided a definition of administrative costs; (3) § 273.2(a)(5) discussed the 15-percent limit on the

amount of MOE expenditures that could be spent on administrative costs and reflected our decision to exclude the same information technology and computerization costs from the MOE cap as the Federal cap; (4) the preamble for § 273.11 explained that we would consider expenditures of more than 15 percent of a State's Federal TANF funds on administrative funds to be a misuse of Federal TANF funds; and (5) the preamble and regulation at § 273.13 provided that, in determining the Federal cap, we would use the definition of administrative costs at § 273.0(b) and not count information technology and computerization for tracking and monitoring as administrative costs. The preamble for § 273.13 also explained that we would look to see whether a State's cumulative expenditures on administrative costs from its grant for any fiscal year exceeded 15 percent of the grant amount and that we would consider expenditures above the limit to be a misuse of funds.

The proposed definition at § 273.0(b) provided that: "Administrative costs means costs necessary for the proper administration of the TANF program or separate State programs. It includes the costs for general administration and coordination of these programs, including indirect (or overhead) costs." It also provided examples of eleven types of activities that would be classified as "administrative costs," such as salaries and benefits not associated with providing program services, plan and budget preparation, procurement, accounting, and payroll.

In the preamble, we stated our belief that the proposed definition would not create a significant new administrative burden on States. We hoped that it was flexible enough to facilitate effective case management, accommodate evolving TANF program designs, and support innovation and diversity among State TANF programs. We also said that it had the significant advantage of being closely related to the definition in effect under the Job Training Partnership Act (JTPA). Thus, it should facilitate the coordination of Welfare-to-Work and TANF activities and support the transition of hard-to-employ TANF recipients into the work force.

More importantly to commenters, the preamble also indicated that we would consider eligibility determinations to be administrative costs, but allow case management to be treated as a program cost. It also required that portions of a worker's time be allocated based on this distinction. Specifically, the NPRM preamble said:



You will note that the definition we have proposed does not directly address case management or eligibility determination. We understand that, in many instances, the same individuals may be performing both activities. In such cases, to the extent that a worker's activities are essentially administrative in nature (e.g., traditional eligibility determinations or verifications), the portion of the worker's time spent on such activities will be treated as administrative costs, along with any associated indirect (or overhead) costs. However, to the extent that a worker's time is essentially spent on case-management functions or delivering services to clients, that portion of the worker's time can be charged as program costs, along with associated indirect (or overhead) costs.

In the preamble, we also indicated that we expected administrative costs incurred by subgrantees, contractors, community service providers, and third parties to be part of the administrative cost cap and that we would determine such costs in the same way as agency costs. Specifically, we said:

We have not included specific language in the proposed rule about treatment of costs incurred by subgrantees, contractors, community service providers, and other third parties. Neither the statute nor the proposed regulations make any provision for special treatment of such costs. Thus, the expectation is that administrative costs incurred by these entities would be part of the total administrative cost cap. In other words, it is irrelevant whether costs are incurred by the TANF agency directly or by other parties.

We realize this policy may create additional administrative burdens for the TANF agency and do not want to unnecessarily divert resources to administrative activities. At the same time, we do not want to distort agency incentives to contract for administrative or program services. In seeking possible solutions for this problem, we looked at the JTPA approach (which allows expenditures on services that are available "off-the-shelf" to be treated entirely as program costs), but did not think that it provided an adequate solution. We thought that too few of the service contracts under TANF would qualify for simplified treatment on that basis.

We welcomed comments on how to deal with this latter dilemma, as well as comments on our overall approach. We had discussed this issue thoroughly during our pre-NPRM consultations, but thought this was a policy area where no single, clear solution existed.

#### (b) Overview of Comments

About one-third of all respondents to the NPRM submitted comments on our administrative cost provisions. A substantial majority of these comments came from representatives of State or local governments, but we also received comments from unions, community

organizations, advocacy groups, national associations, business groups, and Congress. We received comments from a significant majority of the States.

Commenters generally opposed both the breadth of the proposed "administrative cost" definition and the scope of its application. To some extent, unions, community organizations, legal aid and advocacy groups were an exception to this general rule. Comments from these groups tended to be more supportive of the proposed rule. However, they expressed concern about the impact of these policies on the amount of resources that would be available for direct benefits to needy families and the potential impacts of the proposed rules on a State's decisions about program administration, staffing, and contracting. One argued for more specific exclusions from the definition (including costs associated with the delivery of program services and overhead) out of concern about the effect of a tight cap on case manager pay.

To deal with the number and complexity of responses on this issue, we have decided to cluster the comments into the following five general categories: (1) the actual definition (including issues about the appropriateness of a Federal definition, adopting definitions from other programs, the treatment of eligibility determination and case management costs, and the treatment of automated data processing costs); (2) the treatment of costs incurred on contracted services; (3) general questions about the calculation of the two caps; (4) specific issues related to how we determine whether a State has exceeded the MOE cap on expenditures of State MOE funds; and (5) specific issues related to how we determine whether a State has exceeded the Federal cap (including whether the appropriate base for computing the Federal cap is the pre-transfer or post-transfer grant amount).

As you will notice from the discussion that follows, regardless of where they appear in the rule, the administrative cost issues are closely connected to each other. For example, if we have a prescriptive definition of administrative cost, this policy would exacerbate concerns about the negative effects of requirements for subcontractors to track such costs in the same way as TANF agencies.

Although few commenters directly addressed the combined effects of the proposed policies, we considered the combined effect of all these provisions in drafting our responses.

The subject area that received the most attention from commenters was

the proposed definition. Commenters disagreed about whether there should be a Federal definition, suggested alternative definitions that we could adopt, argued for exclusion of case management and eligibility determination costs, raised some issues about the treatment of automated data processing costs, and posed a few miscellaneous questions.

#### (c) Federal Definition

*Comment:* A relatively small number of commenters spoke directly to the question of whether there should be a Federal definition of administrative costs. The commenters' views were mixed, although more argued against a Federal definition than for one.

Among the arguments put forth in support of a definition were: the value of having comparable approaches among TANF jurisdictions; the importance of protecting benefits for needy families especially in light of the elimination of constraints that had existed under the former AFDC program; and the importance of having a meaningful and real Federal limitation on administrative costs.

Those opposed to a Federal definition argued that: (1) it should be the State's prerogative to define administrative costs; (2) we had no authority to define "administrative costs"; or (3) we could defer to State definitions and choose to regulate at some subsequent date if we found that States were not adhering to the statutory limits.

*Response:* While we do believe in granting States broad flexibility to design their programs and have left key definitions up to the discretion of the States, we also believe that there is a need for Federal guidance on the definition of "administrative costs." The approach in this rule is a compromise between a Federal and State definition. It sets a Federal framework that specifies some items that must be considered "administrative costs," but does not attempt to fully define the term.

We believe this framework is important. First, as the comments we received demonstrate, there is no common view of the meaning of this term. If we left this matter entirely to State discretion, we could expect a diversity of approaches, and States might be subject to widely different penalty standards. Also, the fear of a penalty might lead some States to define the term so narrowly as to substantially undermine the intent of the administrative cost cap provisions.

We disagree with the comment that we lack the authority to define "administrative costs." We have

responsibility for four penalty provisions—two on use of Federal funds and two on MOE requirements—where the level of State expenditures on administrative costs is a key issue. On many occasions, we have heard statements about the importance of having clear Federal standards for any penalty decisions that we make. In that context, we have both the authority and the responsibility to provide standards in this area.

As we indicated in the preamble to the proposed rule, we considered not proposing a Federal definition. While that option had some appeal, we were not disposed to deferring totally to State definitions. The philosophy underlying the administrative cost caps is very important; in order to protect needy families and children, it is critical that the substantial majority of Federal TANF funds and State MOE funds go towards helping needy families.

We also indicated that we thought that, by providing a general framework to States, we could avoid numerous disputes with individual States about whether their definitions represented a “reasonable interpretation of the statute.”

#### (d) Applying Other Federal Definitions

*Comment:* A substantial number of commenters suggested that the TANF program adopt the definition proposed for the Child Care and Development Fund. A much smaller number suggested that we adopt the definition in effect under the Job Training and Partnership Act (JTPA) program. Commenters argued that adoption of these other definitions would improve program consistency and simplify program operations at the local level. They also endorsed CCDF’s exclusion of “eligibility determination” as an administrative cost. One argued that the different definition could put local agencies in the untenable position of not being able to hire staff.

*Response:* In terms of program coordination, we do not believe that there is a strong advantage to selecting the CCDF definition over JTPA’s. Where TANF programs work extensively with local providers of employment and training services, compatibility with JTPA may be more important; where TANF and child care programs are administered by a single agency or use a common set of service providers, compatibility with child care providers may be more important.

In the NPRM, we noted that our proposed definition was closely related to the JTPA definition and thus should facilitate the coordination of WtW and TANF activities and support the

transition of hard-to-employ TANF recipients into the workforce. As caseloads decline and the proportion of hard-to-serve clients rises, coordination between these two programs may become even more critical.

While adopting the CCDF definition might facilitate TANF and CCDF coordination, we do not believe that this coordination depends upon a uniform definition. Also, given the differences in the caps of the two programs (15 percent versus 5 percent) and the different legislative histories, there is little reason to believe that Congress intended a uniform definition.

#### (e) Treatment of Eligibility Determinations

*Comment:* Many of those commenting on this issue objected to our proposed inclusion of eligibility determination within the administrative costs definition. Some argued that eligibility determination was not an administrative activity and was not easily or logically separable from case management. Still others commented on the burden associated with our proposal, the general need for State flexibility in this area, and the potential negative effects on a State’s ability to fund critical staff who work directly with clients.

One State agency indicated that the distinction in our proposal was not burdensome and would require only a slight change in its Random Moment Study.

Many commenters took strong exception to our characterization of any portion of the eligibility determination process as administrative. Among other things, they were concerned that: (1) it was inconsistent with existing State practice; (2) the nature of work with families is undergoing significant change, and application of the traditional AFDC approach is no longer appropriate; (3) because eligibility determination is part of the case management function, it should be categorized as a program or service function than administration; (4) the administrative responsibilities of staff performing functions such as screening and assessment are integral to providing services; (5) front-line eligibility determination is arguably a direct service, under the first statutory goal of the TANF program; and (6) as workers assume new roles, differentiating between eligibility and service delivery is becoming increasingly difficult and less useful.

A couple of commenters indicated that our regulations needed to draw a clearer line between administrative and program costs. One commenter provided several specific examples of

situations where the line between administrative and program costs that we drew in the proposed rule was unclear, such as in diversion and sanction activities and in determining hardship exceptions and compliance with behavioral requirements.

A significant number of commenters spoke to the burden of the proposed requirement on TANF agencies. They argued that State and local systems are not geared towards allocating expenses this way. They do not want to divert resources to this activity.

Commenters also made a general plea for flexibility, saying that States need flexibility in order “for the role of front line staff to continue to evolve to best meet the goals of welfare reform” and to enable States to build partnerships with local service providers.

Finally, several commenters noted that we presented this policy only in the preamble, not in the regulation itself.

*Response:* While we do not want our rules to distort State choices about how to deliver services or to divert State resources to cost accounting activities unnecessarily, we have a responsibility to uphold the intent of the statutory administrative cost cap provisions by ensuring that States are not spending large amounts of money on eligibility determinations rather than program benefits or services.

Also, we do not agree that States must incur a significant administrative burden in order to identify the costs associated with eligibility determination activities. We recognize that the nature of staff responsibilities is changing and the line between case management and eligibility determination is blurring. Thus, it may be more difficult to develop rules for allocating the time of workers between administrative and program activities. However, once a State develops its allocation rules, the process of allocating staff time is straightforward and no more difficult than the current cost allocation process.

We also recognize that the TANF program offers the possibility for States to administer programs in new ways. We understand that States are moving towards blended functions, and we support such efforts. These final rules do not in any sense require States to have separate administrative and program staff. They merely require that States provide a reasonable method for determining and allocating administrative and program costs.

Welfare agencies have a long history of identifying the costs of eligibility determinations and allocating these costs as administrative activities. A variety of other significant, related programs—such as Medicaid, the Child

Health Insurance Program (CHIP), and Food Stamps—continue to follow this practice. Thus, this kind of cost allocation has been standard operating procedure in a number of programs and has been accepted as a normal part of doing business.

We also believe that a clear policy on eligibility determinations might produce more consistent penalty determinations and reduce audit disputes, appeals, and litigation regarding application of the misuse of funds and MOE penalties.

Based on these considerations, we have decided to add eligibility determinations to the list of administrative activities at § 263.0(b)(2). More specifically, this rule reflects the basic definition that was in the proposed regulation at § 273.0(b) (with the same basic examples of administrative cost activities), but adds the NPRM preamble policy that required eligibility determination to be treated as an administrative cost. We recognize that this is a significant policy decision that merits inclusion directly in the regulatory text; we agree with commenters that it should not be relegated to the preamble.

Under the final rule, States may develop their own definitions of administrative costs and cost allocation plans, consistent with this regulatory framework.

Also, as we discuss later, we provide States some flexibility in the methods they use to determine the administrative costs associated with contracts. However, we want to reiterate a point we made in the preamble for § 273.13 of the proposed rule: States must properly allocate costs. They must attribute administrative, program, and systems costs to benefiting programs and appropriate cost categories, in accordance with an approved cost allocation plan and the cost principles in part 92.

#### (f) Other Miscellaneous Suggestions for Inclusions and Exclusions

*Comment:* A couple of commenters suggested that our definition make a distinction between general overhead or indirect costs (which would be considered administrative costs) and overhead and indirect costs related to the provision of program services (which would be excluded). A couple of commenters made the broader suggestion that our definition should indicate that administrative costs do not include items such as diversion activities, assessments, development of employability plans, work activities, post-employment services and supports, and case management.

*Response:* The comments identified an area where the language in the proposed rule was unclear. To address this problem, we have revised the regulatory text. The revised language at § 263.0(b)(1) excludes costs of providing services and the associated *direct* administrative costs from the definition of administrative costs. The revised language at § 263.0(b)(2) clearly treats indirect (or overhead) costs as administrative costs. We included these costs as administrative costs in the final rule because we believe this approach is most consistent with the intent of the administrative cost caps and is the simplest and most straightforward approach for States to implement.

*Comment:* One commenter suggested that we specify that diversion assessments are program costs and not administrative costs.

*Response:* We believe the changes that we have made to § 263.0(b), and just discussed, adequately address this concern. The rule at § 263.0(b) now indicates that diversion and assessment activities are both program service costs and not considered administrative costs. (Note: Here, we would make a distinction between assessment activities designed to identify needs and develop appropriate service strategies versus assessing income, resources, and documentation for eligibility determination purposes; the latter are administrative costs.)

*Comment:* One commenter said we should specifically define case management.

*Response:* We do not believe there is a need for a Federal definition of this term.

*Comment:* One commenter asked that we clarify that “public relations” activities would not include State expenditures on providing information to clients.

*Response:* While we believe that the common meaning of “public relations” would not include providing client information, at the new § 263.0(b)(1), we have added “providing program information to clients” as one example of providing program service. Thus, this activity would not be classified as an administrative cost under our rules.

*Comment:* One commenter asked that we clarify that domestic violence and substance abuse services are not considered administrative costs.

*Response:* We believe the new language at § 263.0(b)(1) adequately addresses this concern. It more directly states that costs of providing services are outside the definition of administrative costs, and it explicitly provides that screening and assessments are examples of program services.

#### (g) Computer-Related Costs

*Comment:* Several commenters had concerns that the definition of the exclusion for computer-related costs was not sufficiently clear in the NPRM. Their reasons were mixed. A couple of commenters wanted to make sure that States did not have “unfettered discretion” in this area; they saw this provision as a major loophole and did not want to see money diverted from meeting the needs of poor families. Other commenters felt that the regulations did not adequately address the information technology exclusion.

*Response:* We received a variety of comments on the exclusions of information technology and computerization costs from the 15-percent caps. Based on these comments, we have made some clarifying changes to the regulatory language (which appear in §§ 263.2(a)(5) and 263.13) and are providing some guidance in the preamble. However, we do not believe it is necessary or appropriate to develop detailed Federal regulations on this issue. While the new regulatory language makes the regulation more consistent with the statutory language and makes the language for the Federal and MOE caps more consistent, it also reflects our willingness to defer to State policies, as long as those policies reflect a reasonable interpretation of the statutory language.

We believe that the revised regulatory language represents the best reading of the statutory language at section 404(b). The statute provides for exclusion of certain systems costs in determining whether a State has exceeded the Federal cap on administrative expenditures. It does not exclude such systems costs from the definition of administrative costs. Thus, in this rule, you will note that the systems exclusion is not part of the definition of administrative costs at § 263.0(b). Rather, it appears in the sections where we explain how we determine if a State has excess expenditures on administrative costs.

*Comment:* We received several comments asking us to clarify that personnel costs necessary to comply with reporting requirements and for tracking and monitoring computer systems are covered by the exclusion. Likewise, we received a few comments asking us to clarify that the following items would be excluded: (1) data collection and reporting activities (such as hardware, personnel and supply costs they incur in meeting the TANF disaggregated data reporting requirements); (2) activities such as rental and purchase of computer

equipment and systems procurement; and (3) preparation of reports required under the Act.

*Response:* Under the final rules, we exclude from the 15-percent cap all costs associated with the portions of information technology and computer systems that are used for tracking or monitoring required by or under part IV-A of the Act. The excludable costs are the full range of costs directly associated with the development, maintenance, and support of the relevant systems or the relevant portions of larger systems. Nonsystems costs related to monitoring and tracking (e.g., for the salaries and benefits of data entry clerks, evaluation staffs, statisticians, and report writers) are not covered by this exclusion.

Based on the comments, we have made some modest changes to the definition of administrative cost at § 263.0(b) and the descriptions of the administrative cost caps at §§ 263.2(a)(5) and 263.13. Under the language in the proposed rule, we had not generally recognized that some activities that would otherwise be "administrative" in nature could be part of the systems exclusion. The one exception we mentioned was "management information systems," proposed at § 273.0(b)(10).

To provide the clarification commenters requested, we have revised the language at §§ 263.2(a)(5) and 263.13 to specify that the systems exclusion covers items that "would fall within the definition of administrative costs at § 263.0(b)." In other words, items that would normally be administrative costs, but are systems-related and needed for monitoring or tracking purposes under TANF, fall under the systems exclusion. Thus, we would not consider them in determining whether a State has exceeded either of the 15-percent caps.

We also added language at §§ 263.2(a)(5) and 263.13 to specify that the systems exclusion covers the salaries and benefits costs of personnel who develop, maintain, support, or operate information technology or computer systems used for tracking and monitoring. Under the revised language, it is clearer that States may exclude personnel and other costs associated with the automation activities needed for TANF monitoring and tracking purposes. For example, they may exclude expenditures related to computerization of both the fiscal and program data collection and reporting requirements in part 265 and computer charges related to generating required data and reports. However, they do not exclude nonsystems costs related to monitoring and tracking (such as

personnel costs for data entry clerks, statisticians, and report writers).

Also, we made a minor change to the last example in our list of examples of administrative costs. The revised language refers generically to "preparing reports and other documents" rather than "reports and documents related to program requirements." We revised the language to avoid confusion; the NPRM language was too similar to the statutory exclusion at section 404(b).

*Comment:* One commenter said the regulation should address the permissibility, within the exclusion, of electronic benefit transfer (EBT), Fingerprint Imaging Projects, or other automated fraud prevention activities.

*Response:* While all these activities might be commendable, the statutory exclusion is only for expenditures "needed for tracking or monitoring required by or under this part." EBT would not fit within the exclusion because it is neither a tracking nor a monitoring activity; as the statute at section 404(g) indicates, EBT systems are "for providing assistance."

Fingerprint imaging and other anti-fraud activities might fall under the systems exclusion. For example, expenditures to develop a computerized fingerprint imaging system to identify fugitive felons or individuals who have fraudulently misrepresented their residence would clearly qualify as monitoring under the exclusion.

Since we are not regulating the definition of this exclusion, we are not attempting to draw fine lines between what systems costs should be included versus excluded. We expect States to implement policies that are consistent with a reasonable interpretation of the statute and these regulations.

#### (h) Costs Incurred by Contractors

*Comment:* Another area receiving a significant number of comments was our proposal to apply the definition of administrative costs to contractors and other agencies. The vast majority of commenters opposed this proposal.

One State indirectly argued that the policy was unnecessary, pointing to the State's own cost consciousness and cognizance of the need to limit administrative expenditures in contracts.

A few commenters noted that we had included this policy proposal only in the preamble, but not in the proposed regulatory text. At least one asked that we add the preamble language to the regulation.

One TANF agency requested that we provide more guidance on how States should segregate the administrative

costs associated with subcontracted services.

We organized most of the comments on this issue into four broad categories: (1) suggestions that the 15-percent administrative cost cap apply solely to costs incurred by the TANF agency; (2) the potential effects of applying the administrative cost cap limitation to contractor agencies; (3) the possible negation of existing performance-based contracts; and (4) functionality considerations.

A few commenters recommended that the administrative cost cap apply solely to the expenditures of the TANF agency or that we should treat State and local agencies alike, but not contractors.

A much larger number of commenters expressed general concerns about requiring the tracking of administrative costs to contractors. They objected to: (1) the increased administrative burden on the TANF agency and difficulties associated with tracking administrative costs of contractors; (2) diversion of resources away from needy families to tracking; and (3) inconsistencies between our policy and the policies of other programs (e.g., JOBS and JTPA). Commenters also claimed that our proposed policy would increase the administrative costs of the program, hamper State and local efforts to improve program administration and services, discourage collaborations with community-based organizations and other service providers, violate Congressional intent in limiting our regulatory authority, and impede State procurement activities. For example, contractors might choose not to compete because they would be reluctant to provide detailed itemizations of their expenses, and States might refrain from contracting for fear that unknown contractor costs might cause them to exceed the cap on administrative expenditures. Several commenters expressed concerns that our proposed policy would discourage the development of performance-based contracts and similar funding arrangements.

A subset of commenters said we should base the treatment of subcontractor costs on functionality considerations, looking at the function performed by the contractor or subcontractor, not whether contractors incur administrative costs. A few argued that direct program services provided by contractors were not administrative in nature. Commenters did not want the treatment of contract costs to be based on "an extremely difficult differentiation between administrative and programmatic costs."

*Response:* We have decided that States should be able to determine the administrative costs associated with contracts and subcontracts based on the function or nature of the contract. For example, if a State contracts for case management or job placement services, which meet our definition of program services, the cost of the contracts would be treated as program costs, not as administrative costs. Further, as we discuss later, the entire costs of a contract for payroll services would be treated as an administrative cost subject to the 15-percent cap. If the State had a contract that included a mix of administrative and programmatic activities, it would need to develop a method for attributing an appropriate share of the contract costs to administrative costs. We have revised the regulatory language to reflect that decision.

The approach in the proposed rule reflected some genuine concerns about weakening the administrative cost caps and distorting State decisions about whether to contract. Some commenters expressed similar concerns. However, after reflecting on the totality of comments received, we are convinced that the costs of our proposed approach would have outweighed the benefits. The approach also might have significantly undermined one of our regulatory objectives, i.e., to give States the flexibility they need to serve low-income families.

In administering and operating its TANF Program, each State should make a determination of the most cost-effective and efficient method of performing each of the necessary administrative and programmatic functions. It may use in-house staff and resources, engage other State or local government agencies, or solicit services from outside contractors. Presumably, with each State's procurement procedures requiring free and open competition, and oversight by auditors and State legislative and regulatory bodies, the result of any solicitation will be a high-quality service delivered at a reasonable and acceptable cost.

We believe that, once a particular function is determined to be either administrative or programmatic, that characterization does not vary based on the nature or identity of the service provider. Therefore, if a contract is for a singular administrative or programmatic service, the final rules would treat the entire contract price as an administrative or programmatic cost, respectively. A State would not need to further itemize the contract costs or consider the individual cost

components used to support the contract price.

For example, payroll services is a traditional administrative function. If a State opts to contract out the payroll responsibilities for its TANF program, a State would treat the entire cost of that contract as an administrative cost within the 15-percent cap. It would be unnecessary to further define the contractor's own administrative costs.

On the other hand, if the State contracted with a third party to perform a variety of functions that included a mix of administrative and programmatic activities, the State would need to develop a method for attributing an appropriate share of the contract costs for administrative activities as administrative costs. Likewise, if another agency (State, local, or private) were administering a piece of the TANF program, the State would need to have a method for attributing an appropriate share of the other agency's costs to administrative activities.

Presumably, in developing its individual cost proposals, each contractor includes an allocated portion of their own administrative costs or overhead. However, the matter of interest here is the extent to which Federal and State expenditures are going to administrative activities, not the individual cost components of contracted services.

Our approach is consistent with the regulations at 45 CFR part 92 and should maintain the integrity of the 15-percent administrative cap provisions.

We do not believe this policy will necessarily bias State decisions about how to deliver TANF services, e.g., towards contracting out, or privatization, of program operations. First, the initial expenditure reports we have received from States suggest that their administrative costs are running well within the 15-percent caps; thus, they do not appear to have a strong incentive to change any of their administrative practices. Second, many other very important considerations go into State contracting decisions—including the State agency's internal capacity and expertise and larger political and budgetary considerations. Third, we would expect the State agency, State legislature, and other interested parties to consider the impact on public employees as part of their deliberations. Lastly, because there is a limited difference in the treatment of administrative costs incurred by TANF agencies and third parties, the potential incentive effects of this policy (towards privatization) are limited.

#### (i) Consolidated Caps

*Comment:* A couple of commenters suggested that we should have a single administrative cost cap that covers both Federal and MOE expenditures.

*Response:* The statute clearly requires a separate cap for each. Also, it would not be feasible to apply the 15-percent limitation across the total Federal TANF and State MOE dollars. The MOE cap applies to the total amount of qualified State expenditures for the fiscal year, i.e., per fiscal year. The Federal cap applies to the adjusted SFAG. If a State reserves amounts from its fiscal year grant, then the Federal cap could reflect expenditures over a number of fiscal years.

#### (j) Compliance Periods

*Comment:* One commenter questioned the requirement for quarterly compliance with both the Federal and MOE caps. The commenter suggested annual evaluation as an alternative.

*Response:* We assume this comment reflects a reaction both to the information required on the quarterly TANF Financial Report and some unclear regulatory language in the proposed rule. First, while we do require quarterly reporting of Federal and State administrative and systems costs, we never intended to make quarterly determinations whether the expenditure of State funds violated the MOE cap. The statute at section 409(a)(7) clearly provides that this would be an annual determination. Also, in reflecting on this comment we realized that our regulatory text did not clearly state that compliance with the MOE cap would be determined on an annual basis. Therefore, we have added the phrase "for the fiscal year" to § 263.2(a)(5)(i) to clarify that this is an annual determination.

The Federal administrative cost cap works somewhat differently. For the purpose of the Federal cap, we would look at the total cumulative amount spent on administrative activities from each annual Federal TANF grant. Unless and until the total amount expended as administrative expenditures (exclusive of appropriate systems costs) exceeded 15 percent of the Federal TANF grants (except WtW grants) for any fiscal year, we would not identify a violation of the Federal administrative cost cap. The Department of Labor administers the WtW administrative cost limit. This policy is consistent with the discussion in the preamble to the proposed rule for § 273.13.

#### (k) Base for Computing the Cap

*Comment:* A significant number of commenters (particularly those

representing States or State interests) argued that we should calculate the 15-percent administrative cost cap based on the SFAG amount before any State transfers to title XX or CCDBG (i.e., the adjusted SFAG).

Several of these commenters maintained that, in defining the Federal cap, section 404(b)(1) refers specifically to 15 percent of the "grant." They interpret this language to mean that total SFAG amount would be the appropriate number to use in determining the maximum amount for administrative costs. A few made the additional comment that we did not have the authority to reduce the amount of 15-percent administrative funds available to the State under the statute by applying the 15-percent limitation to a smaller base amount than the adjusted SFAG.

Commenters also expressed concerns that our proposed policy would result in disincentives to the States to transfer funds to CCDBG or title XX.

Finally, a few commenters noted that our proposed rules used a different base amount for computing the administrative cost cap and for computing penalties. More specifically, we proposed to determine penalties based on the adjusted SFAG (i.e., the SFAG amount minus Tribal adjustments, but prior to any transfer), but we computed the administrative cap for TANF based on the adjusted SFAG minus transfers. This inconsistency seemed unjustified.

*Response:* As we noted briefly in the discussion for § 260.30, we made a change to the definition of "adjusted SFAG" that addresses the consistency concerns of commenters. The revised definition, which is used for determining both the Federal administrative cost cap and penalty amounts, excludes monies transferred to either the SSBG or CCDBG programs. Like the proposed definition, it also excludes funds removed from the State's grant because Tribes in the State elected to operate their own TANF programs.

Although the language of the administrative cost limit refers to "the grant," we do not believe what is "the grant" is clear in this context. We did not base the Federal administrative cap on the pre-transfer amount because we believe that proposal would produce a peculiar and undesirable policy result. In effect, it would allow States to double-dip on their administrative expenditures. The transferred funds would be part of the base that we would use to determine how much Federal TANF money was available for administrative costs within the TANF program. It would also be part of the

base for determining how much money was available in CCDBG or SSBG for capped administrative expenditures within these programs, since the statute provides that transferred funds are subject to the requirements of these programs.

We understand the concern that our policy in this area might create modest disincentives for States to transfer Federal TANF funds to CCDF and SSBG. However, we would point out a few factors that should mitigate those concerns: (1) the initial TANF expenditure reports suggest that administrative costs are generally running substantially below the 15-percent caps; thus, States that transfer funds should be able to live within the post-transfer cap amount; (2) this policy affects the Federal cap only, not the MOE cap; (3) States that elect to transfer funds might enjoy some reductions in their administrative costs because they can operate more streamlined child care and social services programs; (4) some of the costs associated with the new TANF data rules are excludable from the cost caps under the information technology and computerization exclusion; and (5) in several places, these final rules reduce the data reporting and administrative burdens to which States would have been subject under the proposed rules.

You will find the discussion of the issues related specifically to the MOE cap in the preamble for § 263.2 and the discussion of issues related specifically to the Federal cap in the preamble for § 263.13.

#### *Subpart A—What Rules Apply to a State's Maintenance of Effort?*

##### *Section 263.1—How Much State Money Must a State Expend Annually to Meet the Basic MOE Requirement? (§ 273.1 of the NPRM)*

#### Overview

To ensure that States would continue to contribute their own money towards meeting the needs of low-income families, section 409(a)(7) requires States to maintain a certain level of spending on programs on behalf of eligible families. If a State does not meet the "basic MOE" requirements in any fiscal year, then it faces a penalty for the following fiscal year. The penalty consists of a dollar-for-dollar reduction in a State's adjusted SFAG.

In the NPRM and in the discussion that follows, we address each of the terms used in the basic MOE requirement.

#### (a) Historic State Expenditures

Each State's basic MOE requirement reflects its historic spending on welfare programs. We calculated the historic State expenditures based on the State's FY 1994 share of expenditures for the AFDC, EA, AFDC-related child care, transitional child care, At-Risk Child Care and JOBS programs (including expenditures for administration and systems operations).

#### (b) Adjusting a State's Basic MOE Level

The statute authorizes an adjustment to a State's basic MOE level when a Tribe or a consortium of Tribes residing in the State submits a plan to operate its own TANF program, and we approve this plan. We will reduce the State's basic MOE requirement beginning with the effective date of the approved Tribal plan.

Section 409(a)(7)(B)(iii) excludes from the basic MOE calculation any IV-A expenditures made by the State for FY 1994 on behalf of individuals covered by an approved Tribal TANF plan. Because TANF funding for Tribes may also reflect a State's IV-F (JOBS) expenditures, we also concluded that it was appropriate to reduce a State's basic MOE levels for IV-A and IV-F expenditures. In summary, we proposed to determine the percentage reduction in the SFAG due to Tribal programs and apply the same percentage reduction to the State's basic MOE requirement. The State's revised basic MOE level would apply for each fiscal year covered by the approved Tribal TANF plan(s).

For example, if the amount of the Tribal Family Assistance Grant represents ten percent of the State's SFAG, then we would reduce the State's basic MOE requirement by ten percent. This approach provides a consistent method for determining both the reduction in the State's SFAG and its required basic MOE level.

#### (c) Applicable Percentage

Under section 409(a)(7)(B)(ii), if any State fails to meet the minimum work program participation rate requirements in the fiscal year, then it must spend at least 80 percent of its FY 1994 spending level. If a State meets the minimum work participation rate requirements, then the "applicable percentage" is 75 percent of its FY 1994 spending level for the year. We refer to the dollar amount representing 75 percent or 80 percent of the FY 1994 State expenditures as the basic MOE level.

We calculated each State's total FY 1994 expenditures and basic MOE levels by using data on the State share of expenditures for AFDC benefits and

administration, EA, FAMIS, AFDC/JOBS Child Care, and Transitional and At-Risk Child Care programs reported by States on form ACF-231 as of April 28, 1995, as well as the State share of JOBS expenditures reported by each State on form ACF-331 as of April 28, 1995.

We transmitted tables showing FY 1994 spending amounts and basic MOE levels to the States via Program Instruction Number TANF-ACF-PI-96-2, dated December 6, 1996. On October 31, 1997, we issued TANF Program Instruction Number TANF-ACF-PI-97-9 informing States of revised basic MOE levels. The revised basic MOE levels reflected a correction in the calculation of the State share of FY 1994 At-Risk Child Care (ARCC) expenditures. Although the data sources remained the same for all States, some of the reported ARCC expenditure amounts used were revised after the original calculation. As a result, the basic MOE levels for some States increased. As TANF-ACF-PI-97-9 was issued so close to the NPRM publication date, we were not able to include information on it in the NPRM.

We also determined FY 1994 spending and basic MOE levels for each of the Territories. For IV-A expenditures for Puerto Rico, we used the Financial Report Form ACF-231 as of April 28, 1995. For Guam and the Virgin Islands, we used the share of expenditures that corresponded to the amount on the Federal grant awards for FY 1994, i.e., the Territories' share of AFDC benefit payments (25 percent), EA (50 percent), administration (50 percent), and Child Care (25 percent). For JOBS, the Territories' basic MOE levels reflect expenditures reported on the ACF-331 as of April 28, 1995.

In addition, for both IV-A (AFDC, EA, and child care) and JOBS, Guam and the Virgin Islands (but not Puerto Rico) benefit from Pub. L. 96-205, as amended (48 U.S.C. 1469a). This law permits waiver of the first \$200,000 of the Territories' share of expenditures. Therefore, for Guam and the Virgin Islands, we reduced the share that they were required to contribute, and thus their basic MOE amount, by \$200,000.

#### (d) FY 1997 Basic MOE Level

Under the proposed rules, we indicated that the State could prorate its basic MOE level for FY 1997 by taking the total FY 1994 State expenditures provided to the State in Program Instruction Number TANF-ACF-PI-96-2, multiplying that number by the number of days during FY 1997 that the State operated a TANF program and dividing by 365. The State's TANF implementation date is the date given in the Department's completion letter to

the State. The State had to meet 80 (or 75) percent of the resulting amount.

#### Comments and Responses

We received a few comments on this section. Two commenters commended our proposal to reduce a State's basic MOE proportionately when the State's TANF grant is reduced once a Tribe or a consortium of Tribes residing in a State has received approval to operate its own TANF program. Most of the other comments focused on the applicable basic MOE level relative to a State's work participation rates. We have made no substantive changes to the provisions in this section as a result of the comments we received. However, as the result of some of the comments we received, we have clarified the regulation. A discussion of the comments follows.

##### (a) Applicable Percentage

*Comment:* A few commenters requested that we amend the regulations to provide that a State's failure to meet the two-parent minimum work participation rate for a year does not automatically require the State to meet 80 percent of its historic State expenditures. Instead, the commenters recommended that, where the State fails only the two-parent rate, the State must increase its spending level between 75 percent and 80 percent based on the ratio of the State's two-parent caseload to the State's entire caseload. Associations representing States pointed out that such an adjustment would be consistent with the proposed regulation under § 271.51 to reduce the maximum penalty amount for failure to meet the work participation rate if the State fails only the two-parent rate.

*Response:* We recognize that the size of a State's two-parent caseload may be small in comparison to the State's total caseload. However, we do not have any discretion under the statute to adjust a State's basic MOE in this way. Section 409(a)(7)(B)(ii) explicitly provides that a State must meet 80 percent of its FY 1994 spending level unless it meets the "requirements" of section 407(a) of the Act for the fiscal year. Section 407(a) includes the minimum participation rate requirements for both all families and two-parent families.

In contrast, section 409(a)(3) requiring a penalty for failing to satisfy minimum participation rates expressly provides for a reduction in the penalty with respect to a fiscal year based on the degree of noncompliance.

*Comment:* Two commenters thought we should modify the final rule to provide that the 75-percent spending level applies for every fiscal year in

which a State meets only the all-family participation rate. They contended that the two-parent participation rate should not affect the required spending level, particularly for a State that has a very low two-parent caseload relative to its total caseload. One of the commenters also believed that the 75-percent spending level should apply immediately unless it can be shown after the fact that a State has not met the work participation rate requirements.

*Response:* We found no statutory basis for excluding the two-parent rate from a State's applicable spending requirement. The 75-percent spending standard, in the parenthetical at section 409(a)(7)(B)(ii), requires that States meet both rates.

We also disagree with the commenter's assertion that the 75-percent spending level should apply immediately. To the contrary, the statute requires that all States maintain an 80-percent spending level for each fiscal year. The reduction is a parenthetical addition if the State meets both participation rates for the fiscal year. Thus, a State would need to demonstrate that it actually meets both rates for the fiscal year for the 75-percent spending level to apply. This language suggests that, to avoid the chance of penalty, it would be most prudent for a State to plan to spend at the 80-percent level every year.

*Comment:* One commenter indicated that we must be clear in the regulations that a State qualifies for the 75-percent MOE standard if it meets the Federal requirement for the year following application of the caseload reduction credit.

*Response:* We have revised the final rule to clarify that a State's basic MOE will be reduced to 75 percent of FY 1994 expenditures if it meets both the all-family and the two-parent participation rate that applies following application of the caseload reduction credit.

*Comment:* Two commenters suggested that we clarify the basic MOE requirement for FY 1997. The commenters noted that the work participation rate requirements apply no earlier than the fourth quarter of FY 1997 for any State. As a result, the basic MOE requirement for FY 1997 should only be based on whether a State met the work participation rate requirements for the fourth quarter of FY 1997. If a State achieves the required work participation rate for the July-September 1997 quarter, the State's basic MOE requirement should be 75 percent of its historic expenditures.

*Response:* We agree that the earliest period States must report information

necessary to calculate participation rates under section 407 is the fourth quarter of FY 1997. The penalty for failure to submit a required quarterly report in a timely manner is one of several penalties that has a delayed effective date. Section 116(a)(2) of PRWORA provides that certain penalty provisions do not take effect until July 1, 1997, or six months after we receive the State's complete TANF plan. We consider the State's TANF implementation date to be the date that we received its complete plan. Most States had to submit a report for all or part of the fourth quarter of FY 1997.

However, there is no delay in the penalty for failure to meet the basic MOE requirement. This is one of several penalty provisions that apply immediately, i.e., from the date a State implements its TANF program. Thus, each State must maintain 80 percent of its historic expenditures for FY 1997 unless it meets the work participation rate requirements both for all families and two-parent families. (The penalty for failure to satisfy the minimum participation rates requirement also has a delayed effective date; however, that penalty is separate from the basic MOE requirement.)

The participation rates for a fiscal year are an average monthly rate. For the States that had to submit a report for all or part of the last quarter of FY 1997, we will calculate the average monthly rate for all families and for two-parent families based on the number of months that must be covered in the required quarterly report.

The remaining States must meet 80 percent of their historic spending levels unless they choose to submit data demonstrating that they actually met both participation rates either for the period during which they were operating their TANF program or for the last quarter of FY 1997, whichever they choose. We decided to give these remaining States this option because we did not think it would be fair to judge their performance over a longer period of time than States that implemented TANF at an earlier date. Also, we have more flexibility with respect to these States since the statute does not specify a precise time frame for measuring their performance.

*Comment:* One commenter wrote that a State should not have to meet the 80-percent level of effort if we waive the State's penalty for failing to achieve either of the required work participation rates due to reasonable cause. Another commenter requested clarification in this area.

*Response:* Under section 409(a)(7)(B)(ii) of the Act, the 75-percent

standard only applies if a State meets the minimum work participation rates, not when a State has reasonable cause for failing to satisfy the rates. Granting reasonable cause does not mean that the State met the rates. States that fail to satisfy the minimum work participation rates, but receive partial or full penalty relief, must still meet the 80-percent MOE requirement.

#### (b) FY 1997 Basic MOE Level

*Comment:* One commenter asked that the final rule clarify how we will calculate the FY 1997 basic MOE level.

*Response:* We calculated the prorated basic MOE levels by first determining the number of days in FY 1997 that a State operated the TANF program. We then multiplied the resulting number of days by the State's basic MOE level for the year, then divided by 365 (the number of days in FY 1997).

We originally published the States' basic MOE levels in Program Instruction Number TANF-ACF-PI-96-2, dated December 6, 1996. We also sent letters dated January 7, 1997, to TANF program directors explaining that we would prorate basic MOE levels for FY 1997 only. As explained earlier, we have since recalculated basic MOE levels for States to correct for the revised State ARCC expenditure figures for FY 1994. As a result, the basic MOE levels for some States increased. We transmitted the revised basic MOE levels for States via TANF Program Instruction Number TANF-ACF-PI-97-9 dated October 31, 1997. This instruction also included each State's prorated FY 1997 basic MOE levels.

However, for States whose revised basic MOE level increased, we did not apply the revised rate retroactively. Rather, we are determining State compliance with the FY 1997 basic MOE level requirements based on the original numbers published in TANF-ACF-PI-96-2, prorated as applicable. All revised State basic MOE levels published in TANF-ACF-PI-97-9 apply beginning FY 1998.

#### *Section 263.2—What Kinds of State Expenditures Count Toward Meeting a State's Basic MOE Expenditure Requirement? (§ 273.2 of the NPRM)*

##### Overview

#### (a) Qualified State Expenditures

Section 409(a)(7)(B)(i) establishes the criteria for the expenditure of State funds to count toward a State's basic MOE level. Congress wanted States to be active partners in the welfare reform process. Thus, States must spend a substantial amount of their own money on aid to needy families. While

Congress gave States significant flexibility in this area, it did establish a number of important statutory restrictions on which State expenditures qualify towards the basic MOE requirements.

Section 409(a)(7)(B)(i) defines "qualified State expenditures" to include certain expenditures by the State under all State programs. We interpret "all State programs" to mean the State's family assistance (TANF) program plus any other separate State program that assists "eligible families" and provides appropriate services or benefits. Thus, States could expend State funds for MOE purposes in three ways.

In addition to expending State funds in separate State programs, States may expend funds within the TANF program in two different ways. They may commingle their State funds with Federal grant funds, or they may use State funds that have been segregated from their Federal grant funds.

We remind States that there are specific statutory requirements that affect the use of State funds under a State's TANF program. States need to be mindful of the TANF requirements to help avert penalties under section 409 of the Act. The specific TANF requirements that apply depend upon which of various programmatic terms is used in the language describing the requirement.

States may also expend State funds in a State program separate from TANF to provide the benefits and services listed under section 409(a)(7)(B)(i)(I) of the Act, e.g., cash assistance, child care assistance, and education activities. None of the TANF program requirements directly apply to eligible families served in separate State programs.

Requirements in the statute that use the terms "under the program," "under the program funded under this part," and "under the State program funded under this part" apply to the State's TANF program, regardless of the funding source. That is, they apply to segregated Federal programs, commingled State/Federal programs, and segregated State programs. Thus, all families receiving TANF assistance (whether funded with State or Federal TANF funds) must meet work participation and child support requirements.

Conversely, some Federal requirements derive from the provisions in the statute that use the term "grant," or "amounts attributable to funds provided by the Federal government." These terms refer to the Federal TANF funds provided to the State under



section 403. Therefore, they only affect the use of Federal TANF funds, unless the State commingles its money with Federal TANF funds. If a State commingles its funds, the Federal and State funds become subject to the same rules. Thus, commingling of State and Federal TANF funds can reduce the total amount of flexibility available to the State in its use of Federal and State funds.

Requirements pertaining solely to the use of Federal TANF funds do not apply to families assisted under TANF with State-only funds. Consequently, if a State segregates its TANF State funds from its Federal TANF funds, State expenditures on assistance must comply only with all of the rules that generally pertain to the TANF program, e.g., work and child support requirements. They are not subject to requirements that pertain only to the use of Federal TANF funds.

A State might choose to operate a "segregated" TANF program because certain limitations, e.g., time limitations and certain alien restrictions, apply to the program funded with Federal TANF funds that would not apply to a TANF program funded wholly with State funds.

Whether the expenditure of State funds is within the TANF program or separate from the TANF program, to count toward meeting the State's basic MOE, all expenditures must: (1) be made to or on behalf of an eligible family; (2) provide "assistance" to eligible families in one or more of the forms listed in the statute under section 409(a)(7)(B)(i)(I); and (3) comply with all other requirements and limitations set forth in this part of the regulations, including those set forth in §§ 263.5 and 263.6.

#### (b) Eligible Families

Section 409(a)(7)(B)(i)(I) provides that State funds under all State programs must be spent with respect to eligible families to count toward the State's basic MOE. Section 409(a)(7)(B)(i)(IV) further clarifies that an eligible family means a family eligible for assistance "under the State program funded under this part." The "State program funded under this part" is the State's TANF program.

Thus, we proposed that, in order to be considered an "eligible family" for MOE purposes, a family must have a child living with a custodial parent or other adult caretaker relative (or consist of a pregnant individual) and be financially needy under the TANF income and resource standards established by the State under its TANF plan. This definition includes two categories of

families. It includes all families funded with MOE funds under TANF, including certain alien families or time-limited families who cannot be served with Federal TANF funds, but who are being served in a segregated State TANF program. (We discuss this alien limitation in detail further on in this section.) It also includes a family that meets these criteria, but is not receiving TANF, and instead is receiving benefits and services from a separate State program. The expenditures to provide these benefits and services under all State programs may count toward the MOE requirement, provided the expenditures also meet all other requirements and limitations set forth in part 263.

A State is free to define who is a member of the family for Federal TANF purposes and may use this same definition for MOE purposes. For example, it could choose to assist other family members, such as noncustodial parents, who might significantly enhance the family's ability to achieve economic self-support and self-sufficiency. By including such individuals within its definition of family, a State could provide them with services through TANF or a separate State program. Noncustodial parents could then engage in State-funded activities such as work or educational activities, counseling, or parenting and money management classes.

The NPRM stated that we expect States to define "child" consistent either with the "minor child" definition given in section 419 or some other definition applicable under State law. The State must be able to articulate a rational basis for the age they choose.

The definition of "eligible family" expressly includes families that "would be eligible for such assistance but for the application of section 408(a)(7) of this Act."

Under section 408(a)(7), States may not use Federal TANF funds to provide TANF assistance to a family that includes an adult who has received federally funded assistance for a total of 60 months. Therefore, if a family becomes ineligible for Federal assistance under the TANF program due to this time limit, but still meets the definition of eligible family, then this family may be considered an eligible family for MOE purposes. (Note: In the NPRM, in § 273.2(c), we did not accurately cite the applicable criteria. The final rule at § 263.2(c) corrects this error; in referencing paragraph (b) of this section, it captures all three criteria for "eligible families.")

Section 5506(d) of Pub. L. 105-33 (the Balanced Budget Act of 1997) clarified

that the definition of an eligible family also includes lawfully present aliens who would be eligible for TANF assistance, but for the application of title IV of PRWORA.

Thus, the definition of eligible family allows States to claim MOE expenditures with respect to three types of family members: (1) those who are eligible for TANF assistance; (2) those who would be eligible for TANF assistance, but for the time-limit on the receipt of federally funded assistance; and (3) those lawfully present who would be eligible, but for the application of title IV of PRWORA. An alien family who meets any one of these three criteria may be considered an eligible family provided they also meet the family composition requirement (i.e., have a child living with a custodial parent or other caretaker relative or be a pregnant individual) and financial eligibility criteria established by the State. These last two requirements are based on the statutory language stating that eligible families "means families eligible for assistance under the State program funded under this part (TANF) \* \* \* and that would be eligible for such assistance."

While this three-part definition of eligible families may appear to allow States to claim qualified expenditures with respect to all lawfully present alien eligible family members, i.e., both qualified and nonqualified aliens, as discussed further below, this is not necessarily the case. Nor is it the case that the amendment to the definition under the Balanced Budget Act precludes States from claiming MOE for illegal aliens under certain circumstances.

While we mentioned the 1997 amendment in the NPRM, at that time, we had not fully analyzed the significance of the statutory language defining "eligible families" for MOE claiming purposes, relative to the extant eligibility provisions in title IV of PRWORA. Title IV of PRWORA sets forth the aliens who are eligible for Federal public benefits and for State and local public benefits; whereas, the definition of eligible families limits the expenditures that may be claimed for MOE. While there is obvious overlap between these two concepts, they are distinct and must be analyzed separately.

To understand eligibility for Federal TANF benefits, readers must be familiar with the definition of qualified alien, Federal public benefit, and Federal means-tested public benefits. Section 401 in title IV of PRWORA provides that, in general, only qualified aliens, as defined in section 431 of PRWORA, are

eligible for Federal public benefits. (At the end of this discussion, we explain two very limited circumstances under which it may be possible for a State to provide certain benefits to all aliens.) The definition of "qualified aliens" at § 260.30 refers to section 431 of PRWORA, as amended (e.g., by the Illegal Immigration Reform and Immigrant Responsibility Act of 1996 (Pub. L. 104-208) and the Balanced Budget Act of 1997 (Pub. L. 105-33)). The revised definition of "qualified aliens" includes: legal permanent residents; asylees; refugees; aliens paroled into the U.S. for at least one year; aliens whose deportations are being withheld; aliens granted conditional entry; battered alien spouses, battered alien children, the alien parents of battered children, and alien children of battered parents who fit certain criteria; and Cuban/Haitian entrants.

The Department has interpreted the term "Federal public benefit" (see TANF-ACF-IM-98-5, dated August 24, 1998, transmitting the notice with comment period interpreting "Federal public benefit," published in the **Federal Register** dated August 4, 1998, vol. 63, No. 14, and available on line at <http://www.acf.dhhs.gov/programs/ofa/im98-5.htm>). It has determined that the TANF program (when using Federal TANF funds) generally provides a Federal public benefit. The Department also issued an interpretation of the term "Federal means-tested public benefit" and designated the TANF program as a Federal means-tested public benefit. (See the **Federal Register** for August 26, 1997, 62 FR 45256.)

Even qualified aliens may be ineligible for means-tested Federal public benefits. Section 403 of PRWORA prohibits qualified aliens, with exceptions, who arrive on or after August 22, 1996, i.e., newly arrived aliens, from receiving Federal means-tested public benefits for five years.

Exceptions to the five-year bar include qualified aliens who are refugees, asylees, or aliens whose deportation is being withheld, Amerasians, and Cuban/Haitian entrants, as well as veterans, members of the military on active duty, and their spouses and unmarried dependent children.

However, as discussed below, States may elect to help any newly arrived aliens who are eligible family members by providing either State or local public benefits or benefits that are not a State or local benefit. If the State uses segregated State funds in TANF or funds in separate State programs to provide

such benefits, the expenditures may qualify as MOE.

Further, in regard to whether qualified aliens may be eligible for Federal TANF benefits, section 402 of PRWORA provides that States have the authority in TANF to decide whether to help qualified aliens who arrived in this country prior to August 22, 1996, and qualified aliens who arrived on or after August 22, 1996, but for whom the five-year bar had expired. In other words, States are authorized to decide whether qualified aliens are eligible for the State's TANF program. However, a State may not deny certain qualified aliens eligibility even if it decides that as a general matter qualified aliens are not eligible to receive Federal TANF benefits. States may not deny eligibility to refugees and asylees, aliens whose deportation has been withheld, Amerasians, and Cuban/Haitian entrants. These groups are eligible for Federal TANF benefits for five years after the date of their entry into the country or the date asylum or withholding of deportation was granted. Also, States may never deny eligibility to legal permanent residents who have worked forty qualifying quarters or to aliens who are veterans, members of the military on active duty, and their spouses and unmarried dependent children.

As with other parts of the TANF program, the way the State structures the delivery of TANF and MOE benefits determines which eligibility requirements apply. If a State commingles Federal TANF funds with State funds, then the benefits provided must follow the rules at section 401(c) for Federal public benefits. A State providing Federal public benefits to aliens and using commingled TANF funds to help aliens may claim, for MOE purposes, only the expenditures that it makes with respect to eligible qualified alien family members. Eligible qualified aliens include those who are eligible for TANF assistance; would be eligible for TANF assistance, but for the time limit on receiving federally funded TANF assistance; or are lawfully present in this country and would be eligible for TANF assistance, but for the application of title IV of PRWORA. If the State decides to restrict the eligibility of noncitizens to receive TANF benefits and commingles its MOE funds, then it will only be able to claim toward MOE the expenditures that it must make on behalf of the excepted qualified aliens mentioned above.

If a State does not commingle Federal and State funds, but instead uses segregated State funds in its TANF program or separate State program funds

to provide benefits that meet the definition of a State or local public benefit, then it must follow the rules of section 411 of PRWORA. State or local public benefits have the meaning prescribed under section 411(c) of PRWORA. It is generally up to the State to determine if the benefits it offers are State or local public benefits within the meaning of the Act. However, because we interpreted that the TANF program, using Federal TANF or State commingled funds, generally provides a Federal public benefit, we also would interpret that the TANF program, using State TANF funds that have been segregated from Federal TANF funds, generally provides a State or local public benefit (subject to the limited circumstances explained at the end of this discussion). We make this interpretation because the statutory language in section 401(c) is identical to the language in 411(c). Within the meaning prescribed under section 411(c), States would also determine whether various separate State or local programs or activities are State or local public benefits.

Section 411(a) of PRWORA provides that only qualified aliens and certain nonqualified aliens are eligible for State or local public benefits. The nonqualified aliens consist of nonimmigrants under the Immigration and Nationality Act or aliens paroled into this country under section 212(d)(5) of such Act for less than one year. There are a handful of legal nonqualified aliens, e.g., temporary residents under the Immigration Reform and Control Act (IRCA), aliens with protected status, and aliens in deferred action status who are prohibited from receiving State or local public benefits under this provision. (At the end of this discussion, we explain two very limited circumstances under which it may be possible to provide certain benefits to all aliens.)

Section 411(d) of PRWORA permits States to expand alien eligibility by providing State or local public benefits to illegal aliens. But this may occur only if the State enacts a law after August 22, 1996, that affirmatively provides that illegal aliens are eligible to receive (all or particular) State or local public benefits.

Section 412 of PRWORA also allows States, at their option, to further limit alien eligibility for State public benefits. There are time-limited exceptions for refugees, asylees, or aliens whose deportation has been withheld. Like Federal TANF benefits, these groups are eligible to receive State public benefits under TANF during their first five years following entry, the grant of asylum, or the withholding of deportation. The